

STATE OF THE FALKLAND ISLANDS ECONOMY 2017

Policy and Economic Development Unit, Falkland Islands
Government

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1. Introduction

The Falkland Islands has a strong economy, which provides a high standard of living for its residents and allows the Falkland Islands Government (FIG) to provide a broad range of public services. The dominant industry is fishing, accounting for a large majority of exports, although wool, meat and tourism also play a part. The Islands are reliant on imports of consumer and industrial goods, fuel and some food, although some locally produced meat, fish and vegetables are available. Hydrocarbon exploration has provided a stimulus to the economy and to government revenues; oil production, should it be sanctioned, would have a still greater impact.

The Falkland Islands enjoys low unemployment and has a high labour force participation rate. Both FIG and the private sector are reliant on migrant labour, both skilled and unskilled, with employers sometimes struggling to fill open positions. Positive net migration, along with a small natural increase in population, has driven an increase in the usually resident population to 3,398¹ in 2016. The transient population contributes to favourable demographics, with a young population and a low dependency ratio by developed world standards.

2. Macroeconomic overview

Growth in gross domestic product

Figure 1 shows how real² Falkland Islands gross domestic product (GDP) has changed between 2007 and 2015.

Figure 1: Falkland Islands GDP, constant 2012 prices



¹ Including people who were temporarily absent from the Islands on census night. This is the most relevant figure when considering economic matters, and it has been used, with the exclusion of the MPC population, to calculate the per capita economic variables included in this report. Excluding people who were temporarily absent on census night, the population was 3,200.

² Real GDP is GDP that has been adjusted for inflation in prices. When looking at trends over time, it is preferable to use real rather than nominal GDP. "Gross" means that the figure is not adjusted for consumption of fixed capital, which is a concept distinct from but in practice related to accounting depreciation.

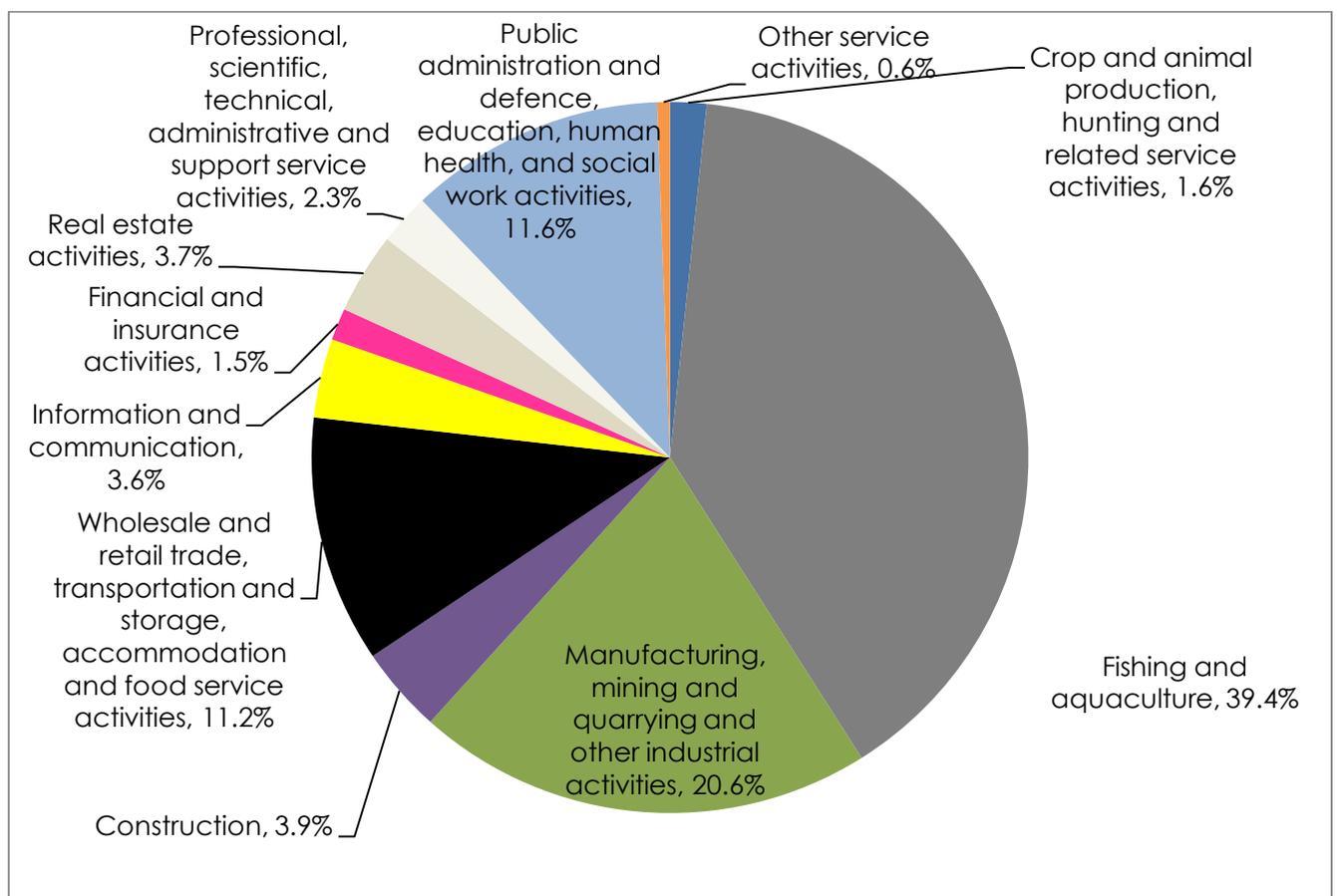
Source: Falkland Islands National Accounts 2007-2015

Over this period, GDP has grown by 48.6%, with a compound annual growth rate of 5.1%. Annual GDP is highly volatile, with double digit year on year swings common. This is mainly due to the importance of the fishing and hydrocarbons industries to the economy. The peaks in 2012 and 2015 are due to major hydrocarbon exploration campaigns.

Gross domestic product by industry

Figure 2 shows the contribution made by different industries to Falkland Islands GDP in 2015.

Figure 2: Gross value added by industry in 2015, current prices



Source: Falkland Islands National Accounts 2007-2015

The single largest contributor to GDP in 2015 was the fishing industry, followed by manufacturing, mining and quarrying and other industrial activities, which includes oil exploration activities.

Tourism, when defined broadly to include the provision of accommodation, meals and other services and amenities to tourists, is not recognised as a discrete industry (this is because industries are defined according to the activity they perform, rather than the identity of their customers). However, the Falkland Islands Tourist Board

produces a set of Tourism Satellite Accounts, which calculate that tourism gross value added was FKP2.9 million, or 1.6 per cent of GDP, in 2014, the latest report available.

Figure 2 presents a static picture of the Falkland Islands economy at a given point in time. It cannot be used to directly infer the consequences of changes to output by a given industry. For example, were output from the fishing industry to fall significantly, this would be expected to reduce government revenues, and hence ability to spend on public services; it would also affect the businesses that provide support services to the fishing industry. Conversely, a decline in another industry might free-up labour that could be re-deployed elsewhere, mitigating the overall negative effects.

Gross domestic product and gross national income per capita

Gross domestic product per capita was FKP70,800 in 2015, based on a population of 2,915³, up from FKP63,000 in 2014.

