

STATE OF THE FALKLAND ISLANDS ECONOMY 2018

February 2019

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 Falkland Islands are reliant on imports of consumer and industrial goods, fuel and most foodstuffs; 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 an even 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. Global trends

Economic growth

According to the International Monetary Fund (IMF)'s World Economic Output Update published in January 2019², "global expansion is weakening and at a rate that is somewhat faster than expected".

Global growth forecasts for 2019 and 2020 have been revised downward, to 3.5 percent and 3.6 percent respectively (see Figure 1), to reflect "the negative effects of tariff increases enacted in the United States and China earlier that year, [...] carry over from softer momentum in the second half of 2018³, [...] but also weakening financial market sentiment [...]."

According to the IMF, even if "downward revisions are modest, [...] the risks to more significant downward corrections are rising", as a number of factors could trigger a further deterioration in risk sentiment at the international level, with adverse growth implications. These include:

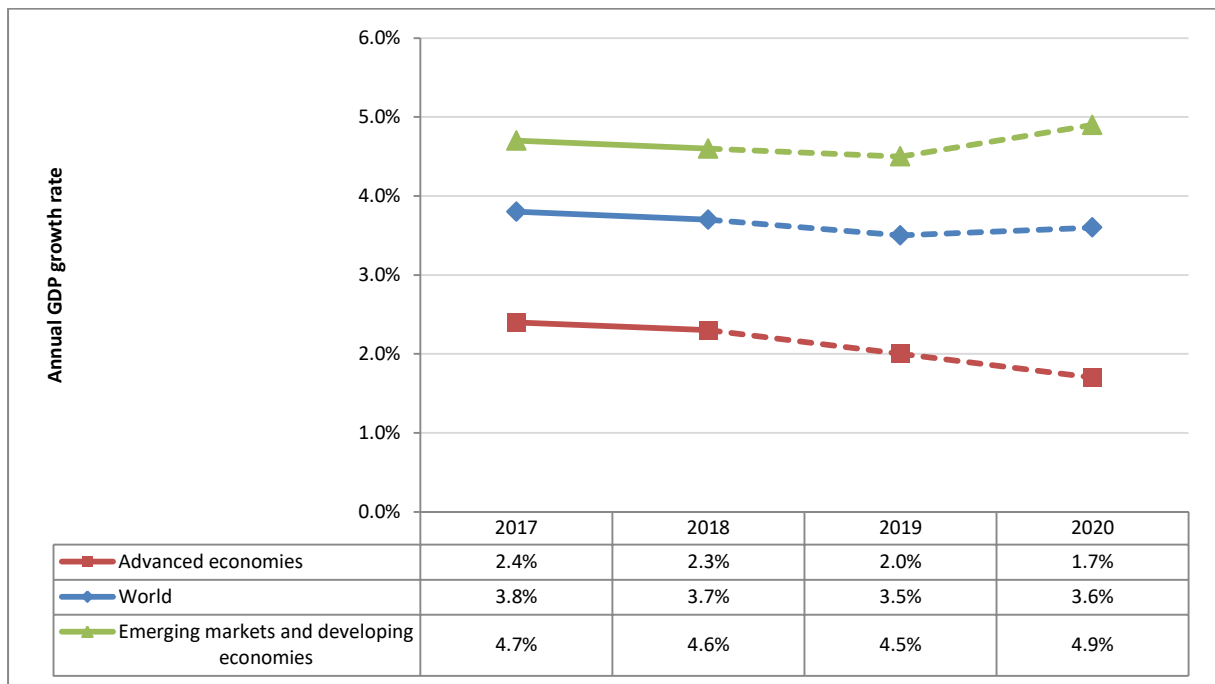
- An escalation of trade tensions beyond those already incorporated in the forecast;
- A more serious tightening of financial conditions;
- A greater-than-envisaged slowdown in China;
- A "no-deal" withdrawal of the United Kingdom from the European Union;
- Costly spillovers between sovereign and financial risk in Italy; and
- A protracted federal government shutdown in the United States.

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 Available at <https://www.imf.org/en/Publications/WEO/Issues/2019/01/11/weo-update-january-2019>

³ Reasons for such momentum include the introduction of new automobile fuel emission standards in Germany, concerns about sovereign and financial risks in Italy, as well as economic contraction in Turkey.

Figure 1: Prospects for the global economy

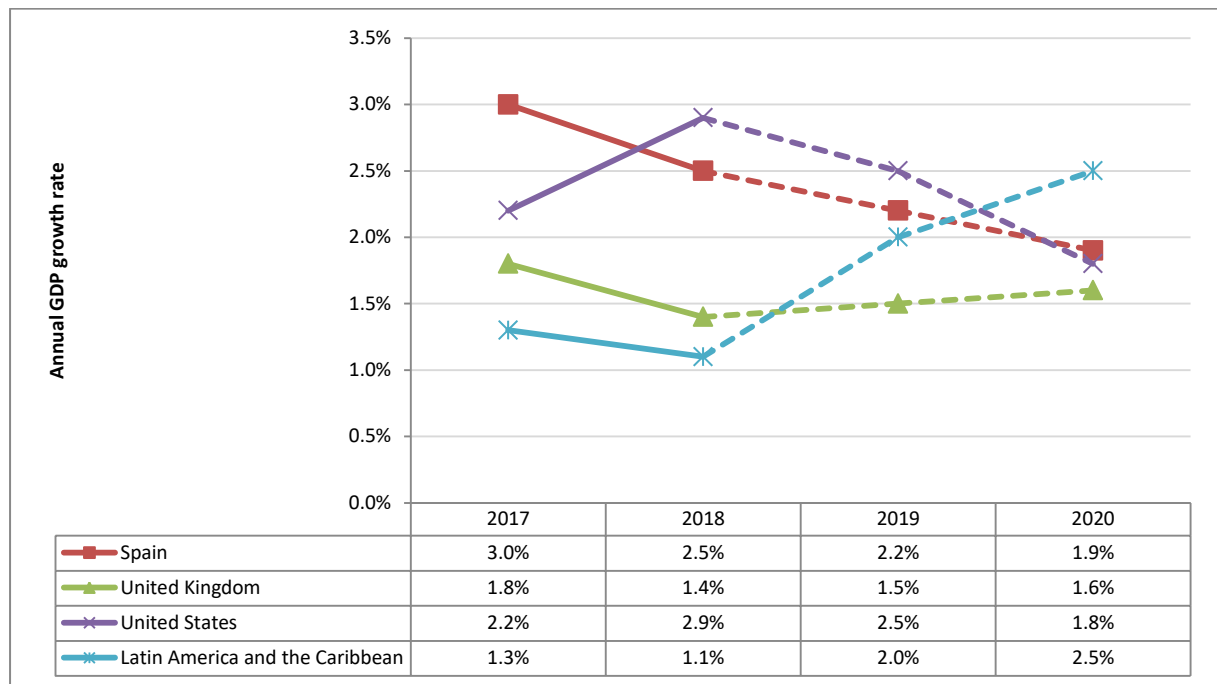


Source: International Monetary Fund, World Economic Outlook, January 2019 Update.

Figure 2 shows the IMF's outlook with specific reference to the Falkland Islands' major trading partners. A number of observations can be highlighted:

- Growth in Spain is expected to decline to 2.2 percent in 2019 and 1.9% in 2020. Similarly, growth in the United States is expected to decline to 2.5 percent in 2019 and soften further to 1.8 percent in 2020.
- Growth in the United Kingdom is expected to be around 1.5 percent in 2019-20. However, the IMF underlines substantial uncertainty around this baseline projection – which assumes that a Brexit deal is reached in 2019 and that the UK transitions gradually to the new regime – “as of mid-January, the shape that Brexit will ultimately take remains highly uncertain”.
- In Latin America, growth is projected to recover over the next two years, from 1.1 percent in 2018 to 2.0 percent in 2019 and 2.5 percent in 2020. Even if this outlook is positive, forecasts are 0.2 percentage point weaker for both years than previously expected. However, forecasts for Brazil have been reviewed upward, as the gradual recovery from the 2015–16 recession is expected to continue.

Figure 2: Falkland Islands' trading partners

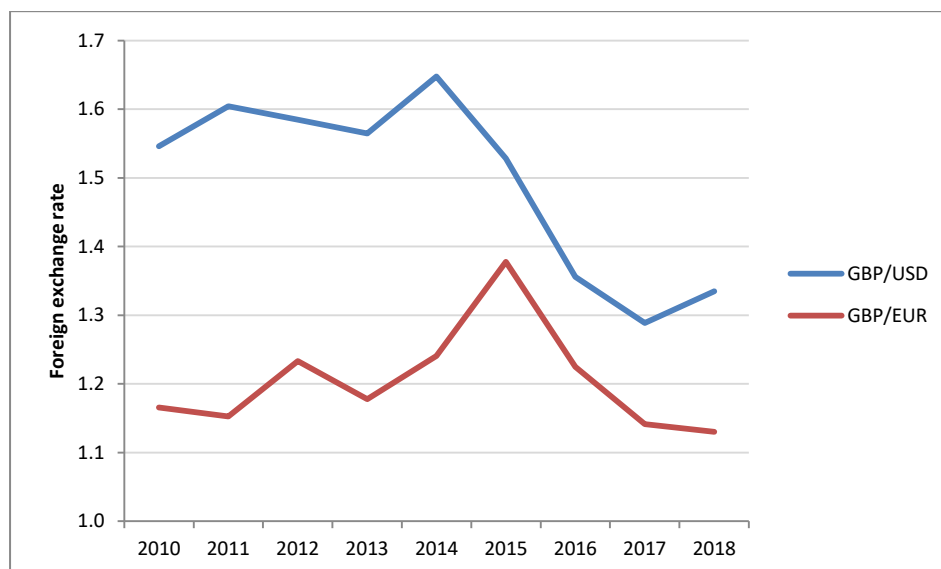


Source: International Monetary Fund, World Economic Outlook, January 2019 Update

Exchange rates

The foreign exchange rate of the Pound Sterling to the US Dollar increased from 1.55 in 2010 to 1.65 in 2014, and then decreased to 1.33 on average in 2016-2018. Similarly, the Pound Sterling has appreciated against the Euro between 2010 (GBP/EUR = 1.17) and 2015 (GBP/EUR = 1.38), and has been depreciating since then, reaching 1.13 in 2018 (see Figure 3).

