SUMMARY OF MR ARMSTRONG'S REPORT
(FEB 1973)
ON THE ECONOMY OF THE FALKLAND ISLANDS:

Introduction

1. The income of the Colony is derived almost solely from the export of wool. During the past 50 years a series of experts have reported on the industry. Their unanimous conclusion has been that unless there is heavy re-investment of farm profits in pasture improvement the wealth of the Colony will decline.

Economic Situation

2. Farm profits tend to rise and fall with the London wool price, although during the last decade the general upward trend of costs has become steeper than that of prices. The profit trend is downward. 1971 was a bad year with London prices at their lowest for 13 years. Fortunately for the Colony over the next 2 years prices trebled but the present reprieve is likely to be short lived as there are indications that by 1974 wool prices will have returned to more normal levels. Without another world wool boom, by 1976 both farms and Government could be in financial difficulties.

3. While pasture improvement must, for the foreseeable future remain the critical factor in determining the future wealth of the Islands it is a long term policy and will not bring a quick return. In the meantime, improvements in the efficiency of the public and private sectors must be sought, and the possibility of introducing new sources of income examined.

THE PUBLIC SECTOR

4. The Colony's civil service provides a wide range of services, but its small scale operations are expensive to maintain. Fortunately the need for any recurrent subsidy from the UK has so far been avoided. The only large capital aided projects are the Stanley Power Station (£50,000 grant and £100,000 loan) and the airfield (£1.74 million grant), the latter yet to be built.

5. In 8 out of the last 15 years (to include the present financial year ending 30 June next) the annual budget has shown a deficit and general reserves have fallen from £232,000 to an estimated £50,000 in the same period.

6. The 18 month lag between a rise in wool prices and resulting higher revenue yields may make it difficult to survive the financial year 1973/74 without drawing on Development Fund reserves. In 1974/75, tax revenues should more than double, giving a small budget surplus. However if 1974 wool prices go below 60p a kilo financial difficulties are likely to recur in 1976 particularly if remedial fiscal measures are not taken now. If this level of prices continues for a number of years the Colony would find it very difficult to maintain its living standards without recurrent external financial assistance.

7. There is a strong case for increasing general taxation receipts by 10%. Modest increases in the duties on spirits, tobacco and diesel fuel, and the imposition of an ad valorem duty on luxuries would neither cause hardship, nor deter tourists. Increases in licences, fees and philatelic sales could augment revenue as could special commemorative coin issues.

8. The Government's investment income is derived from the

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£1.3 million investments of the Savings Bank after 2½% interest has been paid to depositors. Over the last two financial years investment income has been high and has contributed to keeping the budget deficit within bounds. The low interest paid to depositors amounts to a concealed form of income tax on savings. Interest should be raised to 3½%. This will slightly reduce the surplus available to Government but the shortfall should be more than made up by taxes on income and expenditure.

9. The general public should be charged the full cost of all economic (i.e. non-social) services provided by Government unless there is a clear case for a subsidy. Indiscriminate subsidies out of general revenue and UK aid are highly wasteful. Subsidised public services are

a. Administration of Dependencies

b. Stanley Harbour Services and mv Forrest

c. Provision of 53 houses, largely for civil servants

d. Urban utilities; power, water and sewerage

e. Postal (excluding philatelic) and telecommunications

d. Internal air service

There is no possibility of charging economic rents to civil servants overnight, although these should be applied to government houses leased to the private sector, but this form of disguised remuneration should be phased out in favour of increased taxable emoluments. Electricity consumption, external communications and urban utilities should not be subsidised, but there would seem to be a reasonable case for doing so for the internal air service. In general, there must be a more

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substantial direct contribution from those who benefit from public services towards the cost of providing these services. Only about 25% of recurrent expenditure is allocated to the normal administrative functions of Government. The largest share - 40% - is consumed by the so called revenue earning services, and the greatest scope for remedial action lies in this area. Savings from pruning administrative costs will not amount to more than £10,000.

10. Broad recommendations are that increases in revenue should be sought as follows:-

Taxation	£31,000
Philatelic	£5,000
Various	£2,000
Payments for Services	£75.000

These, less a drop of £13,000 in investment income (due to increased interest rates for Savings Bank deposits), should enable a surplus on the recurrent budget in 1973/74 of £100,000 which would be available for capital investment. On average, (providing the suggested remedial measures are taken) a recurrent annual surplus of £70,000 can be expected for the remainder of this decade. In the long-term only private and public sector investment, especially in agriculture, will maintain the present standard of living.

THE PRIVATE SECTOR

11. The basic wealth of the Islands will continue to depend on wool production for the foreseeable future. Failure to invest in and improve the industry has been the subject of many reports. However, no investigation in depth has been carried /out

out into re-seeding pastures - the local grasses do not grow in September/November and this "gap" is the principal constraint on stock levels. A 3-year trial programme by a 3-man Trials Unit (paid for out of Technical Assistance funds) should attack this problem.

12. Opportunities are opening up for the export of sheep on the hoof to the Argentine. This could become an important sideline.