Many companies operating in the Falkland Islands are owned, wholly or partially, by shareholders resident overseas. Similarly, much of the labour in the Falkland Islands economy is performed by non-residents (particularly in the fishing and oil and gas industries). Therefore, gross national income (GNI), which is an estimate of the income received by residents of an economy regardless of where the activity generating that income takes place, and is derived by adjusting GDP for net income received from abroad, can be a better measure of the economic welfare of Falkland Island residents than GDP. GNI per capita for 2015 was FKP46,600, up from FKP44,500 in 2014⁴.

Distribution of the benefits of economic activity (the generation of income account)

The benefits of economic activity are divided between the owners of capital and the providers of labour (and the government). More formally, gross value added is comprised of:

- **Gross operating surplus.** Broadly, profit received by company shareholders, the government and charities.
- **Mixed income.** Profit received by the owners of unincorporated businesses, in return for their supply of capital and labour to the business.

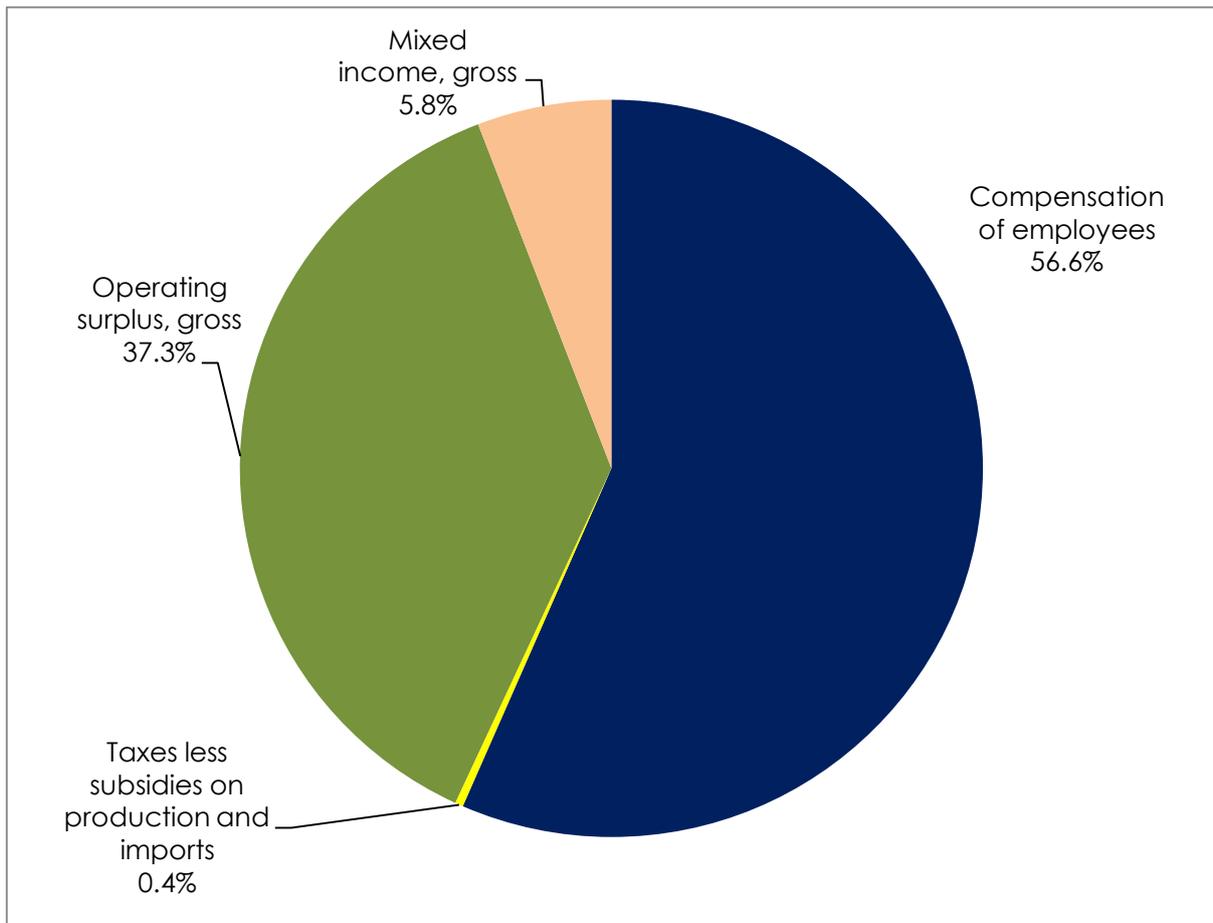
³ For the purposes of national accounts, resident population is defined as the census population excluding people resident in MPC and including those temporarily absent during the census. Similarly, output produced by institutional units resident in MPC (e.g. civilian contractors serving only the military) is excluded from Falkland Islands GDP. 2014 per capita figures have been restated using new population estimates based on the 2016 Census.

⁴ GNI includes income streams such as licence fees and investment income accruing to FIG, as well as companies' operating surpluses not distributed to shareholders, and is not equivalent to the average income received by residents.

- **Compensation of employees.** Wages paid by companies, government, charities and unincorporated businesses, as well as pension contributions and social security payments.
- **Taxes less subsidies on production and imports.**

Figure 3 shows how value added was distributed across these categories in 2015.