Figure 3: GBP/USD and GBP/EUR exchange rates, 2010-2018



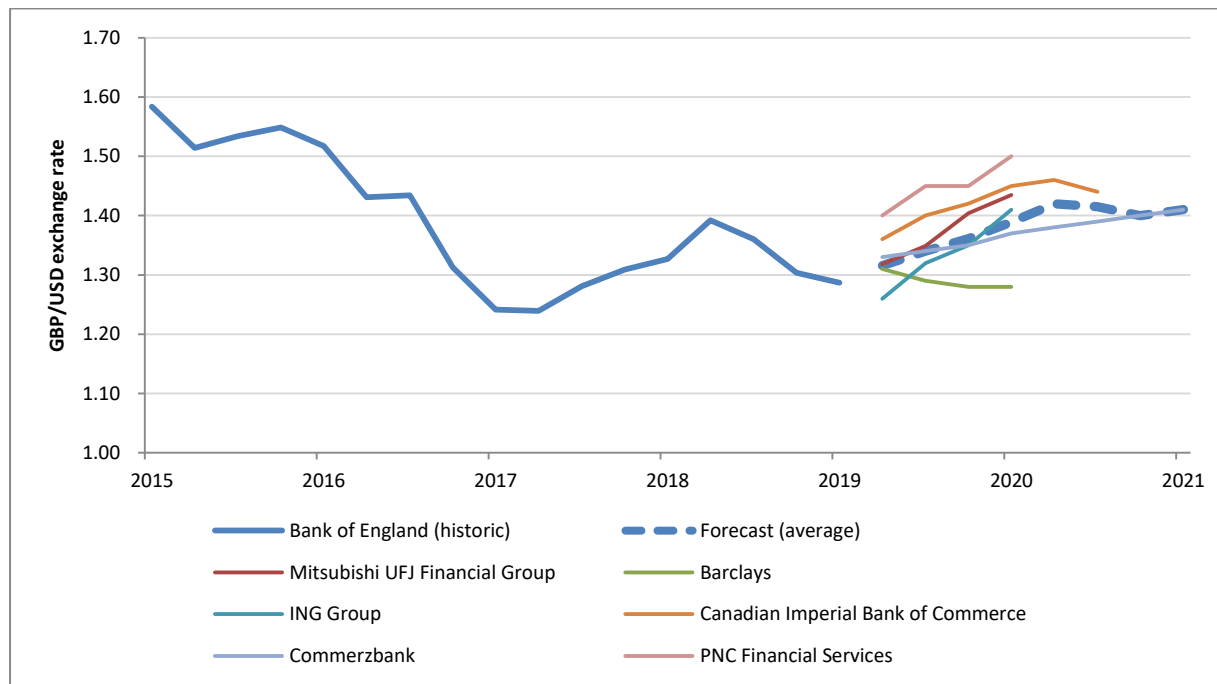
Source: Bank of England and European Central Bank

The relative depreciation of the Pound Sterling against the US Dollar and Euro in recent years has benefitted some Falkland Islands exports (including most of fishing products exports, almost 90% of

which are exported into the European market through the port of Vigo, in Spain), but has negatively impacted on the cost of imports.

According to a number of economic forecasters (see Figure 4), the Pound Sterling is expected to appreciate against the US Dollar in 2019 and 2020. This would negatively impact the competitiveness of Falkland Islands' exports (with the exceptions of exports towards the United Kingdom), but conversely lower the cost of imports and have a deflationary pressure on prices changes in the Falkland Islands.

Figure 4: GBP/USD exchange rate forecasts



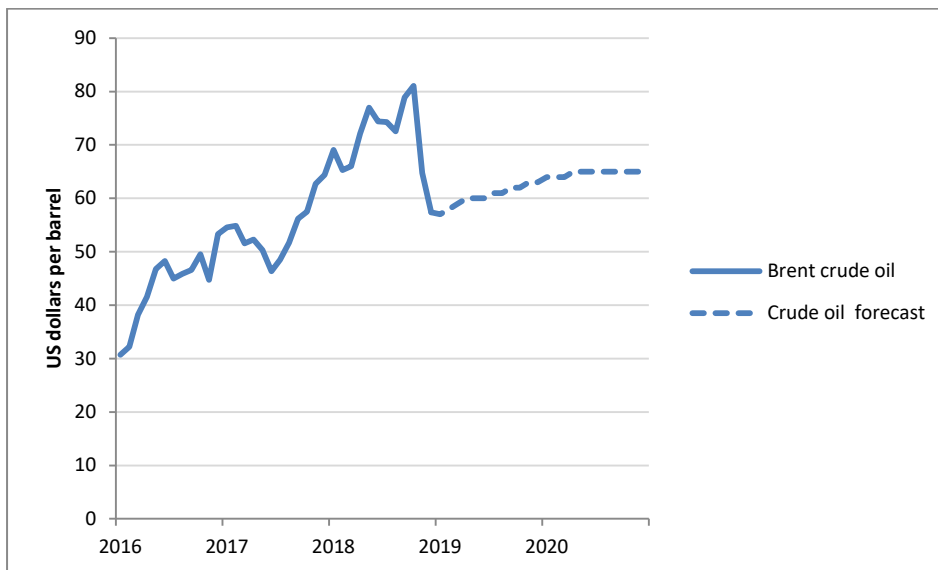
Source: Bank of England, Mitsubishi UFJ Financial Group, Barclays, ING Group, Canadian Imperial Bank of Commerce, Commerzbank, PNC Financial Services

Oil prices

International oil prices have been steadily increasing in recent times; for example, the price of Brent crude oil on the US market has been increasing from an average of USD39.61 per barrel in the first half of 2016 to an average of USD70.65 in the first half of 2018. However, a sharp decrease was recorded in the second half of 2018, with the price of Brent dropping to USD57.36 in December 2018 (see Figure 5).

According to the US Energy Information Administration, oil prices are expected to slightly increase in 2019 and 2020; the price of Brent is projected to reach USD65 by mid-2020.

Figure 5: Brent crude oil historic price (2016-2018) and price forecast (2019-2020)



Source: US Energy Information Administration (EIA), Short-Term Energy Outlook, January 2019

3. Falkland Islands macroeconomic overview

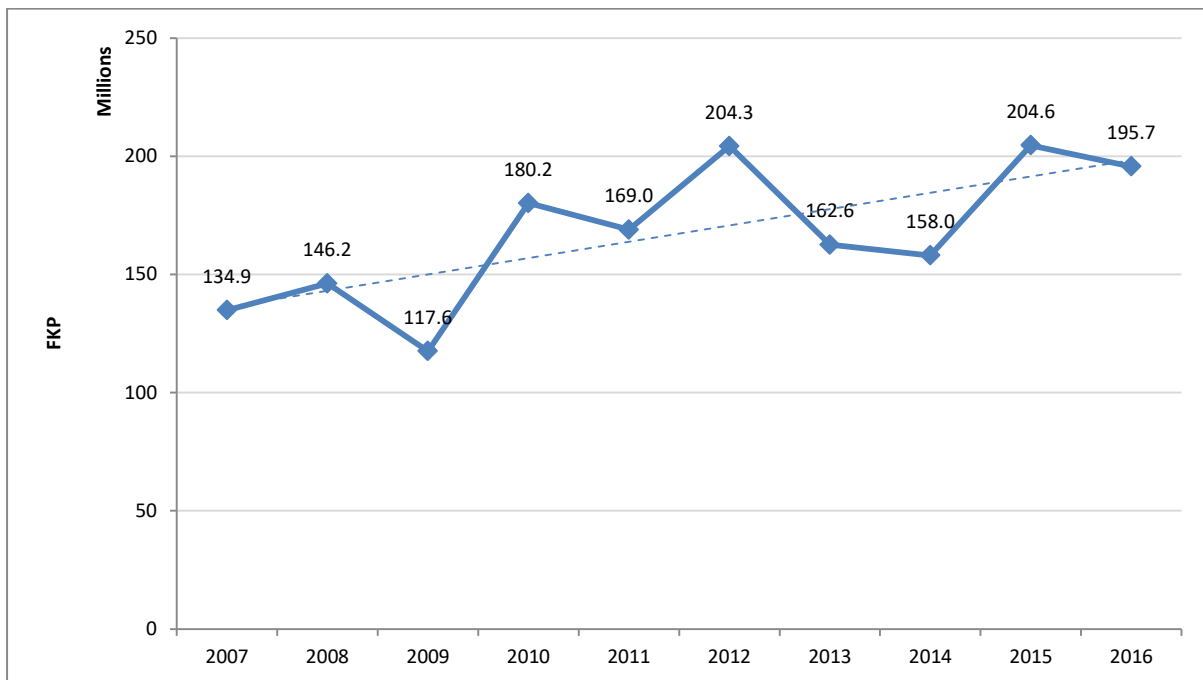
Growth in gross domestic product

In 2016, the Falkland Islands gross domestic product (GDP) in nominal terms was equal to FKP283.4 million. Figure 6 shows how real⁴ Falkland Islands GDP has changed between 2007 and 2016. Over this period, GDP has grown by 45.1% (from FKP134.9 million to FKP195.7 million in 2012 prices), at a compound annual growth rate of 4.2%.

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. In 2016, real GDP decreased by 4.3%, driven primarily by reduced activity in relation to the 2015/16 oil drilling campaign.

⁴ 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.

