

States of Jersey
States Assembly



États de Jersey
Assemblée des États

Corporate Services Scrutiny Panel

Draft 2014 Budget



Presented to the States on 26th November 2013

S.R.13/2013

CONTENTS

1.	EXECUTIVE SUMMARY	2
2.	KEY FINDINGS AND RECOMMENDATIONS	4
3.	CHAIRMAN'S FOREWORD	8
4.	INTRODUCTION	10
5.	THE DRAFT BUDGET AND THE ECONOMIC CONTEXT	12
6.	TAXATION PROPOSALS.....	20
7.	IMPOTS PROPOSALS.....	31
8.	GROWTH ALLOCATIONS	39
9.	2014 CAPITAL PROGRAMME	41
10.	MAJOR CAPITAL PROJECTS	46
11.	THE LONGER-TERM PICTURE	61
12.	CONCLUSION	64
13.	APPENDIX 1: PANEL MEMBERSHIP, TERMS OF REFERENCE AND EVIDENCE CONSIDERED	65
14.	APPENDIX 2: REPORT FROM CIPFA.....	70
15.	APPENDIX 3: REPORT FROM MJO CONSULTING.....	90

1. EXECUTIVE SUMMARY

- 1.1 The Draft Budget contains the proposals of the Minister for Treasury and Resources in respect of taxation (including Impôts); growth expenditure; the 2014 Capital Programme; and the funding of three Major Capital Projects. The latter includes proposals to borrow up to £250 million for the Housing Project and to use £297 million from the Strategic Reserve for the Hospital Project. The Draft Budget does not explicitly cover the Liquid Waste Project but the Minister has indicated a spending envelope for it of £75 million, to be funded from capital allocations and internal borrowing from the Currency Fund.
- 1.2 The Draft Budget has been prepared in a local economic context which remains fragile. Overall, in some respects the Draft Budget displays an improved approach to financial management compared to other jurisdictions and to previous Budgets. However, there are questions regarding the presentation of information at a high level and in respect of certain individual proposals. As the Fiscal Policy Panel (FPP) and our advisors have indicated, the Draft Budget lacks some information which is required to understand its overall impact.
- 1.3 We have found that improvements in the collection and presentation of economic data and information would be beneficial, notwithstanding the challenges to do so in a jurisdiction the size of Jersey. No reports on the economic outlook in Jersey have been published by the Economics Unit since December 2012 – a situation which must be addressed. We have also recommended the re-introduction of Input / Output Tables although we are mindful that any improvements in data collection should not place undue pressure on local businesses.
- 1.4 The most significant taxation proposal is the reduction in the Marginal Rate of Income Tax from 27% to 26%. We have found that the economic rationale for this measure is questionable. It is intended by the Minister to be a first step towards independent taxation. Whilst the proposal has been presented as good news for taxpayers, the majority will not benefit until 2015 at which time they will also feel the effects of the Long-Term Care Charge.
- 1.5 Other taxation proposals have been welcomed by stakeholders. We received submissions, however, that further measures could have been taken to help the Island's economy. Whilst the Minister is already considering some such proposals, we have recommended that he look particularly at measures in respect of productivity that would support the local economy.
- 1.6 The proposed increases in Impôts were the most controversial issue, with industry representatives perhaps unsurprisingly against them. We were advised that the increases would negatively impact on the industry at a time when it continues to face significant challenges. As the primary reason for increasing Impôts on alcohol and tobacco is health-related, additional income raised should be put towards the alcohol and tobacco strategies.

We have also recommended that the Minister take steps to end the position whereby irreconcilable differences appear to exist between him and the industry regarding prices and price comparisons – an unhelpful situation for all. The Minister should also take steps to resolve the question of how much duty-free tobacco and alcohol is consumed in the Island.

- 1.7 We have found that there will be no growth allocations to debate in the Draft 2015 Budget as all growth monies for 2015 will have been allocated this year. In respect of capital expenditure, a programme for 2014 of approximately £89 million has been proposed. As the FPP has highlighted, capital expenditure in 2012 did not reach the levels promised and there was a failure to deliver the fiscal stimulus which the Executive had set out to achieve. We have recommended that the 2014 Capital Programme be examined to clarify whether there is a structural deficit within the States' finances. We have also found that the revenue implications for each 2014 capital project have not been provided, despite the Minister's acceptance of a previous Scrutiny recommendation to do so.
- 1.8 The three proposed Major Capital Projects display some welcome long-term thinking in respect of the funding mechanisms. There is a risk, however, that the injection of such large amounts of capital funding over the next ten years could overheat the local economy; it must not be forgotten that the private sector will also undertake capital projects. Forecasting the economic impact of such expenditure is difficult given the current challenges in measuring capacity within the construction industry and we have recommended that the Minister seek to improve the information currently available.
- 1.9 In terms of the Hospital Project, we concur with the FPP about the proposed use of the Strategic Reserve and fear there is a risk that an unwelcome precedent could be set. We have recommended that the Minister ensure that policy underlying the Strategic Reserve is clearly defined before approval for a transfer is sought. Furthermore, it is apparent that £297 million may not be the final spending envelope. Whilst we welcome the Minister's intention to secure funding from the Assembly in stages (and all withdrawals from the Strategic Reserve require States approval) we have recommended that the Minister provide scenarios which assume a higher spending envelope to ensure clarity about the potential implications.
- 1.10 With regard to the Liquid Waste Project, the detailed funding mechanism cannot be agreed until the Assembly has had an opportunity to debate a liquid waste strategy and, until that time, the spending envelope of £75 million cannot be regarded with certainty. More information is also required on how £1.7 million per annum in savings would be delivered by the Department of Transport and Technical Services as a means of repaying internal borrowing from the Currency Fund.
- 1.11 Ultimately, our review has highlighted that there are other emerging issues and spending pressures which sit outside the Draft Budget and which remain to be addressed.

2. KEY FINDINGS AND RECOMMENDATIONS

Key Findings

1. The economic situation in Jersey remains fragile. (5.10)
2. As the FPP has indicated, the Draft Budget lacks information required to understand the overall impact of proposed fiscal policy and the latest position of States finances. (5.16)
3. No reports on the economic outlook in Jersey have been published by the Economics Unit since December 2012. This must be addressed. (5.20)
4. Input / Output Tables are no longer produced for Jersey as the modelling programme which allowed their production has been discontinued. There is reluctance to re-introduce them due to the potential pressures on businesses. (5.25)
5. Notwithstanding questions regarding the presentation of information at a macro level and in respect of certain individual proposals, overall the Draft Budget displays an improved approach to financial management compared to other jurisdictions and to the past. (5.28)
6. The economic rationale for the proposed reduction in the Marginal Rate is questionable. (6.16)
7. The proposed reduction in the Marginal Rate is intended by the Minister to be a first step in aligning the Marginal and Standard Rates and thereby a first step towards independent taxation. (6.19)
8. The majority of taxpayers will not benefit from the reduction in the Marginal Rate until 2015, at which time they will also see money taken from their pockets through the Long-Term Care Charge. (6.28)
9. As a matter of urgency, further work must be undertaken in considering and identifying taxation measures in respect of productivity that will support the local economy. (6.45)
10. As the primary reason for increasing Impôts on alcohol and tobacco is health-related, the additional income raised should be put towards supporting the alcohol and tobacco strategies. (7.10)
11. Industry representatives have advised that proposed Impôts increases would negatively impact on the industry at a time when the industry continues to face significant challenges. (7.19)
12. There are irreconcilable differences between the Minister and industry regarding prices and price comparisons. This is unhelpful. (7.26)

13. Industry figures for how much tobacco consumed in the Island is purchased duty-free cannot be verified or denied by government. (7.32)
14. There will be no growth allocations to debate in the Draft 2015 Budget as all growth monies for 2015 will, if the Minister's current proposals are adopted, have been allocated in the current Draft Budget. (8.9)
15. As the FPP has highlighted, and as the 2012 Accounts make clear, capital expenditure in 2012 did not reach the levels which had been promised. There was a failure to deliver the fiscal stimulus which the Executive had set out to achieve and an opportunity was therefore lost. (9.16)
16. The Minister accepted a recommendation from the Scrutiny Review of the MTFP that the Draft Budget provide revenue implications for the 2014 Capital Programme. However, the Draft Budget does not indicate such implications for each of the projects on the Programme. (9.20)
17. Although there are some questions regarding the details of the proposals, the Draft Budget displays some welcome long-term thinking in respect of the funding of Major Capital Projects. (10.5)
18. The Panel supports the FPP's findings and recommendations in respect of the Strategic Reserve that matters should be resolved before any transfers from the Reserve are agreed and highlights the risk that a precedent could be set with its use for the Hospital Project. (10.30)
19. The spending envelope of £297 million for the Hospital Project may not represent the final figure. (10.37)
20. The Panel welcomes the Minister's intention to provide break points during the Hospital Contract. All withdrawals from the Strategic Reserve require States approval. (10.41)
21. The current investment strategy for the Currency Fund indicates that 60% of it can be invested in the Alternative Investments Class. As of 31st December 2012, the Currency Fund stood at £67 million, of which 60% is £40.2 million. The investments in the Liquid Waste Project and the JIFC car park will amount to £42 million and the margin for error therefore appears tight. (10.62)
22. The detailed funding mechanism for the Liquid Waste Project cannot be agreed until the Assembly has had an opportunity to debate a liquid waste strategy, until which time the spending envelope of £75 million cannot be taken as certain. (10.63)
23. More analysis is required of how £1.7 million per annum in savings would be delivered by the Department of Transport and Technical Services. (10.64)

24. There is a risk that the injection of large amounts of capital funding over the next ten years could overheat the local economy. It is not only the public sector which will seek to undertake capital projects in coming years. Forecasting the impact of such expenditure on the economy is difficult given the current challenges in measuring capacity within the construction industry. (10.77)
25. There are other spending pressures that are still to be addressed and which sit outside the Draft Budget. (11.12)

Recommendations

1. The Minister for Treasury and Resources should request that, from 2014, the Economics Unit recommence the publication of reports on Jersey's economic outlook. (5.21)
2. The Minister for Treasury and Resources should consult the Chief Statistician regarding whether any improvements could be made to the collection and presentation of statistics regarding Jersey's economy, including the re-introduction of Input / Output Tables, without undue pressure being placed on businesses. (5.26)
3. As a priority, the Minister for Treasury and Resources should identify further taxation measures in respect of productivity to support the local economy. (6.46)
4. The Minister for Treasury and Resources should confirm that additional income raised from increased Impôts on alcohol and tobacco shall be put towards funding the alcohol and tobacco strategies. (7.11)
5. The Minister for Treasury and Resources should resolve differences with the industry in respect of price margins and comparisons for alcohol and tobacco and should update the Assembly by July 2014 on results of his work. (7.27)
6. The Minister for Treasury and Resources should consult the Chief Statistician and Economic Advisor about whether any work by the Statistics Unit could help to address the question of how much duty-free tobacco and alcohol is consumed in the Island. (7.33)
7. The 2014 Capital Programme should be examined to determine which elements are new and which relate to refurbishment or renewal of existing assets in order to clarify whether there is a structural deficit within the States' finances. (9.17)
8. The Minister for Treasury and Resources should ensure that the purpose and optimal size of the Strategic Reserve and the conditions for its use are clearly defined before seeking approval for a transfer from the Strategic Reserve for use towards the Hospital Project. (10.31)

9. The Minister for Treasury and Resources should provide the Assembly with scenarios regarding the Hospital Project which assume a higher spending envelope than £297 million. (10.38)
10. The Minister for Treasury and Resources should clarify for the States Assembly how £1.7 million in savings each year would be delivered by the Department of Transport and Technical Services. (10.65)
11. The Minister for Treasury and Resources should seek to improve the information available on capacity within the construction industry. (10.78)

3. CHAIRMAN'S FOREWORD

- 3.1 The theme common to the Fiscal Policy Panel's report and to the reports of both of our advisors is a plea for a macro review showing how all the pieces of the Budget fit together and how they relate to the Medium Term Finance Plan. Input/output tables would be a valuable aid to such a review.
- 3.2 Notwithstanding questions regarding the presentation of information at a macro level and in respect of certain individual proposals, overall the Draft Budget displays an improved approach to financial management compared to other jurisdictions and to the past.
- 3.3 It should be noted that the majority of taxpayers will not benefit from the reduction in the Marginal Rate until 2015, at which time they will also see money taken from their pockets through the Long-Term Care Charge.
- 3.4 The proposed increases in Impôts were the most controversial issue, with industry representatives perhaps unsurprisingly against them. We were advised that the increases would negatively impact on the industry at a time when it continues to face significant challenges. As the primary reason for increasing Impôts on alcohol and tobacco is health-related, additional income raised should be put towards the alcohol and tobacco strategies and we will be bringing a proposition to this effect.
- 3.5 Productivity is a fundamental part of economic growth and, given the comments by Standard & Poor's on our economic growth –*"the recovery is likely to be uneven and shallow"* – consideration of taxation measures in respect of productivity in the economy in the public and private sectors is an area demanding urgent work.
- 3.6 There is a risk that the injection of large amounts of capital funding over the next ten years could overheat the local economy since it is not only the public sector which will seek to undertake capital projects in coming years. Forecasting the impact of such expenditure on the economy is difficult given the current challenges in measuring capacity within the construction industry. It is equally important to consider whether there is, in fact, a structural deficit underlying States finances.
- 3.7 The Panel supports the FPP's findings and recommendations in respect of the Strategic Reserve that matters should be resolved before any transfers from the Reserve are agreed and highlights the risk that a precedent could be set with its use for the Hospital Project.
- 3.8 The Panel feels strongly that our recommendations are essential for the prosperity of the Island and we commend them to the Treasury.

3.9 I would thank all those people who have contributed to the production of this report. It has been a demanding few weeks for those involved, not least of all the officers of the Treasury and our own Scrutiny Officers.

A handwritten signature in black ink, appearing to read 'Sarah Ferguson', with a stylized flourish at the end.

Senator Sarah Ferguson

Chairman

Corporate Services Scrutiny Panel

4. INTRODUCTION

- 4.1 The Draft 2014 Budget was lodged on 8th October 2013 and will be debated on 3rd December 2013. The Ministerial Foreword to the Draft Budget states that it proposes “*a package [of measures] that is designed to support the aims of economic growth and job creation.*”
- 4.2 The Draft Budget contains proposals of the Minister for Treasury and Resources in a number of areas. These include the amount of income to be raised through taxation (including Impôts); the allocation of growth expenditure; and the 2014 Capital Programme.
- 4.3 For some time prior to publication of the Budget, the Minister indicated that, alongside these more commonly seen elements of the Budget, he would bring forward funding proposals for three major capital projects: Housing, Hospital and Liquid Waste. The Minister has proposed borrowing to fund the Housing Project and the Strategic Reserve is, if approved by the States Assembly, to be used for the Hospital Project. The overall funding mechanism for the Liquid Waste Project is not explicitly covered in the Budget proposition but elements are included in the proposed 2014 Capital Programme.
- 4.4 Given the significant matters which the Minister intended to address in the Draft Budget, we agreed to undertake a more detailed Scrutiny Review than has perhaps been undertaken previously. We set out to consider all elements of the proposition. Our Terms of Reference may be found in Appendix 1. Matters relating to housing, the hospital and liquid waste would not normally fall within our remit. We therefore restricted our consideration to the financial aspects of those proposals, namely the spending envelopes which have been identified and the funding mechanisms which the Minister has proposed. Indeed, many aspects of the Draft Budget touch upon the remit of more than one Scrutiny Panel and, in that regard, we are grateful to our colleagues on the Education and Home Affairs Scrutiny Panel for having considered elements relevant to their remit and for the provision of their comments.
- 4.5 Our review has by necessity been undertaken within a short time frame; the confidentiality of Budget proposals is strictly kept until lodging of the proposition and the public nature of a Scrutiny Review could therefore not begin until that time. We acknowledge the States decision to extend the lodging period for the Draft Budget from six to eight weeks as that has undoubtedly made our task easier. We also acknowledge the efforts of the Minister and his Department in briefing us on draft proposals whilst the Draft Budget was being developed. Whilst we may have been unable to start our work in earnest until the Draft Budget was published, the advice and information we received from such briefings allowed us to start that work quickly and on an informed basis. We are also grateful for the work of our expert

advisors, the Chartered Institute of Public Finance and Accountancy (CIPFA) and MJO Consulting, whose reports may be read in Appendices 2 and 3.

- 4.6 After beginning with an examination of the Draft Budget on a general level (including a look at the economic context in which the Draft Budget has been prepared and lodged), we shall consider the specific proposals in the order in which the proposition asks for States approval. We shall therefore first look at the income-raising proposals, before moving on to consider the proposals in respect of growth allocations and the 2014 Capital Programme. We shall then consider the Minister's proposals in respect of the Housing, Hospital and Liquid Waste Projects. We have not considered explicitly the capital programmes for States Trading Operations, but we shall finish our report with consideration of how the Budget fits with long-term financial management of public finances and how it therefore complements wider attempts to address emerging issues and spending pressures.

5. THE DRAFT BUDGET AND THE ECONOMIC CONTEXT

5.1 The Budget has been prepared and lodged by the Minister for Treasury and Resources under Article 10 of the *Public Finances (Jersey) Law 2005*. Article 10 dictates what the Minister must (or can) propose in the Draft Budget. Unlike in recent years, the Draft Budget for 2014 covers all of those elements, namely:

- i. The amount of income to be raised by taxation. The Minister has proposed, under Part (a) of the Budget proposition, estimated income for 2014 of £639,513,000.
- ii. A maximum amount, if any, that the States may borrow. The Minister has proposed under Part (e) borrowing of up to £250 million for housing purposes.
- iii. Amounts, if any, of growth expenditure to be allocated. The Minister has proposed under Part (b) the allocation of £2.21 million and £1.46 million for 2014 and 2015 respectively.
- iv. For each capital project to be started or continued for which no other approval exists, a capital head of expenditure. The Minister has proposed under Part (c) a capital programme for 2014 totalling £88,892,000.
- v. Details of each capital project to be undertaken by a States Trading Operation. Approval is sought for capital projects totalling £2,351,000 under Part (d).
- vi. Amounts, if any, to be transferred between the Strategic Reserve, Stabilisation Fund, Consolidated Fund or other Specially Constituted Fund. The Minister has proposed under Part (f) the transfer of £10.2 million from the Strategic Reserve to the Consolidated Fund.

5.2 The taxation measures covered in Part (a) of the proposition include a number of specific proposals in respect of Income Tax, GST, Stamp Duty and Impôts.

5.3 According to the Public Finances Law, the Minister cannot propose a Draft Budget if, on the basis of its proposed measures, the Consolidated Fund were to be left in deficit at the end of the year. The very last table in the Draft Budget describes the position of the Consolidated Fund and forecasts that, at the end of 2014, the Fund will stand at £5.709 million. When the Medium Term Financial Plan (MTFP) was developed in 2012, it had been forecast that the Consolidated Fund would in fact stand at £11.563 million at the end of 2014.¹ Our advisor from CIPFA has indicated that he had some difficulty in tracking movements in the Draft Budget between the Consolidated Fund, the Stabilisation Fund and the impact of Contingency Funding. The Fiscal Policy Panel (FPP) has recommended that consideration

¹ *Draft Budget Statement 2014 (P.122/2013)*, Page 164

should be given to the maximum 'buffer' that is required in the Consolidated Fund "*for remaining contingencies in a year*", above which level funds should be transferred to the Stabilisation Fund.²

- 5.4 The Draft Budget has reportedly been "*designed to support the aims of economic growth and job creation.*" In his foreword to the Draft Budget, the Minister states that "*there have been some positive economic developments at the global level in recent months.*" However, it is apparent that a 'sustainable recovery' has not yet established itself.³
- 5.5 The Draft Budget goes on to report that, in 2012, economic activity in Jersey (as measured by Gross Value Added (GVA)) fell by 4%, the fifth consecutive annual fall. Latest information showed that business activity in the finance sector was improving. News for the non-finance sector was still negative but was the 'least negative' it had been since September 2010. Headline business activity remained negative but was less negative. Real earnings in Jersey had increased for the first time in four years which could be taken as an indication that economic trends had improved. Total employment fell from 2011 to 2012, with an increase in part-time employment masking a decrease in full-time employment.⁴
- 5.6 During our review, we asked both the Chamber of Commerce and the Institute of Directors for their assessment of how the Island's economy was currently performing. The Chamber advised us that "*things are still very tight in Jersey*" and that the Island would need to make sure it was on the back of any recovery in the United Kingdom (UK) as "*the UK is our main source economy.*"⁵ The Institute of Directors advised us that the medium-term outlook for the Island's economy was still fragile and that whilst there was reportedly some optimism in London about the UK's circumstances, the Institute's members had encountered some surprise from Institute members in the UK that the Island was not in fact ahead of the UK (as people in the UK would expect the reverse to be true).⁶ Both witnesses called for the Draft Budget to help stimulate the economy (see Chapter 6).
- 5.7 Our advisor from MJO Consulting has provided an analysis of the state of Jersey's economy in his report (see Appendix 3). He has looked at recent developments in respect of GVA, employment and performance in the finance sector. He indicates that "*although the finance sector has long dominated Jersey's economy, its share of GVA has fallen from a peak of 53% in 2000 and stood at 40% in 2012*" and that "*in 2010, the combined non-finance sector of the economy overtook finance in its contribution to GVA for the first time in at least a generation.*" He has highlighted that there is a "*likelihood that parts of the economy are in structural decline*" and that there are "*some significant concerns for the finance industry.*"

² Jersey's Fiscal Policy Panel Annual Report – November 2013, Page 7

³ P.122/2013, Page 11

⁴ Ibid., Page 12

⁵ Chamber of Commerce, Public Hearing, 21st October 2013, Transcript Page 25

⁶ Institute of Directors, Public Hearing, 21st October 2013, Transcript Page 23

- 5.8 The Minister and the Assembly benefit from the work of the FPP in understanding Jersey's economic position. The FPP published its report on 5th November 2013 and briefed States Members on the same day.
- 5.9 The FPP's report indicated that, in terms of the international outlook, global growth had slowed by more than forecast in 2012 and below long-run average growth was expected for 2013. Some of the major downside risks in the global economy (such as the potential collapse of the Eurozone) had dissipated, but other significant risks had increased and there had been a change in the pattern of growth in the world economy. In respect of Jersey's economic outlook, the FPP referred to the fall in GVA in 2012 and forecast GVA growth of between -2% and 2% for 2013 and between -2% and 3% for 2014. The FPP reported that surveys indicated an improvement in local conditions in 2013 compared to 2012. Nevertheless, the FPP also identified that things 'had gone wrong' in Jersey in 2012 and that "*the fiscal stance was less accommodative in 2012*" in that fiscal policy had been pro-cyclical, rather than counter-cyclical – contrary to advice which the FPP had previously given. The FPP ultimately made eight recommendations, some of which related directly to the areas we had covered in our review, and we shall return to those recommendations in later chapters of our report.

KEY FINDING

5.10 The economic situation in Jersey remains fragile.

- 5.11 Taking into account this economic context, our advisor from MJO Consulting has raised questions regarding overall income forecasts for future years. In his report, our advisor has provided an analysis to show the impact of updated economic forecasts, advising that "*from a macroeconomic perspective, it has been difficult to understand what is being proposed in the Budget and to calculate the impact of the fiscal changes on the economy.*" We understand that income forecasts have been updated, which have been considered by our advisor in connection with what was included within the MTFP. The following table indicates what this consideration has revealed:

	2013	2014	2015	2016
	£m	£m	£m	£m
(1) MTFP Upper	470	495	525	N/A
(2) MTFP Central	450	470	500	N/A
(3) MTFP Lower	435	450	475	N/A

(4) Scrutiny 1	440	450	465	N/A
(5) Scrutiny 2	440	455	475	N/A
(6) New Upper	460	480	500	525
(7) New Central	445	460	480	495
(8) New Lower	435	440	455	465
(9) Difference between (2) and (7)	5	10	20	
(10) Difference between (5) and (7)	5	5	5	

Scrutiny 1 and Scrutiny 2 refer to forecasts generated upon the basis of assumptions identified by MJO Consulting during the Scrutiny Review of the MTFP in 2012.