Figure 3: Generation of income account, 2015

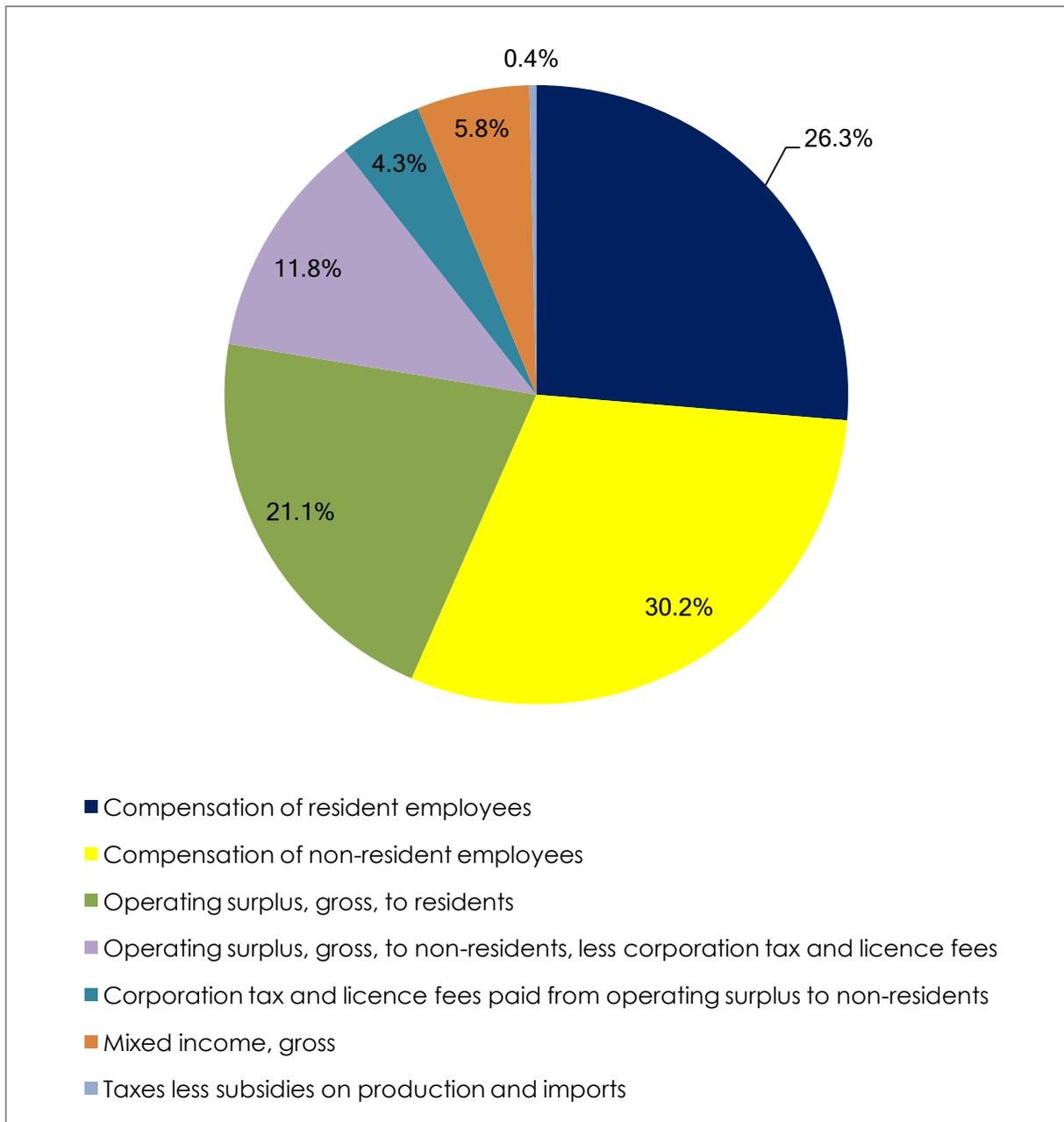


Source: Falkland Islands National Accounts 2007-2015

As discussed above with respect to the difference between gross domestic product and gross national income, the benefits of economic activity are split between residents and non-residents of the Falkland Islands. In 2015, 53% of compensation of employees was paid to non-residents of the Falkland Islands (mainly fishermen and oil workers). 43% of gross operating surplus created in the Falkland Islands can be attributed to non-resident shareholders, although if corporation tax payments and fishing licence fees, which form part of the operating surplus but will ultimately remain within the Islands, are deducted from this then the figure drops to 32%.

Figure 4 shows how compensation of employees and gross operating surplus break down between residents and non-residents.

Figure 4: Generation of income account split by residence, 2015

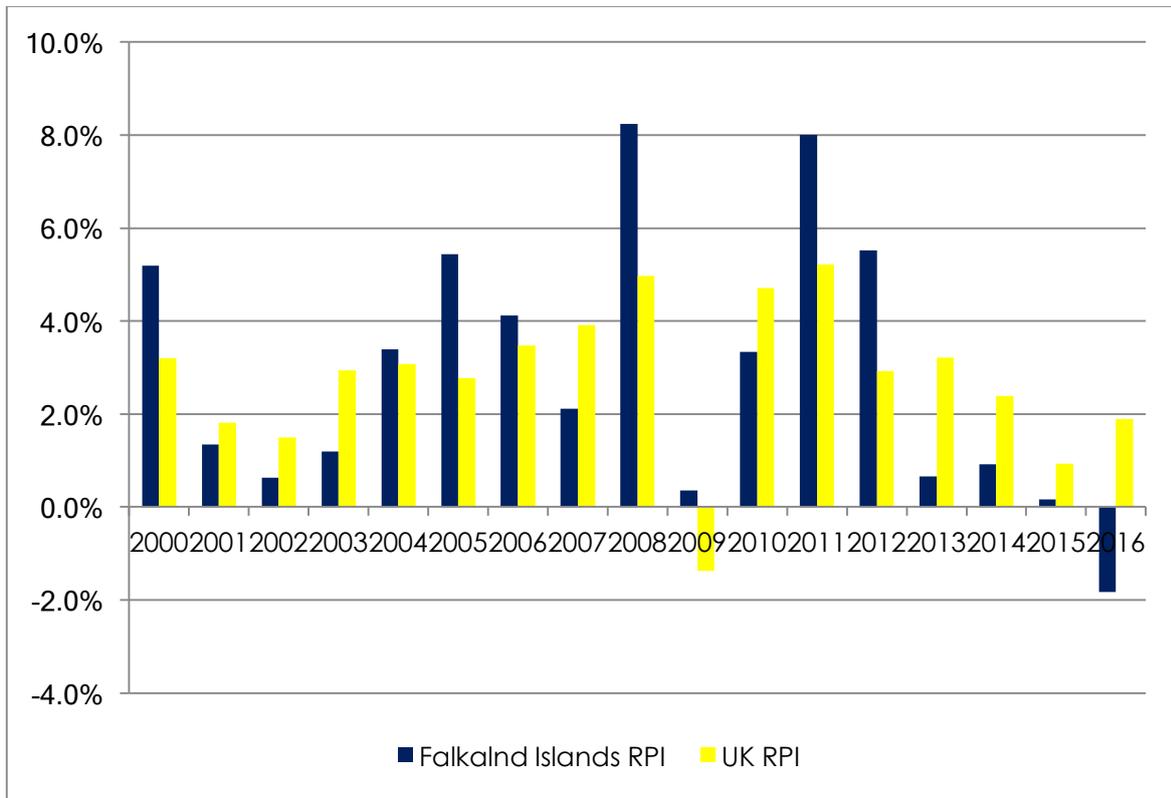


Source: Falkland Islands National Accounts 2007-2015, Policy and Economic Development Unit analysis

3. Retail prices

Retail prices in the Falkland Islands have tended to be volatile, although inflation has moderated in recent years. Figure 5 shows annual changes in the Falkland Islands and United Kingdom retail price indices.

Figure 5: Falkland Islands and United Kingdom retail price indices, annual changes, 2000-2016



Source: Falkland Islands Government Retail Prices Index, United Kingdom Office for National Statistics

Inflation in the Falklands seems to be correlated to inflation in the UK, although on several occasions price changes in the Falklands have been much larger. Inflation in the Falkland Islands can be strongly influenced by changes in the price of certain goods and services, such as fuel and broadband internet.

4. Trade

Imports

Most goods consumed in the Falkland Islands are imported. The FIG Customs and Immigration Department recorded FKP48 million worth of imported goods in 2014 (FKP9.2 million of which was classified as "Heavy Duty Industrial And Technical Machinery And Equipment, Parts And Accessories Thereof"), with 88% by value coming from the UK and the remainder imported from the rest of the EU, Chile, Uruguay and other countries.^{5,6}

⁵ These are the places of loading; the goods may have been produced elsewhere.

⁶ Note that the FIG Customs and Immigration Department does not record imports of bunker fuel, which are likely to be worth tens of millions of pounds annually.

The Falkland Islands economy also imports a considerable amount of services. These include professional technical expertise, including engineering, construction management and specialist health care, as well as services related to oil exploration, transportation and fishing.

Exports

The Falkland Islands' main exports are fish, wool, meat and tourism.