Figure 6: Falkland Islands GDP, constant 2012 prices

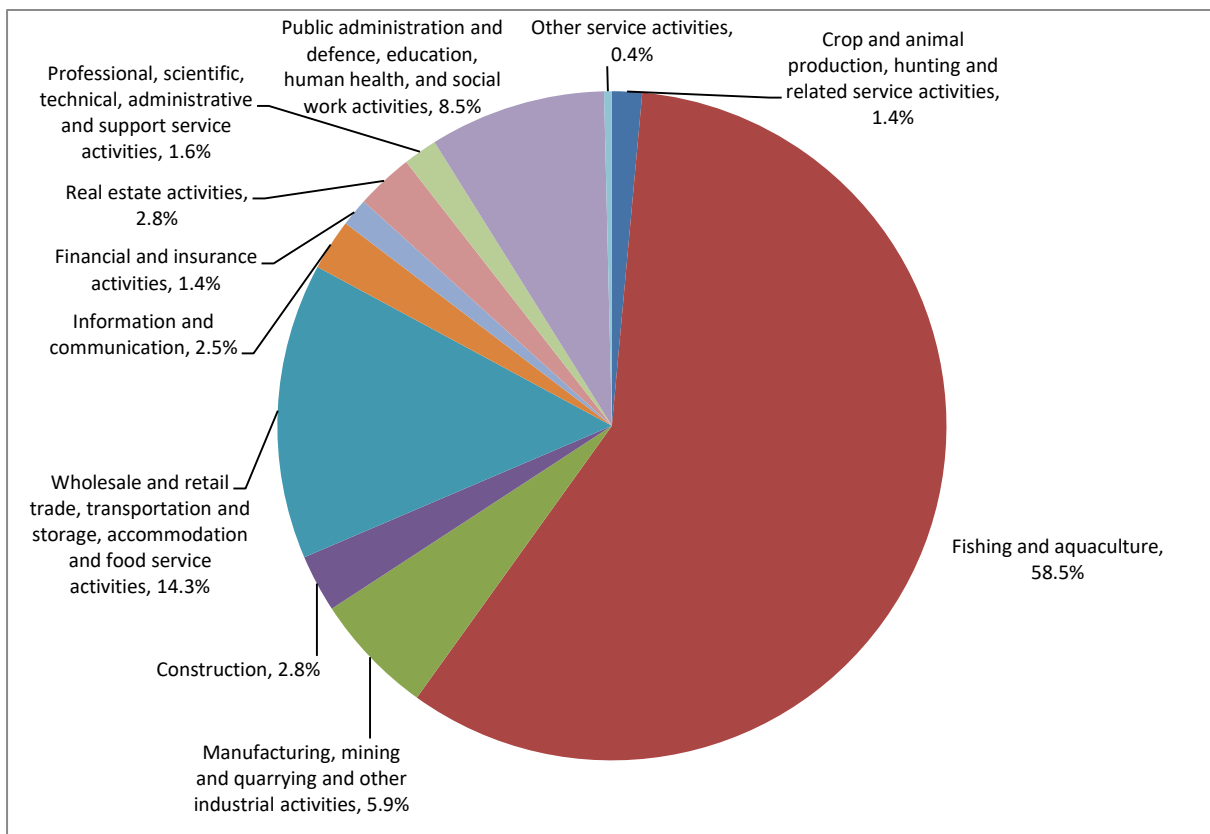


Source: Falkland Islands National Accounts 2007-2016

Gross domestic product by industry

Figure 7 shows the contribution made by different industries to Falkland Islands GDP in 2016.

Figure 7: Gross value added by industry in 2016, current prices



Source: Falkland Islands National Accounts 2007-2016

The single largest contributor to GDP in 2016 was the fishing industry (accounting for 58.5 per cent of total GDP in current prices), followed by wholesale and retail trade, transportation and storage, accommodation and food service activities (14.3 per cent of GDP), and public administration-related activities (8.5 per cent of GDP).

Table 1 details changes in gross value added (GVA) in current prices, by economic activity, between 2015 and 2016. The great majority of total change in GDP (+29%) is due to an 85% increase in the fishing industry's GVA, and a 61% decrease in GVA from oil & gas exploration activities.

Table 1: Gross value added by economic activity, at current and basic prices, 2015 and 2016

Code	Industry	2015	2016	Change	% change
1-01	Crop and animal production and related service activities	3.4	4.1	+0.7	+20.6%
1-03	Fishing and aquaculture	89.6	165.7	+76.1	+84.9%
2	Oil and gas exploration, quarrying, manufacturing and other industrial activities	42.4	16.7	-25.7	-60.6%
3	Construction	8.1	7.9	-0.2	-2.5%
4	Wholesale and retail trade, transportation and storage, accommodation and food service activities	28.5	40.5	+12.0	+42.1%
5	Information and communication	7.4	7.0	-0.4	-5.4%
6	Financial and insurance activities	3.0	3.8	+0.8	+26.7%
7	Real estate activities	7.6	7.8	+0.2	+2.6%
8	Professional, scientific, technical, administrative and support service activities	4.8	4.7	-0.1	-2.1%
9	Public administration and defence, education, human health, and social work activities	23.9	24.1	+0.2	+0.8%
10	Other service activities	1.2	1.1	-0.1	-8.3%
Total	Gross domestic product (GDP)	219.8	283.4	+63.6	+28.9%

Source: Source: Falkland Islands National Accounts 2007-2016

Tourism, defined broadly to include the provision of accommodation, meals and other services and amenities to tourists, is not recognised as a discrete industry.⁵ However, the Falkland Islands Tourist Board produces the Tourism Satellite Account (TSA) on a biannual basis. The latest TSA, for the 2016 calendar year, calculates that tourism gross value added was FKP3.8 million (or 1.3 per cent of GDP) in 2016.⁶

Figure 7 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 redeployed elsewhere, mitigating the overall negative effects.

⁵ This is because industries are defined according to the activity they perform, rather than the identity of their customers.

⁶ Falkland Islands Tourist Board, Acorn, Tourism Satellite Account 2016, December 2018

Gross domestic product and gross national income per capita

Gross domestic product per capita was FKP93,300 in 2016, based on a population of 3,039⁷, up from FKP75,400 in 2015.

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). This represents income that leaves the Falkland Islands. Similarly, income earned by Falkland Islanders on activities abroad is a net contribution to the economy. 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, is deemed to be a better indicator of the economic welfare of Falkland Island residents compared to GDP. GNI per capita for 2016 was FKP56,900, up from FKP46,600 in 2015⁸.

4. Retail prices

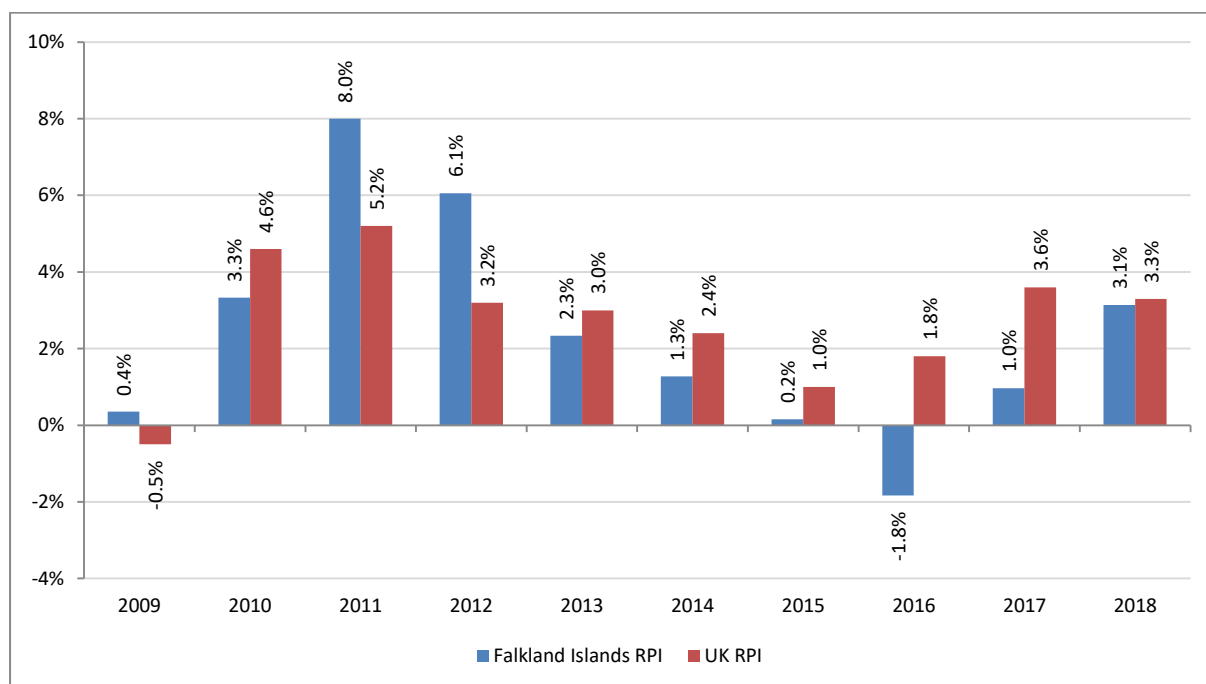
Retail prices in the Falkland Islands have tended to be volatile, although inflation has moderated in recent years. Figure 8 shows annual changes in the Falkland Islands and United Kingdom retail price indices between 2000 and 2018.

Inflation in the Falklands seems to be correlated with 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 internet.

⁷ 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.

⁸ 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.

Figure 8: Falkland Islands and United Kingdom retail price indices, annual changes, 2009-2018



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

In 2018, the Falkland Islands RPI has increased by 3.1% on 2017. Retail categories that have mostly contributed to changes in the price index have been:

- Fuel & Power – prices in this category have grown by 21% in 2018, contributing +1.8 percentage points to overall inflation;
- Food and non-alcoholic beverages – prices in this category have grown by 5% in 2018, contributing +0.9 percentage points to overall inflation;
- Recreation & culture – prices in this category have decreased by 6% in 2018, contributing -0.5 percentage points to overall inflation;
- Communication – prices in this category have decreased by 12% in 2018, contributing -0.6 percentage points to overall inflation.⁹

5. Trade

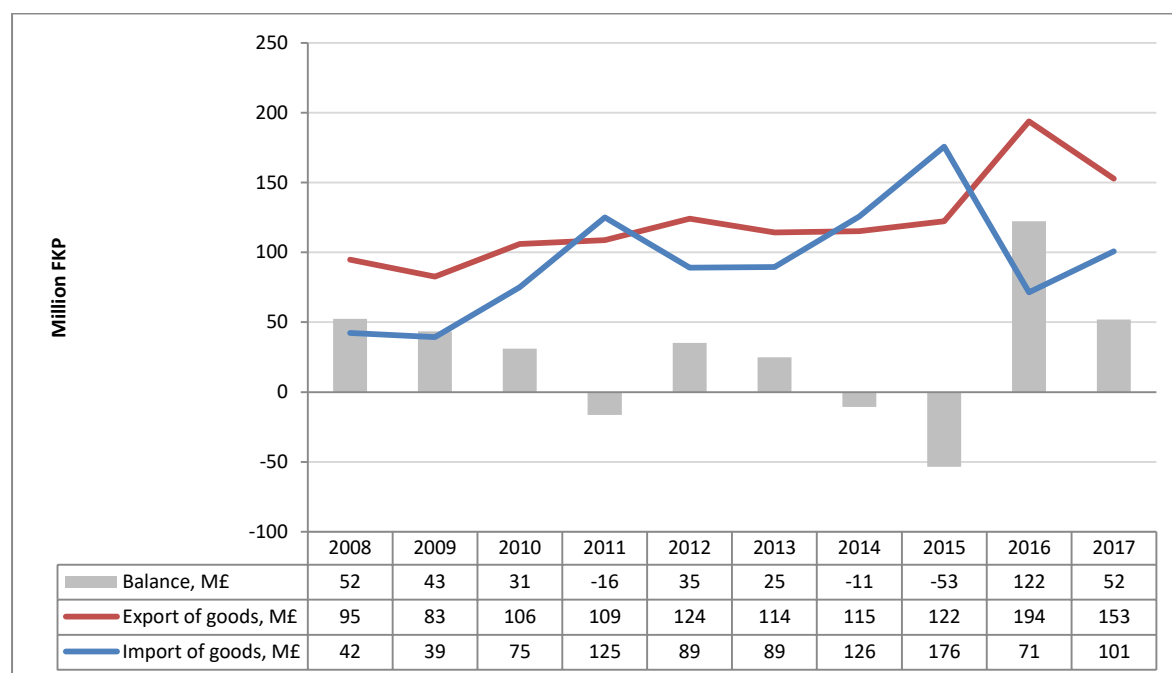
According to the International Monetary Fund, in the decade between 2008 and 2017, goods exported by the Falkland Islands have been growing at a compound annual growth rate (CAGR) of 5.4%. In 2017, exports of goods amounted to FKP153 million, down from FKP194 million in 2016 (-