- 5.12 Our advisor has highlighted that “*significant downside risks to the economic outlook*” have been identified. He has also highlighted that revised income forecasts do not take into account the specific measures proposed in the Draft Budget (i.e. reduced income through a reduction in the Marginal Rate of Income Tax).
- 5.13 Our advisor from CIPFA, meanwhile, has stated that “*the total impacts of [the Draft Budget’s] Income Tax proposals have a recurring structural change in the base line position for the Income Tax component of the States Income model.*” The FPP also referred to structural changes in the tax system in its own report, for instance through the proposed reduction of the Marginal Rate of Income Tax. Indeed, we have noted the FPP’s comment that “*Draft Budget 2014 lacks a lot of basic and important information that is required to understand the overall impacts of proposed fiscal policy and the latest position of States finances.*” The FPP expressed its disappointment on this matter as it represented “*a step back from previous Budgets in terms of completeness and transparency.*” The FPP therefore made a recommendation as to what, in its view, each Budget should include.⁷
- 5.14 CIPFA has advised us that, whilst the year-on-year impact of taxation measures has been stated (see the next chapter), “*what is less clear is how this reduction in the baseline Income Tax yield position is tracked to the latest MTFP position, Budget 2013 position and latest In-Year Forecasts.*” We understand that the Draft Budget (and the summary tables it contains) was prepared on the basis of the MTFP financial framework adjusted only for Budget

⁷ Jersey’s Fiscal Policy Panel Annual Report – November 2013, Page 41

measures and does not in itself provide a full reforecast of States income or expenditure. CIPFA has indicated that the Draft Budget forecasts income taxation revenue of £474.965 million (the most substantial part of the overall £639 million which the Draft Budget estimates will be raised in total through all income-raising measures), the same figure embedded within an adjusted MTFP position for 2014. Revised forecasts indicate, however, that overall revenues may be lower than previously forecast (by £9 million in 2013; £13 million in 2014; and £26 million in 2015). CIPFA has also highlighted that revised forecasts did not take into account measures proposed in the Draft 2014 Budget. Ultimately CIPFA has advised:

“It is difficult to accurately track and test 2014 budget income tax position of approximately £475m based on this Budget Presentation particularly in the context of the Economics Unit mid-range forecast of £460m (actually £462m based on the 2013 YOA – year of assessment) for 2014 which itself excludes the relevant Budget 2014 proposals requiring a net reduction of some £10.9m on potential tax yields or £5.5m from the MTFP baseline position. The lack of transparency on tracking baseline figures does not provide the level of confidence which we would expect in the overall financial modelling surrounding the £474.965m used for the 2014 budget at this stage of the process.”

5.15 CIPFA therefore has concerns *“over the affordability of various Budget proposals (given transparency issues and the aspirational nature and relative lack of firm details behind some of the Capital Proposals) and the positioning of the 2014 Budget against the overall fiscal strategy that the States has previously set for itself.”* CIPFA has therefore recommended that the Draft Budget would benefit from *“a full Macro Model – MTFP adjusted for all Budget Proposals – on the assumption they are all approved by the States on a hypothetical basis.”*

KEY FINDING

5.16 As the FPP has indicated, the Draft Budget lacks information required to understand the overall impact of proposed fiscal policy and the latest position of States finances.

5.17 The FPP’s report was presented on 5th November 2013, just under a month before the debate on the Draft Budget. We have noted that, prior to publication of the FPP’s report, no reports on the economic outlook in Jersey had been published by the Economics Unit since December 2012. The production of no reports in 2013 represents a change from 2011 and 2012 when the Unit published three reports each year on the economic outlook.

5.18 We understand there may have been concerns regarding the use of resources within the Unit for the production of reports which no-one seemed to read and to which nobody referred. Nevertheless, one potential implication of the decision to cease publishing such reports is that the FPP could become relied upon as the sole (public-facing) provider of economic advice and its report could become the only source of publicly available,

authoritative information on the performance of Jersey's economy. In practical terms as well, the FPP's report is only published a few weeks before the Budget debate, when reports produced earlier in the year could provide a useful basis on which Members, Scrutiny Panels and the wider public could begin to assess the Draft Budget against the economic backdrop.

- 5.19 We believe it is important for the Assembly and for the public to have access to sufficient economic data and information. Further to the FPP's own recommendations, we therefore believe that it would be beneficial for the economic outlook reports to be reinstated to insure that there is sufficient information publicly available about economic performance. We accept that the Economics Unit may wish to examine the timetabling of such reports in order to ensure that they dovetail appropriately with the publication of the FPP's report to avoid the risks of duplication of effort or confusion.

KEY FINDING

- 5.20 No reports on the economic outlook in Jersey have been published by the Economics Unit since December 2012. This must be addressed.**

RECOMMENDATION

- 5.21 The Minister for Treasury and Resources should request that, from 2014, the Economics Unit recommence the publication of reports on Jersey's economic outlook.**

- 5.22 It is apparent, however, that there are challenges in assessing the economic circumstances in Jersey due to the difficulty in collating certain types of data. This may in part be because of the size of the Island as a jurisdiction but it was acknowledged during our review that, without certain types of data, some economic assessments could be difficult to achieve. As the Economic Advisor told us, when asked about assessing the economic impact of certain measures within the Draft Budget:

"It is very hard. You need to know what the counter factor would be if you are going to do a detailed assessment but secondly, you probably need more detailed economic data than we have in Jersey. You would need detailed national accounts, probably input/output tables as well but in terms of the individual interventions, yes, you can assess the impact. You know, Advance to Work, what is the impact there? They are monitoring the people that go through Advance to Work, that enter employment. That is monitored on a monthly basis. In terms of an economic growth and diversification strategy, the enterprise strategy has got smart objectives in there. The Innovation Fund has got an assessment framework to see the impact of that. In terms of the overall macro implications of the Budget, as I said before, getting the capital investment right, meet the 3Ts, then you are minimising the risk. Yes, you can look at

*the amount of money that you put into the economy. Unfortunately we do not have a detailed model where we can say: "Okay, if the Government did this, this would be the impact. If it did that, that would be the impact" because we do not have the detailed information but we can look at it."*⁸

5.23 We noted the Economic Advisor's reference to Input / Output Tables and the fact that their use would be of benefit to the work of the Economics Unit. Such tables were provided in the past for Jersey through work undertaken by Strathclyde University. During our public hearings with the Minister and his Department we asked why this exercise had been discontinued. We were informed that gathering data for the production of such tables would potentially place an undue burden on businesses which were already being asked to comply and assist with the collection of other data through surveys undertaken by the Statistics Unit. The Minister himself suggested that the model of the economy had changed somewhat since the 1990s (when Input / Output Tables had been produced) and that a better understanding of Jersey's economy had been developed through the undertaking of other work, for instance the commissioning of the 'McKinsey Report'.⁹ Nevertheless, it would be beneficial if means to collect data such as that previously collected through Input / Output Tables could be identified.

5.24 Our advisor from MJO Consulting speaks in his report of the need for improved economic data. He advised us of the need to improve information in respect of productivity, for instance, given that it is "*one of the most important concepts in measuring the supply-side performance of an economy and with it, the efficiency of labour.*" His analysis suggests that "*any significant renewal in productivity growth and output is not a foregone conclusion.*"

KEY FINDING

5.25 Input / Output Tables are no longer produced for Jersey as the modelling programme which allowed their production has been discontinued. There is reluctance to re-introduce them due to the potential pressures on businesses.

RECOMMENDATION

5.26 The Minister for Treasury and Resources should consult the Chief Statistician regarding whether any improvements could be made to the collection and presentation of statistics regarding Jersey's economy, including the re-introduction of Input / Output Tables, without undue pressure being placed on businesses.

5.27 Overall, the Draft Budget was described as 'quiet' in some of the testimony we received given that it did not go as far in stimulating the economy as such contributors would have liked to have seen. Our advisor from CIPFA, however, has recognised a "*commendable*

⁸ Economic Advisor, Public Hearing, 11th October 2013, Transcript Page 5

⁹ Minister for Treasury and Resources, Public Hearing, 24th October 2013, Transcript Page 52

level of innovation and drive within the 2014 Budget especially in embedding wholly necessary projects of national significance within the States' Financial Strategy." In CIPFA's view, whilst the Draft Budget was "*bold*", it was not without some risk. CIPFA has indicated the approach taken in the Draft Budget in some respects resembles the 'punch through' approach found in the UK where attempts are made to 'square the circle' "*of reducing resources with higher expectations / demand.*" However, Jersey's approach is commendably different in that the Draft Budget displays more medium to longer-term thinking. In CIPFA's view, the Island therefore has access to "*a more robust approach to the formulation of Financial Strategy than most organisations we have worked with and would easily be placed within the top quartile of organisations, in terms of good practice within Financial Strategy measured against the standards outlined within the CIPFA Financial Management Model.*" In CIPFA's view, whilst transparency and visibility of the Draft Budget's impact could be improved (and revised economic forecasts appeared to provide a cautionary note on the economic foundations for the Draft Budget), comparatively speaking the Draft Budget could be viewed favourably if considered alongside budget-setting in other jurisdictions.

KEY FINDING

5.28 Notwithstanding questions regarding the presentation of information at a macro level and in respect of certain individual proposals, overall the Draft Budget displays an improved approach to financial management compared to other jurisdictions and to the past.

6. TAXATION PROPOSALS

6.1 The Draft Budget asks the Assembly to approve an estimated income for 2014 of £639,513,000. This estimate takes into account a number of specific measures which the Minister has proposed and which we shall explore in this chapter and, in the case of Impôts, the next chapter. The Minister's proposals cover the following areas:

a) Income Tax

Significant Income Tax proposals include:

- Increasing exemption thresholds by 1.5% and the age of entitlement to higher exemption thresholds;
- Enhancing tax relief for parents with children in higher education and removing restrictions to child allowance by reference to the child's earned income;
- Reducing the Marginal Rate from 27% to 26%;
- Removing the three-year rule of residence for making lump sum charitable donations; and
- Allowing High Net Worth Individuals (previously known as '1(1)(k)s') registered under a pre-July 2011 regime to elect to the new regime introduced at that time.

Some administrative changes have also been proposed including the revision of relief due to the self-employed in respect of Social Security contributions and the repeal of the tax credit for electronic tax returns.

b) Goods and Services Tax (GST)

The Minister has undertaken to look at GST legislation in order to support the development of an aircraft registry. Some administrative changes have also been proposed including clarification of the position regarding white goods, carpets et al in respect of supplies to zero-rated dwellings and clarification in the Law of the definition of an 'existing building'. No changes to the overall rate of 5% have been proposed.

c) Stamp Duty

The Minister's only proposal is to continue the extension of the maximum threshold for first-time buyer relief from £400,000 to £450,000.

d) Impôts

Increases in Impôts on alcohol, tobacco and fuel (and on Vehicle Emission Duty (VED)) have been proposed.

6.2 The Minister reiterated on more than one occasion the message given in the Draft Budget that his proposals were a package of measures and should therefore be treated (and voted upon) as such. The Draft Budget advises that, in total, the package of measures will see an additional £294,000 of income collected in 2014 but a 'cost' to the Treasury of £5.47 million in 2015. Those figures take into account assumptions made in the MTFP, however.¹⁰ Our expert advisor from CIPFA has indicated that the 'cost' of taxation measures alone (i.e. exclusive of Impôts) would amount to £10.9 million on a full-year basis (i.e. not taking into account MTFP assumptions which have been unadjusted for actual re-forecasting). Notwithstanding their comments about the impact of the proposals on baseline budgeting (see the previous chapter), CIPFA has advised that the "*quantification and impacts of the individual component changes to the Taxation Revenue appears to be well worked through.*"

6.3 We asked the Assistant Minister who would be the winners and the losers of the 'package' and were advised that:

*"I would like to think that there are no losers in terms of those on the higher earning bands are not made any worse by this budget and those on what we deem to be (it is a definition) 'middle Jersey', we are trying to help those because over the past five or six years, they have taken the brunt of the tax changes that have gone through, just to try and alleviate some of the pressures on them. I believe that those who are less fortunate have been and continue to be well supported."*¹¹

6.4 The Institute of Directors indicated its view that not everyone would benefit from the Draft Budget proposals, however. The Chamber of Commerce, meanwhile, said that, in its view, the winners would be low- to middle-income earners who did not smoke or drink.¹²

6.5 The 'package' contains a large number of taxation proposals. During our review, we focussed on the most significant of those proposals and sought to understand the rationale underlying them and the potential impact they would have. We also received submissions to suggest that the Draft Budget could have gone further with its taxation proposals.

The Proposed Reduction in the Marginal Rate

6.6 Perhaps the most significant of the taxation proposals we considered was that the Marginal Rate of Income Tax should be reduced from 27% to 26%. The Marginal Rate has been at 27% since 1998 and at times in its history has been as high as 30%. Approval of the Draft Budget would see it drop to its lowest ever rate.

¹⁰ P.122/2013, Page 48

¹¹ Assistant Minister for Treasury and Resources, Public Hearing, 11th October 2013, Transcript Page 11

¹² Chamber of Commerce, Transcript Page 18

- 6.7 We were consistently advised that this measure would affect 84% of taxpayers although that did not include individuals and couples exempt from paying tax or, indeed, individuals or couples not required to complete a return. In terms of figures, we understand that (for the year of assessment 2011) 39,701 individuals or couples were charged at the Marginal Rate whilst 7,535 were charged at the Standard Rate. 14,463 were exempt from Income Tax and a further 6,893 were not required to make a tax return. The Draft Budget provides the breakdown of Marginal Rate taxpayers by single people and couples.
- 6.8 All taxpayers assessed at the Marginal Rate would be affected by the reduction. Furthermore, we were informed that, due to the manner in which assessments are made, some 1,200 individuals or couples would find themselves assessed at the Marginal Rate rather than the Standard Rate. All in all, the measure would ‘cost’ the Treasury £7.8 million in revenue that would otherwise be gained if the Marginal Rate were not reduced.
- 6.9 The Minister explained that 25% of taxpayers on the Marginal Rate would see the benefit immediately (i.e. in 2014), whilst the remainder would see the benefit in 2015 (on account of their Income Tax being assessed on a prior-year basis).¹³ The Draft Budget confirms that the impact of the measure would not be felt until 2015. The Minister put to us, however, that:
- “If people are confident that they are going to have their tax reduced, then they are going to be more confident about their spending. They are going to feel better about house prices, I hope. They are going to feel better about security of their jobs. They are going to feel better about being able to ensure that their incomes are rising.”¹⁴*
- 6.10 The Institute of Directors, whilst saying that the reduction would not in itself make a difference in terms of jobs, indicated that the money left in people’s pockets would indeed hopefully find its way into the economy:
- “I do not believe those people are likely to be saving at the moment because of the economic circumstances we all find ourselves in, so one would imagine, yes, some of it will find its way into retailers, et cetera, locally to the extent there is a marginal increase, yes.”¹⁵*
- 6.11 The Assistant Minister similarly stated that it would be difficult to track what happens with the extra money people would be left with, but he hoped it would be spent in the local economy, albeit *“there is no cast iron guarantee.”¹⁶*
- 6.12 The Chamber of Commerce welcomed the tax break, as more money would be left within people’s pockets, but highlighted that the money which would be ‘put back’ represented a small proportion of overall States expenditure. The Chamber President also stated:

¹³ Minister for Treasury and Resources, Transcript Page 44

¹⁴ Ibid., Transcript Page 43

¹⁵ Institute of Directors, Transcript Page 3

¹⁶ Assistant Minister for Treasury and Resources, 11th October 2013, Transcript Page 18

“I think we are saying in the short term customers, consumers will welcome a bit more cash but before we trumpet it as a big give back and a great measure, we would want it to be put in the context that you do realise that this money is going to be clawed back in part a little bit down the road. So it is great news short term. People need some money at the moment. They are finding things hard, but they need to be aware this is not a long-term give. It is a short-term give.”¹⁷

- 6.13 In terms of the rationale underlying the proposed reduction, there appear to be various aspects. In light of the Minister’s comments, however, there appeared to be some hope that the measure would assist the economy by leaving people with more money in their pockets and boosting confidence.
- 6.14 MJO Consulting has advised us that *“it is not clear at this stage if this structural change to the tax system has been considered from an economic perspective.”* The measure would not be a good economic tool, in terms of fiscal stimulus, as there would be a time lag between its implementation and its impact and that *“given the fall in GVA in 2012, the high levels of unemployment and widespread feelings of job insecurity, there is limited confidence in the Jersey economy.”* Furthermore, the proposed reduction would not in itself increase confidence: *“it is incorrect to assume that a tax cut on its own can deliver confidence and influence expectations in a positive way.”*
- 6.15 We asked, via the Economics Unit, that the FPP consider the Minister’s proposal in respect of the Marginal Rate. The FPP described the proposal in its report as *“perhaps the most significant measure.”* It would be a structural change and would not score highly as a fiscal stimulus measure. The FPP therefore suggested that *“to ensure such a decision can be afforded, careful consideration of the structural position of States finances is required although it is not clear from the Budget 2014 report that this has been undertaken.”* The FPP highlights that the people who would benefit most from the reduction would be *“those at the high income end of the 27% rate and at the margin of the 20% rate. The desirability, or otherwise, of this distributional change is a matter for the States.”¹⁸*

KEY FINDING

6.16 The economic rationale for the proposed reduction in the Marginal Rate is questionable.

- 6.17 We sought to understand how the Minister’s proposals, and in particular the proposed reduction in the Marginal Rate, would fit with long-term tax policy. We were informed that it was policy to ensure that people did not unwittingly drop out of the tax system. Reducing the Marginal Rate would not cause that. We were also advised that the long-term policy was to

¹⁷ Chamber of Commerce, Transcript Page 16

¹⁸ Jersey’s Fiscal Policy Panel Annual Report – November 2013, Page 42

keep taxation low, broad and simple and that reducing the Marginal Rate would achieve that aim because it would “*reduce the tax so we are going towards a lower rate of tax for people.*”¹⁹

- 6.18 There was also the fact that a 1% reduction in the Marginal Rate had been recommended by the Tax Policy Unit as a first step in aligning the Marginal and Standard Rates and thereby facilitating subsequent work on the introduction of independent taxation. Alongside the Draft Budget, the Minister has published a feasibility report on the introduction of independent taxation. We were advised that decreasing the Marginal Rate, in conjunction with the 1.5% increase in exemption thresholds, would be a step towards independent taxation in that it would facilitate subsequent alignment of the Marginal and Standard Rates. Such a move would simplify the taxation system and thereby provide for an easier context in which to move towards a system of independent taxation, with separate assessment.

KEY FINDING

- 6.19 The proposed reduction in the Marginal Rate is intended by the Minister to be a first step in aligning the Marginal and Standard Rates and thereby a first step towards independent taxation.**

- 6.20 We believe it is important to consider the Draft Budget in the context of what else might be on the horizon in terms of charges, particularly given that the Draft Budget has been described as good news and providing a tax break for taxpayers. The ‘money that is going to be clawed back’ to which the Chamber referred relates to the effects of the proposed Long-Term Care Charge.
- 6.21 The Long-Term Care Charge is due to be introduced in 2015. It will be a contribution collected from Jersey residents with income high enough to pay Income Tax and it will include both working-age adults and pensioners. Liability for the charge will be assessed in the same way as Income Tax liability, although an upper income limit would apply. The rate will start at 0.5% in 2015 and rise to 1% in 2016. It is intended that it should remain at 1% for three years. In 2015, it is anticipated that the charge will generate £8 million and in 2016 (when the rate increases to 1%), £16 million.
- 6.22 In its report, the FPP welcomed the fact that plans for the Long-Term Care Charge have taken the medium term into account. The FPP indicated it would keep “*a watching brief to see whether this plan to phase in the charge is appropriate, given the economic outlook and fiscal balance in 2015 or 2016, and report back on this in the next annual report.*”²⁰
- 6.23 The effect of the reduction in the Marginal Rate will not be felt until 2015 for most taxpayers assessed at the Marginal Rate (as they will be assessed on a prior-year basis). The

¹⁹ Director of Tax Policy, Public Hearing, 24th October 2013, Transcript Page 38

²⁰ Jersey’s Fiscal Policy Panel Annual Report – November 2013, Page 5

implication is that, for such taxpayers, 2015 will see a slight drop in their Income Tax assessment. However, at the same time the Long-Term Care Charge will be introduced and will be felt in 2015. Whether the Long-Term Care Charge is a contribution or a tax, as some submissions to us suggested, the impact on those taxpayers' pockets is ultimately the same.

6.24 The Institute of Directors indicated that more attention could have been given in the Draft Budget to the introduction of the Long-Term Care Charge. They advised us:

*"The long-term care will be a half a per cent, going up to 3 per cent, which will suck money out of the economy. That extra tax will come out. It does come in 2015, exactly the same time as most people are taking advantage of the marginal relief, so as a range of tax measures I do not think they hit the spot because it is neither low, broad nor simple."*²¹

6.25 The Chamber of Commerce also said that the introduction of the Long-Term Care Charge should not be forgotten, highlighting that it would take money from people's pockets which had been put back by the reduction in the Marginal Rate of Income Tax. Our advisor from MJO Consulting has also raised the subject of the Long-Term Care Charge and the fact that it would be introduced in 2015, thereby countering the beneficial impact of the proposed reduction in the Marginal Rate for the 75% of people who would stand to benefit from that reduction.

6.26 When we raised this matter with the Minister, we were advised:

*"The other thing, Chairman, to respond to your question is that we have done the thinking around that because the long-term care charge will be across a broader base because it is across people's earned income and unearned income as well. So it is a broader base than the 84 per cent of taxpayers who are paying at the marginal rate."*²²

6.27 We asked for examples to be provided to indicate how taxpayers might be affected by the cumulative impact of the proposed reduction in the Marginal Rate and the Long-Term Care Charge. The following table indicates the figures provided to us by the Department of Treasury and Resources. It indicates the tax saving that such households would expect to see in 2014 through the measures being proposed in the Draft Budget and the amount such households would be expected to contribute in 2015 for the Long-Term Care Charge when the rate would be 0.5%. The rate is expected to increase to 1%, at which point the amounts paid would also increase.

²¹ Institute of Directors, Transcript Page 11

²² Treasurer of the States, Public Hearing, 24th October 2013, Page 37

Household	Income	2013 Liability	2014 Liability	Tax Saving	LTCC Charge
Single, No children	£20,500	£1,814	£1,690	£124	£42
Married, 2 children, wife not working	£36,000	£2,136	£1,976	£160	£49
Married, 2 children (1 child at university), wife working	£40,000	£1,191	£286	£905	£7
Married, 2 children, £240k mortgage (5% interest), wife working	£62,000	£4,701	£4,446	£255	£111
Married, 2 children (1 child at university), wife working	£70,000	£9,291	£8,086	£1,205	£202
Married, 2 children (1 child at university), wife working	£140,000	£26,200	£26,200	£0	£655
Single Pensioner	£20,500	£1,385	£1,274	£111	£32
Married Pensioner	£26,000	£194	£78	£116	£2

KEY FINDING

6.28 The majority of taxpayers will not benefit from the reduction in the Marginal Rate until 2015, at which time they will also see money taken from their pockets through the Long-Term Care Charge.

Other Parts of the Package

6.29 In terms of other parts of the 'package' of taxation proposals, we received some favourable comments from stakeholders. For instance, both the Chamber of Commerce and Institute of Directors welcomed the proposal to increase allowances for taxpayers with children in higher education. The Education and Home Affairs Scrutiny Panel advised us that it too was supportive but that it should be seen as a first step in addressing questions surrounding the funding of students in Higher Education. The Panel highlighted, for instance, that consideration could feasibly be given to the parental income thresholds used to assess whether parents should begin to contribute towards the costs of tuition and maintenance.

6.30 This measure will only apply to taxpayers assessed at the Marginal Rate, however. In that regard, we were advised that 1,013 taxpayers would stand to benefit in relation to 1,166

children. There would be 535 taxpayers (with 685 children) assessed at the Standard Rate of Income Tax who would not benefit.

- 6.31 The Institute of Directors supported the proposals in respect of High Net Worth Individuals, advising that:

“The point of that is to enable more of the high net worth individuals that are already here to bring more of their funds into the Island to be administered in the Island and generate tax revenue. So we very much support that.”²³

- 6.32 The Institute estimated that approximately 18 individuals might choose to change to the new regime and explained in clear terms why such individuals might wish to do so:

“If I am faced with a wealthy individual who came to Jersey in 2011 and he wants to buy a garage, if he buys a garage in Guernsey he pays no tax. If he buys a garage in Jersey he pays tax. It is as simple as that.”²⁴

- 6.33 We were informed by the Minister that income from Stamp Duty was down although information from the construction industry suggested that there might be an upturn in income the following year. The maximum threshold of first-time buyer relief would continue to be increased *“to help those Islanders get on the property ladder. It is one of government’s policies to encourage home ownership, along with the deposit scheme that we introduced this year. It is a way of helping Islanders get on the property ladder.”* Increasing the limit still further could have led to a bubble in the market, however.²⁵

- 6.34 Given the Minister’s seeming desire to put something back into people’s pockets, we questioned him on whether any alternatives to the reduction in the Marginal Rate had been considered in that regard. We were informed that a greater increase in the exemption thresholds (potentially by the 3% anticipated in the MTFP) would have taken more people out of paying tax and this would have been against the principles of long-term tax policy.

- 6.35 We also considered whether any consideration had been given to amending the rate of GST. The Chamber of Commerce indicated that there was no pressure amongst its members to reduce the rate from its current level of 5% but advised that there was a case for the *de minimis* level to be looked at. However, the President advised of his view that there were other matters which might also affect local retailers and which would need to be addressed beyond the *de minimis* level: parking, investment and technology.²⁶

- 6.36 The Assistant Minister informed us that there were two difficulties with reducing the rate of GST as an option. First, it would be an untargeted measure (affecting everybody) rather

²³ Institute of Directors, Page 5

²⁴ Ibid., Page 9

²⁵ Assistant Minister for Treasury and Resources, 11th October 2013, Transcript Page 39

²⁶ Chamber of Commerce, Transcript Page 21

than targeting simply those paying Income Tax at the Marginal Rate, and, secondly, there would be no guarantee that retailers would in fact lower their prices accordingly. The proposed reduction in the Marginal Rate would therefore be the most effective tool of achieving the Minister's aim of providing something back to taxpayers.²⁷

Other Measures?