Fish products are by far the largest exported good. According to the Falkland Islands Fishing Companies Association (FIFCA), exports of fish from the Falkland Islands in 2016 were worth FKP191.0 million.

The second largest exported good is wool, with a value of FKP5.5 million in 2015, while lamb and mutton exports were worth FKP2 million.

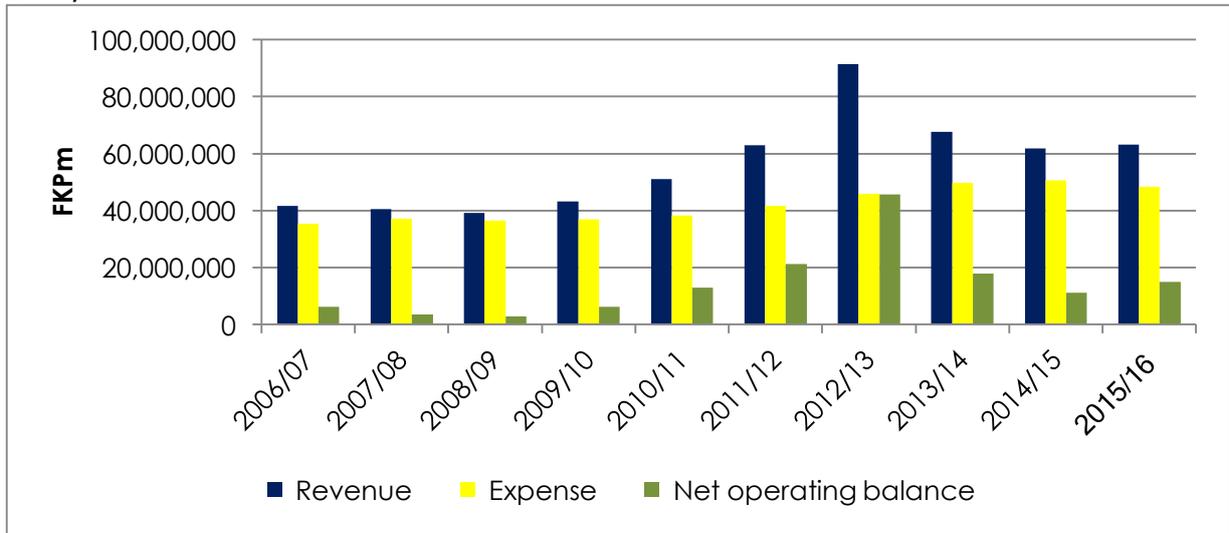
Cruise passengers spent FKP3.2 million in the Falkland Islands during the 2016/17 season (October 2016 to April 2017), and land-based leisure tourists spent FKP2.3 million during calendar year 2016 (tourists more broadly defined to include any "non-residents of the Falkland Islands travelling to the country for at least one night and for not more than one consecutive year, for leisure, business and other purposes" spent FKP5.7m in 2016, with almost half of this accounted for by business and transit tourists).

5. Government

Figure 6 shows government revenues, expenses (which include operational expenditure, including consumption of fixed capital, but exclude capital expenditure) and net operating balance (the difference between these two figures).⁷

⁷ This chart, and the others in this section, has been prepared in accordance with UN Government Financial Statistics standards and may vary from figures published by FIG Treasury.

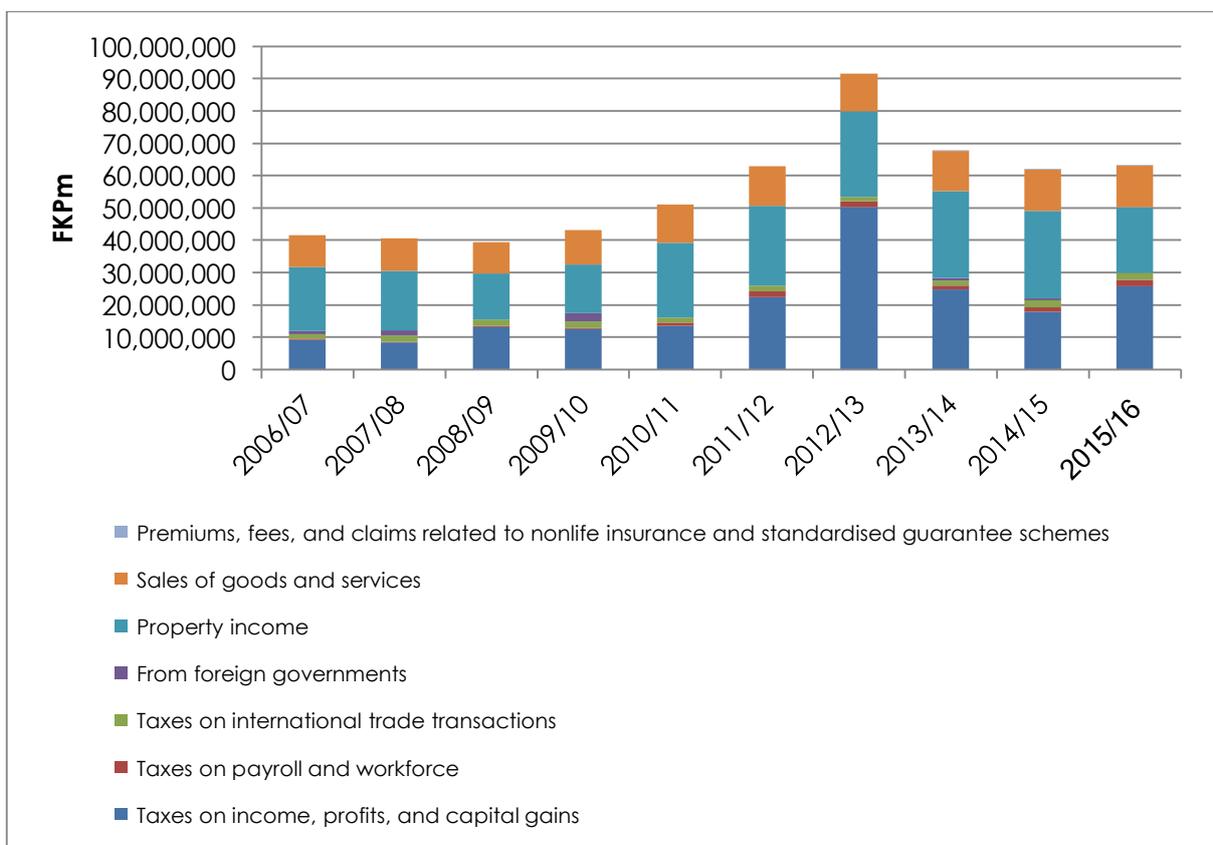
Figure 6: Government revenue, expense and net operating balance, 2006/07 to 2015/16



Source: Falkland Islands Government Treasury, Policy and Economic Development Unit analysis

Figure 7 breaks down the government revenues by source, according to UN Government Financial Statistics (GFS) categories.

Figure 7: Government revenues by GFS category, 2006/07 to 2015/16



Source: Falkland Islands Government Treasury, Policy and Economic Development Unit analysis

Property income, mainly made up of fishing licence fee revenues and investment income, is generally the largest source of revenue. Taxes on income, profits and capital gains, which are mainly composed of personal and corporate taxes, are usually the second largest contributor to government finances, and are more dependent on the level of economic activity in a given year. Income from sales of goods and services reflects goods and services sold by FIG, such as electricity and quarry products. Grants from foreign governments are EDF grants received from the EU.