⁹ Reasons for decrease in prices in this category can be listed as follows:

- In July 2018, Sure increased data allowance within each broadband package (e.g. the “Lite” package went from 6GB to 9GB) without changing the package price, resulting in a unit price decrease (in terms of FKP per GB). An increase in data allowance means an increase in the quality of the service provided, and thus results in a deflationary pressure on the Retail Price Index (which measures the change in prices of a basket of goods of constant quality);
- Sure completed the installation of the new 4G mobile network and, in August/September 2018, introduced new 4G mobile packages. At the same time, data allowance in the 2G network mobile packages was increased (e.g. bundled data in the “Premium 25” package went from 25MB to 100MB). The effect of this change is similar to what is discussed above with respect to broadband packages. A weighted sum of minutes, texts, and data is taken as a measure of the size of each package.

21%). In the first three quarters of 2018, Falkland Islands exports have been 44% higher than in the same period of the previous year.¹⁰

Figure 9: Falkland Islands Balance of International Trade



Source: International Monetary Fund, Direction of Trade Statistics (DOTS), and European Central Bank

Exports

The Falkland Islands' main exports are fishery products, wool, and meat.

Fishery products are by far the largest exported good. According to the United Nations Comtrade database, exports of fish from the Falkland Islands in 2017 were worth FKP152.5 million, down from FKP185.1 million in 2016 (-18%).¹¹

Over the last ten years (2008-2017), Falkland Islands exports of fishery products have increased in value at a compound annual growth rate (CAGR) of 6.2% (see Figure 10).

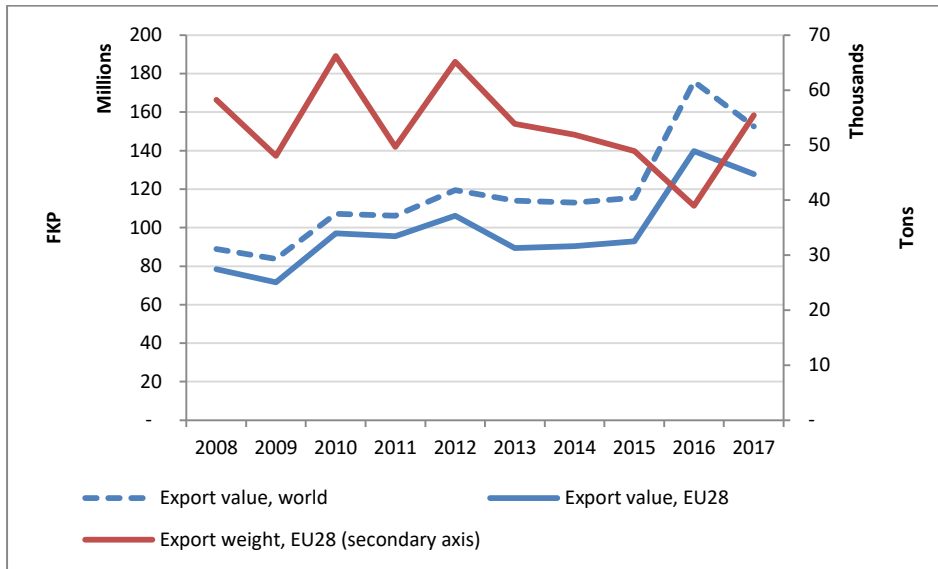
With respect to exports to the European Union only¹², export value has increased by 63% between 2008 and 2017 (i.e. at a CAGR of 5.6%), resulting from an increase in prices of 71%, while quantities exported have decreased by 5% in the same period (although quantities have been highly volatile, with double digit swings being common).

¹⁰ Source: International Monetary Fund, Direction of Trade Statistics (DOTS)

¹¹ Decrease in export value of fishery products between 2016 and 2017 has been due to a decrease in average prices. With respect to exports to the European Union only, between 2016 and 2017 quantity exported (in terms of tons) have increased by 42%, while average prices (in terms of FKP/ton) have decreased by 36%, resulting in a decrease of export value of fishery products to the EU of 9%. For more details on effects of quantity, prices, and exchange rates on trade value, please see Chapter 9. ("Fishing and aquaculture").

¹² Accounting, on average, for 86% of export of fishery products between 2008 and 2017 (source: DataComex).

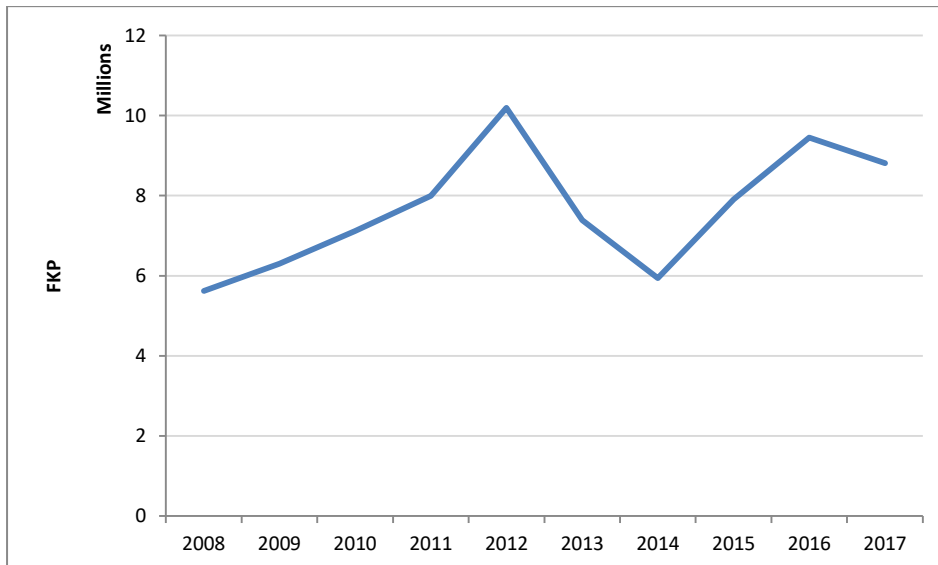
Figure 10: Falkland Islands export of fishery products, 2008-2017



Source: United Nations ComTrade database, DataComex

The second largest exported good is wool, with a value of FKP8.8 million in 2017, down from FKP9.9 million in 2016 (-11%). Over the last ten years (2008-2017), the export value of Falkland Islands wool has increased by 57%, at a compound annual growth rate (CAGR) of 5.1% (see Figure 11).¹³

Figure 11: Falkland Islands export of wool, 2008-2017



Source: United Nations ComTrade database

Lamb and mutton exports were worth FKP2.3 million in 2017, up from FKP1.7 million in 2016 (+37%). Over the last ten years (2008-2017), the value of Falkland Islands meat exports has increased by 211% (CAGR of 13.4%), driven by an increase of 106% in quantities exported, from 298 tons in 2008 to 614 tons in 2017 (see Figure 12).

¹³ Data on tons of wool exported are not available.

Figure 12: Falkland Islands export of meat, 2008-2017

Source: United Nations ComTrade database, DataComex

Potential trade implications of Brexit

The Falkland Islands have enjoyed a special partnership with the EU since the UK entered in 1973. This partnership is formalised through the Overseas Association Decision (OAD), which seeks to “promote economic development and social development of the Overseas Countries and Territories and establish close economic relations between them and the Community as a whole”.

As a result of the OAD, the Falkland Islands benefit from tariff- and quota-free access for fishery and meat products exported to the EU.¹⁴ The EU does not currently levy tariffs on wool imports, regardless of their country of origin.

As a demonstration of the importance to the Falkland Islands economy of tariff- and quota-free access to the EU; in 2017, the EU27¹⁵ was the destination for 88% of the Falkland Islands’ exports of fishery products, as well as 47% of meat products (see Table 2).

Table 2: Destination of Falkland Islands’ exports (2017)

	Fishery products	Meat	Wool
EU27	88.0%	47.4%	77.3%
United Kingdom	0.0%	52.6%	22.7%
Non-EU countries	12.0%	0.0%	0.0%

Source: United Nations Comtrade database

On 23rd June 2016, 51.9% of citizens in the United Kingdom (UK) and Gibraltar voted in a referendum to leave the European Union. Once the UK Parliament passed the EU (Notification of Withdrawal) Act 2017 (16th March 2017), the Prime Minister invoked Article 50 of the Lisbon Treaty on 29th March 2017, triggering the UK’s exit from the EU (also known as “Brexit”).

¹⁴ Access to the EU for wool exports is tariff- and quota-free regardless of their country of origin.

¹⁵ The EU28 is the abbreviation of the European Union consisting of 28 countries as of 1st July 2013. In the context of this report, the EU27 is defined as the EU28 with the exclusion of the United Kingdom.

If the UK were to leave the EU without any free trade agreement or deal (“No deal” scenario), fishery exports from the Falkland Islands into the EU would, at best, be subject to WTO Most Favoured Nation tariffs (MFN) of between 6% and 18%.

Meat exports from the Falkland Islands into the EU would, at best, be subject to the WTO Agreement on Agriculture. This would result, on average, in meat exports to the EU being subjected to WTO MFN tariffs of 12.8%, plus a fixed amount, on average, of €155.68 per 100kg, depending on the cut (corresponding to an overall levy of about 42%).

Such a scenario would have a significant impact on the economy of the Falkland Islands as well as on government revenues.

In the event of a deal, the Falkland Islands would continue to trade with the EU27 on the same terms as we do at present until December 31st 2020. During this period, the UK Government would negotiate (with the participation of the Falkland Islands Government) a new trading relationship between the Falkland Islands and the EU27.