6.37 Both the Chamber of Commerce and Institute of Directors questioned whether the Draft Budget could have gone further in supporting the economy. The Institute, for example, was concerned that there was little amongst the taxation measures in the Draft Budget which would stimulate economic growth in the short term and indicated that it wished the Draft Budget "to demonstrate and create an aura of an Island or an economy that is open for business, wants business, is not complacent and is hungry to get things done." The Institute's view was that there was a 'basket of measures' which could be adapted for implementation in Jersey from what was within use elsewhere.²⁸

6.38 Specifically, the Institute asked why 100% capital allowances had not been introduced:

*"The point of 100% capital allowances is simply to accelerate investment by local business in a new bit of plant and machinery. It was difficult for us really to see what the downside in that in economic terms was for the Treasury."*²⁹

6.39 The Minister advised us that this proposal had been considered but had ultimately not been pursued as "the actual proposal that was being asked was not 100% write-off, it was effectively 300% write-off in terms of capital allowances. People were asking us for a tax system that would give them a credit for an investment, not just an offset."³⁰

6.40 The Institute had also proposed the development of a Seed Enterprise Investment Scheme, similar to what had been introduced in the UK in April 2012.

*"Rather than at the moment we seem to be stuck in this idea that we have zero per cent tax for most companies; therefore, how could we possibly improve matters for them? Fundamentally, we think that is the wrong direction of travel for this debate. As the burden of taxation moves, as it is elsewhere in the world, from corporates to individuals, one must look at the individuals as being the people who drive the investment and the economic growth behind the corporates."*³¹

²⁷ Assistant Minister for Treasury and Resources, 11th October 2013, Transcript Page 38

²⁸ Institute of Directors, Transcript Page 5

²⁹ Institute of Directors, Transcript Page 5

³⁰ Minister for Treasury and Resources, Transcript Page 41

³¹ Institute of Directors, Transcript Page 5

The Institute therefore felt that it would be good if individuals were allowed to invest post-tax income into a company in order to allow the company to create jobs. The Institute accepted the scheme would need to be tightly drawn to counter risks of abuse but it would, in the Institute's view, be of more potential benefit than the Jersey Innovation Fund. In that regard, the Institute saw the Innovation Fund as 'Stage 2' in a process for which 'Stage 1' had yet to be covered and which would be covered by a seed investment scheme. In terms of the risks, the Institute also advised us that *"it [is] difficult to see how the appetite for investing public money in brand new start-up businesses will go from nothing at all, which is where we are at the moment, to a huge hunger for risk taking."*³²

6.41 The Chamber of Commerce was also in favour of greater measures being taken to encourage investment and referred to the measures which the Institute of Directors had suggested:

*"I would certainly welcome tax breaks for inward investment, yes. The scale of them and how they were applied we would have to debate, but Jersey has got to do a little bit more to attract this business and to grow its economy. My basic concern with the budget is that it is a very stable and a very certain budget but this is not necessarily a time just for stability and certainty. We need a little bit of motivation, a little bit of action, and we need to get going."*³³

6.42 The Minister expressed his disappointment at the criticism he had received for not taking the measures to which the Institute and Chamber had referred:

*"We have deployed every effort to support business through the downturn: fiscal stimulus, economic growth strategy, financial services reorganisation, Digital Jersey, giving Economic Development...this refrain is not coming from Economic Development I hasten to add, it is coming from the I.O.D. (Institute of Directors) and Chamber. So we have given Economic Development all the support."*³⁴

6.43 In terms of the measures specifically proposed by the Institute of Directors, the Minister advised that consideration had been given to capital allowances and that consideration would be given to it once again, as well as to the Seed Enterprise Investment Scheme. The Minister highlighted, however, that such schemes had been introduced in other jurisdictions against the backdrop of very different taxation systems, thereby intimating that any scheme introduced would need to be right for Jersey.

6.44 Our advisor from MJO Consulting has considered the suggestion that a Seed Enterprise Investment Scheme could be introduced. In his report, he considered the significance of

³² Ibid., Page 7

³³ Chamber of Commerce, Transcript Page 19

³⁴ Minister for Treasury and Resources, Page

productivity to economic performance and has advised that it is “*unfortunate that an opportunity was missed in the Budget to reinforce and highlight the productivity improvements that [certain strategies] could generate for the economy.*” Our advisor was referring to work undertaken by Digital Jersey and the Department of Education, Sport and Culture in that regard. He has intimated, however, that further measures could feasibly be taken to promote productivity and has referred to examples from elsewhere, such as Singapore.

KEY FINDING

6.45 As a matter of urgency, further work must be undertaken in considering and identifying taxation measures in respect of productivity that will support the local economy.

RECOMMENDATION

6.46 As a priority, the Minister for Treasury and Resources should identify further taxation measures in respect of productivity to support the local economy.

7. IMPOTS PROPOSALS

The Proposals

7.1 The area of the Draft Budget which generated most comment during our review concerned Impôts and the proposed duty increases on alcohol, tobacco and fuel. We received a number of submissions from industry representatives, to which we refer below, although we recognise that they had a particular interest in this matter and we therefore considered the evidence received accordingly. We shall focus on Impôts separately in this chapter, albeit they form part of the Minister's 'package' of income-raising proposals.

7.2 The Minister has proposed the following increases in Impôts in the Draft Budget:

- Tobacco 11%
- Strong beer and cider 11%
- Spirits 11%
- Wine 5%
- Weak beer and cider 5%
- Fuel 2%
- VED 5%

7.3 In terms of the impact such increases would have, the Draft Budget advises that an additional £594,000 would be raised in 2014 through these measures, although that calculation takes into account assumptions which had been made in the MTFP regarding Impôts. The Draft Budget indicates that if such assumptions were not accounted for, the proposed increases would raise additional revenue in 2014 (compared to 2013) of £3,163,000. During our public hearings, we were informed that the Impôts increases would have an impact of 0.25% in terms of RPI.

7.4 The Draft Budget states that, in formulating Impôts proposals, the Minister takes into account the prevailing economic conditions; the Island's financial position; and the tobacco and alcohol strategies. Consideration is therefore given to the rate of inflation and consultation is undertaken, particularly with the Ministers for Health and Social Services; Home Affairs; and Economic Development. From our public hearings, however, the primary reason for the proposed increases, particularly in respect of tobacco and alcohol, appeared to be to reduce consumption. The Assistant Minister advised us:

"Providing we maintain our revenues, then from a Treasury point of view we balance our budget, so to speak but, if increasing duty helps people change their behaviour

and reduce consumption of both alcohol and tobacco, then that is a good thing for our Island and the knock-on effect for our colleagues at Health and Social Services is that they see less people with less disease coming through their facilities.”³⁵

- 7.5 In terms of this justification for increases on health grounds, the Liberation Group could not see any link between duty increases and health benefits; in that regard, in their view the specific problems of a small minority “*need to be solved with targeted education.*” This would not be helped by the fact that increased duties would lead to greater buying in supermarkets and therefore ‘unsupervised’ drinking at home.³⁶ The Jersey Hospitality Association made similar comments.³⁷
- 7.6 In the MTFP, it was stated that there were no plans for any significant changes to the setting of Impôts over the period of the Long-Term Revenue Plan (i.e. to 2019). The strategy was therefore “*to increase duties by RPI [...] for all categories except alcohol and tobacco, where above RPI increases will be considered to support Health strategies on these.*” The MTFP reports that such increases could raise an additional £8.5 million per annum by 2019.
- 7.7 We were informed that duty rates could potentially be set on other bases. For instance, Randalls Limited advised us that they had suggested to Ministers “*to apply a sliding scale of duty as they have in the UK, as opposed to our two tier system whereby we tax from 1.2 degrees alcohol up to 4.8 at one rate and then it jumps by 50% for product above 4.9%.*”³⁸
- 7.8 As we shall explore below, industry representatives had concerns regarding the Impôts proposals due to the potential impact there would be on business, due to perceived inaccuracies in price comparisons and because increases might lead to greater duty-free consumption. However, one member of the public who wrote to us stated that the proposed increases were “*disappointing*” but he felt that they were acceptable provided that the additional income raised was put towards the relevant area (e.g. income from fuel duty would be spent on road maintenance).
- 7.9 This argument has some logic: if the reason for increasing Impôts on alcohol and tobacco is primarily on health grounds, then it appears a reasonable expectation that the income raised would be put towards the alcohol and tobacco strategies which the Draft Budget is purported to support. Undertakings could be made by the Minister to ensure that this income is subsequently used for health purposes. Indeed, we were advised that additional funding for health would be required, given the need to deliver on agreed reforms to health and social care services and to meet the previous commitment to provide the Department of Health and Social Services with 2% real growth per annum.

³⁵ Assistant Minister for Treasury and Resources, 11th October 2013, Transcript Page 29

³⁶ Liberation Group, Written Submission, 24th October 2013

³⁷ Jersey Hospitality Association, Written Submission, 25th October 2013

³⁸ Randalls Limited, Written Submission, 14th October 2013

KEY FINDING

7.10 As the primary reason for increasing Impôts on alcohol and tobacco is health-related, the additional income raised should be put towards supporting the alcohol and tobacco strategies.

RECOMMENDATION

7.11 The Minister for Treasury and Resources should confirm that additional income raised from increased Impôts on alcohol and tobacco shall be put towards funding the alcohol and tobacco strategies.

The Impact on Business

7.12 The Panel received a number of submissions from industry representatives in opposition to the Minister's proposals, particularly in respect of tobacco and alcohol. The Liberation Group felt that the proposed increases were *"excessive and will cause real harm to Jersey's tourism hospitality sector as well as hitting the hard working people of Jersey."* The increases were, according to the Group, between three and seven times the rate of inflation as it had stood in June 2013. The Group further stated that *"Jersey's duty increases are a blunt instrument that clearly has not worked in the past"*, advising that collections were down in 2013 and that 2014 was likely to see a similar result. The Group could therefore see no evidence for the claims that the proposals would see increased revenue. A number of correspondents highlighted that the increases would see some Impôts rise to some of the highest levels in Europe: the new Impôts on spirits, for example, would reportedly put Jersey only behind Sweden and Finland. The Liberation Group was not aware of another jurisdiction which was looking to increase duties at such rates (even taking into account Guernsey).³⁹

7.13 The Liberation Group also advised that lower earners tended to be higher consumers of alcohol and tobacco. The Assistant Minister did not believe that people were being penalised, however:

*"There is a very modest duty on what we call standard beers and ciders, lower alcohol content ones of something like two pence per pint. I think that is quite a modest increase. If someone drank two pints a night for seven nights a week, that would only be 28 pence. I think that is quite a modest increase in duty."*⁴⁰

7.14 We understand, however, that the Household Spending Survey 2009 / 10 shows that households in the lowest income quintile have the lowest weekly spend on alcohol of the five income quintiles. As a result, the weight for alcohol in the RPI (low income) is lower than in

³⁹ Liberation Group, Written Submission

⁴⁰ Assistant Minister for Treasury and Resources, 11th October 2013, Transcript Page 30

the RPI for all households (4.3% and 5.5% respectively). Low income households do have the second greatest weekly spend of the five income quintiles on tobacco, meaning there is a higher weight for tobacco in the RPI (low income) compared to the RPI for all households (2.5% compared with 1.7% respectively).

7.15 The Chamber of Commerce also spoke against the proposed increases and argued that increases based upon RPI (or RPI plus a percentage, as occurs in Guernsey) would be preferable.⁴¹ The Institute of Directors commented to a lesser degree but questioned whether the time was right for such increases when the Tourism Shadow Board had yet to complete its work. The Institute understood the health reasons for proposing increases *“but based on the percentage increases it appears that the Treasury have taken the view that there is a lot more unhealthy people this year than there have been in recent years. So the percentage increases seem out of line with what has come before.”*⁴²

7.16 The Liberation Group stated that *“this is the worst possible time to hit us with these increases as we are struggling to see any green shoots of economic recovery in the Island.”*⁴³ A similar message was given by Randalls Limited, which reported that business had declined over recent years due to the fall in tourism, the poor economic context, unemployment, the smoking ban and the high business costs. Randalls also pointed out that the promotion of the sale of alcohol was permitted in the UK, but not in Jersey, whilst UK businesses could also benefit from income derived from gaming machines – unlike their Jersey counterparts. Randalls stated that some outlets could close as a result of the proposed increases being implemented.⁴⁴

7.17 We also received a written submission from the Jersey Hospitality Association, in which we were advised that:

*“Trading wise, the Tourism industry in 2013 had a very difficult winter and spring. We experienced improved trading through the key summer months; however, this improvement will be affected if these increases are adopted by the States. The hospitality industry in Jersey faces high operating costs compared to our competitor markets so it is important that our sector of the economy is not constrained further through excessive above inflation duty increases (RPI in June was 1.5%) and we are allowed to remain competitive particularly as we expect significant challenges again in our core UK market in 2014.”*⁴⁵

7.18 The Assistant Minister questioned whether prices of alcohol and tobacco had that great an influence on people’s choice of holiday destination:

⁴¹ Chamber of Commerce, Transcript Page 4
⁴² Institute of Directors, Transcript Page 11
⁴³ Liberation Group, Written Submission
⁴⁴ Randalls Limited, Written Submission
⁴⁵ Jersey Hospitality Association, Written Submission

“Most people are a bit more sophisticated when they come to choosing their choice of where they take their vacations by what is on offer to see and do in those locations. I think that is where our tourism industry has to concentrate its efforts, to making sure that we are a destination because of what we have to offer here, not the price of our cigarettes and our alcohol.”⁴⁶

KEY FINDING

7.19 Industry representatives have advised that proposed Impôts increases would negatively impact on the industry at a time when the industry continues to face significant challenges.

Price Comparison

- 7.20 One of the principal bones of contention amongst the industry representatives from which we heard was the price comparisons which the Minister had published alongside the Budget proposals. Randalls Limited, for instance, challenged those comparisons, stating that the average pint of lager in Jersey cost £3.30 and not £3.79 as the Minister had suggested.⁴⁷ The Liberation Group posed a similar challenge, highlighting that the average price of a pint of Carling in its 74 pubs was £3.50, not £3.79. Similarly, the Group claimed that the UK Retail Price for a pint of lager was £3.50 and not £3.30 as the Minister had published. The Chamber of Commerce also expressed concerns regarding the price comparisons and highlighted that *“this issue comes up nearly every year.”*⁴⁸
- 7.21 The Chamber of Commerce spoke of the figures taken for the UK and asked whether it was a reasonable comparison for Jersey’s averages to be compared to the UK national average rather than with a particular area within the UK that might be comparable to Jersey in terms of level of affluence. The Chamber also advised that *“the UK prices are taken from the Office of National Statistics. The O.N.S. produced that data in 2010, so you have got three years worth of RPI that is not taken into account if you are comparing a 2010 figure to a 2013 figure.”*⁴⁹ It was subsequently clarified that the Chamber was referring to regional price variations within the UK which had been based on 2010 data, rather than overall UK figures which indeed dated from June 2013.
- 7.22 At our public hearings with the Minister, we were advised that the figures for Jersey prices were generated from the work of the Statistics Unit. The Unit produces an annual report that compares prices between Jersey, Guernsey and the UK for a range of products (not simply

⁴⁶ Assistant Minister for Treasury and Resources, 11th October 2013, Transcript Page 30

⁴⁷ Randalls Limited, Written Submission

⁴⁸ Liberation Group, Written Submission

⁴⁹ Chamber of Commerce, Transcript Page 7

alcohol and tobacco) which involves the collation of 2,500 separate price quotations. UK figures are for the most part taken from the Office of National Statistics. The most recent report was published in September 2013 in respect of June 2013.

- 7.23 The Liberation Group highlighted the high operational costs of doing business in Jersey and the role the industry played in employing local residents and expressed its dismay at being attacked for charging too high prices.⁵⁰ The Minister, however, appeared convinced that high costs of alcohol and tobacco could not be blamed upon Impôts increases: “*The facts are the facts. Even if we are out by 50%, there is an inexplicable margin on a pint of beer and a tot of whiskey.*”⁵¹
- 7.24 We put it to the Minister that the issue regarding price comparisons was one which indeed arose with every Budget and asked whether something could be done to ensure that there was greater agreement between Government and industry regarding the veracity of the information available. The Minister advised us that he intended to correspond with the industry to ask for alternative suggestions regarding Impôts. He also advised that he had asked the Channel Islands Competition and Regulatory Authorities (CICRA) to investigate the issue.⁵²
- 7.25 The Minister’s efforts are welcome as this is not an ideal situation in which the Assembly (and the public) is placed: arguments about pricing in which it is difficult to determine the true nature of costs in Jersey and how they compare to costs elsewhere. There needs to be clarity and certainty regarding the facts in order that decisions on the Draft Budget (both this year and in future years) can be made on an informed and evidential basis. The Minister should therefore continue his efforts to resolve the situation.

KEY FINDING

7.26 There are irreconcilable differences between the Minister and industry regarding prices and price comparisons. This is unhelpful.

RECOMMENDATION

7.27 The Minister for Treasury and Resources should resolve differences with the industry in respect of price margins and comparisons for alcohol and tobacco and should update the Assembly by July 2014 on results of his work.

⁵⁰ Liberation Group, Written Submission

⁵¹ Minister for Treasury and Resources, Transcript Page 47

⁵² Ibid., Page 48

Duty-Free Consumption

- 7.28 Another argument raised during our review was whether the Impôts increases would cause greater consumption of duty-free purchases. We were advised by the Channel Island Tobacco Importers and Manufacturers' Association (CITIMA) that 41% of the tobacco consumed in the Island is purchased duty-free.⁵³ We understand that figure was derived from a survey of 250 people who smoke and who were asked where they purchase their tobacco. According to the Liberation Group, the tobacco proposals would push even more people to consume duty-free purchases.⁵⁴ The Chamber of Commerce highlighted that duty free allowances should potentially be examined in order to address this problem but highlighted that *"the issue with that is if you cannot police 200 as your limit how can you police 50, which was the suggestion."*⁵⁵
- 7.29 The Draft Budget acknowledges that there have been reports that many locals and tourists have turned to duty-free sources of tobacco. However, there had reportedly been no change in this trend in 2013 and, whilst there was some impact on revenue yield, there was neither 'evidence nor intelligence' that commercial quantities of cigarettes were being smuggled into the Island.⁵⁶
- 7.30 At our hearing with the Assistant Minister, we were advised that the industry's figures in respect of duty-free consumption could not be verified or challenged although we were told that over 1,000 people had been stopped over the last two years with tobacco in excess of their duty-free allowance. We were advised that there was no evidence, however, of large numbers of people bringing in excess of their duty free allowance of alcohol.
- 7.31 Again, it is somewhat unhelpful that claims from the industry (regarding the level of duty-free tobacco consumption) cannot either be countered or verified. It would be preferable if the situation could be resolved, if possible, through the collation and presentation of data on the matter.

KEY FINDING

7.32 Industry figures for how much tobacco consumed in the Island is purchased duty-free cannot be verified or denied by government.

RECOMMENDATION

7.33 The Minister for Treasury and Resources should consult the Chief Statistician and Economic Advisor about whether any work by the Statistics Unit could help to

⁵³ Channel Island Tobacco Importers and Manufacturers' Association, Written Submission, 25th October 2013

⁵⁴ Liberation Group, Written Submission

⁵⁵ Chamber of Commerce, Transcript Page 11

⁵⁶ P.122/2013, Page 40

address the question of how much duty-free tobacco and alcohol is consumed in the Island.

Other Impôts Proposals

7.34 In terms of VED, we asked the Assistant Minister what impact VED had made on consumer choice and were informed that "*hopefully consumers will buy more environmentally friendly vehicles.*"⁵⁷ The Draft Budget itself acknowledges that "*it is not known the extent to which the introduction of VED has influenced consumers' decisions on vehicle purchases.*"⁵⁸

⁵⁷ Assistant Minister for Treasury and Resources, 11th October 2013, Transcript Page 32
⁵⁸ P.122/2013, Page 41

8. GROWTH ALLOCATIONS

8.1 Part (b) of the Draft Budget proposes the appropriation of £2.21 million and £1.46 million of growth expenditure for 2014 and 2015 respectively.

8.2 The process for the agreement and allocation of growth expenditure is set out in the Public Finances Law. There are effectively two stages:

1. In the MTFP, the States approve overall limits for growth expenditure that can be allocated in each of the years of the MTFP; and
2. In the Annual Budgets for those years, the States allocate that funding for the following year to individual items.

8.3 The spending envelopes for growth in 2014 and 2015 were agreed in the MTFP and were the result of an amendment we lodged to the MTFP (when initially lodged, the Draft Budget had included no specific allocations for growth). The amounts available for growth allocations were reduced by subsequent amendments from the Council of Ministers and Chief Minister.

8.4 Under Article 10(1) of the Public Finances Law, the Minister is obliged to inform the Assembly of the amounts intended to be allocated to growth expenditure. The Minister met this obligation with the presentation of *Medium Term Financial Plan Compromises and Central Growth Allocation 2014* (R.114/2013) in which he set out how he would propose the allocation of £2.21 million and £1.46 million of growth money in 2014 and 2015 respectively. The Draft Budget reflects those proposals and indicates the schemes to which the funding will be allocated. The following Departments are due to benefit:

- Chief Minister's Department £410,000 in both 2014 and 2015
- Home Affairs £50,000 in both 2014 and 2015
- Social Security £750,000 in 2014 and £1 million in 2015
- Transport and Technical Services £1 million in 2014 alone

8.5 The effect of these proposals is that the relevant Departmental expenditure limits for those Departments affected will be increased by the amounts concerned for the years in question. The schemes to which the funding will be provided mirror the provisional list which was provided in the MTFP with one minor exception within the Department of Home Affairs.

8.6 The provision for growth funding was originally provided for in the Public Finances Law in order to allow States Members some influence over future spending allocations (once the MTFP had been agreed). Thus, the report accompanying P.97/2011 (which amended the Public Finances Law) stated that "*the growth allocation also provides an annual opportunity*

*for a States Member to influence the allocation of funding to emerging pressures or priorities within the overall States spending limits.*⁵⁹

- 8.7 The Minister's proposals were therefore open to amendment by any Member who might have felt that the funding should be put towards a different scheme. That will not occur in the Draft 2015 Budget, however. The Public Finances Law allows the Minister to propose, and the States to allocate, growth expenditure more than one year in advance. As many of the schemes included within the Minister's proposals are recurrent through 2014 and 2015, the proposals for growth allocation will effectively see allocation of all of the expenditure. There will therefore be no remaining growth allocation for 2015 left to decide upon by the time the Draft 2015 Budget is prepared and debated.
- 8.8 Following our review of the MTFP in 2012, the Minister undertook to enhance the financial reporting mechanism used for States expenditure. Within that, he undertook to report specifically on the use of growth allocations and, for each growth item, would report:
1. Amount approved in the MTFP;
 2. Amount spent to date;
 3. Amount to be returned to the consolidated fund as not needed (if any);
 4. Brief details of how the money was spent;
 5. Outcomes anticipated from the expenditure; and
 6. Actual outcomes achieved.⁶⁰

If the Assembly approves the Minister's proposals in respect of growth allocations, we therefore anticipate that the Quarterly Corporate Reports considered by the Council of Ministers will include specific monitoring of the growth items to which funding is granted (as already occurs for those items of 'growth' agreed within the MTFP itself).

KEY FINDING

8.9 There will be no growth allocations to debate in the Draft 2015 Budget as all growth monies for 2015 will, if the Minister's current proposals are adopted, have been allocated in the current Draft Budget.

⁵⁹ *Draft Public Finances (Amendment No.3) (Jersey) Law 201- (P.97/2011)*

⁶⁰ *Review of the Medium Term Financial Plan (SR18/2012): Response of the Minister for Treasury and Resources (SR18Res/2012)*

9. 2014 CAPITAL PROGRAMME

Overall Spending Envelope and Programme

- 9.1 Part (c) of the Draft Budget asks the Assembly to approve, in accordance with Article 10(3)(d) of the Public Finances Law, “*a capital head of expenditure for each of the capital projects for States-funded bodies to be started or continued in 2014 [...] totalling £88,892,000.*”
- 9.2 Under the Public Finances Law, the total amount for the Capital Programme must not exceed the envelope which was agreed in the preceding MTFP. In the MTFP, the Assembly approved capital spending envelopes of £88,892,000 and £77,341,000 for 2014 and 2015 respectively. The Draft Budget therefore respects the envelope agreed in the MTFP for 2014.
- 9.3 In the MTFP, an indicative programme for 2014 was provided. Some changes to that programme were made by the time the Draft Budget was lodged on 8th October 2013, as the accompanying report to the Draft Budget makes clear. Those changes are:
1. Funding of £8,188,000 for additional primary school accommodation rather than £15 million for a ‘replacement school’;
 2. £1.55 million for Sports Strategy Infrastructure (not covered in the MTFP);
 3. £10.2 million for Phase 1 of the Future Hospital (not covered in the MTFP);
 4. £0.5 million for Future Hospital Planning rather than £2 million;
 5. £6,657,000 for the T&TS Infrastructure Rolling Vote rather than £10,657,000;
 6. £10.1 million for Phase 1 of the Liquid Waste Strategy rather than £3.1 million; and
 7. £1,252,000 for Fiscal Stimulus and Parish Projects (not covered in the MTFP).
- 9.4 Some of these changes relate to the proposals for the three major capital projects which we shall cover in the next chapter.
- 9.5 Departmental capital expenditure (not including housing) is intended to be £66,692,000 whereas the corresponding amount in the MTFP was forecast to be £57,502,000. As a consequence, the estimate for capital expenditure on housing has reduced from £31,390,000 to £22,200,000. We questioned the Minister on why this was so and were advised that the Department of Treasury and Resources was now operating on the basis that housing would be incorporated as of July 2014. Consequently, enough capital expenditure had remained allocated for the first part of the year but afterwards, it was expected that the newly incorporated Housing Association would fund its own capital

expenditure (for which explicit States approval would not be required).⁶¹ We are uncertain whether this means that housing capital expenditure will therefore effectively fall out of the table describing capital expenditure.