6. Population, demographics, income and employment

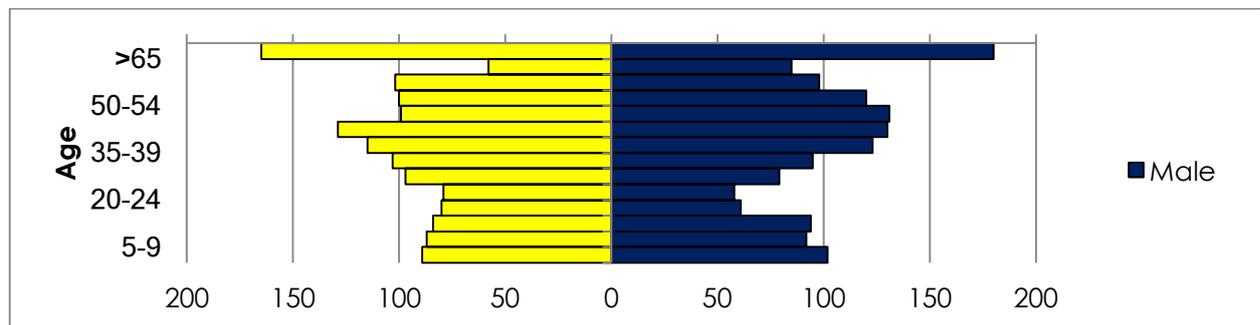
Population and demographics

Following a period of stagnation between 2001 and 2012, the Falkland Islands population grew to 3,200 in 2016 (2,841 excluding MPC), from 2,840 (2,471) in 2012, an increase of 360 people, equating to an annual growth rate of 4.3% over that period.⁸ The population increase was mainly driven by net migration (319 people), with a natural increase (births minus deaths) of 41 people. Over this period, the number of people with Falkland Islands Status increased by 44, and the number of people holding a Permanent Residence Permit (PRP) increased by 81. This change would be made up of natural increase in population as well as work permit holders applying for PRP (and PRP holders applying for Status). At least some of the increase in population is driven by discrete projects (for example, demining) and is therefore likely to be temporary.

Note: The population at MPC is excluded from all the following data and analysis on demographics.

Figure 8 gives a breakdown of the Falkland Islands population by age and sex.

Figure 8: Falkland Islands population (excluding MPC) by age and sex, 2016



Source: Falkland Islands Census 2016

The Falkland Islands has a relatively young population when compared to other developed economies. 12.2% of the population is aged 65 or over, compared to

⁸ These figures are for the usually resident population who were present on the night of the census. Serving British military personnel are excluded.

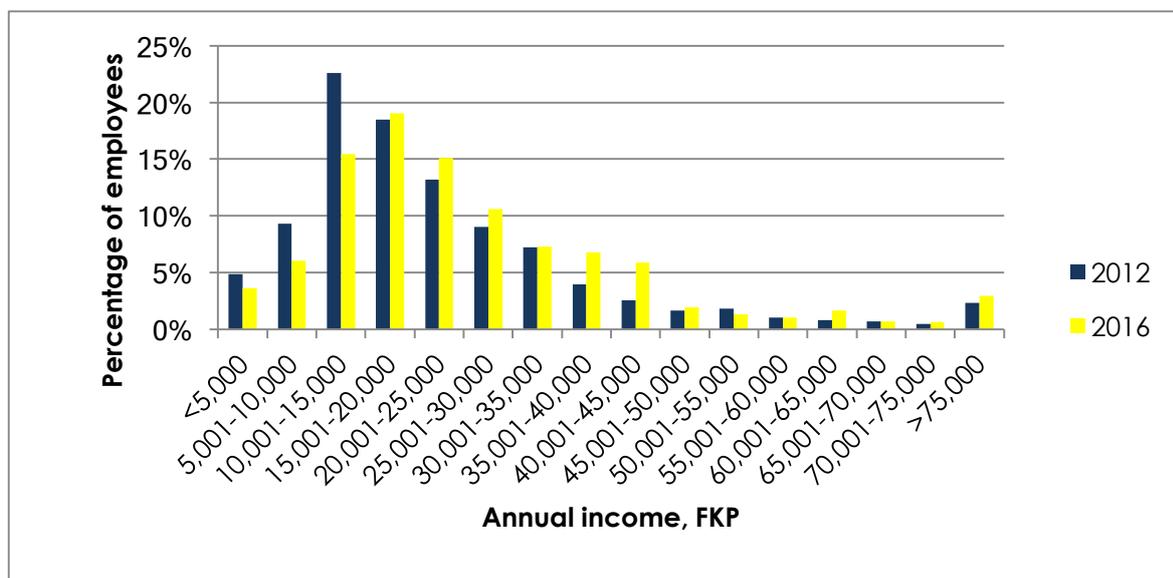
17.8% in the United Kingdom, 14.8% in the United States and 26.3% in Japan. Excluding visitor and work permit holders and their dependents, 14.8% of the population is aged 65 or older. This age structure is beneficial to public finances and to the economy as a whole, as there is a large working age population which pays taxes while consuming, on average, fewer health and social care services than people outside working age.

The dependency ratio is a statistic that compares the working age population (those aged 15-64) to the remainder of the population. As an example, a dependency ratio of 50% means that each person of non-working age is supported by two people of working age, and a 100% ratio would mean that each non-working age person is dependent on just one working age person. The dependency ratio for the Falkland Islands is 46%, meaning that each non-working age person is supported by just over two working age people. Excluding visitor and work permit holders and their dependents, the dependency ratio is 56%. The global average dependency ratio is 54%.

Income

Figure 9 shows how the distribution of income received by employees (excluding MPC) has changed between 2012 and 2016.

Figure 9: Income of people in employment, 2012 and 2016, current prices



Source: Falkland Islands Census 2016

The percentage of employees with incomes in the three lowest categories declined between 2012 and 2016, with the biggest fall, 7%, in those earning FKP10,001 to FKP15,000. There have been moderate increases in the percentage of employees falling into most of the higher categories⁹.

⁹ Retail prices increased by only 1.8% between 2012 and 2016, so while this chart is in nominal terms, trends in real income would be very similar.

Employment and unemployment

The unemployment rate in the Falkland Islands in 2016 was just 1.0%. This is very low by international standards: for example, the UK's unemployment rate was 4.4% in the period April to June 2017¹⁰. While this is clearly something to be celebrated, the very tight labour market conditions can pose problems for businesses, which will be further discussed below. As it is, a large amount of labour is carried out by non-residents of the Falkland Islands, not all of which is due to a lack of skills available locally.