Imports

Most goods consumed in the Falkland Islands are imported. According to the United Nations Comtrade Database, FKP63.4 million worth of goods were imported by the Falkland Islands in 2016, with the major exporters being the United Kingdom (74%), Greece (9%)¹⁶, Spain (6%), and the Netherlands (5%).

According to the FIG Customs and Immigration Department, in 2016 the share of total imports (by value) coming from the UK was as high as 91.9%, with the remainder imported from Uruguay (4.6%), the rest of the EU (2.2%), Chile (1.2%), and South Africa (0.2%).^{17, 18}

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.

6. Government

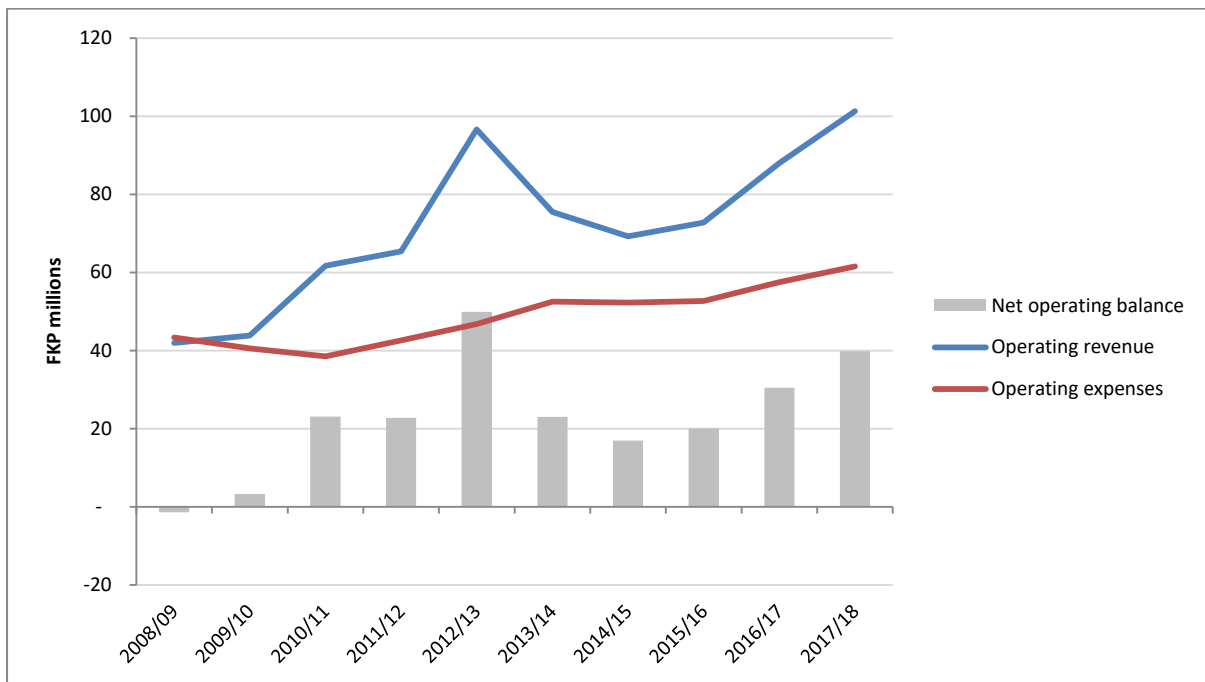
Error! Reference source not found. shows government operating revenues and expenses (which include operational expenditure, including consumption of fixed capital, but excluding capital expenditure) and net operating balance (the difference between these two figures).

¹⁶ Imports from Greece consist 100% of fuels.

¹⁷ These are the places of loading; the goods may have been produced elsewhere.

¹⁸ 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.

Figure 13: Government revenue, expense and net operating balance, 2008/09 to 2017/18



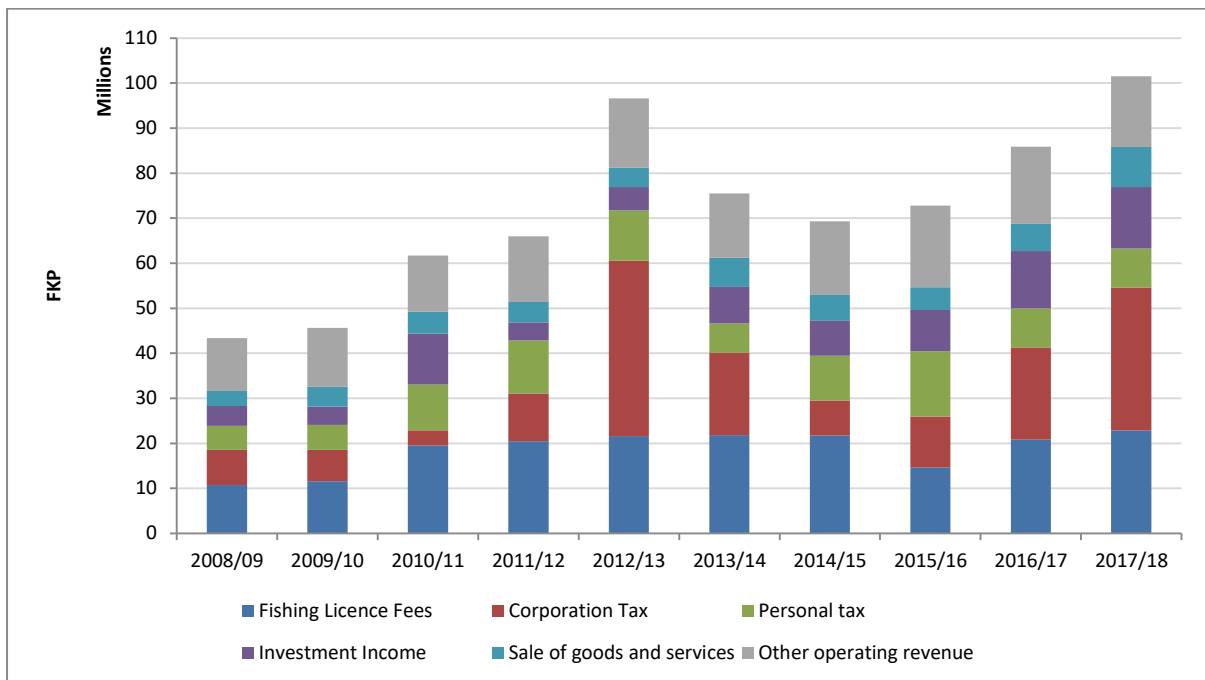
Source: Falkland Islands Government Treasury, Policy and Economic Development Unit analysis

Figure 14 breaks down government revenues by source. Fishing licence fees and corporation tax are generally the two major sources of revenue, accounting respectively for 26% and 20% of total budget on average between 2008/09 and 2017/18. Revenues from corporation tax have been highly volatile in recent years, being dependent on the level of economic activity in a given year. Licence fee income can also be volatile, due to variations in the *illex* catch.

Personal tax and investment income also contribute significantly to the government budget (respectively, 13% and 11% on average between 2008/09 and 2017/18).

Income from sales of goods and services (8% on average between 2008/09 and 2017/18) reflect goods and services sold by FIG, such as electricity and quarry products.

Figure 14: Government revenues, 2008/09 to 2017/18



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

7. Population, demographics, income and employment

Population and demographics¹⁹

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.²⁰ The population increase was mainly driven by net migration (319 people), with a natural increase (births minus deaths) of 41 people.

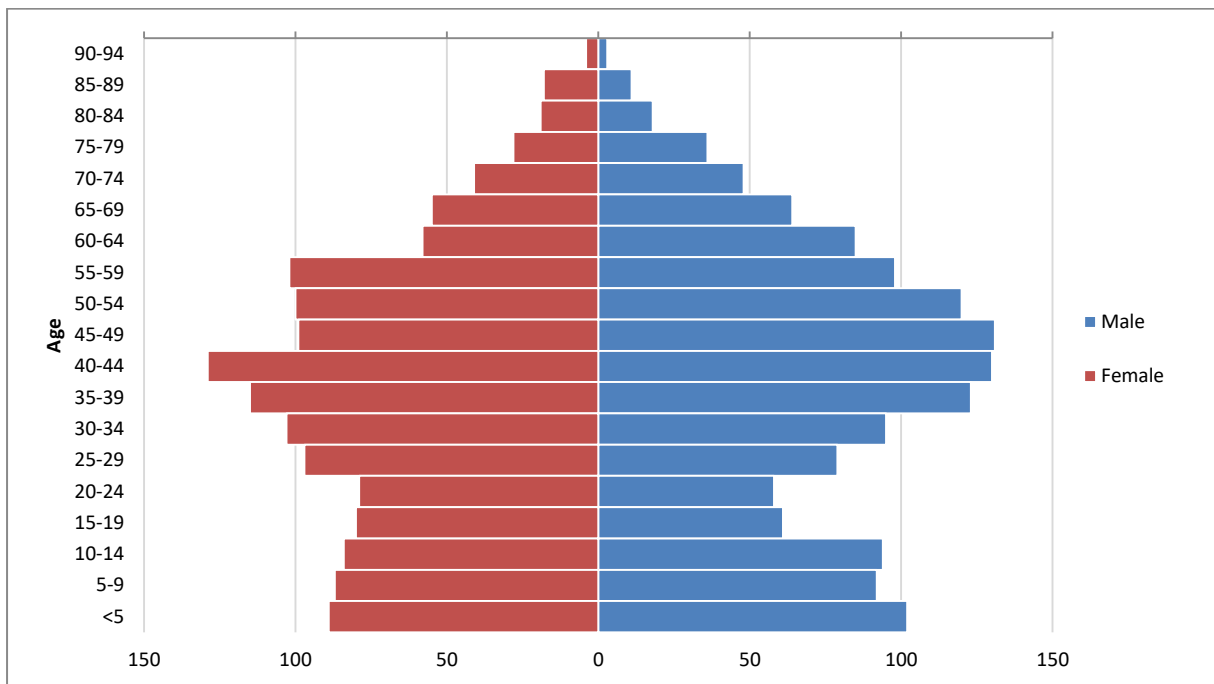
Over this period, the number of people with Falkland Islands Status increased by 44, and the number of people holding a Permanent Residence Permit (PRP) increased by 81. This change would be made up of natural increase in population as well as work permit holders applying for PRP (and PRP holders applying 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.

Figure 15 gives a breakdown of the Falkland Islands population by age and sex.

¹⁹ Note: The population at MPC is excluded from all the following data and analysis on demographics.

²⁰ These figures are for the usually resident population who were present on the night of the census. Serving British military personnel are excluded.