- 9.6 We are also therefore uncertain what this will mean for the 2015 Capital Programme which the Minister will propose as part of the Draft 2015 Budget. In the MTFP, the Assembly agreed to a spending envelope of £77,341,000, of which £45,873,000 would be for Housing Funding. If the housing element were effectively to disappear once incorporation occurs, but the overall spending envelope for capital expenditure were to remain at approximately £77.3 million (as described in the MTFP), this would suggest that the Minister will have greater scope to bring forward further proposals for 2015 for other Departments beside Housing beyond those which were indicatively shown in the MTFP for that year. That would be dependent, however, upon the identification of further funding sources for such additional proposals as the expenditure could not be undertaken without requisite funding being available.
- 9.7 The FPP has recommended that “*further work should be undertaken on the nature of the capital programme, in particular distinguishing between spending to maintain and renew existing infrastructure and spending on new or enhanced infrastructure.*”⁶² This chimes with comments we received from the Education and Home Affairs Scrutiny Panel. The 2014 Capital Programme includes £1.55 million for Sports Strategy Infrastructure. Whilst welcoming the investment for improved sports facilities, the Panel has also advised us of its concerns that a large part of this investment merely enables the States to catch up on its relative neglect of maintenance of sports facilities in recent years.

Funding Sources

- 9.8 We noted the change in anticipated housing capital expenditure in 2014 when considering the funding sources for the Capital Programme for that year. There have been slight changes from what was shown in the MTFP. For instance, there is now funding of £3 million due to come from the Currency Fund which was not anticipated at the time of the MTFP. We were advised that the Minister is under no obligation to maintain the same funding sources for the Capital Programme as that shown in the MTFP.

⁶¹ Minister for Treasury and Resources, Transcript Page 10

⁶² Jersey's Fiscal Policy Panel Annual Report – November 2013, Page 7

Economic Impact

9.9 One question we sought to address was how much capital expenditure would in fact impact upon the economy in 2014. This is a question also relevant in the longer term to the three major capital projects of Housing, Hospital and Liquid Waste but we shall deal with the matter here. The allocation of funds is not the same as the funds actually being used. In that regard, we were advised that “*a substantial part*” of the 2014 Capital Programme would be spent and that all projects listed for 2014 would at least be started.

9.10 We were informed that, in response to FPP recommendations made in 2012, the Department of Treasury and Resources had provided the FPP with a report to show the economic impact of anticipated capital expenditure. From the FPP’s perspective, we were told, capital expenditure was taken to have an economic impact when a tender for a project was awarded. On that basis, we were advised that the economic output for 2014 (not including States Trading Operations) was expected to be £110 million, comprising £49 million on major capital projects; £23 million on the Departmental programme; and £37 million brought forward from previous years. The relevant figures for 2015 and 2016 were expected to be £138 million and £166 million respectively. We were also informed that a new reporting mechanism for the Council of Ministers on capital expenditure had been developed which would include reporting of whether local contractors had been used for existing capital projects.⁶³

9.11 The Institute of Directors highlighted the need for the construction industry to be supported, due to its role within the economy:

*“We are not seeing the projects being passed in order to generate the construction industry moving on. In relation to the unemployed, a lot of them are low skilled and the construction industry, after the fulfilment industry have gone, must be an obvious outlet for these people.”*⁶⁴

9.12 The Chamber of Commerce also emphasised the need for the economic impact to be felt within the local economy and for it not to be lost elsewhere:

*“What we would want to see is given that the budget is a considerable investment, we would want to see some parameters, some way of guaranteeing that that money does flow into the local economy and does not support, say, the U.K. (United Kingdom) economy in terms of importing labour or supplies.”*⁶⁵

The Chamber welcomed the close to £90 million of capital expenditure which would be allocated for 2014.

⁶³ Treasurer of the States, Transcript Page 3

⁶⁴ Institute of Directors, Transcript Page 4

⁶⁵ Chamber of Commerce, Transcript Page 2

- 9.13 The need for the Capital Programme to make some economic impact was highlighted by the FPP's report, in which the FPP was critical that capital expenditure in 2012 had only amounted to £36 million – only half of what had been anticipated at the time of the FPP's previous report. This consideration included an examination of £27.1 million of additional funding which the Assembly had agreed in 2012 to provide to the Department of Housing, essentially as a fiscal stimulus measure, but of which only £12 million had been spent. The FPP's statements are borne out in the Financial report and Accounts for 2012. The FPP has therefore recommended that this situation not be allowed to re-occur and has also recommended that "*any bottlenecks and barriers*" be identified and addressed.⁶⁶
- 9.14 The FPP has also recommended that the Capital Programme be examined in order to determine which elements are new and which relate to refurbishment or renewal of existing assets. The results of such an examination would help to clarify whether there is a structural deficit within the States' finances.
- 9.15 CIPFA has highlighted concerns regarding capital expenditure for 2014, given the track record for 2012 and advised that the "*impact would be predicated upon the way that such budgets are constructed and the strength of the underlying assumptions used,*" CIPFA had previously advised us in a similar vein during our review of the MTFP.

KEY FINDING

9.16 As the FPP has highlighted, and as the 2012 Accounts make clear, capital expenditure in 2012 did not reach the levels which had been promised. There was a failure to deliver the fiscal stimulus which the Executive had set out to achieve and an opportunity was therefore lost.

RECOMMENDATION

9.17 The 2014 Capital Programme should be examined to determine which elements are new and which relate to refurbishment or renewal of existing assets in order to clarify whether there is a structural deficit within the States' finances.

- 9.18 In our review of the MTFP in 2012, we recommended that the Annual Budgets for 2013, 2014 and 2015 should provide sufficient detail on individual capital projects, including the revenue consequences of those projects. This recommendation was accepted at the time by the Minister, who stated that "*the Annual Budgets for 2014 and 2015 will include details of revenue implications of capital projects.*"⁶⁷
- 9.19 Whilst the Draft Budget provides details for the individual projects listed on the 2014 Capital Programme, we have not found descriptions of the revenue implications of those projects

⁶⁶ Jersey's Fiscal Policy Panel Annual Report – November 2013, Page 32
⁶⁷ SR18Res/2012

(including any general statements of whether or not there would be any such implications) except in the case of Ash Cells and La Collette Headland (albeit no figures are attached to the revenue implications identified for that project). No revenue implications are listed amongst the Financial and Manpower Implications within the Draft Budget.

KEY FINDING

9.20 The Minister accepted a recommendation from the Scrutiny Review of the MTFP that the Draft Budget provide revenue implications for the 2014 Capital Programme. However, the Draft Budget does not indicate such implications for each of the projects on the Programme.

10. MAJOR CAPITAL PROJECTS

Introduction

- 10.1 For some time prior to the Draft Budget's publication, the Minister for Treasury and Resources made it clear that, alongside the Budget's more commonly seen proposals (such as taxation), he would bring forward proposals in respect of three major capital projects: housing, the hospital and liquid waste.
- 10.2 For the Housing Project, the Minister is proposing that up to a maximum of £250 million be borrowed externally. For the Hospital Project, he is proposing that investment returns from the Strategic Reserve be used over a ten-year period to fund a replacement hospital at a cost of £297 million. The first tranche of that (£10.2 million) is listed amongst the 2014 Capital Programme. £10.1 million is included in the 2014 Capital Programme for the Liquid Waste Project. The report accompanying the Draft Budget indicates that a spending envelope of £75 million has been identified for the construction of a new sewage treatment plant but the overall funding mechanism is not proposed as part of the Budget proposition. Nevertheless, the Draft Budget indicates what the funding mechanism for the Liquid Waste Project could entail: future Capital Programmes are proposed for use alongside some internal borrowing from the Currency Fund.
- 10.3 The Institute of Directors welcomed the medium- to long-term impact of the construction projects and expressed its pleasure that consideration had been given to major capital projects.⁶⁸ The Chamber of Commerce made similar comments.
- 10.4 Our advisor from CIPFA was complimentary of the overall work undertaken by the Minister and his Department in identifying funding options for the three projects, advising that *"in respect of all three projects we are satisfied that Treasury and Resources have properly explored all alternative funding options – indeed we would commend the work that has been undertaken in this regard."* Nevertheless, CIPFA highlighted some specific matters in relation to the projects which we shall cover below. CIPFA advised that innovative funding options had been considered and noted that one of the attributes of the Draft Budget was that the three major projects could have a significant economic impact.

KEY FINDING

10.5 Although there are some questions regarding the details of the proposals, the Draft Budget displays some welcome long-term thinking in respect of the funding of Major Capital Projects.

⁶⁸ Institute of Directors, Transcript Page 20

The Housing Project

- 10.6 Part (e) of the proposition seeks States approval for external borrowing of up to £250 million. This is in keeping with the provisions of the Public Finances Law in respect of the Budget, as Article 10(3) of the Law allows for the Minister to propose borrowing as part of the Budget. The Minister confirmed that no further decisions beyond the Draft Budget would be required of the Assembly for the Housing Project to proceed.
- 10.7 The Draft Budget makes reference to previous decisions taken by the Assembly in respect of housing and, indeed, a number of significant matters have already been settled upon. With the adoption of *The Reform of Social Housing* (P.33/2013), the Assembly agreed that States-owned housing should be incorporated. Alongside that proposition, Members had been provided with further information on the proposals in *States of Jersey Housing Transformation Programme: Full Business Case* (R.15/2013). The proposals were subjected to review by the Health, Social Security and Housing (HSSH) Scrutiny Panel (see *Housing Transformation Programme Review* (SR6/2013)).
- 10.8 The material in P.33/2013 and R.15/2013 contained references to external borrowing and, as we were advised during our public hearings, it should therefore not come as a surprise to see that the Minister has proposed such a funding mechanism for the Housing Project. Indeed, Paragraph 3.62 of *The Reform of Social Housing* (P.33/2013) stated that “*the Minister for Treasury and Resources has subsequently indicated that the States of Jersey may, for major investments such as social housing, which have long term benefits and a defined income stream, decide to borrow in order to finance the project.*”
- 10.9 Our advisor from CIPFA had the opportunity to consider the 30-year financial model developed by external advisors and used by the Department of Housing for the Housing Transformation Programme. He has stated that “*this is a well-developed Financial Model which is industry standard in construction. We would consider this model to be robust and are of the view that this model should provide a solid basis for the company moving forward.*” CIPFA therefore indicated its support for the proposal, albeit with some comments in specific areas.
- 10.10 For instance, CIPFA has indicated some concerns with the assumption “*that there is no additionality in terms of funding required by the taxpayer for this proposal*” and it does not agree with that assumption. For the assumption to work, CIPFA advised us, “*there requires to be the condition that the net migration to the additional tenancies from the Private Sector will not be replaced by fresh Private Sector tenancies and consequential Income Support Housing Component.*” CIPFA do not see this as a likely scenario and believes additional spend on the Income Support Housing Component will be required.

- 10.11 The Draft Budget explains the options available in terms of external borrowing. It is apparent that the preferred option is for the borrowing to be done through the issuing of a public rated bond. The HSSH Scrutiny Panel reported in SR6/2013 that bond lending was preferable to bank lending.
- 10.12 The President of the Chamber of Commerce advised us that he was not opposed to the idea of external borrowing to fund the Housing Project. He stated that, from his perspective, there did not appear to have been much debate around alternatives.⁶⁹
- 10.13 The Housing Project would require the States to secure a credit rating. At our public hearing with the Minister, we were informed that work was almost complete on securing a credit rating and that, once secured, it would mean Jersey was in a similar position to many other jurisdictions in having a credit rating and it would provide a statement of confidence in the Island's public finances. The Minister was confident that an AA+ rating could be secured for the Island:

“From the extensive discussions that we have had, we have got a very strong interest from lots of the world's biggest financial services companies in this bond and that came into sharp focus to me with meetings that I had with the Director of Financial Services in Washington, where all the financial services community was there.”⁷⁰

The Hospital Project

- 10.14 Similarly to housing, the Assembly has already made decisions in respect of the Hospital Project, a fact to which the Draft Budget refers.
- 10.15 In October 2012, the Assembly approved *Health and Social Services: A New Way Forward* (P.82/2012) which sought the re-design of health and social care services in Jersey. Part of the proposals was for a new hospital, further information on which was provided at the time in *Hospital Pre-Feasibility Spatial Assessment Project: Interim Report* (R.125/2012). In that report, it was stated that the potential cost of a new hospital could be between £389 million and £431 million (rising by approximately £60 million if other measures proposed in P.82/2012 were not implemented). P.82/2012 and R.125/2012 built upon the work undertaken by the Department of Health and Social Services through both a Green Paper and a White Paper. That work was reviewed by the HSSH Scrutiny Panel.
- 10.16 The vision expressed in the report accompanying P.82/2012 was for the delivery of “a new hospital, built to modern standards, within the next ten years.” A preferred solution would be identified by the end of 2013 and detailed work undertaken in 2014. A preferred solution has

⁶⁹ Chamber of Commerce, Transcript Page 13

⁷⁰ Minister for Treasury and Resources, Transcript Page 33. The AA+ rating was confirmed publicly on 22nd November 2013.

been identified and the proposal is for a split-site solution involving redevelopment of both the existing hospital site and the Overdale site.

10.17 In Part (f) of the Draft Budget proposition, the Minister is seeking States approval for the transfer of £10.2 million from the Strategic Reserve to the Consolidated Fund for the “*planning and creation of new hospital services in the Island.*” Approval is also sought for an “*exception*” to be made to the policy underlying use of the Strategic Reserve in order that it can be used for this purpose.

10.18 Work on the Hospital Project is still at a relatively early stage; we understand that it has been subjected to a ‘Pre-Feasibility Study’ and that it is now due to undergo a ‘Feasibility Study’. We anticipate that the Project will be subjected to further review in due course by the HSSH Panel. We were advised that the running revenue costs for the projects have yet to be finalised. CIPFA has therefore recommended that “*full operational costs are fully evaluated and the consequences considered against the overall MTFP financing capability in respect of the appropriate Health and Social Services Budgets.*”

10.19 Nevertheless, given the provisions of Part (f) of the Draft Budget, there were a number of issues that we considered in respect of the Project:

- a) Was the use of the Strategic Reserve for this purpose justifiable?
- b) How had the spending envelope for the Hospital Project been decided upon?
- c) What impact would there be on the Strategic Reserve?

10.20 The Minister has indicated that borrowing would not be an appropriate funding mechanism for the Hospital Project as, unlike the Housing Project, there are limited opportunities for an income stream to finance any debt incurred. The use of ‘existing resources’ has therefore been chosen as the preferred option.

10.21 The Strategic Reserve is established by Article 4 of the Public Finances Law in which it is stated that the fund is a permanent reserve and should not be used “*to defray directly expenditure of the States.*” Transfers to and from the Reserve are permissible under the Law and Part (f) of the Draft Budget is therefore proposed in accordance with Article 4(3) and 10(3)(f) of the Law.

10.22 The Draft Budget helpfully provides information on the history of the Strategic Reserve. It was created in 1986 and, over the years, has seen capital transfers to it of £177,175,224 and transfers out of £60 million. The Strategic Reserve has not been used, however, since 1999 and there has been an apparent hardening since that time of the position taken by the Assembly in respect of its use.

10.23 For the first years of its existence, there was no policy underlying the use of the Strategic Reserve beyond what was laid out in statute. Under previous public finances legislation,

however, provision was made for the Finance and Economics Committee of the time to propose uses of the Reserve and it was under that provision that transfers out of the Reserve were agreed during the 1990s. That provision was removed with the introduction of the current Public Finances Law in 2005.

10.24 With the adoption of *Economic Growth Plan* (P.38/2005), the Assembly agreed that a new framework would be developed for the Strategic Reserve in which it would be “*clearly reserved for use only if the Island faces a major shock to its economy.*”⁷¹ The report accompanying P.38/2005 acknowledged that the uses to which the Strategic Reserve had been put during the 1990s had not been in keeping with the purpose for which it had been established. The report therefore stated that the Reserve would be “*solely for the purpose of protecting the standard of living of future generations in the Island when the economy faces severe structural decline or a natural disaster. It would be off-limits for all other purposes and this could be made clear from the outset. The circumstances in which the Strategic Reserve could be accessed would be set out clearly in advance.*”

10.25 A policy was subsequently agreed for the Strategic Reserve with the adoption of *Establishment of a Stabilisation Fund and Policy for Strategic Reserve* (P.133/2006). That policy was subsequently amended with the adoption of *Strategic Reserve Fund: Use for Bank Depositors’ Compensation Scheme* (P.84/2009). The Draft Budget refers to both in asking for an “*exception*” to be made to that policy.

10.26 The Minister has previously stated that he would not favour the use of the Strategic Reserve for one-off expenditure. In answer to an oral question in March 2012, for instance, he indicated that there was no reason to amend the existing policy. When he appeared before us at a public hearing, the Minister acknowledged that he had changed his mind in that regard and that he would not have done so if the Assembly had not tackled the deficit; if there were not more confidence in the economic outlook; and if investment returns on the Strategic Reserve had not performed so well.⁷²

10.27 None of the submissions or testimony we received from other stakeholders or interested parties commented at great length on the proposed use of the Strategic Reserve. One member of the public who contacted us spoke against the proposed use, arguing that it would be better to have borrowed over the longer term (e.g. 50 years) and that the Strategic Reserve “*should be allowed to grow and to be used for the purposes it was intended.*” Another correspondent, however, agreed that use of the Strategic Reserve would be appropriate for the Hospital Project. The Chamber of Commerce stated that use of the Reserve in this way was “*an idea worth progressing*” although there were questions to be

⁷¹ The adoption of P.38/2005 would also lead to the establishment of the Stabilisation Fund.

⁷² Minister for Treasury and Resources, Transcript Page 27

addressed regarding the anticipated investment returns (see below)⁷³ whilst the Institute of Directors advised that use of the Strategic Reserve “*looks like an imaginative way of dealing with a problem and if the investment returns can be achieved then it certainly looks like a viable option.*” With “*enough checks and balances,*” the Institute considered the use of the Strategic Reserve might be a risk worth taking.⁷⁴ CIPFA has highlighted that the proposed use could be seen to challenge the legal position, as set out in the Public Finances Law. Nevertheless, CIPFA also described the proposal as “*an innovative solution*” which was relatively low risk and appropriate. CIPFA agreed with the FPP’s conclusion, however, that the proposal could not be described as ‘cost free’ from the public’s perspective, despite statements in the Draft Budget that there would be “*no new cost to the tax payer.*”

10.28 The FPP covered the proposed use of the Strategic Reserve in its report, expressing some concerns at the proposed use of the Strategic Reserve and stating that before any decision on whether to use the Reserve or not was taken, “*the States should clearly define the purpose of the Strategic Reserve and set out conditions for its use, including how borrowing from the Reserve would be dealt with.*”⁷⁵ Under the Public Finances Law, the Minister is able to propose transfers from the Strategic Reserve at any time; it does not need to be done at the time of the Draft Budget.

10.29 It is apparent that the proposal to use the Strategic Reserve is not in keeping with current policy; the Draft Budget’s request for an ‘exception’ to be made highlights that. The FPP has expressed some reservations as it could set a “*worrying precedent.*” We understand that the legal position allows the Minister to propose transfers out of the Strategic Reserve and that once transfers are made to the Consolidated Fund, the legal provision that the funds not be used ‘to defray directly expenditure of the States’ no longer applies. It is ultimately therefore a political matter, rather than a legal one; a fact which highlights both the need for clear policy about the use to which funds from the Strategic Reserve should be used and the risk that a precedent might be set. CIPFA has advised us that it has seen similar moves elsewhere where “*organisations start out to use investment performance [from reserves] to fund recurring expenditure which has, through the twin pressures of funding retrenchment and service growth expectation, led to the organisation utilising the capital component of such reserves and significantly diminishing the value of the reserve.*” In CIPFA’s words “*when it is gone – it is gone.*” Politically speaking, there is therefore a risk that the use of the Reserve in this way could set a precedent for further calls for its use. We raised this point with the Minister who advised us that he would not be in favour of other one-off uses.

⁷³ Chamber of Commerce, Transcript Page 14

⁷⁴ Institute of Directors, Transcript Page 22

⁷⁵ Jersey’s Fiscal Policy Panel Annual Report – November 2012, Page 45

KEY FINDING

10.30 The Panel supports the FPP's findings and recommendations in respect of the Strategic Reserve that matters should be resolved before any transfers from the Reserve are agreed and highlights the risk that a precedent could be set with its use for the Hospital Project.

RECOMMENDATION

10.31 The Minister for Treasury and Resources should ensure that the purpose and optimal size of the Strategic Reserve and the conditions for its use are clearly defined before seeking approval for a transfer from the Strategic Reserve for use towards the Hospital Project.

10.32 In the Draft Budget, the Minister indicates that a spending envelope of £297 million has been identified for the Hospital Project. At his public hearing with us, he emphasised that the word 'agreed' should not be used in terms of the spending envelope; rather, in determining that figure, the Minister was "*setting out what we expect to be the envelope of funding for the hospital.*" During the Pre-Feasibility Study, some numbers had developed (see Paragraph 10.15) "*which we did not think were affordable.*"⁷⁶

10.33 Nevertheless, we were advised that the figure of £297 million would cover new build, refurbishment of existing facilities, accounting cost and some short-term theatre requirements and that allowance had also been made for contingency and optimism bias. Our advisor from CIPFA has highlighted that a 5% contingency has been included, as well as a 10% optimism bias (equating to £21 million). Optimism bias involves adjustments to the estimates for a project's cost, benefits and duration to take into account an inherent tendency to be over optimistic. The Minister was confident that the Project would be delivered in the spending envelope that had been 'set out':

*"Our message to the Health Department is that is the budget and that is the budget that has got to be worked within. I was uncomfortable and not prepared to agree a budget that was £450 million."*⁷⁷

10.34 The Institute of Directors expressed some doubt as to whether the Project would be delivered within budget.⁷⁸ Our advisor from CIPFA has highlighted that the methodology used to construct the spending envelope substantially matches the HM Treasury Green Book; however, points raised in HM Treasury's Supplemental 'Green Book' Guidance did not appear to be present. Such guidance, we were told, recommends optimism bias of 51% for specialist projects such as the Hospital Project and a duration timeline excess of 39%.

⁷⁶ Minister for Treasury and Resources, Transcript Page 24

⁷⁷ Ibid., Page 25

⁷⁸ Institute of Directors, Transcript Page 22

CIPFA indicated the work undertaken by W.S. Atkins during the Pre-Feasibility Study had been industry standard and robust; however, it would be dependent upon the “*accuracy of the specification in terms of meeting the clinical resources required to deliver the appropriate health outcomes.*” A 10% optimism bias would, in CIPFA’s view, potentially prove to be inadequate.

10.35 CIPFA ultimately concluded that “*we do get the impression that overall project specification has been tailored to an acceptable cost envelope that can be financed through the Strategic Reserve.*” This raises the question of whether the costs had been established on the basis of what was affordable or on the basis of what was required from a clinical and health perspective. CIPFA had indicated that, in its view, the project currently remains “*more aspirational than fully specified and costed.*”

10.36 There does therefore appear to be at least some doubt regarding the spending envelope for the Hospital Project as although a sum has been identified (and it is a sum in which the Minister reportedly has confidence), it has not been ‘agreed’. The different scenarios presented in the Draft Budget for the Hospital Project all assume a spending envelope of £297 million.

KEY FINDING

10.37 The spending envelope of £297 million for the Hospital Project may not represent the final figure.

RECOMMENDATION

10.38 The Minister for Treasury and Resources should provide the Assembly with scenarios regarding the Hospital Project which assume a higher spending envelope than £297 million.

10.39 In monetary terms, the Draft Budget only seeks approval for the transfer of £10.2 million from the Strategic Reserve to the Consolidated Fund for subsequent use as part of the 2014 Capital Programme. It is anticipated, however, that the Minister will return in due course with proposals to transfer much larger sums in order that the remainder of the Hospital Project can be financed. The Minister advised us that he currently anticipates two further withdrawals to make up the necessary funding. The first of these would be brought as part of the Draft 2015 Budget, unless there was an opportunity to bring it forward earlier.

10.40 The Minister subsequently explained that, in theory, the Assembly could approve one transfer and not the other, however undesirable that might prove to be in practical terms.⁷⁹ It would appear advisable, however, for ‘break points’ to be built into the Hospital Project.

⁷⁹ Minister for Treasury and Resources, Transcript Page 32

KEY FINDING

10.41 The Panel welcomes the Minister's intention to provide break points during the Hospital Contract. All withdrawals from the Strategic Reserve require States approval.

10.42 It is proposed that investment returns from the Strategic Reserve be used to fund the Hospital Project over a ten-year period.

10.43 As of May 2013, the Strategic Reserve stood at £720 million, an increase of some £170 million since mid-2010 and the inception of the Common Investment Fund. The Draft Budget reports that the capital level of the Strategic Reserve therefore stands at £117,175,224, although taking real term growth into account, that level could be taken to stand at approximately £230 million. The FPP has indicated that there may be other ways of viewing and establishing the capital element of the Strategic Reserve. Given that the policy underlying use of the Strategic Reserve is for the capital to be used, there does need to be clarity about how much of the Reserve is indeed to be viewed as capital.