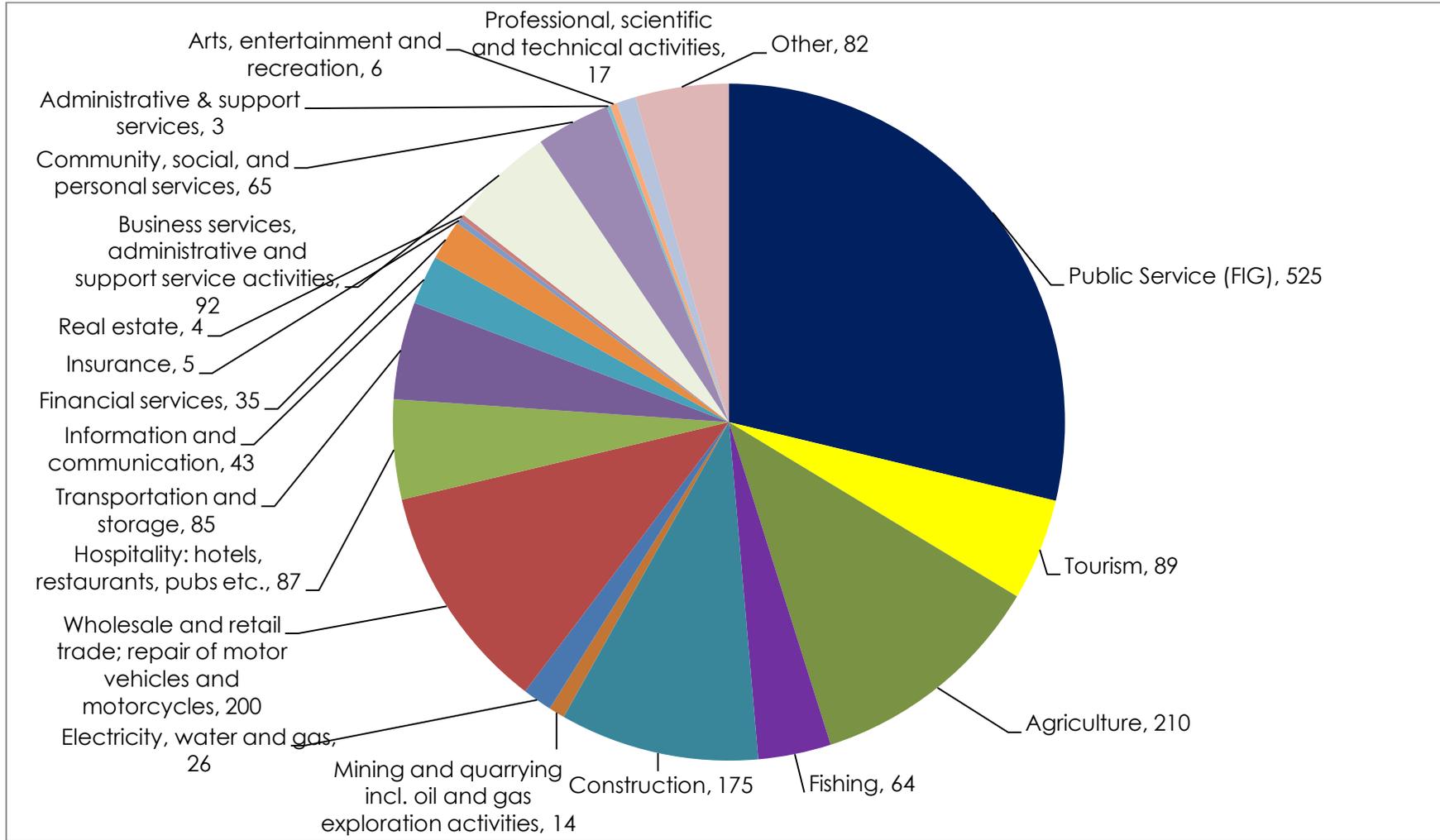
The economic activity rate (that is, the percentage of the working age population who are in, or are seeking, employment) was 90.0%. The UK figure was 78.7% in April to June 2017¹¹. The high economic activity rate in the Falklands suggests that there is little scope for increasing labour supply by drawing additional residents into the labour force, and that any net new jobs will require immigration. The number of people in employment in 2016 was 1,850, compared to 1,599 in 2012 (including people who are self-employed).

Figure 10 shows the number of employees in each industry in 2016, according to the 2016 census. This is restricted to primary employment only (372 people stated that they hold more than one job, of whom 96 worked in tourism)

¹⁰ Labour market statistics time series dataset, Office for National Statistics

¹¹ Labour market statistics time series dataset, Office for National Statistics

Figure 10: Primary employment by industry, excluding MPA



Source: Falkland Islands Census 2016

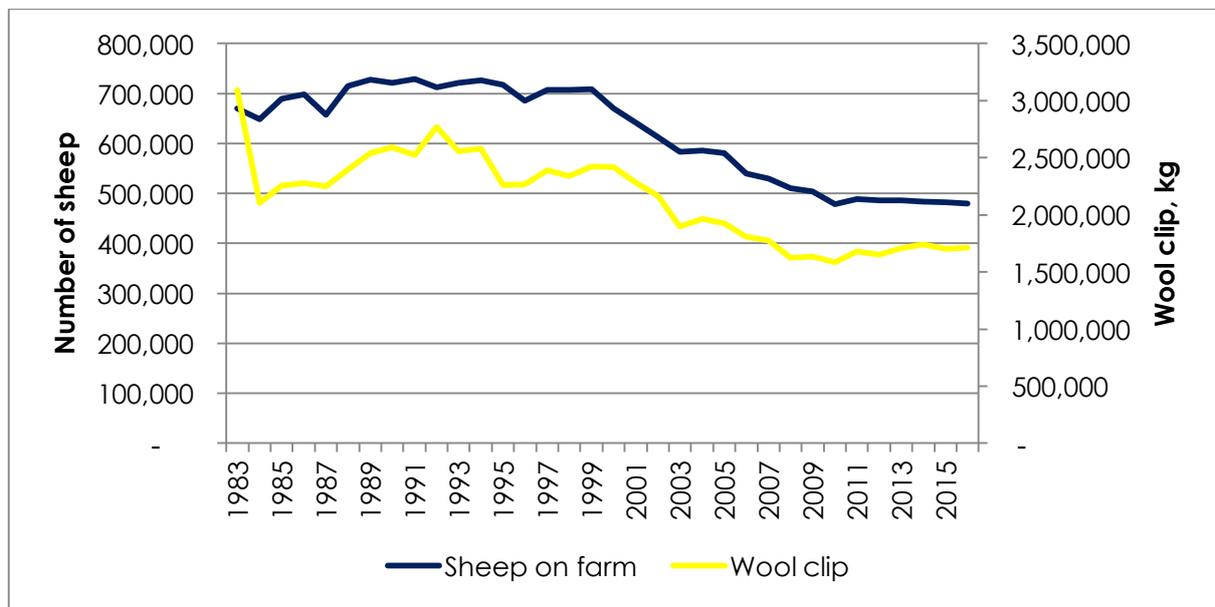
7. Agriculture

Agriculture is the second largest employer in the Falklands, accounting for 9.7% of employment. The industry employed 210 people in 2016, down from 260 in 1991. The agriculture industry's gross value added was FKP3.4m in 2015, 1.6% of GDP. 22% of agriculture industry output in 2015 was produced by Falkland Landholdings in 2015.

The number of sheep on farms has declined 34% from the recent peak of 729,000 in 1991, falling to 480,000 in 2016, although numbers have remained fairly steady since 2010. The wool clip has experienced a similar declining trend, with a clip of 1,703,000kg in 2016, down from 2,773,000kg in 1992.

Figure 11 shows trends in sheep numbers and wool clip since 1983.