Figure 15: Falkland Islands population (excluding MPC) by age and sex, 2016



Source: Falkland Islands Census 2016

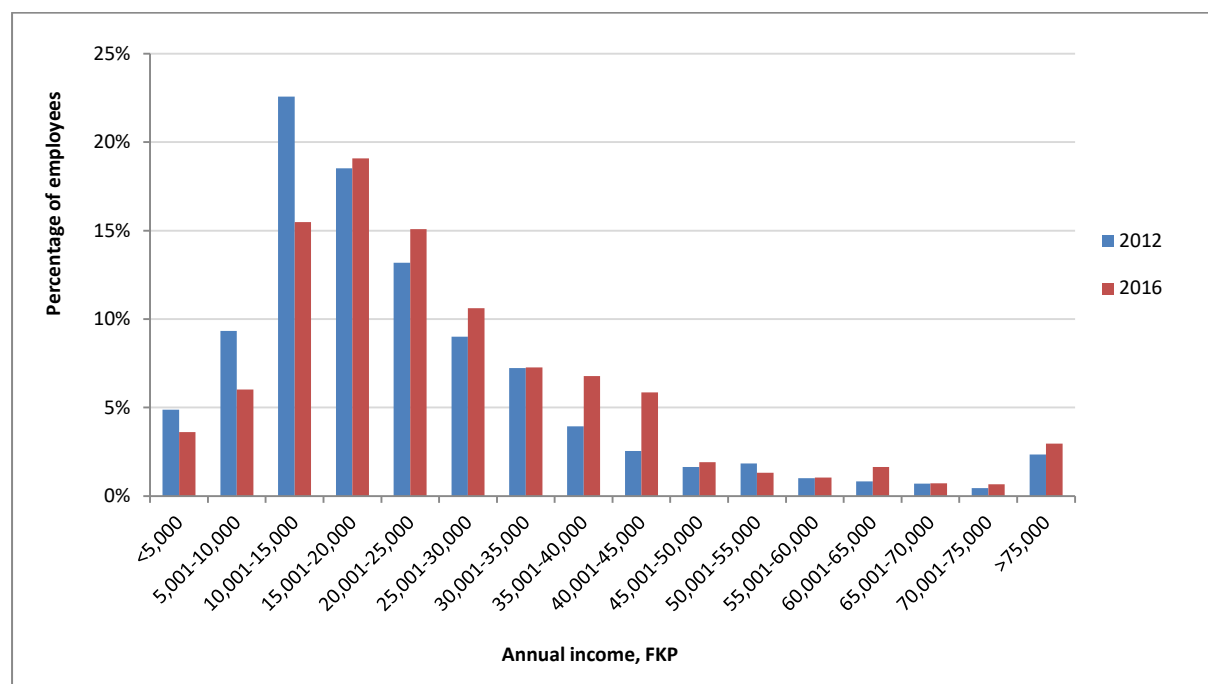
The Falkland Islands has a relatively young population when compared to other developed economies. 12.2% of the population is aged 65 or over, compared to 17.8% in the United Kingdom; 14.8% in the United States; and 26.3% in Japan. Excluding visitor and work permit holders and their dependants; 14.8% 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 dependants, the dependency ratio is 56%. The global average dependency ratio is 54%.

Income

Figure 16 shows how the distribution of income received by employees (excluding MPC) has changed between 2012 and 2016.

Figure 16: 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 categories²¹.

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 2017²². 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 significant amount of labour is carried out by workers who are temporarily resident in the Falkland Islands, as the number of jobs available in most sectors is greater than local supply.

The number of people in employment in 2016 was 1,850, compared to 1,599 in 2012 (including people who are self-employed), reflecting a labour force participation rate (percentage of the working age population who are in, or seeking, employment) of 90.0%. The high economic activity rate 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. By comparison, UK labour force participation was 78.7% for the period of April to June 2017²³.

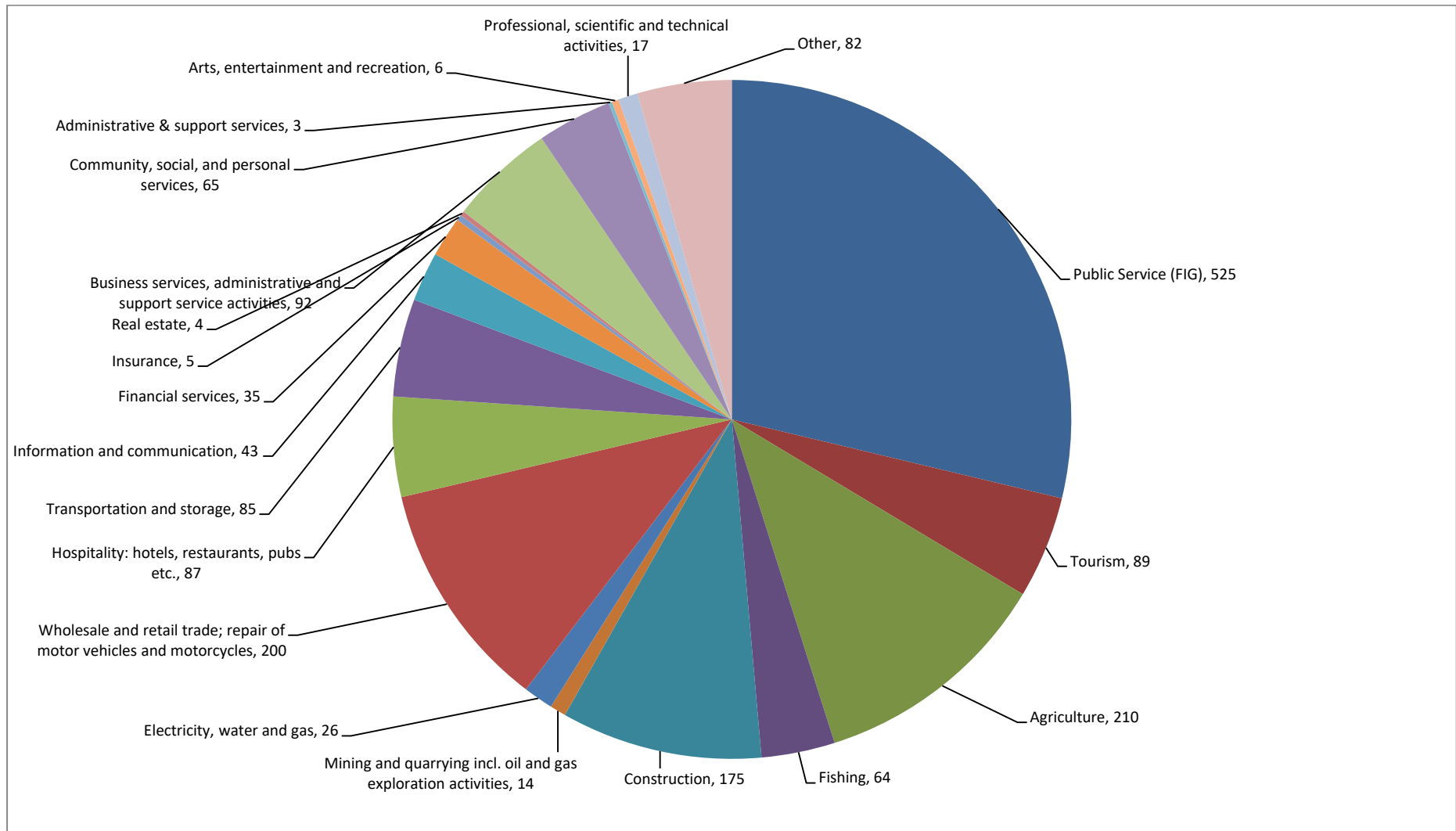
Figure 17 shows the number of employees in each industry in 2016, according to the 2016 census. This is restricted to primary employment only (372 people stated that they hold more than one job, of whom 96 worked in tourism).

²¹ 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.

²² Labour market statistics time series dataset, Office for National Statistics

²³ Labour market statistics time series dataset, Office for National Statistics

Figure 17: Primary employment by industry, excluding MPA



Source: Falkland Islands Census 2016

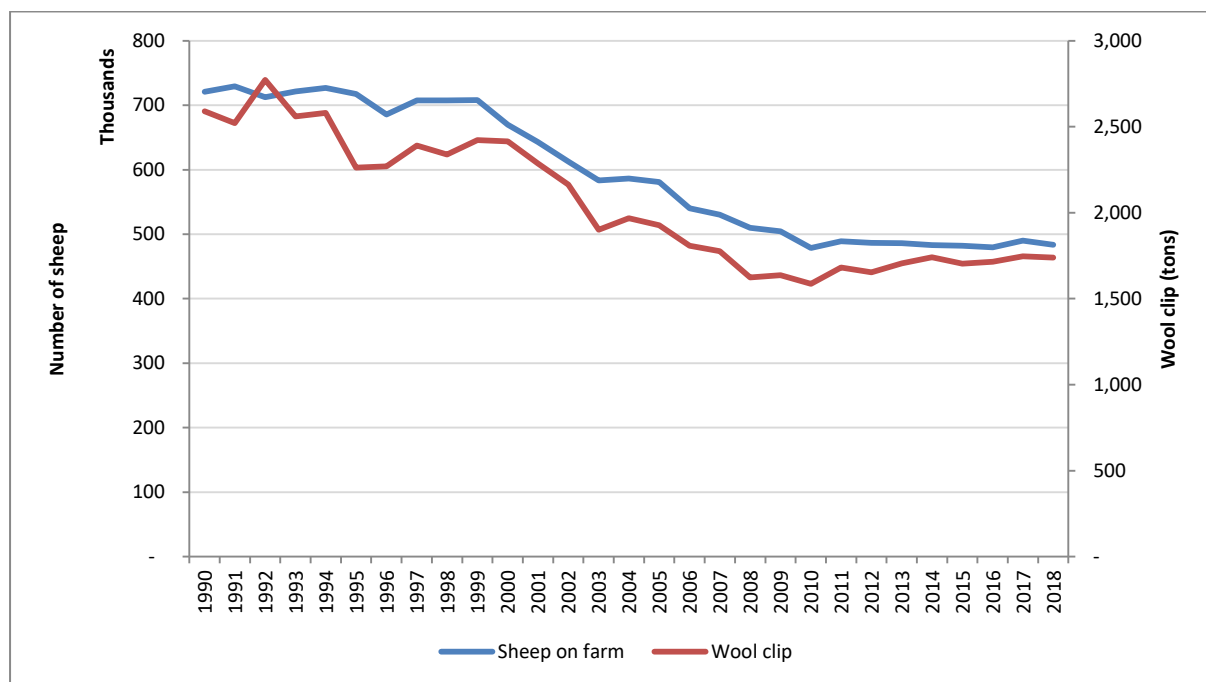
8. Agriculture

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, a decrease of 19%. The agriculture industry's gross value added was FKP4.1 million in 2016 (or 1.4% of GDP), up from FKP3.4 million in 2015.