10.44 Both the Chamber of Commerce and the Institute of Directors questioned the anticipated investment returns on the Strategic Reserve. The Draft Budget explains that 10% returns have been achieved over the past three years and states that an average return of 5% has been assumed for the period over which the Strategic Reserve is to be used for the Hospital Project. In terms of sensitivity analyses, the Draft Budget also sets out the possible status of the Reserve were returns of 2% or 10% achieved, or if there was a desire to complete the Hospital Project within five years, rather than ten years. The analyses are all based upon the spending envelope of £297 million.

10.45 The Chamber of Commerce advised us that investment returns would not remain static each year and asked how, in a 'bad year', it would be funded. The Chamber also advised us that:

*"One of the other implications for the use of the Strategic Reserve is that my understanding is that relying on the investment return would effectively tie up the capital for that period because you need the return from the invested capital. So quite what would happen if we needed that capital for anything else, I am not so sure."*⁸⁰

10.46 The Institute of Directors, meanwhile, stated that anticipated returns looked "*on the optimistic side*" but that they appeared "*to have been modelled and thought through on some professional basis.*"⁸¹ CIPFA has highlighted that "*any potential slippage [in the Hospital Project] will appear to improve the investment performance of the Strategic Reserve.*"

⁸⁰ Chamber of Commerce, Transcript Page 14

⁸¹ Institute of Directors, Transcript Page 21

10.47 As an aside during our public hearing, the Minister indicated that he would give consideration to placing any credits accrued from the States of Jersey Development Company (SoJDC) in either the Strategic Reserve or the Stabilisation Fund.⁸² In its own report, the FPP has indicated that use of the Strategic Reserve in the manner proposed could effectively place the Strategic Reserve out of use for other purposes during the duration of the Hospital Project.

The Liquid Waste Project

10.48 The third major capital project is the Liquid Waste Project which essentially entails the construction of a new sewage treatment plant. The Draft Budget does not deal with the Liquid Waste Project in quite the same way as it does with the Housing and Hospital Projects: there are no specific provisions within the proposition itself by which the Assembly will approve the overall funding mechanism for the Project. The Minister has indicated that will effectively be a decision for another day.

10.49 Nevertheless, the report accompanying the Draft Budget identifies a spending envelope for the project of £75 million and explains the proposed funding mechanism as it currently stands. Furthermore, within the proposed 2014 Capital Programme, some funding is sought for the initial stage of the Project.

10.50 Two funding routes have been identified for the Project. First, use of the annual Capital Programme; thus, it is anticipated that future years' Capital Programmes will include some allocation for the Liquid Waste Project (2014, 2016, 2017, 2018 and 2019). Furthermore, some of the annual infrastructure capital vote for the Department of Transport and Technical Services will be used (specifically in 2014, 2016 and 2017). This route has been identified as capable of delivering £45.5 million of the identified spending envelope.

10.51 It is envisaged that £29 million of the £75 million will be delivered through internal borrowing via an investment from the Currency Fund. CIPFA has advised us that this "*is considered to be a relatively non-standard way of funding capital spend*" although this option benefits the Currency Fund (as it would require a 4% interest return from the Department of Transport and Technical Services compared to the 0.8% cash return currently achieved by the Fund). The annual repayments of this borrowing have been identified as £1.7 million. These would be repaid by the Department of Transport and Technical Services through savings, £1 million of which would be achieved through greater efficiency of the new sewage treatment plant compared to the current one; and £700,000 of which the Department would find elsewhere.

⁸² Minister for Treasury and Resources, Transcript Page 35

- 10.52 In terms of the Currency Fund, we have noted that the Minister has also recently approved an investment of £13 million from the Fund to provide the SoJDC with financing for the underground car park of the first phase of development of the Jersey International Finance Centre (JIFC). The current investment strategy for the Fund indicates that 60% of it can be invested in the Alternative Investments Class. As of 31st December 2012, the Currency Fund stood at £67 million, of which 60% is £40.2 million. The approved investments in the Liquid Waste Project and the JIFC car park will amount to £42 million.
- 10.53 The details regarding a new sewage treatment plant lie without our remit. Nevertheless, within the context of the Draft Budget we sought to understand what certainty there is regarding the Liquid Waste Project funding proposals. We also pondered how funding decisions could be taken before the Assembly has debated (and approved) a liquid waste strategy.
- 10.54 The Minister advised us that the liquid waste strategy would be brought forward during the second quarter of 2014. However, it is apparent that there are matters which need to be resolved beforehand and the Minister referred to "*a live debate between T.T.S. and Planning on the type of liquid waste strategy.*"⁸³ The nature of this debate has been made all too apparent with recent articles in the *Jersey Evening Post* reporting the views of the Minister for Planning and Environment on the matter. The Minister for Treasury and Resources indicated during our review that the funding proposals would need to be revisited if the Assembly were to approve a more expensive option.
- 10.55 In its advice to us, CIPFA has indicated that, from its perspective, "*this project has the least developed cost base information as the overall cost will not be fully known until a detailed specification and associated tender is produced and returned.*" The spending envelope may therefore be subject to change, although we understand that some contingency has already been built into the envelope of £75 million to the tune of approximately £11.5 million.
- 10.56 In terms of how the States can be asked to approve funding of £10.1 million for 2014 before a strategy is apparent, we understand that expenditure in 2014 is required in respect of clinical waste and some 'enabling works'. That work is necessary for the Liquid Waste Project (as provisionally envisaged) to be undertaken but we understand that it is essentially work which would be required in any event. The Minister stated that "*we are not pre-empting anything with what we are doing in 2014 on those three major schemes. It would not be right to do that and it would be beyond what we are able to do under the Law.*"⁸⁴
- 10.57 We questioned the Minister on the certainty that the Department of Transport and Technical Services would be able to deliver £1.7 million to repay the investment from the Currency

⁸³ Minister for Treasury and Resources, Transcript Page 17

⁸⁴ Ibid., Page 11

Fund. We were advised that the Department had itself offered to find £700,000 of savings (beyond those of £1 million emanating from efficiency savings for the new plant) and that “*if T.T.S. say they are going to do it they tend to do it.*”⁸⁵ We understand that the level of savings required of the Department could be lowered if the Project were delivered for less than £75 million and less investment were therefore required from the Currency Fund.

10.58 We also questioned whether delivery of the Project was dependent upon the introduction of a new sewerage charge. The Minister was adamant that it was not “*on the basis of the numbers that they currently put forward*” but that the States still needed to decide upon the final project.⁸⁶

10.59 There are indeed therefore decisions for another day to be taken in respect of the Liquid Waste Project. Notwithstanding that approval of £10.1 million for the Project is sought in the Draft Budget, we understand that the detailed funding mechanism for the Project cannot be agreed until the Assembly has had an opportunity to debate a liquid waste strategy. Until that strategy is in place, there must therefore be some degree of uncertainty surrounding the identified spending envelope of £75 million.

10.60 There also remains a degree of uncertainty regarding the deliverability of savings within the Department of Transport and Technical Services. CIPFA has highlighted that £2.1 million in efficiency savings were required of the Department through the Comprehensive Spending Review (CSR) and, in CIPFA’s view, a further £700,000 represents a significant challenge for the Department. CIPFA acknowledges the Department’s track record but advises that, in its view, “*without some precision on the direct management interventions that will generate such savings, [...] such a savings requirement is expectational and without an appropriate level of certainty that would allow such a Project to be properly appraised and decided upon.*”

10.61 The Minister for Treasury and Resources has confidence in the Department to deliver. We have no reason to doubt the Minister’s confidence; however, more analytical confirmation of how the savings would be delivered would be beneficial and we anticipate that the Assembly will need to see such analyses when it comes to debate the liquid waste strategy in 2014.

KEY FINDING

10.62 The current investment strategy for the Currency Fund indicates that 60% of it can be invested in the Alternative Investments Class. As of 31st December 2012, the Currency Fund stood at £67 million, of which 60% is £40.2 million. The investments in the Liquid Waste Project and the JIFC car park will amount to £42 million and the margin for error therefore appears tight.

⁸⁵ Ibid., Page 22

⁸⁶ Minister for Treasury and Resources, Transcript Page 17

10.63The detailed funding mechanism for the Liquid Waste Project cannot be agreed until the Assembly has had an opportunity to debate a liquid waste strategy, until which time the spending envelope of £75 million cannot be taken as certain.

10.64More analysis is required of how £1.7 million per annum in savings would be delivered by the Department of Transport and Technical Services.

RECOMMENDATION

10.65The Minister for Treasury and Resources should clarify for the States Assembly how £1.7 million in savings each year would be delivered by the Department of Transport and Technical Services.

Capacity

10.66 We were particularly keen to explore whether there would be sufficient capacity within the local construction sector to accommodate both short-term capital plans (in the 2014 Capital Programme) and, in the long term, the three major capital projects. The Minister advised us that discussions had been undertaken with the construction industry on this matter:

“I think the construction industry over a long period of time has said that we do not want the States basically coming in with huge projects and then it is feast or famine. It has certainly been famine in terms of private sector construction projects. The private construction project market I expect to improve in the next few years. It will take some time before we start seeing the confidence levels and obviously there is a long lead-in time between economic optimism returning and actual capital projects coming forward. I think the forward guidance, to use a concept which is being talked about in terms of interest rates’ forward guidance, that we are now giving the industry about the scale of capital projects and particularly the timings of when that money is likely to be spent is going to allow the construction industry almost to prepare for that increased capacity requirement.”⁸⁷

We were informed that the construction industry had itself made an assessment of capacity.

10.67 The Minister also stated that *“my advice to colleagues in the States is we need light touch oversight of this and an adherence to fundamental principles of allowing the construction industry, giving it guidance, not individual guidance, but also ensuring that we have a sufficiently open market in terms of construction firms.”⁸⁸*

10.68 The Chamber of Commerce accepted that some parts of the major capital projects would require expertise from outside the Island; however, Chamber was *“equally sure there is a lot*

⁸⁷ Minister for Treasury and Resources, Transcript Page 13

⁸⁸ Ibid., Page 18

of that work that could be done locally if there was a reason to do so and a focus on doing so and it was politically unacceptable not to.”

10.69 The Chamber also advised us that there were a lot of live planning applications “*that could be pursued if the funding was there to do so but because of the economic circumstances at the moment much of it is not.*”⁸⁹

10.70 We were advised that matters appeared to be improving for the construction industry:

*“But the information that we have from the construction industry, which is very interesting for us, is that our first quarter position showed an under achievement of income projected forward of around £8 million and at the time the construction industry was showing a third reduction in the level of activity that they were anticipating for the whole year. At the end of the second quarter they were expecting an 11 per cent reduction and now they tell me, because, of course, they see the current position, they are only 2 per cent below in September. So the construction industry have been monitoring flows through the Royal Court and the flows have gone from an expected minus a third down to minus 11 per cent down to only minus 2 per cent down so we are very much hoping that - needless to say our stamp duty will lag that - it will follow the same pattern and that our stamp duty position will improve by the time we get to the end of this year and certainly into next.”*⁹⁰

10.71 Measuring capacity can be challenging but without some measure, it can be difficult to assess the potential impact of plans for capital expenditure. The FPP has provided some measure of current capacity within the construction industry, stating that “*the industry reported it was operating close to capacity in 2010. Output is now 12% below the 2010 level, suggesting a significant level of spare capacity.*”⁹¹

10.72 CIPFA has advised us of its reservations, in respect of the Housing Project, “*about the likely capacity of Jersey’s construction industry to deliver the £200 million investment within a ten-year period.*”

10.73 Our predecessors on the Corporate Services Scrutiny Panel considered capacity within the construction industry when reviewing the Fiscal Stimulus Package. The Panel of the day was advised that, in 1999/2000 capacity within the construction industry had amounted to £148 million, 50% of which was absorbed by the public sector. The capacity in 2008 was estimated at £158 million.⁹² It would be beneficial if information on the capacity of the economy, and indeed the construction sector, could be improved in order to be able to assess more fully proposals such as the Minister’s for the three major capital projects.

⁸⁹ Chamber of Commerce, Transcript Page 12

⁹⁰ Treasurer of the States, 11th October 2013, Page 23

⁹¹ Jersey’s Fiscal Policy Panel Annual Report – November 2013, Page 22

⁹² Economic Stimulus Plan (P.55/2009) (SR4/2009)

10.74 The FPP included within its report the following table which shows current estimated capital expenditure by the States in the coming years (taking into account the Capital Programme and the Major Capital Projects):

	2013	2014	2015	2016	2017	2018	2019	2020
	£m							
Estimated Capital Expenditure	84	110	138	166	140	120	89	70

10.75 These figures do not include any proposed capital expenditure in these years by the private sector or States-owned companies (such as the SoJDC), all of which would also need to be factored in when considering if there were sufficient capacity within the construction industry to accommodate proposed capital expenditure. The FPP has recommended that “*the States should make contingency plans for an improvement in economic conditions and reduction in spare capacity from 2015.*”⁹³ If there were a reduction in spare capacity, there is the risk that injection of such large amounts of capital funding could overheat the economy. In such circumstances, the economic benefits of the proposed major capital projects would be mitigated. We note, however, that there are other reasons for the projects having been proposed beyond economic ones.

10.76 MJO Consulting has advised us that “*without a vibrant and growing economy producing high value jobs, public infrastructure investment on the scale planned for in the 2014 Budget is a luxury that the Island cannot afford.*”

KEY FINDING

10.77 There is a risk that the injection of large amounts of capital funding over the next ten years could overheat the local economy. It is not only the public sector which will seek to undertake capital projects in coming years. Forecasting the impact of such expenditure on the economy is difficult given the current challenges in measuring capacity within the construction industry.

RECOMMENDATION

10.78 The Minister for Treasury and Resources should seek to improve the information available on capacity within the construction industry.

⁹³ Ibid., Page 32

11. THE LONGER-TERM PICTURE

- 11.1 In undertaking our review of the Draft Budget, we wished to understand its place in the longer-term work of the Minister and his Department in addressing emerging issues and spending pressures. We believe it important not to lose sight of what else may be forthcoming in future years and we therefore highlight other matters of which the Assembly should remain aware. In that regard, we have already referred to economic forecasts and changing assumptions which might impact on overall income forecasts.
- 11.2 As we have also highlighted, some matters are not directly covered by the Draft Budget itself but are likely to impact upon the public. For instance, the Long-Term Care Charge which the States will also soon debate. Furthermore, we are aware that the Assembly will in time be asked to debate funding mechanisms for reform of health and social care services.
- 11.3 Overall, tax policy is due to be considered in due course. The Tax Policy Unit has indicated that a long-term tax programme will be published in 2014 (alongside the Draft 2015 Budget). Current long-term policy was essentially set out in an appendix to the MTFP, in which a number of principles and focuses were set out. These included continuing protection for 0/10; ensuring that legislation was applied as intended; simplifying the system; removing barriers to competitiveness; and considering widening of the tax base. At our public hearings, we were advised that guiding principles for policy were that taxation should be low, broad and simple.
- 11.4 On the subject of long-term policy, the Institute of Directors challenged the assertion that Jersey's tax system was currently simple and stated that "*it is getting more and more complicated by the day.*"⁹⁴
- 11.5 Further thought will be given to the introduction of independent taxation. We were told that its introduction would be a complicated affair, however, and it would not be a cost-neutral move (i.e. there would be a cost either to taxpayers or to the States). MJO Consulting advised us that the experience in the UK of moving to independent taxation in the early 1990s was indeed not a "*quick or totally smooth process.*"
- 11.6 Our advisor also highlighted that "*there needs to be a far more thorough analysis of which taxpayers in Jersey would be better or worse off with a move to independent taxation with the inclusion of a transferable allowance.*" He stated that there are four basic principles of taxation: that it should be equitable, simple, efficient and progressive. What has been missing, in our advisor's view, "*is the articulation of a clear vision based on the function of taxation in relation to economic development and how this will incorporate the principles of*

⁹⁴ Institute of Directors, Transcript Page 11

taxation.” He has welcomed the indication that a long-term tax programme will be published alongside the Draft 2015 Budget although, he has said, “*it is to be hoped that the long-term tax programme will also provide some political vision rather than a technical discussion.*” In that regard, he has indicated that it can be difficult to ascertain what tax policy is intended to achieve, unlike in other jurisdictions where there were more explicit discussions regarding how tax policy could be used to influence social policy (e.g. the promotion or otherwise of marriage as an institution).

- 11.7 There are also future spending pressures to be considered. For instance, it was confirmed during our review that, for future spending plans, assumptions took into account the real 2% growth which the Assembly has previously agreed should be provided to the Department of Health and Social Services, as well as growth to the same Department for the “*new configuration of services*” which had been approved by the Assembly in P.82/2012. The details for these matters would be factored into the Long-Term Revenue Plan and would form part of the next MTFP. Our advisor from CIPFA also highlighted the need to establish running revenue costs for the Hospital Project, something which has not yet occurred.
- 11.8 We were informed that if future revenues continued to be greater than expected, consideration could be given to reducing the Marginal Rate still further. We therefore questioned the Minister on whether future occurrences of greater-than-expected revenue would indeed lead to such measures, or whether other measures would be taken such as replenishing the Stabilisation Fund. The Stabilisation Fund was established to help “*make fiscal policy more countercyclical and create in the Island a more stable economic environment with low inflation.*” In the past, the FPP has recommended that surplus funds within the Consolidated Fund be transferred to the Stabilisation Fund (even if funds were shortly afterwards to be transferred out again for use). The Minister advised that credits accrued from the SoJDC were likely to be placed in either the Fund or the Strategic Reserve. CIPFA was critical about the lack of clarity “*on the arrangements for the building up of the Stabilisation Fund.*”
- 11.9 We put to the Minister whether the level of carry forwards which regularly appear to be available within Departments’ revenue expenditure suggested a lack of rigour. There were £27.6 million in Departmental Carry Forwards from 2012 to 2013 and there had been £27.8 million such Carry Forwards from 2011 to 2012. In response, the Minister advised:

“We have carry-forwards of about £20 million, £30 million, on a total spend of £650 million. Now, it is a lot of money and every penny counts, but it is still a relatively small percentage of actual approved spend, firstly. Secondly, we have repeated at the Panel many times if you do not give departments the ability to carry forward their budgets and to give them the right to use their money over a period of 3 years, which we have now given them in the Medium-Term Financial Plan, and if you simply say to

departments: “Underspend and we will take the money away” where is the incentive for them to underspend? We will go back to the bad old days of fences being erected in December, police cars being bought in November, the capital projects being spent in October with the expectation of an underspend. We wanted to move away from short-termism and a reoccurring underspend of around £20 million does not, Chairman, indicate fat in the system. It does not.”⁹⁵

It was also put to us that concerns might legitimately be expressed if the level of carry forwards was growing from one year to the next. However, that was not the case and the level of carry forwards had been consistent in recent years.

11.10 In terms of savings, we were informed that work was already underway on identifying savings for future years:

“What we are trying to do this time is to get the cart before the horse. So, we are working on making changes in our systems and procedures and service delivery now with a view to taking those savings out in the next Medium Term Financial Plan in 2016 to 2019. As you know, there were some areas where C.S.R. targets, substantial targets, were identified and then the very detailed work on exactly how they would be delivered. Some of that was left until later. What we are trying to do this time is to do it the other way around. We are doing the detailed work now. Departments are very actively working on changing their systems, procedures and service delivery methods so that they will achieve those changes in time to take the Budgets out in 2016 to 2019. So, we will have more certainty than that those savings targets will be delivered.”⁹⁶

11.11 CIPFA advised us that *“transparency on financial performance is critical and needs to be maintained.”* They also referred to the *“relative lack of precision in the Departmental Budget build-up as well as issues over the required performance management levers and motivation that will enable the delivery of budgets to outturn.”* CIPFA’s view remained that the significant level of flexibility enjoyed by Departments (which has been enhanced by recent amendments to the Public Finances Law) *“can impair transparency and ultimately Financial Management performance.”*

KEY FINDING

11.12 There are other spending pressures that are still to be addressed and which sit outside the Draft Budget.

⁹⁵ Minister for Treasury and Resources, Transcript Page 49

⁹⁶ Treasurer of the States, 11th October 2013, Transcript Page 42

12. CONCLUSION

- 12.1 The Draft Budget is just one part of the overall picture of States financial management. As we have indicated, there are other matters (such as the Long-Term Care Charge and the funding mechanism for health and social care) which we must not lose sight of when considering the impact that the Minister's proposals may have, both on government finances and on taxpayers' pockets.
- 12.2 In itself, the Draft Budget on some levels represents an improvement on previous years and our advisors have indicated that, in comparison with other jurisdictions, several aspects of the Draft Budget would score highly. It also represents some welcome longer-term thinking in respect of the funding of Major Capital Projects.
- 12.3 Nevertheless, at a high level, we have found that some information is lacking. We have made recommendations in respect of the collection and presentation of economic information which may help, in future, to develop an understanding of the economic context and thereby to inform decisions about the measures that need to be taken.
- 12.4 There are also questions to be addressed in respect of some of the Draft Budget's individual proposals, such as the funding of Major Capital Projects, proposed increases in Impôts or the proposed reduction in the Marginal Rate. Our key findings and recommendations in these areas are intended to ensure that both the Assembly and the public are provided with sufficient information for a full understanding to be achieved of what is being proposed, how much confidence there is currently with those proposals and what impact they may have.

13. APPENDIX 1: PANEL MEMBERSHIP, TERMS OF REFERENCE AND EVIDENCE CONSIDERED

Panel Membership and Terms of Reference

13.1 The Corporate Services Scrutiny Panel comprises the following Members:

Senator S.C. Ferguson, Chairman

Deputy J.G. Reed, Vice-Chairman

Connétable D.W. Mezbourian

Deputy R.J. Rondel

The Panel appointed MJO Consulting, represented by Professor M. Oliver, and the Chartered Institute of Public Finance and Accountancy (CIPFA), represented by Mr. S. Fair, to act as expert advisors during the review.

13.2 The following Terms of Reference were agreed for the review:

1. To consider the proposals of the Minister for Treasury and Resources in the Draft 2014 Budget Statement in respect of:
 - a) Income Tax;
 - b) Goods and Services Tax (GST);
 - c) Impôts; and
 - d) Stamp Duty;
2. To consider the proposed allocation of growth money within the Draft 2014 Budget Statement;
3. To consider the Capital Programme for 2014 as presented in the Draft 2014 Budget Statement;
4. To consider the proposals of the Minister for Treasury and Resources in respect of the financing of major capital projects;
5. To consider the economic implications of the Minister's proposals in the Draft 2014 Budget Statement; and
6. To consider whether the Minister's proposals within the Draft 2014 Budget Statement provide adequate provision in respect of emerging issues and spending pressures.

Evidence Gathered

13.3 The following documents were considered by the Panel and its expert advisors during the review:

1. 2014 Budget Presentation – 15th July 2013
2. Major Capital Funding Presentation – 15th July 2013
3. Briefing Paper on Involvement of Treasury and Resources in respect of the New Hospital
4. *Establishment of a Stabilisation Fund and Policy for Strategic Reserve* (P.133/2006)
5. *Strategic Reserve Fund: Use for Bank Depositors' Compensation Scheme* (P.84/2009)
6. *States Investment Strategies* (R.117/2012)
7. Quarterly Revenue Report – June 2013
8. Quarterly Capital Report – June 2013
9. Major Capital Funding Presentation – 17th September 2013
10. *Medium Term Financial Plan Compromises and Central Growth Allocation* (R.114/2013)
11. *Hospitality Pre-Feasibility Spatial Assessment Project: Interim Report* (R.125/2012)
12. *Health and Social Services: A New Way Forward* (P.82/2012)
13. *Health and Social Services: A New Way Forward (P.82/2012) – Amendment* (P.82/2012(Amd))
14. *The Reform of Social Housing* (P.33/2013)
15. *States of Jersey Housing Transformation Programme: Full Business Case* (R.15/2013)
16. *Housing Transformation Programme Review* (SR6/2013)
17. Information provided by Minister for Treasury and Resources on progressive nature of Income Tax system in response to written question – 1st May 2012
18. *Hospital Pre-Feasibility Spatial Assessment Project Outcome* (Council of Ministers Report) – 2nd October 2013
19. Impôts statistics 1996 to 2013
20. Social Security Contributions 2007 to Q1 2013
21. *Draft Budget Statement 2014* (P.122/2013)
22. *Draft Finance (2014 Budget) (Jersey) Law 201-* (P.123/2013)

-
23. *Draft Income Tax (Amendment No.43) (Jersey) Law 201-* (P.124/2013)
 24. *Draft Income Tax (Prescribed Limit and Rate) (Jersey) Regulations 201-* (P.125/2013)
 25. *Tax Regime for High Net Worth Individuals Review 2013* (R.126/2013)
 26. *A Feasibility Report into the Introduction of Independent Taxation in Jersey* (R.127/2013)
 27. *Tax Rules Applying to Pensions and Pension Schemes: White Paper – October 2013* (R.128/2013)
 28. Analysis of Duty and GST as Proportion of Price
 29. Rent Model and Financial Model (Housing Transformation)
 30. Information on Personal Tax Base for Year of Assessment 2011
 31. Council of Ministers Part B Minutes relating to the Budget
 32. *Draft Public Finances (Amendment of Law No.1) (Jersey) Regulations 201-* (P.133/2013)
 33. *Income Tax Forecast Note for Income Tax Forecasting Group*
 34. *Financial Forecasts – Additional Information for the Fiscal Policy Panel*
 35. Advice on the involvement of the Tax Policy Unit in development of the Draft Budget
 36. *Jersey General Hospital: Refined Concept – Addendum to the Strategic Outline Case*
 37. *Jersey General Hospital: Refined Concept – Addendum to the Strategic Outline Case – Appendices*
 38. Report on Venture Investment Programme
 39. *Jersey's Fiscal Policy Panel Annual Report – November 2013*
 40. Historical Developments in the Marginal Rate
 41. Statistics in respect of proposals to increase child allowance for taxpayers with children in higher education
 42. Information regarding Beer Prices in the UK
- 13.4 The Panel put out a call for evidence on 15th and 22nd October 2013, to which a total of 3 written submissions were received from members of the public. The Panel also wrote directly to a number of key stakeholders, from which the following written submissions were received:
1. Randalls Limited
 2. Liberation Group

3. Jersey Hospitality Association
4. Channel Island Tobacco Importers and Manufacturers' Association (CITIMA)
5. Chartered Institute of Taxation
6. Huggler Group
7. Jersey Finance Limited

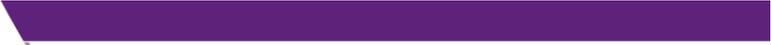
The Jersey Motor Trades Federation, the Jersey Construction Council and Unite were all approached directly but chose not to make a written submission.