Figure 11: Falkland Islands sheep numbers and wool clip, 1983-2016



Source: Falkland Islands Farming Statistics, Department of Agriculture

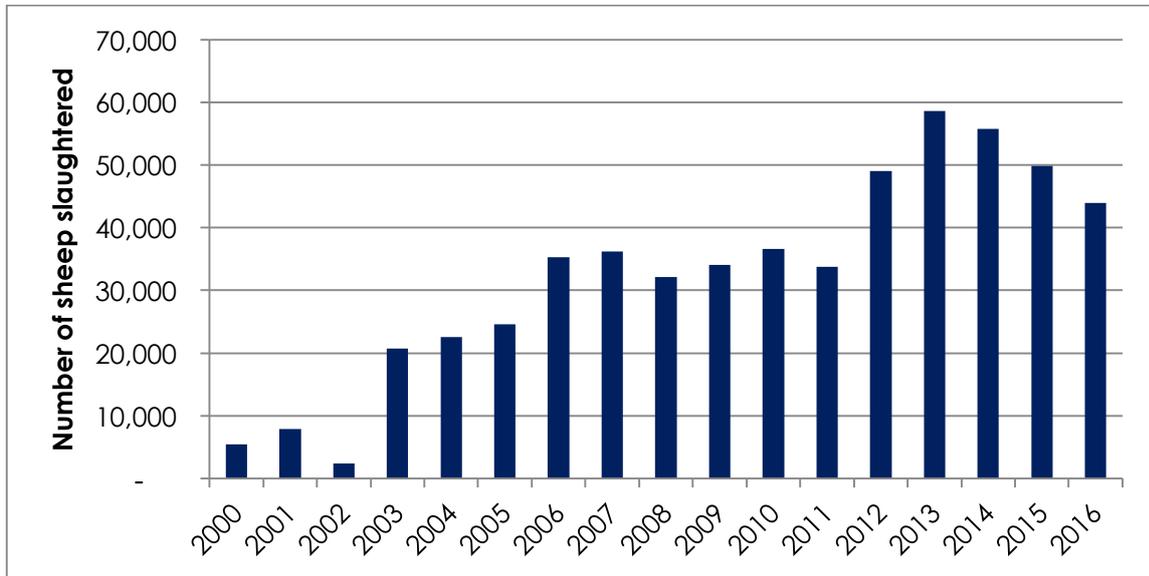
Wool remains the most important agricultural product, with an estimated export value of FKP5.5 million in 2015.

Government and industry have made significant efforts to reduce the micron of Falkland Islands wool, to obtain a better price on world markets. A recent report¹² commissioned by the Falkland Islands Development Corporation (FIDC) has suggested a number of other ways to add value to Falkland Islands wool.

¹² Value Adding Opportunities for Falkland Islands' Wool, Blake + Associates Consulting

Large scale exports of lamb and mutton began after the establishment of the Falkland Islands Meat Company (FIMCO) in 2003¹³. The value of meat exports was estimated at FKP2.0 million in 2015, and FIMCO also supplies lamb, mutton and beef to the domestic market. The number of sheep slaughtered peaked at 58,596 in 2013, before falling to 44,000 in 2016.

Figure 12: Number of sheep slaughtered annually, 2000-2016



Source: Falkland Islands Farming Statistics, Department of Agriculture

Eggs and vegetables are also produced commercially on the Islands, albeit on a small scale.

8. Fishing and aquaculture

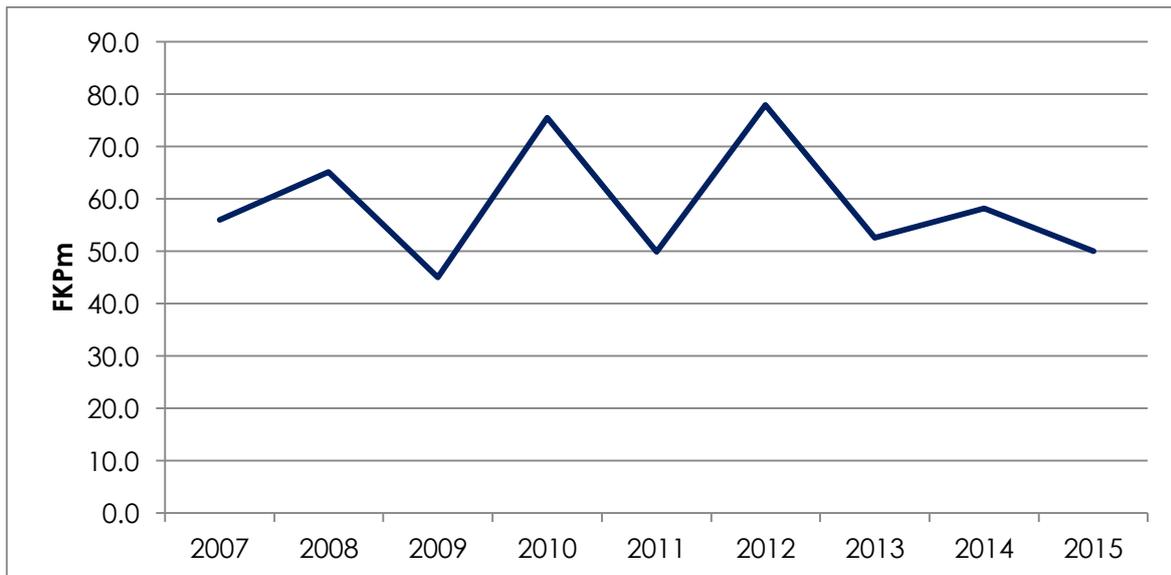
The Falklands Interim Conservation Zone was established in 1986, giving the Falkland Islands control over its fishery. This area was later expanded with the Falklands Outer Conservation Zone.

With the exception of the *ill*ex squid fishery, fishing in Falklands waters is controlled by a system of individual transferrable quotas, and is carried out by Falkland Islands resident companies acting either alone or in joint ventures with foreign (mainly Spanish) partners.

Fish catches are influenced by a complex range of factors, including climate, fishing pressure inside and outside Falklands waters and interactions between species. The price achieved for fish sold onto global markets is also variable. Figure 13 shows the annual gross value added by the fishing industry in real terms, demonstrating the volatility of this figure.

¹³ Although there have been previous attempts at establishing a meat export enterprise in the Falklands, including the Ajax Bay freezer plant.

Figure 13: GVA of the fishing and aquaculture industries, constant 2012 prices



Source: Falkland Islands National Accounts 2007-2015

Note: This chart does not include the activity of non-resident fishing companies fishing for *illex* squid on type B licences.

In 2015, the fishing and aquaculture industry accounted for 39% of Falkland Islands GDP, with this figure varying between 35% and 48% over the period 2007 to 2015.

Fishing vessels are almost entirely crewed by non-residents of the Falkland Islands. However, there is some onshore employment within fishing companies, with 64 Falklands residents stating in the 2016 Census that their primary employment was in fishing. The fishing industry also purchases goods and services in the Falkland Islands, including transportation, logistics (including trans-shipment), fuel and provisions, supporting further employment and profit in these industries.

Fishing licence fees are typically the biggest single source of government revenues, and have generated between FKP10 and FKP30 million per annum since they were first charged in 1987. Revenues were FKP14.7 million in 2015/16, which was a very poor season for the *illex* fishery; revenues had been FKP21.8 million in 2014/15. Falklands resident fishing companies are also significant contributors to corporation tax revenues. As well as earning revenues, FIG incurs costs in managing the fishery: expenditure on fisheries administration, fisheries protection/harbour control and the scientific budget together came to FKP5.2 million in 2015/16.