The number of sheep on farms has declined 34% from the peak of 729,000 in 1991, falling to 484,000 in 2018, although numbers have remained fairly steady since 2010. The wool clip has experienced a similar declining trend, with a clip of 1,739 tons in 2018; down from a maximum of 2,773 tons in 1992 – although numbers have increased 9.6% since 2010.

Figure 18 shows trends in sheep numbers and wool clip since 1990.

Figure 18: Falkland Islands sheep numbers and wool clip, 1990-2018



Source: Falkland Islands Farming Statistics, Department of Agriculture

Wool remains the most important agricultural product, with an estimated export value of FKP8.8 million in 2017.

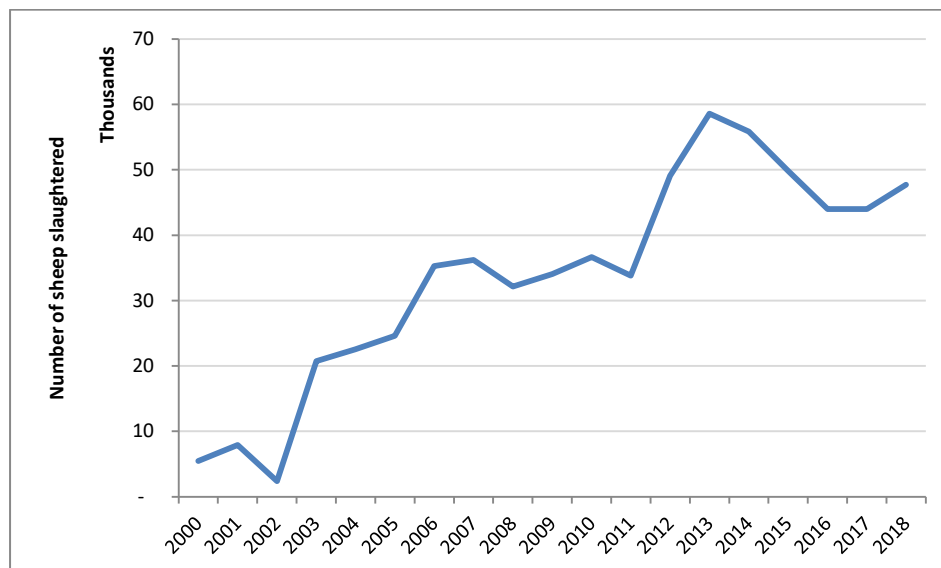
Government and industry have made significant efforts to reduce the micron of Falkland Islands wool, to obtain a better price on world markets. A recent report²⁴ commissioned by the Falkland Islands Development Corporation (FIDC) has suggested a number of other ways to add value to Falkland Islands wool.

²⁴ Value Adding Opportunities for Falkland Islands' Wool, Blake + Associates Consulting, 01/05/2017

Large scale exports of lamb and mutton began after the establishment of the Falkland Islands Meat Company (FIMCO) in 2003²⁵. The value of meat exports was FKP2.3 million in 2017²⁶, 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 47,688 in 2018 (see Figure 19).

Figure 19: Number of sheep slaughtered annually, 2000-2018



Source: Falkland Islands Farming Statistics, Department of Agriculture

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

9. 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 *illux* 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.

Fishing industry revenues are almost exclusively dependent on exports. Value of exports depends on a number of variables, including fish catches, international fish prices, and exchange rates. Fish catches themselves are influenced by a complex range of factors, including climate, fishing pressure inside and outside Falkland Islands' waters and interactions between species.

As an example of the interactions of these variables in the determination of value of export, Figure 20 shows a disaggregation of the annual change in the value of Falkland Islands' exports of fishery products to the European Union, by change in volume (tons) exported, average sell price (€ per kg), and exchange rate (GBP/EUR).

²⁵ Although there have been previous attempts at establishing a meat export enterprise in the Falklands, including the Ajax Bay freezer plant.

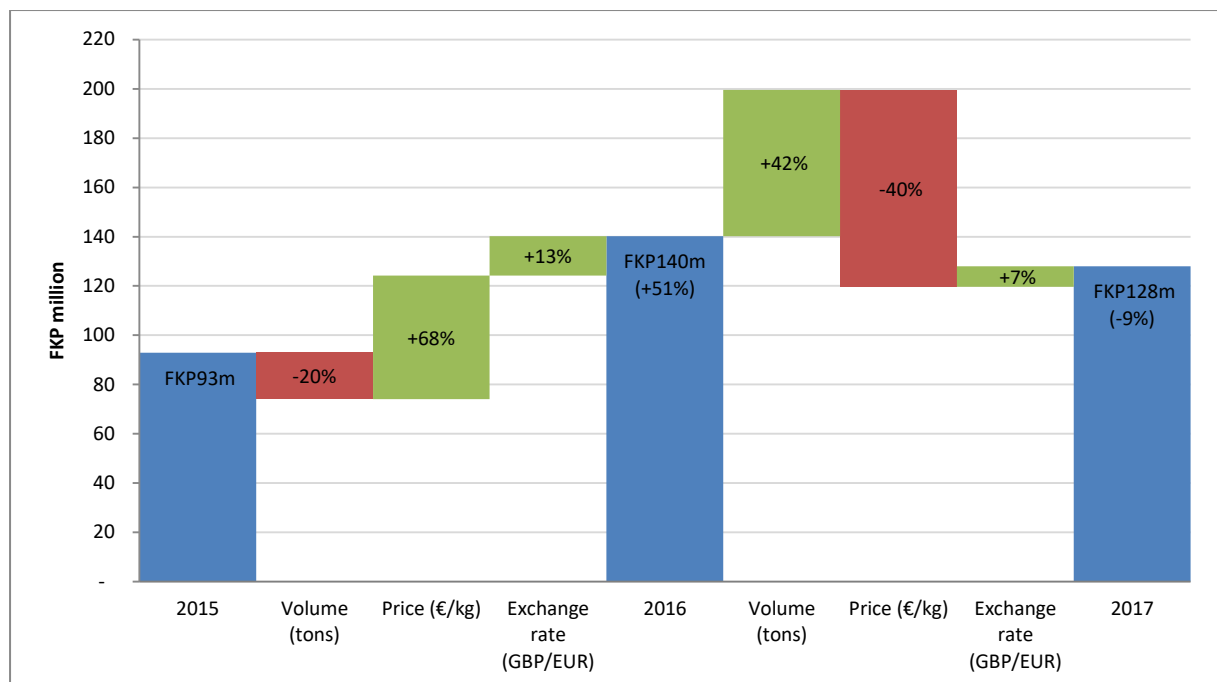
²⁶ Source: UN Comtrade database

In 2016, Falkland Island exports of fishery products to the EU (in FKP million) increased by 51% compared to 2015. This was due to a number of factors, including:

- low catches and inventories of cephalopods (squid in particular) globally, which paired with increasing global demand led to significantly higher prices;
- good catches of loligo squid by Falkland Island vessels; and
- foreign exchange gains due to the collapse of Sterling against the Dollar and Euro in the wake of the Brexit vote.

In 2017, mostly driven by a significant decrease in prices – offsetting an increase in volumes exported – Falkland Island exports of fishery products to the EU decreased by 9% compared to the previous year.

Figure 20: Export of fishery products to the EU, breakdown by main driver (2015-2017)



Source: DataComex

In 2016, the fishing and aquaculture industry accounted for 59% of Falkland Islands GDP, with this figure varying between 35% and 59% over the period 2007 to 2016.

Fishing vessels are almost entirely crewed by non-residents of the Falkland Islands. However, there is some direct 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 FKP20.8 million in 2016/17.

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

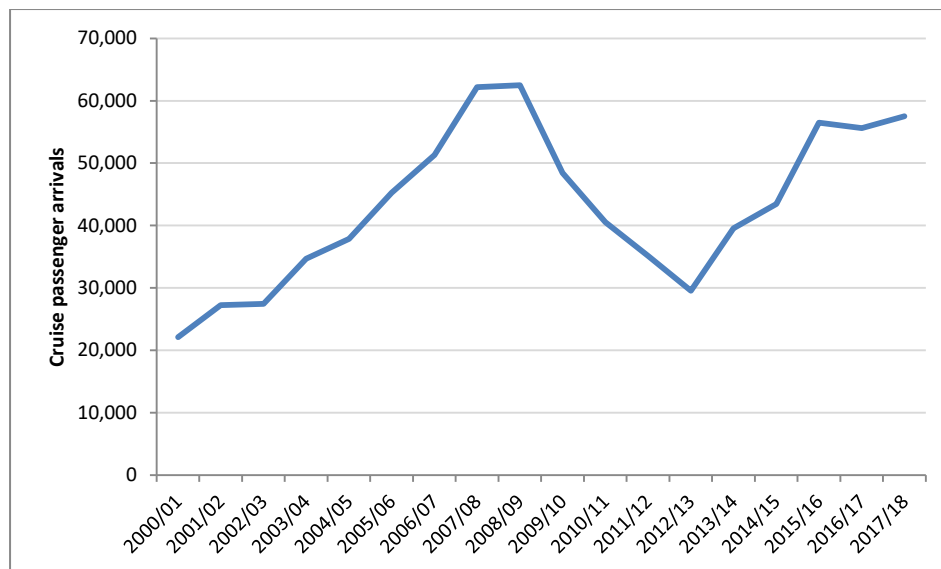
administration, fisheries protection/harbour control and the scientific budget combined came to FKP5.5 million in 2016/17.

10. 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).

The number of cruise passenger arrivals in the Falklands has grown from around 20,000 in the 2000/01 tourist season to 57,496 during the 2017/18 season, spending a total of FKP3.0m²⁷. Government income from passenger levies paid in respect of cruise passengers were FKP1.0 million in the 2016/17 financial year²⁸.