13.5 The Panel received three briefings from the Minister for Treasury and Resources and his Department during the development of the Draft Budget: on 15th July, 9th September and 23rd September 2013. In addition, the following Public Hearings were held:

- | | |
|-------------------|--|
| 11th October 2013 | Assistant Minister for Treasury and Resources, accompanied by the Treasurer of the States, the Economic Advisor, the Director of Tax Policy, the Comptroller of Taxes and the Director of Legal Status and Revenue – Customs and Immigration |
| 21st October 2013 | President and Chief Executive, Chamber of Commerce
Chairman and Members, Institute of Directors – Jersey Branch |
| 24th October 2013 | Minister for Treasury and Resources, accompanied by the Assistant Minister for Treasury and Resources, the Treasurer of the States and the Director of Tax Policy |

13.6 The transcripts of the Public Hearings, as well as those written submissions not received in confidence, are available to read on the Scrutiny website: www.scrutiny.gov.je

14. APPENDIX 2: REPORT FROM CIPFA



CIPFA

The Chartered Institute of
Public Finance & Accountancy

States of Jersey
States Assembly



États de Jersey
Assemblée des États

CORPORATE SERVICES SCRUTINY PANEL

BUDGET 2014 PROPOSALS

REPORT

OCTOBER 2014

CIPFA
3 Robert Street
London WC 2N 6RL
Phone: 0207 543 5600
Email: stuart.fair@cipfa.org.uk

CIPFA FINANCE ADVISORY



Certificate No. 5631/06

1. Commentary

1.1 In September 2013, the States of Jersey commissioned CIPFA Business - Finance Advisory (the commercial arm of the Chartered Institute of Public Finance and Accountancy) to support the work of the Corporate Services Scrutiny Panel in an assessment of the States of Jersey Budget Proposals 2014. This draft report outlines CIPFA's preliminary position on this work to November 8 2013.

Our Approach

1.2 Our approach to this independent review has sought to draw together a wide range of evidence together as a foundation for our analysis and assessment of the Budget Proposals 2014.

Scope

1.3 Our scope of work included for the assessment of the Financial Management attributes of good practice in respect of the main components of the Budget Proposals covering the following:-

- Income Tax Yield Implications
- Central Growth Allocations and Capital Programme
- Major Programme Investment – Housing
- Major Programme Investment – Hospital
- Major Programme Investment – Liquid Waste Facility
- Other Budget Proposal Implications

1.4 Our comments on these components of the Budget Proposals 2014 are outlined below.

Income Tax Yield Implications

1.5 It is understood that proposals covering Income Tax include the following:-

- Increasing thresholds for marginal relief by 1.5% in line with inflation – total full year cost - £2.5m;
- Cutting the marginal rate of tax from 27% to 26% - total full year cost £7.8 m;
- Increasing in the tax relief allowance on the marginal band with children and higher education from £6000 a year to £9000 a year – total full year cost £900,000.
- Removing the restriction to child allowance by reference to the Child's Earned income -total full year cost £420,000;
- Increasing the age of entitlement to a single, married persons and civil partners to the higher income tax exemption threshold space-space yielding £750,000 in additional revenue.

- 1.6 There is a range of other additional Income Tax proposals which largely deal with assessment and other minor modifications. In terms of significance we have not incorporated them into the analysis.
- 1.7 The total impact of these Income Tax proposals are an approximately £10.9 million reduction to potential tax yields on a full year basis or a £5.5m movement from the MTFP baseline position. However it is it is worth noting that the majority of the total impacts of these Income Tax proposals have a recurring structural change in the base line position for the Income Tax component of the States Income model.
- 1.8 Whilst we note the annual impact of these proposals, what is less clear is how this reduction in the baseline Income Tax yield position is tracked to the latest MTFP position, Budget 2013 position and latest In-Year Forecasts. For example, the projected Tax Yield incorporated within the Budget 2014 modelling for Income Tax is £474.965m – the same figure as embedded within the adjusted MTFP position for 2014. The following is an extract from Summary Table A of the Draft Budget Statement highlights overall Taxation Revenue with a detailed breakdown for each component including Income Tax:-

Summary Table A – States Income 2014

	Outturn		MTFP (July 2012)		Budget 2013 (Dec 2012)		Budget 2014 (Oct 2013)
	2012	2013	2014	2013	2014	2014	
	£'000	£'000	£'000	£'000	£'000	£'000	
Income Tax							
Personal Income Tax	351,121	377,000	394,000	377,000	394,000	394,000	394,000
Companies	79,339	77,000	80,000	79,965	82,965	82,965	82,965
Provision for Bad Debt		(4,000)	(4,000)	(2,000)	(2,000)	(2,000)	(2,000)
	430,460	450,000	470,000	454,965	474,965	474,965	474,965

- 1.9 We also note the note the projected Tax Yield incorporated within the Income Tax Forecast Note dated September 2013 for the Income Tax Forecasting Group produced by the State's own Economics Unit highlights that "overall revenues are expected to be lower than previously forecast by around £9m in 2013, £13m in 2014 and £26m in 2015."⁹⁷ This projection incorporates a number of factors including lower growth expectations from personal tax. Indeed the states or in economics unit project and mid-range position of approximately £460 million. A matter of further concern is the fact that this forecast calculated by the Economics Unit does not appear to include the Budget 2014 Income Tax.
- 1.10 The actual economics unit forecast of £462m in respect of the Income Tax forecast for 2014 (down by £13 on the 2012 MTFP component) is outlined below:-

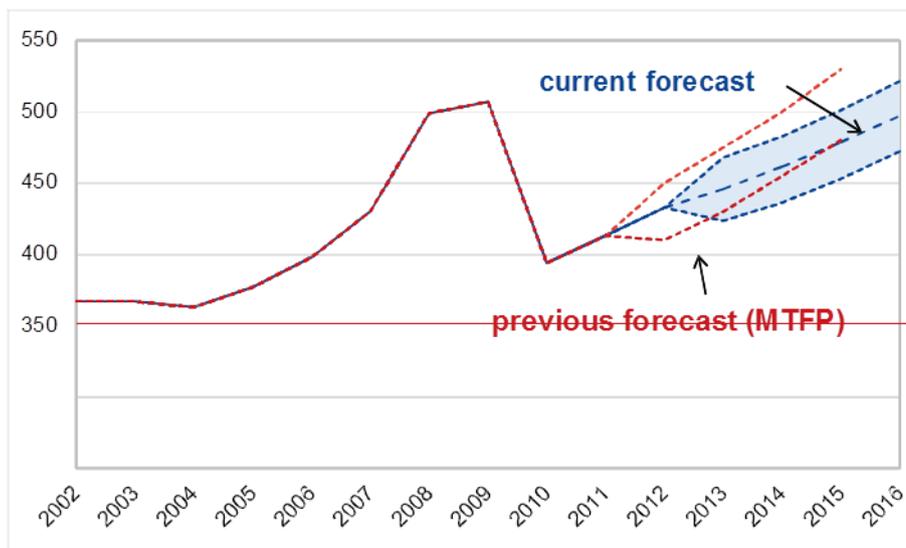
⁹⁷ Income tax Forecast Note for ITFG – September 2013 – Page 13

YOA	2011	2012	2013	2014	2015
Budget Year	2012	2013	2014	2015	2016
	£m	£m	£m	£m	£m
Personal	356	362	371	386	401
Companies	79	86	93	96	99
Bad debts	-3	-2	-3	-3	-3
March 2013 income tax forecast	433	446	462	479	497
March 2012 income tax forecast (used in MTFP)		455	475	505	
Total change		-9	-13	-26	

1.11 It is clear that the Economics Unit have incorporated a wide range of factors within their assessment. Indeed it is understood that their optimistic and pessimistic scenarios with Upper and Lower range predictions. For Income Tax this has been translated into the following Upper, Central and Lower Forecasts:-

Budget year	2013	2014	2015	2016
	£m	£m	£m	£m
Upper	460	480	500	525
Central	445	460	480	495
Lower	435	440	455	465
Total range as % of central	6%	8%	10%	12%

1.12 The revised forecasts compared to the previous modelling used within the MTFP are well illustrated within Table 12 of the Economics Unit Forecast Note as follows where the Blue line within the following table extract represents outturns and current forecasts and the Red lines illustrate the range of the forecast which were used within the MTFP in 2012:-



1.13 When we carried out previous work on the Medium Term Financial Plan (MTFP) in September 2012 for the Corporate Services Scrutiny Panel the relevant comparable information provided by Treasury and Resources was as follows:-

Tax	Budget 2012 £000	Forecast 2012 £000	MTFP 2013 £000	MTFP 2014 £000	MTFP 2015 £000
Personal Income Tax	344,000	360,000	377,000	394,000	420,000
Companies	76,000	74,000	77,000	80,000	84,000
Provision for Bad Debt	(4,000)	(4,000)	(4,000)	(4,000)	(4,000)
Totals	416,000	430,000	450,000	470,000	500,000

1.14 Given the relative similarity of the 2014 figures, yet acknowledged changes to the income base, it is difficult to assess the net impact of the overall Income Tax proposals totalling £10.9m and the baseline figure.

1.15 It is also interesting to note that the In-Year Quarterly Report – June 2013 forecast Income Tax yield as £460.965m for 2013. Whilst accepting there are a number of variables including latest data that show a more accurate baseline position and expectations of stronger company growth, it is difficult to accurately track and test 2014 budget income tax position of approximately £475m based on this Budget Presentation particularly in the context of the Economics Unit mid-range forecast of £460m (actually £462m based on the 2013 YOA – year of assessment) for 2014 which itself excludes the relevant Budget 2014 proposals requiring a net reduction of some £10.9m on potential tax yields or £5.5m from the MTFP baseline position. The lack of transparency on tracking baseline figures does not provide the level of confidence which we would expect in the overall financial modelling surrounding the £474.965m used for the 2014 budget at this stage of the process. In terms of affordability – given the lack of clarity on the baseline position we would agree with the comments made by the Fiscal Policy Panel in its November 2013 Report in respect of the marginal rate reduction component:-

“As a fiscal stimulus measure it does not score well as it is neither timely (it will impact largely in 2015) nor temporary. To ensure such a decision can be afforded, careful consideration of the structural position of States finances is required although it is not clear from the Budget 2014 report that this has been undertaken.”⁹⁸

Central Growth Allocations and Capital Programme

1.16 Following previous advice from the Scrutiny Panel in respect of the MTFP that growth and capital allocation should be decided by the States each year at budget time, the Budget 2014 has included for the bringing forward of Central Growth Allocations of £2.2m for 2014 and 1.5 million 2015.

1.17 Given the :-

⁹⁸ Jersey’s Fiscal Policy Panel Annual Report – November 2013 – Page 42

1. Extent of departmental carry forwards for 2012 to 2013 of £27.6m;
2. The latest projected Net Revenue underspending position of Departments – down £19m;
3. Extent of the Remaining balances relating to 2012 to 2013 Carry Forwards and
4. A total Capital first half year spend position where only £16m from a total Programme spend for 2013 of £84m has been achieved;

it is difficult to foresee how Budgets are fully founded on accurate levels of activity and also difficult not to conclude that some Budgets are more aspirationally or expectationally based.

- 1.18 We understand that Departments are being held to account for the delivery of agreed efficiency savings however on the basis of track record in delivering spend to budget it would be our considered view that transparency on financial performance is critical and needs to be maintained – especially in the delivery of the agreed Central Growth Allocations, any In Year/End of Year movements between Contingency and other Funds and performance in delivering Carry Forwards – Quarter 2 Report highlights a remaining Revenue Carry Forward Balance of £12.1m.
- 1.19 In terms of the Capital Programme Proposals as contained within the Draft Budget Statements (excluding the three major projects outlined below), we would have significant concerns, based on recent track record of spending on the prospectivity for Departments to deliver the approved total allocation of £88.892m in 2014. We understand that the Fiscal Policy Panel has highlighted concerns in this area-particularly in how this impacts upon economic activity. Impact would be predicated upon the way that such budgets are constructed and the strength of underlying assumptions used. This concern was previously highlighted in our previous work with the Medium-Term Financial Plan in respect of the general methodology used to construct budgets.
- 1.20 A recurring theme within our work has been the relative lack of precision in the Departmental Budget build-up as well as issues over the required performance management levers and motivation that will enable the delivery of budgets to outturn. It would be our continuing view that the significant level of flexibility within which Departments can transfer resources between Budget Headings can impair transparency and ultimately Financial Management performance. Indeed, it would be our position that it is this level of flexibility that can negatively impact the degree of motivation required to deliver optimal efficiency savings and utilisation of resources. At worst, such lack of potential accountability can lead to ‘bad’ budget management behaviours and can contribute towards the delivery of sub optimal decisions. In our experience this behaviour set usually manifests itself in a significant imbalance of final quarter expenditure indicating a “trolley-dash” approach towards utilising resources.

Major Programme Investments

- 1.21 A significant feature of Budget 2014 is the proposals to deliver three significant Capital Projects over a 10 year period:-
- Twin site Hospital Development - estimated total capital costs of £297m;

- Setting up of new Social Housing delivery vehicle with substantial investment programme of New Build and bringing existing stock to a “Decent Homes Standard” – estimated total Capital costs of £250m; and
- A new Liquid Waste Sewerage Treatment Works system – estimated total capital costs of £75m.

1.22 Funding for these significant Capital Projects have been chosen to minimise the effect on Departmental Revenue and are exclusive to each project:-

- Hospital Development - capital costs of £297m being met by using “excess” within Strategic Fund assuming a 5% investment performance being achieved - the Strategic Fund stood at approximately £720m as at July 2013:
- Housing Investment Project - funding total Capital costs of £250m through a mix of external borrowing guaranteed by the States of up to £200m at an average rate of 5% and “internal States borrowing” of £40m at 4%: and
- A new Liquid Waste Sewerage Treatment Works system – estimated total capital costs of £75m – funded from £12m of existing TTS Infrastructure Budget with the balance of funding met from £30.5m main Capital Programme funding over the duration and an investment of the Currency Fund - £29m, Consolidated Fund - £3m, Existing resources - £0.5m.

1.23 In respect of all three projects we are satisfied that Treasury and Resources have properly explored all alternative funding options – indeed we would commend the work that has been undertaken in this regard.

Major Programme Investment - Hospital

1.24 The development of a new and substantially redeveloped General Hospital for Jersey is one of three major capital programme projects which are a feature of Budget 2014. After a significant feasibility exercise indicative project costs of £297m were established. Using this Pre-Feasibility study by WS Atkins we were able to analyse the costing data underpinning the two site scheme which effectively grows the existing operational capacity of 39,000m² to some 64,000m² with the capacity to provide 296 beds within a single room environment – up from 245 beds - most currently in open Wards.

1.25 We understand that original studies by Atkins produced initial Construction Costs within a range of £389m to £431m and this was not deemed to be an acceptable cost envelope which Jersey could bear. The subsequent reduction to just under £300m is indicative of what is deemed to have been more acceptable.

1.26 Overall construction costs equate to a quantum of some £210m including a 5% contingency. A provision for Optimism Bias of 10% or £21m is provided and inflation factor of some £43.9m makes up a total of £274.9m. Whilst the HM Treasury Green Book methodology has been substantially followed the HMT Supplemental “Green Book” Guidance points to high level Optimism Bias factors for Non-Standard Construction Projects such as Specialised Hospitals of 51% and a duration timeline excess of 39% on original forecasts for completion.

- 1.27 It would be our view that the WS Atkins work associated with the costings appears to be industry standard and will be robust relative to the specification provided. A significant amount of work between officers of Health and Social Services together with WS Atkins appears to have taken place and the underlying concept appears to be robust. However, this is very much dependent upon the accuracy of the specification in terms of meeting the clinical resources required to deliver the appropriate health outcomes as originally outlined in the Health and Social Services White Paper Caring for Each Other, Caring for ourselves. Assuming that the specification delivers an optimal set of outcomes comes consistent with the clinical objectives required; it would be our considered view that the 10% provision may be inadequate for such a specialist project which incorporates a complex transitional business as usual requirement within the existing main site.

Hospital Project Recurring Revenue Costs

- 1.28 We understand that significant work has been carried out in determining transitional revenue costs and on-going recurring revenue costs which are tied in the overall running of the new facilities. However, we have been unable to satisfy ourselves that these are sufficiently mature and that the full additional cost exposure for the delivery of projected health outcomes over the lifetime of the Project (say 30 years) has been fully estimated. Whilst the financing of the project's capital costs is a major factor in the promotion of this project we would recommend that full operational costs are fully evaluated and the consequences considered against the overall MTFP financing capability in respect of the appropriate Health and Social Services Budgets.

Financing of Capital Costs – Use of the Strategic Reserve

- 1.29 We understand that there is a potential legal restriction placed around the utilisation of the Strategic Reserve following the States agreement on the establishment of a Stabilisation Fund and Policy for Strategic Reserve (P.133/2006). In the context of P.133/2006 it is understood that the Strategic Reserve would be "a permanent reserve, where the capital value is only to be used in exceptional circumstances to insulate the Island's economy from severe structural decline such as the sudden collapse of a major Island industry or from major natural disaster." If this represents the subsisting legal position, to use the Strategic Reserve to fund Capital Expenditure would appear to challenge this legal position. We would recommend that the legal position is clarified accordingly.
- 1.30 Integral to this proposal is the assumption that a 5% rate of return on the Investment of the Strategic Fund will be achieved. Indeed, in recent years performance on the Fund has been exceptional with a compound average annual growth rate of 9.4% per annum being achieved growing the strategic reserve fund balance from £550 million in July 2010 and £720 million as at July 2013. Treasury and Resources have applied a range of sensitivity analysis to expected growth and they have recommended that an average of 5% return is a prudent assumption. It is also highlighted within the proposal that a more modest 2% return on the strategic reserve fund would enable the £297 million to be drawn down "without too much damage" and by 2024 the balance of the Strategic Reserve Fund would still be close to £600 million. The profile for drawdown on this fund will obviously be tied to actual spend and it will be the case that any potential slippage will appear to improve the investment performance of the Strategic Reserve.

- 1.31 Through our experience of supporting public bodies we have noted that some organisations have struggled to effectively utilise significant reserves and incorporate a strategy for using reserves within a Medium and Longer term approach. Indeed, we have seen organisations start out to use investment performance to fund recurring expenditure which has, through the twin pressures of funding retrenchment and service growth expectation, led to the organisation utilising the capital component of such reserves and significantly diminishing the value of the reserve. As such reserves were ostensibly created with the intention of preserving funds for the use by future Tax payers or as a contingency against unforeseen disaster the loss of such a resource has been especially difficult for decision makers as within the current climate the capability of building such funds back up to previous levels is considered to be almost an impossibility as “when it is gone – it is gone”.
- 1.32 Despite reservations expressed by the Fiscal Policy Panel within their November 2013 Report on the lack of consistency or clarity in the utilisation of the Strategic Fund – “*It sets a worrying precedent for the States to make an exception to the Fiscal Framework in order to spend money from the Strategic Reserve.*”⁹⁹, it would be our considered view that the financing of this project from the Strategic Reserve Fund is indeed an innovative solution – particularly in the context of the alternatives to external borrowing and existing arrangements in which the States finance major projects. However we would have to agree with the Fiscal Policy Panel (FPP) that there is a cost relating to the opportunity foregone-the opportunity cost relative to alternative options for the utilisation of the Strategic reserve Fund – should Jersey law allow for it utilisation on alternatives.
- 1.33 The Fiscal Policy Panel also highlighted a previous aspiration to grow the Strategic Reserve to 20% of the economy in terms of Gross value Added (GVA) and that using existing assumptions the value of the strategic reserve would be £820 million (by 2012 prices) in 2024 and that would be equivalent to 20% of GVA in that year. The determination of the actual capital value and performance on investments relating to the fund has been appropriately outlined by Treasury and Resources. Notwithstanding any reservations which the FPP may have and the potential conflict with the existing Fiscal Framework, we would regard this source of financing to be innovative, relatively low risk and appropriate – all dependent upon the relative acceptability of the opportunity cost of using the Strategic Fund in relation to the Budget proposal.
- 1.34 In summary whilst we would be of the considered view that the use of the Strategic Reserve to finance a project of this type is innovative, we do get the impression that overall project specification has been tailored to an acceptable cost envelope that can be financed through the Strategic Reserve. Indeed the concept of providing a new “state of the art” set of facilities without markedly reducing the Strategic Reserve over a period of 10 years is an attractive one. However, as the costs have been produced in an artificial non-tendering environment, we would conclude that whilst this is a very desirable project, it is still at a proof of concept stage and is more aspirational than fully specified and costed.

Major Programme Investment - Housing

⁹⁹ Jersey’s Fiscal Policy Panel Annual report – November 2013 – Page4

- 1.35 We understand that through the creation of a Special Purpose Vehicle (SPV) that a wholly-owned States Company will be engaged in managing what is currently the State's Social Housing Stock with direct responsibility for driving a programme of investment to ensure that all of this related housing stock meets the 'Decent Homes Standard' within 10 years. Additionally, the proposal includes for a programme of new build works which will establish a net gain of some 434 housing units. Subject to movements in housing stock this will take the current housing stock of 4,539 units to 4,623 units including for the aforementioned 434 new build units and sales/disposals. In making the transition to the company structure we understand that significant additional transitional/set up and Company formation and continuing governance costs will be required and provision for the continuation of some £1m of Central Support Costs and £120,000 for the establishment of a Regulator for Social Housing. The company will be required to deliver a continuing return to the States of Jersey and will include for the recovery of transitional costs – the agreed return is £28.154m in 2014 and £29.521m in 2015 and it is anticipated that this trajectory will be maintained. Other implications include the establishment of an independent Social Housing Regulator (as highlighted above) and arrangements for the licensing of all social housing providers in Jersey, of which, the proposed new wholly States owned Housing Company will be one. In terms of structure it is anticipated that approximately 50.2 full-time equivalent existing housing department staff will transfer to the new company upon formation and that Employee related Pension arrangements for these employees transferring will be unaffected.
- 1.36 As part of our work in this area a 30 Year Financial Model developed by external advisers was evaluated and the main parameters and assumptions analysed. Investment costs associated with refurbishing existing properties (bringing them up to the 'Decent Homes Standard' were founded upon standard cloning methodology for stock condition surveys (applied by Ridge and Partners) and the unit costs for new build properties appear to relate to appropriate local values. This is a well-developed Financial Model which is industry standard in construction. We would consider this model to be robust and are of the view that this model should provide a solid basis for the company moving forward. The Financial Model is supplemented by a comprehensive full Business Case narrative which includes a detailed assessment of risk.
- 1.37 A critical assumption integral to the financing of such levels of investment is that borrowing costs (Principal and Interest) associated with overall investment quantum of some £200 million, which is spread over a 20 year period is fully met by on-going rental income. Aside from the net gain of 434 tenancies and the sale of some 300 properties over a 20 year period, external borrowing financing costs have been assumed by Treasury and Resources to be set at a fixed interest rate of 5% per annum. The overall rental income model assumes that the existing rental income base increases in a progressive way over time with phased increases to existing tenancies up to a baseline Market Rent position of some 90% with new tenancies immediately meeting the 90% market rent condition. It is estimated that by the year 2043 the 95% of all units will have a rental charge equivalent to the revised benchmark position of 90% of market rent. Additionally rents will increase by RPI plus an average earnings inflation mark up of 0.75% up to that overall ceiling of 90% of Market Rents. Compounding Rental Income by RPI 0.75 per annum should provide a sufficiency of rental income providing that the base rent position, in actuality is equivalent to the model position.

- 1.38 Implicit within this Budget proposal is the assumption that there is no additionality in terms of funding required by the taxpayer for this proposal. However, we do not fully agree with this assumption that there is no additional cost to the public purse as a result of this proposal¹⁰⁰. As 67% of existing tenants are currently entitled to an element of the housing component of income support, then the required revised rental income base for existing as well the 434 net additional tenancies will generate a commensurate increase in housing component income support. For the assumption to work that there will be no additionality there requires to be the condition that the net migration to the additional tenancies from the Private Sector will not be replaced by fresh Private Sector tenancies and consequential Income Support Housing Component. In reality, we do not foresee this to be a likely scenario. Additionally, the Business Case acknowledges that the additional rental income will require additional Income Support Housing Benefit component – this could exceed £69m over a 30 year period in scope¹⁰¹.
- 1.39 It would be our considered position that these Budget proposals will deliver a sustainable Social Housing Business Model that will allow the overall objectives set by the States to be achieved. Whilst we would fully support this proposal we do have some reservations about the likely capacity of Jersey’s construction industry to meet deliver the £200m investment within a 10 year period and the fact that the income model will require additional States spend in the form of Income Support Housing component.