Recent developments in and related to the industry include a trout farm at Fitzroy and a fish processing plant in Stanley.

9. Tourism

The Falkland Islands receives visits from cruise ship passengers as well as visitors who stay on the Islands for one or more nights (land-based tourists).

According to the Tourism Satellite Account 2014, produced by Acorn Consulting on behalf of the Falkland Islands Tourist Board, gross value added by the tourism industry was FKP2.9m in 2014, 1.6% of GDP. In the 2016 census, 89 people stated that their primary employment was in tourism (of whom 31 work part-time or are semi-retired), with a further 96 people saying that they had secondary employment in the industry.

The number of cruise passenger arrivals in the Falklands has grown from a few thousand in the mid-1990s to 55,633 during the 2016/17 season, spending a total of FKP3.2m¹⁴. Government income from passenger levies paid in respect of cruise passengers were FKP1.4m in the 2015/16 financial year¹⁵.

1,540 land-based leisure tourists visited the Falkland Islands in 2016, staying for an average of 9.8 days and spending a total of FKP2.3m. The number of leisure tourists has increased from 1,291 in 2000 (the first year for which data are available), but has remained fairly constant since 2005, except for some notable peaks, coinciding with significant anniversaries of the 1982 conflict.

The Tourism Development Strategy (2016-2023) has set a target of increasing tourist overnights (that is, each night spent on the Islands by a tourist) by 87% by 2023, and increasing the number of cruise ship visitors by 49%, and their expenditure by 42%, by the 2022/23 season.

10. Hydrocarbons

Hydrocarbon exploration has been taking place in Falkland Islands waters for some time, with major drilling campaigns taking place in 2010-2012 and 2015-16. Oil deposits have been identified, and the decision of oil companies on whether to sanction production will be driven by expectations of future oil price, attractiveness of the specific project, investment climate and other factors.

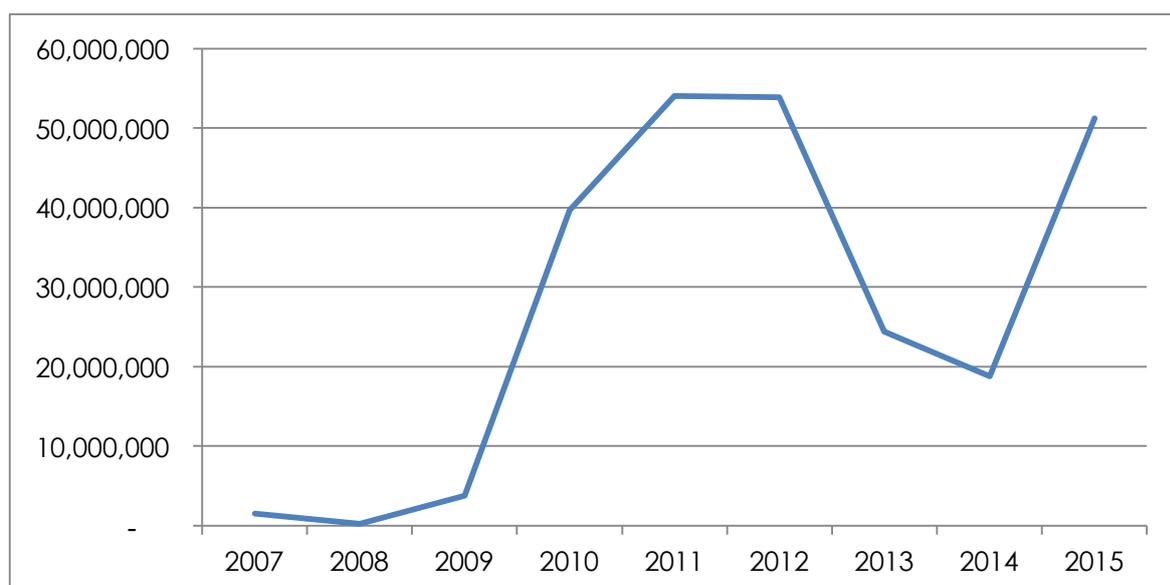
Exploration activity has provided a stimulus for the Falklands economy, as well as providing a contribution to government revenues. The economic impact of oil production, should it be sanctioned, would be much larger. Figure 14 shows annual gross value added by oil and gas related activities between 2007 and 2015.¹⁶

¹⁴ International Leisure Tourism Statistics Report 2016, Falkland Islands Tourist Board

¹⁵ FIG Budget Book 2017/18

¹⁶Oil and gas related activities include value added by oil companies, as well as by companies providing support services in the Falklands that are directly linked to oil. It does not include activities carried out in support of oil exploration by businesses that provide goods or services more generally in the Falklands. For example, the boost to demand for land transport services in the Falklands is not included in the above figures, but the activities of geotechnical survey companies contracted by oil licensees are.

Figure 14: GVA of oil and gas related activities, constant 2012 prices



Source: Falkland Islands National Accounts 2007-2015

Note: Data for 2010 were not available, and therefore have been estimated based on value added by the mining and quarrying industry in that year, rather than on a detailed analysis of oil and gas related activity at the company level, as was the case for other years. Value added has been deflated using deflators for the mining and quarrying industries, which includes the bulk of oil and gas related activities.

11. Business environment and competition

Business environment

According to the FIDC Business Climate Survey 2016, the five barriers to growth most frequently reported by business respondents were:

Barrier	Percentage of respondents who cited it as a barrier
Shortage of Skilled Labour	32.4%
Freight costs by Sea - Import	21.6%
Small Local Market	21.6%
Distance to Markets	20.6%
Air Link to Chile (LAN)	19.6%
Immigration Regulations & System	19.6%

Shortage of skilled labour is, by some distance, the most commonly cited barrier to growth (shortage of unskilled labour was cited by 15.7% of respondents).

As noted above, the unemployment rate in the Falklands is very low, and the economic activity rate is high. This means that it can be difficult to fill jobs with local

workers - 32% of jobs (looking only at an individual's primary employment) are currently held by work permit holders. The difficulties businesses experience in meeting their labour force needs may be linked to their concerns with the immigration regulations and system.

Some other barriers, such as the small local market and the distance to other markets, are consequences of being a small, isolated, community, which cannot easily be overcome, although steps may be taken to mitigate their impact on the economy.

Competition

Many goods and services in the Falkland Islands are supplied by either one supplier or a small number of suppliers. In many cases the supplier is FIG, or the service is supplied under a contract between FIG and a single private sector supplier.

Natural monopoly conditions exist in several industries. Broadly, a natural monopoly will exist where suppliers experience economies of scale that are large relative to the size of the market. This has the consequence that costs are minimised if just one firm participates in the market, raising a barrier to entry for other firms. Natural monopolies often occur in industries where fixed costs are high relative to total costs, which is more likely to happen in small markets like the Falkland Islands.

A monopoly provider may be able to exploit its position by setting prices higher than the marginal cost of providing the good or service, which is the price that would be determined in a competitive environment. This would result in the good or service being consumed at less than the socially efficient level. Governments may respond to this concern by regulating the monopoly provider or by providing the service itself.