13. If the plans of Alginate Industries Ltd for the collection and export of dried seaweed are implemented considerable additional revenue (directly and indirectly about £75,000 per annum) should accrue to the Falkland Islands Government. The Company and the Falkland Islands Government are at present considering certain taxation proposals as a first step.

14. Approximately 30-40% of the aggregate national income is distributed in the form of dividends, and the investment of personal savings, in the United Kingdom. The Falkland Islands Company which owns half the total land has invested most of its agricultural surplus in United Kingdom property.

15. The possibilities of using fiscal measures to discriminate in favour of local agricultural investment should be borne in mind but there are difficulties in using such a tool.

16. The present local income from tourists - mainly those from cruise liners - is somewhere about £15,000 a year. When the permanent airfield is operational there should be opportunities to attract the 'residing' specialist tourist interested in wild life and fishing, but it would be optimistic to expect more than 400 in a 'season' (November to March). On an average stay of two weeks and a hotel occupancy rate of 70%

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for a 150 night season, the accommodation requirement is 55 beds. The present hotel at Stanley - the Upland Goose - is inadequate except as a transit hotel before the visitor goes to other accommodation, e.g. fishing or bird watching lodges, and private enterprise should be encouraged to invest in these. A total of 35-40 beds outside Stanley should be aimed at by 1976. There is not a strong case for a large new hotel in Stanley, but the situation could change and potential overseas investors should be encouraged to keep the situation under review.

17. Tourism in the Falkland Islands can never be a large industry and its promotion should not receive a disproportionate share of Government resources, but a small injection of public capital would be justified to get it 'off the ground'. Thereafter tourism should not be subsidised at Government expense.

18. Existing banking services are provided by the Government Savings Bank and the Falkland Islands Company.

19. There is some possibility of establishing a sea fishing base in the Falklands. The Russians and Spanish are already fishing local waters using factory ships. An Argentine Company has been investigating and the Falkland Islands Government is trying to interest the Japanese company Taiyo.

20. Although agriculture is and will remain the primary industry, the possibilities of other diversifications (eg the extraction of montan wax from peat, should, where possible, be investigated. The dearth of surplus labour and the isolation of the Islands weigh heavily against many technical possibilities.

GOVERNMENT CAPITAL BUDGET

21. Public sector capital development is financed mainly from the Colony Development Fund (standing at £102,500 at 30 June 1972), small local loan repayments and UK aid in the form of grant or loan. The only large amount of UK aid received in recent years

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was for the building of a new Stanley power station. Expenditure from the Development Fund has been running at about £15,000 per annum, mainly on very small projects.

22. Capital development funds will, in future, consist of the existing fund, the surplus on the recurrent budget, local loan repayments and UK aid, but reserves for both recurrent and capital purposes should be minimised. Until further notice all UK aid should be in the form of grants.

DEVELOPMENT EXPENDITURE

23. Agriculture must have priority but public funds should not be used to give an immediate boost to the distributed profits of farms. It is recommended that in the financial year 1973/74 £50,000 should be allocated to purchase of materials required for 200 miles of sub-division fencing. An aid project, including a request for a tied aid waiver for the purchase of timber (South America is the cheapest source), should be submitted as soon as possible. Grants of materials should cover only new fencing and all farms should draw up five year investment plans to clarify the case for public subsidy. After 1973/74 a subsidy for about 50 miles of fencing per annum is recommended, with the non UK component (timber) being purchased from local public funds.

24. Public funds could be utilised for the purchase of ditching/peat cutting machines, but there is some private interest in this and it would be as well to await the outcome. In the meantime, one machine would be useful in Stanley.

25. Most of the cost of a Grassland Trials Unit should be met from Technical Assistance funds. If trials prove successful there could be a case for subsidising fertilisers and grass-seed.

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26. An allocation of £40,000 as a loan spread over 1973/74 and 1974/75 for the construction of tourist accommodation is recommended. Repayment should be over ten years. Small loans for handicraft development are also required.

27. Major road developments should await the completion of the permanent airfield, but there is a case for some small, more immediate outlay on road improvement.

28. The prison needs replacing. A specialist dustcart is needed.

29. On available figures the closing of Darwin School and the building of a new hostel in Stanley is not financially justified and the decision must rest on the educational benefits to be derived from such a move.

30. By 1976 a third aircraft will be required for the Internal Air Service and replacements for existing aircraft will be required around 1977/78.

31. The recent Crown Agents' report on telecommunications suggested an investment of £325,000 over five years. This is unrealistic, but much of the existing equipment will certainly require to be replaced. Major telephone developments, especially in Stanley, cannot be afforded before the late 1970's. Some new broadcasting equipment should be purchased by 1975/76.

32. A summary of proposed capital expenditure is given at Appendix A.

TECHNICAL ASSISTANCE

33. This has been increased in the last four years. The development of the air-link has provided further possibilities for visits by experts.

34. Cadet farm managers from the UK would benefit from a course at an agricultural college.

UK Aid

		1973/4	1974/5	1975/6	1976/7	1977/8
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
		100,000	50,000	50,000	50,000	50,000
(15.	New School Hostel)	(20,000)	(70,000)			

Local Capital Funds

		1973/4	1974/5	1975/6	1976/7	1977/8
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.	Telecommunication	-	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 1974/5 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.