Major Programme Investment – Liquid Waste

- 1.40 This proposal includes for the complex Sewerage treatment replacement programme which will be phased including remediation of the Sewerage outfall. Of the three major programme proposals this project has the least developed cost base information as the overall cost will not be fully known until a detailed specification and associated tender is produced and returned. The indicative casts are highlighted within the following table:-

Cost Estimate Summary	Direct Cost	Contingency		Total
	Estimate	%	£	
Feasibility, EIA, Tender Documents & Design	£1,700,000	15%	£255,000	£1,955,000
Site Remediation	£1,000,000	25%	£250,000	£1,250,000
Initial Service Diversions and Temporary Works	£3,000,000	25%	£750,000	£3,750,000
Accommodation Works	£9,800,000	25%	£2,450,000	£12,250,000
STW Phase 1 Construction	£18,450,000	20%	£3,690,000	£22,140,000
STW Phase 1 Commissioning	£200,000	20%	£40,000	£240,000
STW Phase 2 Construction	£12,500,000	20%	£2,500,000	£15,000,000
STW Phase 2 Commissioning	£300,000	20%	£60,000	£360,000
Effluent Outfall	£2,750,000	30%	£825,000	£3,575,000
CWI Replacement	£7,000,000	0%	£0	£7,000,000
TTS Costs	£2,055,000	0%	£25,000	£2,080,000
Professional Fees	£4,800,000	13%	£600,000	£5,400,000
	£63,555,000		£11,445,000	£75,000,000

¹⁰⁰ States of Jersey Housing Transformation Programme: Full Business case – Section 3.4.1.3 – Page 26

¹⁰¹ States of Jersey Housing Transformation Programme: Full Business case – Section 3.4.1.3 – Page 26 table refers

- 1.41 Whilst there appears to be an appreciation of contingency the lack of real depth on the detailed costing information is not a reflection on the States officers or the Department involved but merely reflects the sheer complexity of the project itself which requires a largely bespoke solution. We understand that the application of the proposed arrangements and technology used was based on a working plant in Ireland with a similar configuration of locational constraints. Significant work has been undertaken to determine an optimal design for the Bellozanne complex which requires incorporating transitional arrangements to deliver a critical on-going service within the same site area. We understand that specialist contractors and engineers are required for this work and that preliminary site investigation and resultant options considered were significantly restricted as a result of prevailing geographical limitations and existing infrastructure issues.
- 1.42 In terms of indicative costs we understand that a provision of some £63.55m has been calculated in respect of substantive infrastructure investment and use of existing resources whilst a contingency of some £11.45m has been provided. In relation to funding the overall £75m of indicative costs we understand that this is to be phased over seven years ending in 2019. For this proposal there is a mix of funding sources including TTS rolling vote of £12m, mainstream Capital Programme of some £30.5m, Consolidated Fund - £3m, Infrastructure Investment from the States Currency Fund - £29m and is additional utilisation of existing resources - £0.5m.
- 1.43 The investment from the Currency Fund of some £29m is considered to be a relatively non-standard way of funding capital spend. We understand that this internal borrowing actually benefits the currency fund as the agreement would require a 4% return from the Department as a borrower and this is better than a cash return of only 0.8% currently achieved. Whilst we would agree that the borrowing cost and risk to TTS is indeed minimised in this configuration of funding, the real challenge will be to find the estimated £1.7 million per annum for principal and interest payments to finance such a level of borrowing.
- 1.44 It has been proposed that the £75m investment will generate immediate savings of £1m which will be used to fund part of the annual financing costs in respect of the following:-
- Energy Savings on £1m annual exposure - £0.5m
 - Chemical – Pasteurisation savings - £0.25m
 - Annual site maintenance on outdated and customised equipment - £0.25m
- 1.45 We understand that the remaining £0.7m will be financed from additional internal departmental efficiencies. Following on a CSR efficiency saving requirement of £2.1m for 2013 alone this additional £700,000 is considered to be a formidable challenge for the Department. That said, we do acknowledge that the Department is considered to have a reasonable track record of delivering savings, however it would be our view that without some precision on the direct management interventions that will generate such savings, that such a savings requirement is expectational and without an appropriate level of certainty that would allow such a Project to be properly appraised and decided upon – in terms of prevailing good practice.

- 1.46 In summary this significant and wholly necessary project lacks maturity in terms of the lack of overall cost exposure information as well as lacking precision in the sourcing of a significant component of annual financing costs. The Department has endeavoured to take a prudent position on contingency provision – however, as noted within our comments on HM Treasury Green Book Guidance – the level of Contingency and provision for Optimism Bias can be extremely high relative to the specialist nature of the project. Whilst this may appear to be a negative reflection we do fully acknowledge the complexity of this project and the Department’s desire to “punch through” difficulties in making this happen.

Other Budget Proposal Implications

- 1.47 In relation to the proposals that relate to Impots Duty we have sufficient confidence in the States’ ability to calculate the additional revenue income and recurring implications and we understand that their impacts are incorporated within the Taxation Revenue outlined in Summary Table A of the Draft Budget Statement 2014. The setting of the level of such duties is largely associated with political judgement and is accordingly, not within the scope of our work.

Concluding Comments

- 1.48 It is clearly evident that a significant amount of work has gone into the proposals that underpin the Draft Budget Statement 2014. In terms of detail the quantification and impacts of the individual component changes to the Taxation Revenue appears to be well worked through. However the impacts that these proposals make on baseline budgets are less clear. There is still some difficulty in tracking the movements between the Consolidated Fund, the Stabilisation Fund and the impact of Contingency Funding requirements – the Fiscal Policy Panel is rightly, in our view, especially critical of the lack of clarity on the arrangements for the building up of the Stabilisation Fund. Lack of clarity within the 2014 Budget proposals was raised within the overall commentary by the Fiscal Policy Panel within their November 2013 Annual Report. Although our scope and approach to this work differs from the work of the Fiscal Policy Panel, there is an aspect of their comments which does feed into our assessment on the 2014 Budget Proposals – albeit our scope of work mainly focusses upon accounting and financial management implications of the budget proposals.
- 1.49 Economic forecasting necessarily impacts the financial modelling used within the Budget Proposals and there is a need for optimal accuracy within assumptions used and clarity/transparency in the tracking of such impacts. In this respect it is of some concern that the forecasts of Income Tax yields differ from the baseline position used within the Budget 2014 Statement. Whilst we differ from the Fiscal Policy Panel’s assessment on Capital Funding issues including the utilisation of the Strategic Reserve, we do share concerns over the affordability of various Budget proposals (given transparency issues and the aspirational nature and relative lack of firm details behind some of the Capital Proposals) and the positioning of the 2014 Budget against the overall fiscal strategy that the States has previously set for itself. We believe that the Budget Analysis, in terms of transparency, would benefit from a full Macro Model – MTFP adjusted for all Budget Proposals – on the assumption they are all approved by the States on a hypothetical basis.

- 1.50 In terms of the prevailing economic outlook and the foundational assumptions inherent within the Budget Proposals and the MTFP the States would do well to heed the cautionary note of the Fiscal Policy Panel in respect of the economic outlook in both the international and local context - excerpts include:-

International Economic Outlook

“Although growth is expected to accelerate next year, forecasts for 2014-2017 have been considerably downgraded. Primarily this relates to significant downward revisions to forecasts for the emerging and developing economies.

A number of the previous major downside risks appear to have diminished but new risks have emerged around a prolonged slowdown in the emerging economies, policy uncertainties in advanced economies, capital withdrawal from emerging markets and falling prices of risk assets as the advanced economies tighten monetary policy.

Jersey Economic Outlook

The longer-term outlook is clouded by the continued weak productivity performance across the economy; the continued regulatory and competitive pressures on financial services; and the future impact of the ageing society.”¹⁰²

- 1.51 Our approach used in assessing the strength of the Budget 2014 proposals against best practice financial management principles will inevitably differ from the approach used by economists. Overall we recognise a commendable level of innovation and drive within the 2014 Budget especially in embedding wholly necessary projects of national significance within the State’s Financial Strategy. Additionally, efforts are proposed to deliver some marginal changes to Income Tax which may appeal to taxpayers albeit at a cost in terms of potential affordability.
- 1.52 It would be our considered view that whilst this Budget may be seen as bold in some respects it is not without some risk. In terms of providing some balance, in comparative terms we believe it is not dissimilar, in terms of its attributes, to Budget setting arrangements set within other jurisdictions and indeed, it has broad characteristics similar to those found within a broad base of UK Public Bodies at this point in time. The characteristics of this Budget may appear to be outwith ‘the norm’ in relation to the direction of travel now being proposed in Jersey. Certainly the pursuit of innovative financing solutions and a “punch through” approach to deliver much needed infrastructure programmes in the face of rising demands (in terms of service delivery expectations and an ageing and more dependent population) are characteristics we come across regularly within the UK - which is still in the grip of significant fiscal retrenchment for its public services.
- 1.53 Typically such characteristics are symptomatic of a more reactive approach taken by organisations in order to “square the circle” of reducing resources with higher service expectations/demand. However, Jersey’s approach is different in this respect. Within the State’s 2014 Budget proposals we can identify medium/longer term as well as obvious short term imperatives and in this respect maintaining this balanced approach within the

¹⁰² Jersey’s Fiscal Policy Panel Annual Report – November 2013 – Page 42

previously commended MTFP framework, is one we would readily endorse. In summary, whilst we have identified a range of issues within the Budget 2014 Proposals that may be potentially problematic, it would be our considered opinion that the States of Jersey has, on a comparative basis, a more robust approach to the formulation of Financial Strategy than most organisations we have worked with and would easily be placed within the top quartile of organisations, in terms of good practice within Financial Strategy measured against the standards outlined within the CIPFA Financial Management Model.

- 1.54 We have outlined the following strengths and risks associated with our analysis of the 2014 Budget Proposals:-

Attributes and Risks

- 1.55 During the course of our work we were able to identify a good number of relative attributes and some risks associated with the Budget proposals.

Attributes

- 1.56 The following list highlights some high level attributes:-

1. Strong Medium/Longer Term approach taken to meeting much needed infrastructure investment
2. Comprehensive Funding Options considered for all three major Capital Projects
3. Robust analysis with a good blend of sensitivity analysis used in individual funding options
4. Total Taxation Revenue Components - good level of detailed work on the forecasted financial impact for each Budget Proposal
5. Innovative Funding Options incorporated within each of the major Capital Investment Projects
6. The three major Capital Projects have the obvious capability of significant economic impacts
7. HM Treasury Green Book Guidance substantially followed on the Hospital and Housing Projects
8. Robust Housing Financial Modelling – potential to lever in significant external borrowing delivering the Decent Homes Standard and a net quantum of 434 ‘New Build’ tenancies
9. Much-needed additional clinical capacity which aspires to meet the objectives set out within the White paper- Caring for each other, Caring for ourselves - arising from the twin site hospital proposal delivered within an innovative funding solution

Risks

- 1.57 These were identified as follows:-

10. Absence of a full “Macro Model” incorporating impacts from all Budget proposals setting new baselines
11. Lack of clarity on Budget Baseline changes arising from the proposals – despite good work in quantifying individual Taxation proposals

12. Lack of clarity on overall affordability of all options and lack of sensitivity analysis at a macro level – e.g. significant changes to GVA, Employment and base interest rates
13. Marginal Income Tax rate reduction impact and affordability is highly questionable as an effective stimulus measure
14. Inconsistent messages on Income Tax yield forecasting (e.g. States Economics Unit Forecasts with Budget Baseline positions) - difficulty in tracking the annual recurring £10.9m reduction in potential base yield re Income Tax or the £5.5m in baseline MTFP movement
15. Lack of legal clarity on the utilisation of the Strategic Reserve - the intended Hospital financing approach appears to be inconsistent with the stated 2006 position
16. The opportunity cost of alternatives forgone in using the Strategic Reserve to finance the Hospital Project should be considered and fully acknowledged (if legally permissible re purpose of utilisation)
17. Lack of transparency within the Budget on movements between the Consolidated Fund, Stabilisation Fund, Carry Forwards and Contingencies
18. Hospital Project cost envelope appears to be made to fit an acceptable level of financing from the Strategic Reserve rather than based on an overall clinical specification of need
19. The Hospital Project cost optimism bias provision of 10% incorporated within the indicative costs is considered to be potentially inadequate - without detailed costings and ultimately full tendering, indicative costs should be treated with significant caution
20. Lack of clarity on construction industry capacity needed to service all three major Capital Projects
21. Housing Project - lack of acknowledgement that additional rental income requirement will create an additional Income Support spend of some £69m over 30 years excluding the impact of the back filling of tenants transferring from Private Landlords - say 434 tenants x 100% market Rent x 67% Income Support Housing Component eligibility
22. Lack of Capital Project Management capacity may impair the delivery of substantive 2014 capital expenditure programme of £88.9 million
23. Lack of acknowledgement that total allocations (including Central Growth Allocations) will not, in reality, crystallise into full actual expenditure – based on track record

Summary

- 1.58 An overall summary of our comments can be condensed within three high level comments:-

Transparency – transparency on impacts and movements between Income Spend and Reserves is not what it might be. Visibility on the impact of the Budget Proposals would be greatly aided by the presentation of a “Macro Model” which allows for the individual proposals to be tracked covering Income, Expenditure and Balance Sheet items.

Affordability – revised economic forecasts on GVA, Employment, Interest Rates etc. consistently provide a cautionary note on the economic foundations to the critical assumptions that are contained within the Budget and consequential adjusting of the

MTFP. Affordability testing on the 2014 Budget proposals against this cautionary background needs to be more explicitly demonstrated.

Comparability – a proportionate and balanced view on the comparative positioning of the 2014 Budget Proposals within the prevailing MTFP Financial Strategy against Macro Budget Setting within the UK and overseas is indeed a positive one. Innovative financing solutions have been developed and significant detailed work has been undertaken to provide the foundational work for the Budget proposals. From an Accounting and Financial Management perspective there are relative strengths within the way the States sets out its Financial Strategy within what we consider to be a robust framework – and for this the States should be commended.

15. APPENDIX 3: REPORT FROM MJO CONSULTING

Jersey's 2014 Budget

Michael J. Oliver

1. INTRODUCTION

- 1.1 Five years after the collapse of Lehman Brothers, the Jersey economy – which is heavily dependent on finance for economic growth – continues to perform poorly. Recently published Gross Value Added (GVA) figures for 2012 have revealed a fifth year of contraction. The fiscal stimulus of 2009 did little to reduce unemployment and it now stands at a level which policymakers must have thought unimaginable four years ago. Nominal incomes have been squeezed in the public and private sectors and real incomes have hardly grown since 2009. Politicians have trumpeted the low inflation figures but this is only a symptomatic of depressed economic activity in Jersey. One of the most important statistics for measuring public welfare is the economic standard of living, which measured by GVA per capita, has fallen by 21% since 2008.
- 1.2 Against this backdrop, the Treasury and Resources Minister has described the 2014 Budget as a budget for economic growth and job creation. The intention of the Budget is to help achieve the Council of Ministers key economic objectives of supporting the economy in the short-term through fiscal stimulus, creating new employment opportunities and laying the foundations for economic growth whilst committing to essential investment in Jersey's infrastructure.
- 1.3 Despite the eye-catching headlines of the Budget, which have included cuts in the marginal rate of taxation, one locally respected accountant has described its impact as 'very neutral'.¹⁰³ Although it may be very neutral, the enormous planned increases in capital expenditure in the short- to medium-run will impact the economy when the Economic Unit believes that Jersey will have returned to its long-term trend rate of economic growth. One of the key characteristics of Jersey's economy over the last twenty years is its pronounced 'boom-bust' cycle. Are the seeds of the next boom and bust contained in the 2014 Budget?
- 1.4 During the course of this review, the author has discussed how the range of economic data might be improved. This has been a recurring theme from several Scrutiny reviews. The author is pleased to note that the Economic Adviser is keen to develop input-output tables and improve measures of productivity for Jersey. This is also a key aspiration for the Chief Statistician who hopes that within the next couple of years, there should be improved ways of measuring the Jersey economy.
- 1.5 Lack of data cannot be an excuse for poor policy decisions. Economic history is replete with examples where politicians have ignored advice from civil servants in the pursuit of political goals. That is their choice. In the words of the late Lady Thatcher, advisers are there to advise and Ministers are there to decide. It seems hard to believe that some of the decisions in the 2014 Budget did not go against the advice of officials. Since the publication of the Budget, the Fiscal Policy Panel (FPP) have voiced their concerns. Do we really need hindsight to show us that some policy decisions contained in the 2014 Budget are a mistake?
- 1.6 To examine the 2014 Budget, this report is divided into four. The first section considers recent developments in Jersey economy. Chapter 2 examines the income forecasts and taxation policy. Section 3 considers supply side measures. Finally, section 4 provides some conclusions and observations on the Budget.

¹⁰³ Wendy Dorman's evidence to the Corporate Services Scrutiny Panel 2014 Budget Review Hearing with the Institute of Directors, 21 Oct. 2014.

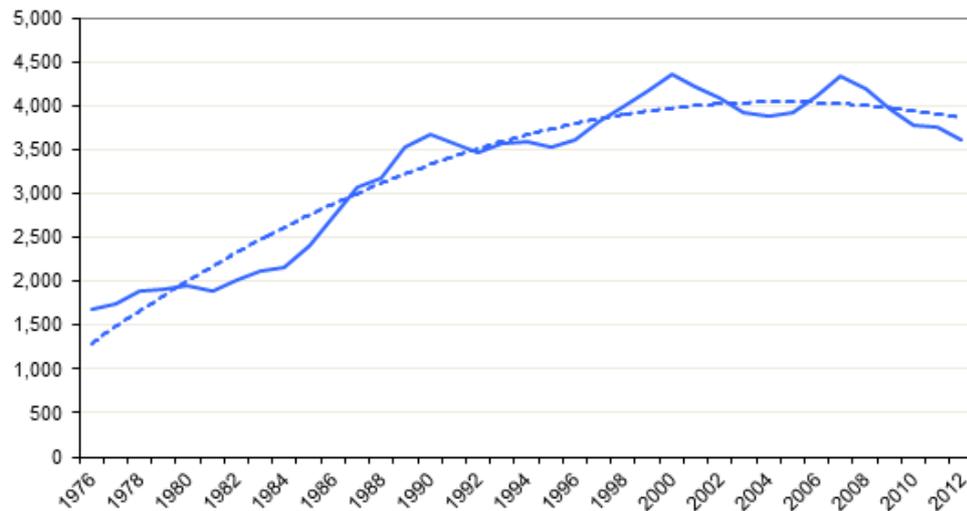
1. THE JERSEY ECONOMY

1.1 Economic performance

1.1.1 GVA

The growth of Jersey's real GVA is illustrated in Figure 1. Considerable caution should be attached to data points prior to 1998, but this graph is nevertheless useful to illustrate the pattern of economic growth in Jersey since the mid-1970s. Over this period, Jersey's economy has moved from low value added activities (e.g. tourism and agriculture) to high value added activities (financial services). As can be seen from the trend line, the impact of this transition has diminished over the last decade. Coupled to the depth and duration of the current recession, this adds to the likelihood that parts of the economy are in structural decline.

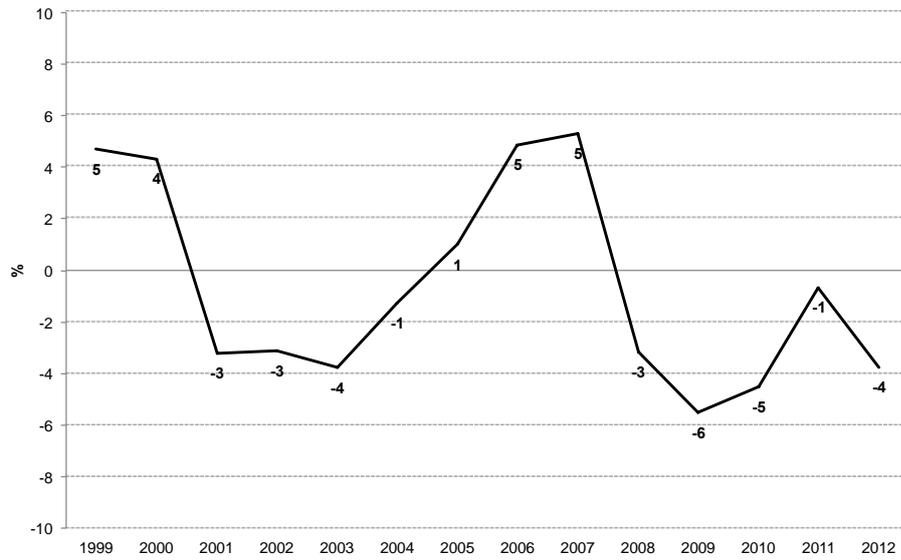
Figure 1. Real GVA, 1976–2012 (£m, current prices)



Source: States of Jersey Economics Unit

The recent economic performance of Jersey's economy is illustrated more clearly in Figure 2. On the basis of real-term behaviour of GVA, the Jersey economy has spent more time with negative growth than positive growth since 1999. If the start of the global financial crisis is taken from the collapse of Lehman Brothers in 2008, then total GVA has fallen by 16% in real terms.

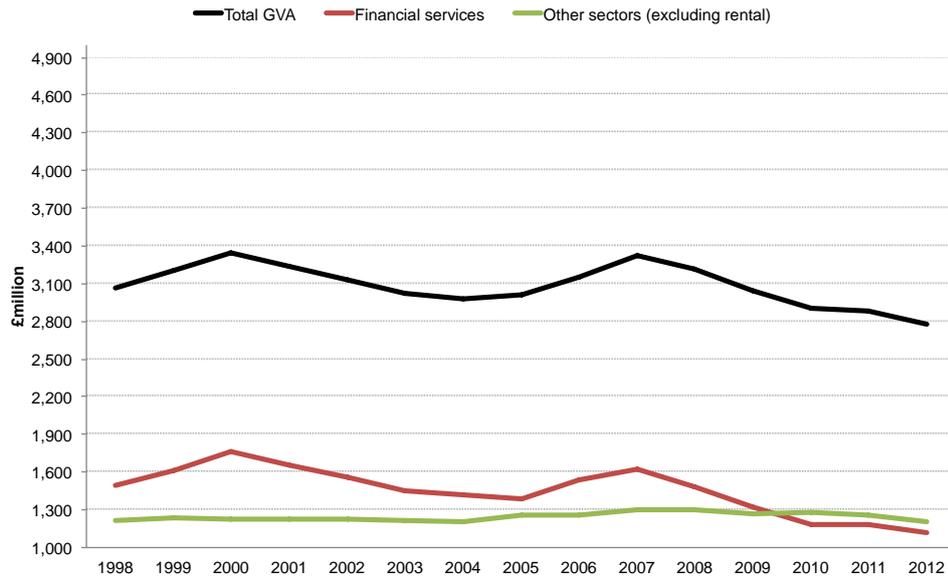
Figure 2. Annual percentage change of GVA in real terms, 1999-2012 (2003 = 100).



Source: States of Jersey Statistics Unit

Figure 3 illustrates how the finance sector has driven the periods of growth and decline that can be seen in the earlier Figures, with the growth of the non-finance sector remaining broadly constant. Although the finance sector has long dominated Jersey's economy, its share of GVA has fallen from a peak of 53% in 2000 and stood at 40% in 2012. Since 2008, the GVA of the finance sector has declined by 31% and the GVA of the non-finance sector has declined by 7%. In 2010, the combined non-finance sector of the economy overtook finance in its contribution to GVA for the first time in at least a generation.

Figure 3. GVA in constant (2003) values, 1998–2012

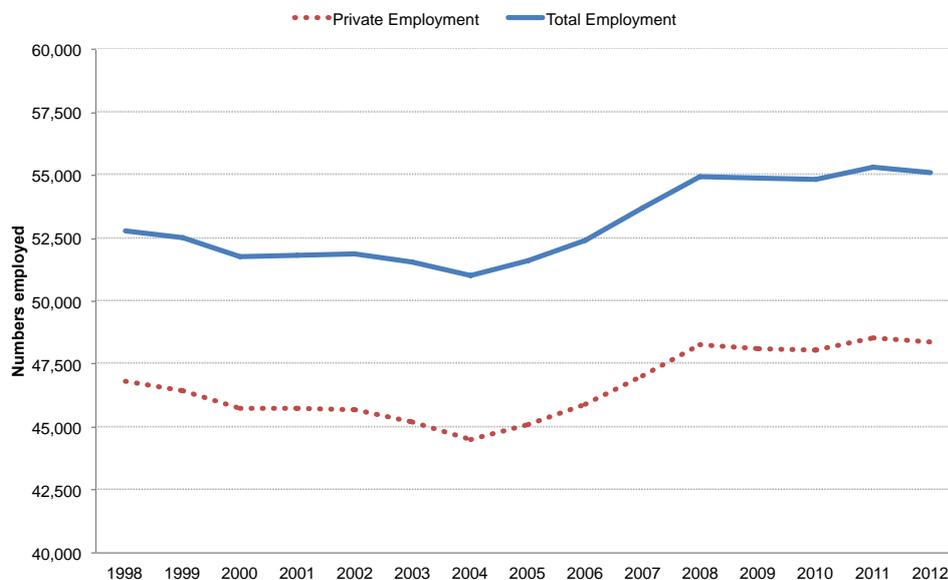


Source: States of Jersey Statistics Unit

1.1.2 Employment and unemployment

Employment growth since 1998 on a calendar year average is shown in Figure 4. During the recession in the early 2000s, total employment fell by around a thousand, but grew strongly after 2004. On the basis of these figure, the post-2008 recession does not appear to have had as dramatic an effect on total employment growth as the early 2000s recession.