Figure 21: Cruise passenger arrivals, 2000/01 – 2017/18



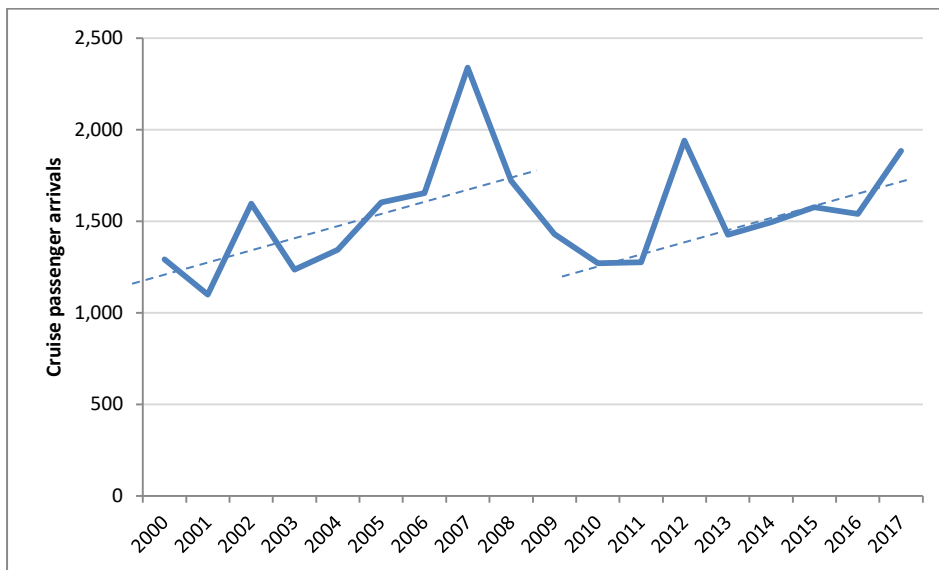
Source: Falkland Islands Tourist Board, International Leisure Tourism Statistics Report 2017

1,884 land-based leisure tourists visited the Falkland Islands in 2017, staying for an average of 10.1 days and spending a total of FKP3.0 million.²⁹ The number of leisure tourists grew between 2000 and 2007, and again between 2010 and 2017, as the global economy recovered from the economic crisis. Some notable peaks coincide with significant anniversaries of the 1982 conflict.

²⁷ Source: International Leisure Tourism Statistics Report 2017, Falkland Islands Tourist Board

²⁸ Source: FIG Budget Book 2018/19

²⁹ Source: International Leisure Tourism Statistics Report 2017, Falkland Islands Tourist Board

Figure 22: Land-based leisure tourist arrivals, 2000-2017

Source: Falkland Islands Tourist Board, International Leisure Tourism Statistics Report 2017

According to the Tourism Satellite Account 2016, produced by Acorn Consulting on behalf of the Falkland Islands Tourist Board; gross value added by the tourism industry was FKP3.8 million in 2016 (or 1.3% of GDP), up from FKP2.9 million in 2014 (+31%).³⁰

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 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; increasing the number of cruise ship visitors by 49%; and increasing their expenditure by 42%, by the 2022/23 season.

11. Transport

The establishment of a new weekly commercial air link connecting the Falkland Islands with São Paulo in Brazil is expected to bring a number of benefits to the economy of the Falkland Islands, as well as improving social wellbeing and quality of life.

With a new commercial air link, people will have additional options for travel to the Falkland Islands. A new flight would be expected to offer more competitive pricing and may reduce travel time for some visitors. Travellers may have more flexibility on the duration of their visit, increasing the likelihood of adding the Falkland Islands to their itinerary. This is likely to encourage some people to visit the Falkland Islands who would not have done so in the absence of a new air link. These additional tourist visitors will spend money while they are in the Falkland Islands, thus enabling an increase in the revenue of the tourism-related industries which will increase their output to meet the additional demand.

Additional tourist expenditure would stimulate further economic activity, because of increasing intermediate demand on the suppliers of the tourism-related industries and so on down the supply

³⁰ Source: Acorn Consulting, Falkland Islands Tourist Board, Tourism Satellite Account 2014 and Tourism Satellite Account 2016

chain. Also, overall household income will increase as a result of increased employment, and a proportion of this increased income will be spent on final goods and services sought locally; stimulating economic activity.

These short-run effects are likely to deploy in the first year after the initial injection of additional tourist expenditure into the economy. In the first year of operation³¹ of the new air service, we forecast industry turnover to increase by between FKP1.5 to 1.9 million, and Falkland Islands' GDP to increase by 0.3% - 0.4%. These figures are likely to increase in subsequent years as the new service's load factor will improve. Additionally, we estimate FIG net revenues from Customs & Immigration services provided at MPA to increase by about FKP100,000.

The establishment of a second air link is likely to generate a number of further benefits. Most of these benefits are likely to occur in the medium- to long-term and there is no easy way to quantify their impact. However, it is expected that their full impact on economic growth and wellbeing will be observed in the longer term. These long-term economic benefits include:

- Reduced costs for the oil industry, leading to increased likelihood of oil exploration/production in the near term (which could generate increased revenues to FIG and to other FI industries);
- Reduced costs for other industries (and particularly the fishing industry);
- Reduced freight costs and improved capacity, reliability, and speed of cargo transport;
- Increased opportunities for business development (including science and technology, and construction services) due to better, more frequent and more reliable connections;
- Reduced employee recruitment and retention costs as more frequent connections may make it more viable to consider long-term residence in the Falkland Islands;
- Opportunities to further expand tourism by providing additional passenger capacity during peak tourist season, as well as the opportunity for shorter stays. Additionally, the additional flight will improve the international reputation of the FI as an accessible tourist destination;
- More competitive travel prices, generating savings by FI households and increasing their net wealth.

Employment impacts will include indirect and induced employment generated by increased levels of tourist expenditure, as well as additional direct employment at Mount Pleasant Airport. We forecast employment to increase by about 35 to 45 employees due to increased activity associated with the second flight. Other employment impacts will result from increased frequency and reliability of flights, which will increase the attractiveness of the Falkland Islands as a work destination due to improved flexibility for individuals; thus improve recruitment processes and levels of workforce retention.

Further benefits will include wellbeing and mental health benefits (as FI residents will have more opportunities to go on holiday, more options for visits from family and friends, and more reliable options for emergency and medical trips); increased quantity and quality of services available to FI residents due to increased customer base and improved business case; and enhanced opportunities for cultural exchange and awareness.

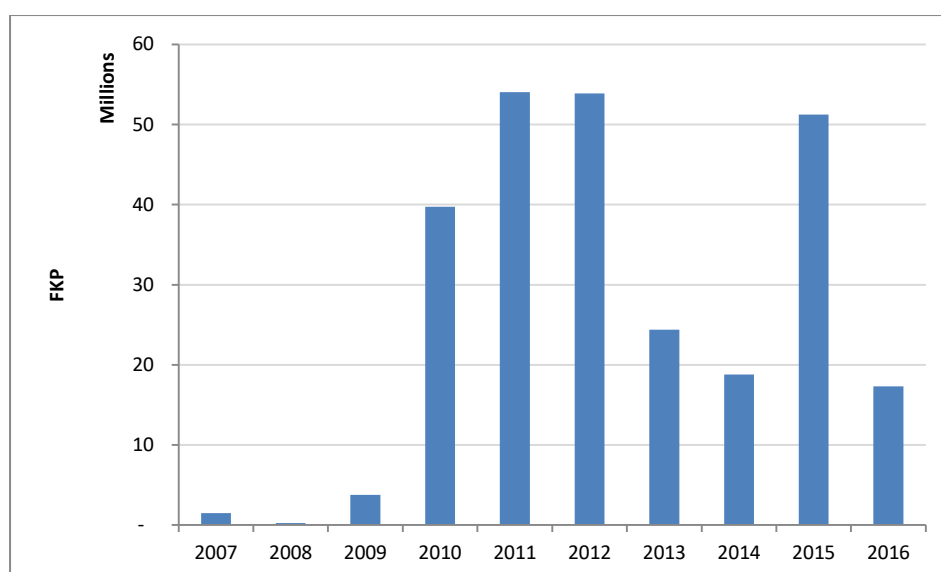
³¹ That is, in the first full 12 months from the start of the service.

12. Hydrocarbons

Hydrocarbon exploration has been taking place in Falkland Islands waters for some time, with major drilling campaigns occurring 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 23 shows annual gross value added by oil and gas related activities between 2007 and 2016.³²

Figure 23: 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.

13. Business environment and competition

Business environment

According to the 2018 FIDC's Business Climate Survey, the ten barriers to growth most frequently reported by business respondents were as detailed in Table 3.

³² Oil 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.

Table 3: Top 10 barriers to business growth

Rank (2018)	Change in rank from 2016 (no. of positions)	Barrier	% of respondents who cited it as a barrier (2018)	Change from 2016 (percentage points)
=1	+4	Air Link to Chile (LAN)	30.9%	+11.3
=1	+8	Telecommunications - Bandwidth (Speed & Quality)	30.9%	+13.2
3	-2	Shortage of Skilled Labour	29.6%	-2.8
4	+5	Telecommunications - Cost	27.2%	+9.6
5	+10	Air Link to the UK (Airbridge)	24.7%	+12.0
6	-4	Freight costs by Sea - Import	19.8%	-1.9
=7	-3	Distance to Markets	18.5%	-2.1
=7	+7	Shortage of Unskilled Labour	18.5%	+2.8
=9	+11	Taxation	17.3%	+8.5
=9	+19	Telecommunications - Package Size	17.3%	+11.4

Source: Falkland Islands Development Corporation, Business Climate Survey 2018, Results Report

The most significant barriers to business growth identified in the 2018 survey were ‘Air Link to Chile (LAN)’ and ‘Telecommunications - Bandwidth (Speed & Quality)’, with 30.86% of respondents selecting each of these options. Interestingly, 6 of the answer options selected within the top 10 barriers to growth are all regarding Transport and Communications. Commenting on these findings; FIDC noted “that this is not overly surprising considering the ongoing issues with ‘rotor winds’ at MPC³³ and the knock-on effect it has had on LAN flights being delayed [...], alongside issues regarding capacity, cost and reliability of freight services relying on air links, and the renewed Telecommunications license, which had been felt by many in the private sector, to have been too heavily in favour of the provider and not the consumers”.³⁴

‘Shortage of Skilled Labour’ as a barrier to business growth moved from the first place in 2016 to third place in 2018, with 29.63% of the respondents selecting this option. This has remained within the top five since the 2012 edition of the survey, suggesting that this has been an issue for many years and is still on-going.

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 – in 2016, 25% of jobs (looking only at an individual’s primary employment) were held by work permit holders.³⁵ 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.

³³ Mount Pleasant Complex.

³⁴ Source: Falkland Islands Development Corporation, Business Climate Survey 2018, Results Report, p. 19.

³⁵ Source: Falkland Islands Census 2016

Competition

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

In the 2018-2022 Islands Plan, the Falkland Islands Government is committed to reviewing the key monopoly industries in the Falklands to ensure that the regulatory environment results in the best outcomes for both consumers and suppliers of key products, including telecommunications and fuel.