Figure 4. Total and private sector headcount (calendar year average), 1998–2012

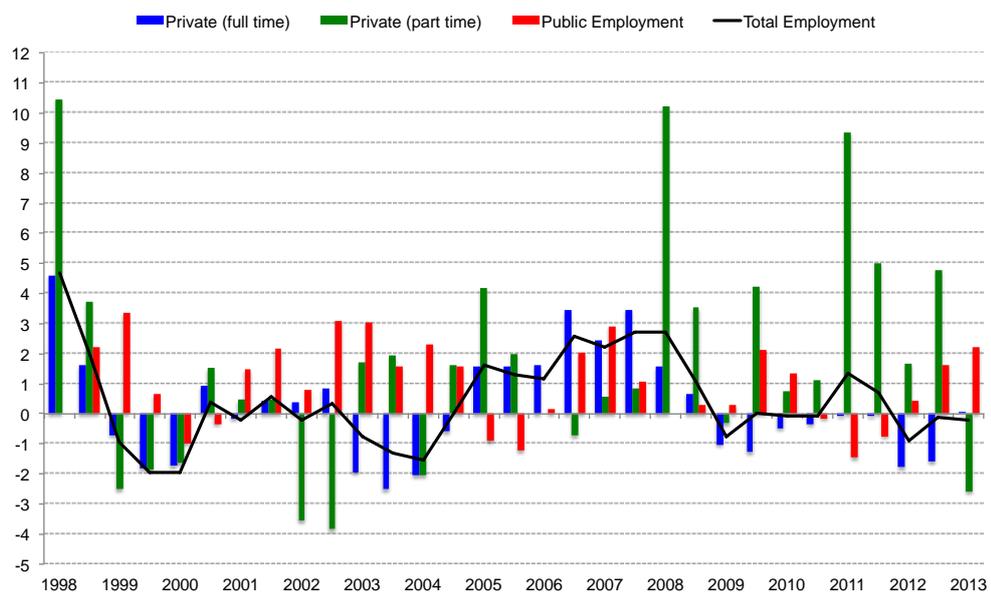


Source: States of Jersey Statistics Unit

The annual percentage change in employment (Figure 5) plotted on a six monthly basis shows how after the recession of the early 2000s, total employment grew by between 1% and 3% per annum from 2005 to 2008. Employment growth was

essentially flat between 2009 and 2010 before growing in 2011 and then falling again in the twelve months to June 2012. Over the year since June 2013, the fall in total employment on an annual basis was less than 1%. Growth in full time private employment has contracted since 2009 but there has been a significant growth in part-time private employment in recent years. By June 2013, the number of full-time staff employed in Jersey’s private sector was at its lowest June level since 2006. By the same date, the number of part-time staff employed in the private sector accounted for 21% of total private sector employment. Public sector employment, which had fallen in 2011 for the first time since 2005, has again grown strongly over the last two years.

Figure 5. Annual percentage change in employment, June 1998–June 2013

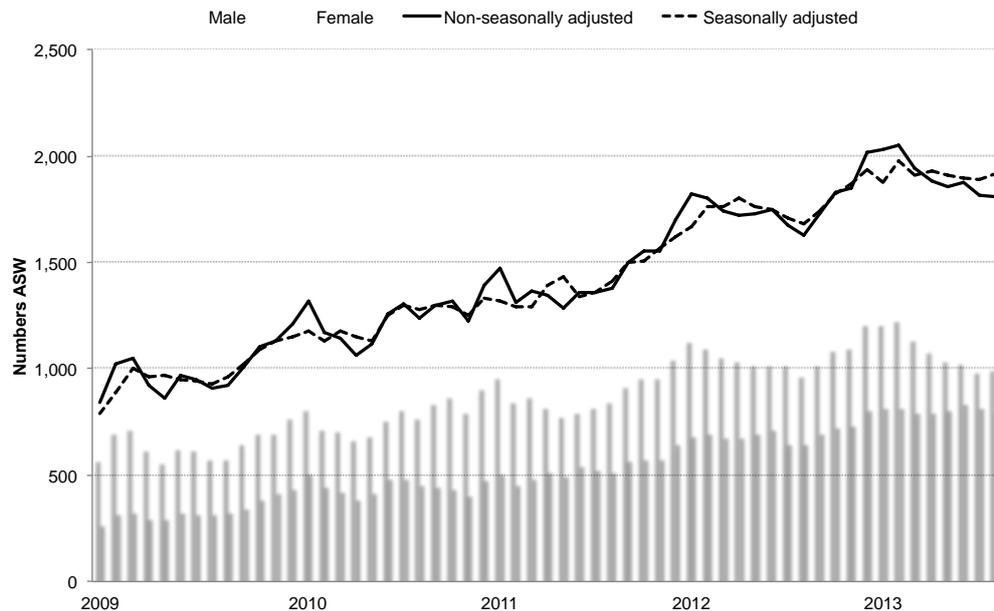


Source: States of Jersey Statistics Unit

Unemployment has doubled between 2009 and 2013 (Figure 6). In June 2013, the unemployment rate was 5.7%.¹⁰⁴ There does not appear to have been any significant reduction in unemployment since the onset of the recession and given the focus of the current Budget, policymakers must be hoping that this figure will reduce over the next twelve months.

Figure 6. Total number of individuals registered as Actively Seeking Work, Jan 2009 – September 2013

¹⁰⁴ There is no legal requirement for all unemployed residents of Jersey to register as actively seeking work (ASW) with the Social Security Department. It is widely accepted that there is a lot of hidden unemployment in Jersey which might, in the worst case, add an additional one to two thousand to the ASW figures. This would then produce an unemployment rate more akin to rates in some other developed economies.



Source: States of Jersey Statistics Unit

1.2 The finance sector

- 1.2.1 The growth in financial services has been critical for the success of the Jersey economy over the last two decades. It has been estimated that financial services and its employees, combined with second round effects on other business and employees grew to contribute between 60% and 70% of States' revenues each year by the late-2000s (Fiscal Policy Panel 2008, p. 15). Given the dependence of Jersey's economy on finance, it is worth examining the recent performance of the finance sector in a little more detail.
- 1.2.2 The Statistics Unit publishes an annual Survey of Financial Institutions, which examines gross operating surplus, profits by sub-sector, the total number of staff employed in financial services, *inter alia*. Financial services is defined in the Survey as the activities of banks, fund managers, trust and company administrators and accountancy firms operating in Jersey. The survey does not analyse firms predominantly engaged in insurance and financial advisory services.¹⁰⁵
- 1.2.3 A key measurement of economic performance in Jersey's financial services sector is gross operating surplus (GOS).¹⁰⁶ Data on this only goes back to 2009 and is illustrated in Table 1. This shows that although the total GOS increased in 2010 and 2011, it fell back in 2012.

¹⁰⁵ The 2011 Survey returned to the methodology which had been adopted prior to 2009 of allocating companies to sub-sectors according to their main area of business activity using the Standard Industrial Classification (SIC) of economic activity. In 2009 and 2010, companies were asked to report separate information for each business area. With the approach taken in 2009 and 2010, the total manpower in Banking reduced significantly because banks were involved in Fund management and Trust and company administration activities. In turn, the number of staff involved in Fund management increased by 400 full time employees (FTEs). The return to the SIC methodology in 2011 will lead to shifts between sub-sectors, particularly in manpower and profits.

¹⁰⁶ Gross operating surplus represents revenue minus operating costs, and excludes income transferred to resident parent companies in Jersey by non-resident units operating outside of the Island.

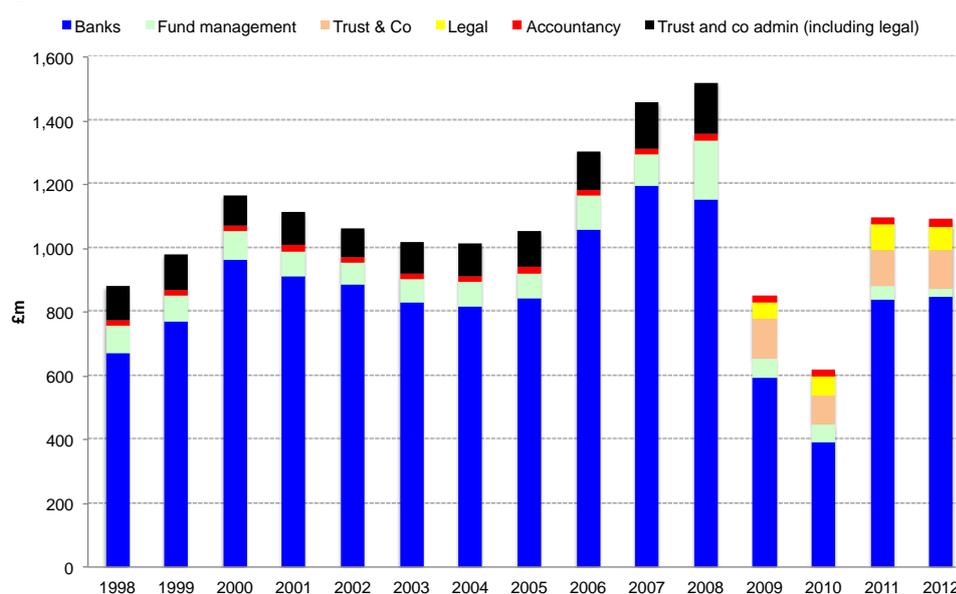
Table 1. Total GOS and average GOS per FTE employee 2009– 2012

	2009	2010	2011	2012
Total GOS (£ million)	870	720	730	720
Mean GOS per FTE employee (£ k)	70	61	62	61

Source: States of Jersey Statistics Unit

- 1.2.4 Although figures for net profit can be susceptible to the volatility of such income transfers (and hence why GOS is the preferred measure of economic performance in financial services), they do provide data which goes back to 1998. Total net profit for the finance sector is illustrated in Figure 7.

Figure 7. Total net profit for finance sector, 1998–2012



Source: States of Jersey Statistics Unit

Note: Trust and company administration and legal net profits have been separately recorded since 2009.

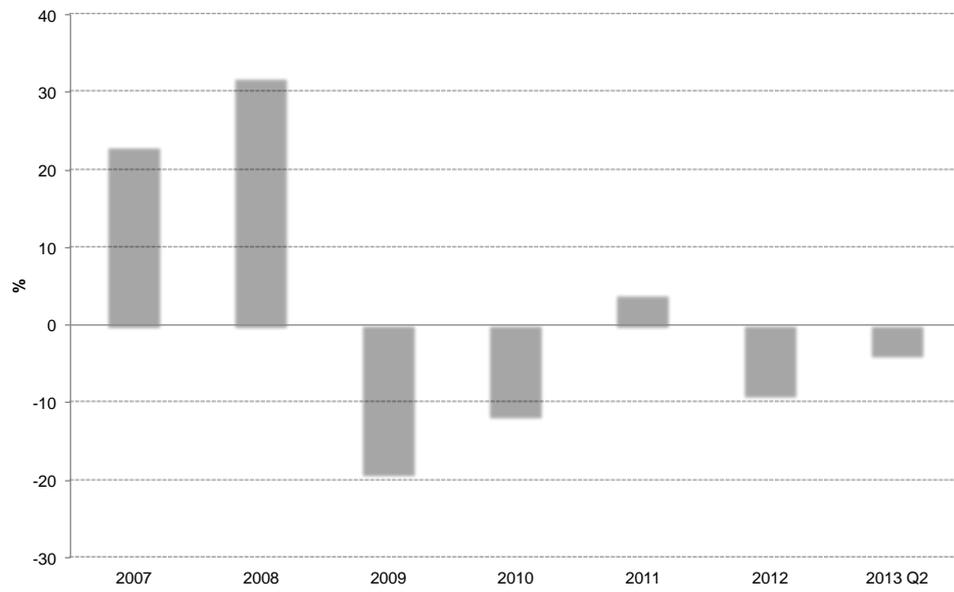
- 1.2.5 The importance of the Banking sub-sector for Jersey’s economy is emphasised in Figure 8. Historically, it has had a strong influence on the movement of total net profits in the finance sector. In 2012, banking accounted for 78% of the total net profits of Jersey’s entire financial services sector. This was a similar proportion from the mid-1990s up until 2008. However, in 2009 and 2010, there was a collapse in total net banking profits. Over the period 2007 to 2010, net profits fell by 66%. In contrast, during the recession in the 2000s, total net profit in banking fell by just over 10%. An even more dramatic fall in net profits can be found in Fund management, where they have fallen by more than 80% since their peak in 2008. After a fall in 2009, the Legal sub-sector saw an increase in net profits between 2010 and 2011 but profits declined by 9% in 2012.

- 1.2.6 The banking sub-sector has traditionally been a large employer, accounting for almost half of total employment within financial services. The fall-out in employment from financial services since 2008 has been dramatic with a decrease in employment of over 1,000. In June 2013, the number of people employed in banking was the lowest recorded since 1998.

- 1.2.7 There are some significant concerns for the finance industry. In the short-term, for the banking sub-sector, one major concern is the future path of net interest

income, which is largely driven by interest rates.¹⁰⁷ Prior to the crisis, net interest income accounted for nearly two thirds of the banking sectors' gross income, so profits from net interest income are vital part of all banking profits (and financial services as a whole). Figure 8 illustrates the changes in net interest income between 2007 and the second quarter of 2013. In a low interest rate environment, net interest income will continue to grow slowly.

Figure 8. Trends in net interest income, 2007–Q2 2013 (percentage change)



Source: Jersey Financial Services Commission

As the FPP note in their 2013 report, there are some indications that things are improving locally with indicators in the Business Tendency Survey moving in a positive direction. Business optimism has moved from negative in 2012 to strongly positive in the most recent quarter and the headline business activity measure now stands at the highest level since early 2011. Yet the Panel also note that following their meetings with representative from the finance industry and key finance sector institutions in September 2013 that there were mixed views about current performance and future prospects for the industry. Considerable uncertainties and risks remain for the finance industry largely because of the unknown impact of UK and US FATCA negotiations.

¹⁰⁷ The difference between the interest a bank receives on its loans and the interest the banks pays to its depositors.

2. INCOME FORECASTS AND TAXATION

2.1 Last autumn the States Assembly approved the MTFP. Since then, there has been no public update on the financial forecast contained in the MTFP. It was expected that this would be contained in the 2014 Budget, along with a three-year updated income projection. Unfortunately, this information is not available in the Budget. From a macroeconomic perspective, it has been difficult to understand what is being proposed in the Budget and to calculate the impact of the fiscal changes on the economy. This was also recognized by the FPP who have observed that the draft 2014 Budget is a 'step back from previous Budgets in terms of completeness and transparency, rather than the steps forward which the Panel recommended a year ago' (Fiscal Policy Panel 2013, p. 41). Whilst the FPP does not appear to have been given an update on the income forecasts, the Economics Unit did prepare an income tax forecast note for the Income Tax Forecasting Group which has allowed some of the data in the MTFP to have been updated. The data from the forecast note has been included in some of the discussion below.

2.2 The initial economic assumptions which formed the basis of the MTFP for budget years 2012–15 are shown in Table 2 and the income forecast are shown in Table 3. The central income forecast (in bold) is produced in a range with an upper figure (optimistic) and a lower figure (pessimistic). The range of the upper and lower figures is put at +/- 5% which allows for the uncertainties associated with forecasting total tax take. Although the emphasis is on the range and not the estimated points, the central income forecast is used in the MTFP.

Table 2. Assumptions behind the MTFP forecasts, 2012–15 (budget years)

% change	2012	2013	2014	2015
Real GVA	1.4	2.0	2.5	2.5
RPI	3.8	3.0	3.1	3.5
Employment	0.5	1.0	1.0	0.5
Average Earnings	3.5	3.8	4.1	4.8
Interest rates (%)	0.5	0.6	0.9	1.4

Table 3. Income tax forecasts in the MTFP, 2012-15 (budget years)

	2012	2013	2014	2015
	£m	£m	£m	£m
Upper	450	470	495	525
Central	430	450	470	500
Lower	410	425	450	475

2.3 The forecasts were prepared by the Economics Unit in March 2012. By the time the MTFP was published towards the end of July 2012 it was clear that the economic situation in Jersey had deteriorated. In the summer of 2012, the author queried the economic assumptions behind the income forecasts. The shaded figures in Table 4 were his assumptions downgraded from those in Table 2.

Table 4. Revised assumptions, 2012–15

% change	2012	2013	2014	2015
Real GVA	0.0	0.5	1.5	1.5
RPI	3.8	3.0	3.1	3.5
Employment	0.5	0.5	1.0	0.5

Average Earnings	1.5	1.5	1.75	2.5
Interest rates (%)	0.5	0.6	0.9	1.4

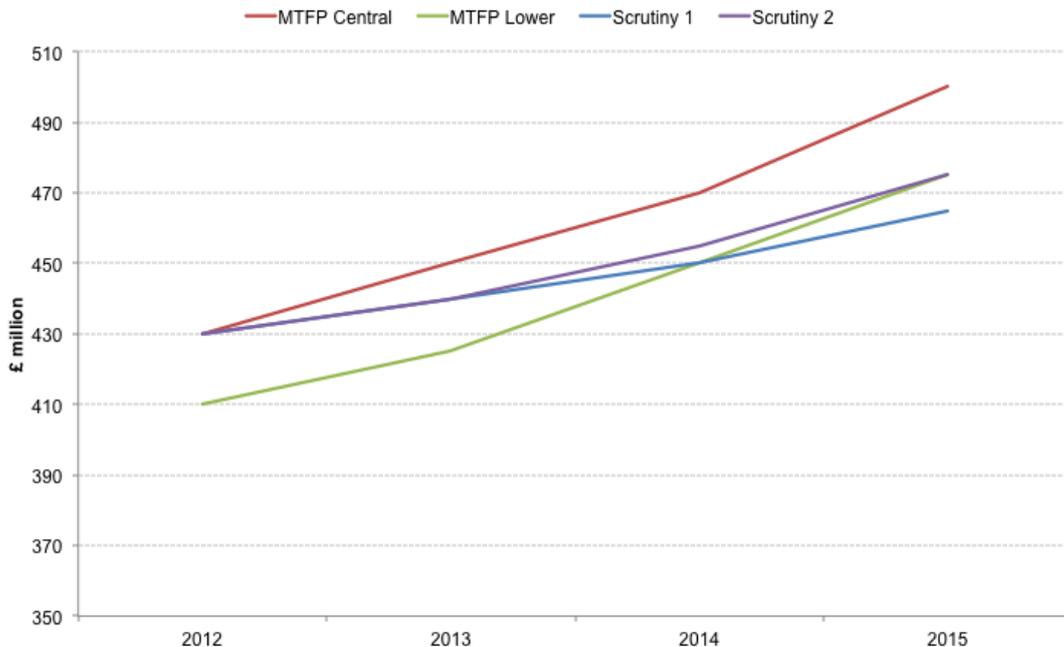
The States Economic Adviser and his team ran these economic assumptions through the States model. *It should be stressed that the Economic Unit and the States Economic Adviser did not endorse the economic assumptions used to remodel the Income Tax Forecasts.*

- 2.4 From these assumptions, two revised income tax forecasts (Scrutiny 1 and Scrutiny 2) were prepared and are shown in Table 5 along with the lower, central and upper MTFP forecasts for comparative purposes. These are illustrated in Figure 13.

Table 5. Revised income tax forecasts, 2012-15 (budget years)

	2012	2013	2014	2015
	£m	£m	£m	£m
MTFP Upper	450	470	495	525
MTFP Central	430	450	470	500
MTFP Lower	410	425	450	475
Scrutiny 1	430	440	450	465
Scrutiny 2	430	440	455	475

Figure 13. Income tax revenue, new forecast



Source: calculated from data provided by the States of Jersey Economics Unit.

- 2.5 With hindsight, some of the economic assumptions assumed by the author were incorrect (for example he did not expect a 4% contraction in GVA). The author has not asked the Economics Unit to re-do the calculations based on new economic assumptions as they prepared a series of assumptions in September 2013 (18 months on from the time of their initial forecast in March 2012). These are shown in Table 6.

Table 6. New economic assumptions behind the MTFP forecasts, 2012–16

% change	2012	2013	2014	2015	2016
Real GVA	-1.0	-0.5	1.0	1.0	1.5
RPIX/RPIY	3.0	2.8	2.8	3.0	3.0
Nominal GVA	1.9	2.3	3.8	4.0	4.5
Company profits	2.4	3.0	3.5	4.0	4.5
Compensation of employees	1.0	2.0	3.5	4.0	4.7
Employment	-0.5	0.0	0.5	0.5	1.0
Average Earnings	1.5	2.0	3.0	3.8	3.7
Interest rates (%)	0.5	0.5	0.5	0.7	1.1
Interest rates (pp change)	0.0	0.0	0.0	0.2	0.6
House prices	-1.0	-1.0	1.0	2.0	3.0

The items in grey are actuals. At the time of the forecast, the GVA figure for 2012 was not known and the outturn was significantly below the forecast (minus 4%) as was the nominal figure (minus 1%).

- 2.6 Table 7 presents the revised income tax forecasts (rows 6 to 8) based on the judgment of the Economics Unit. For the sake of completeness, the original MTFP forecasts have been included, as have the original Scrutiny 1 and Scrutiny 2 forecasts from 2012 (they are shown in bold and are the central forecasts).

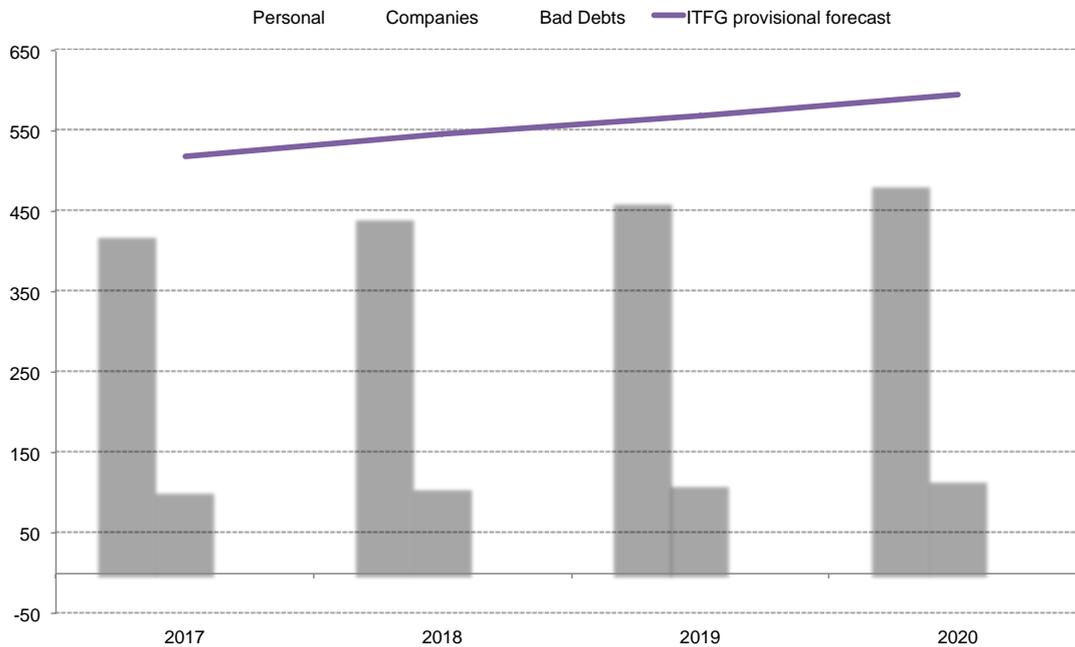
Table 5. Revised income tax forecasts, 2013–16 (budget years)

	2013	2014	2015	2016
	£m	£m	£m	n.a
(1) MTFP Upper	470	495	525	n.a
(2) MTFP Central	450	470	500	n.a
(3) MTFP Lower	425	450	475	n.a
(4) Scrutiny 1	440	450	465	n.a
(5) Scrutiny 2	440	455	475	n.a
(6) New Upper	460	480	500	525
(7) New Central	445	460	480	495
(8) New Lower	435	440	455	465
(9) Difference between (2) and (7)	5	10	20	
(10) Difference between (5) and (7)	5	5	5	

Row 10 show how the revised economic forecast produces a central range closer to Scrutiny 2 than the initial central range calculated for the MTFP (row 9). Overall, the new forecasts have taken into account slower economic growth, employment and average earnings than was envisaged in March 2012. Even this central forecast might be too optimistic however, as the GVA figure for 2012 was not known at the time of the September forecasts. The Economics Unit has cautioned that there are significant downside risks to the economic outlook, some of which have been discussed in Section 1. The FPP's latest forecast is for GVA growth of between minus 2% to plus 2% in 2013 and between minus 2% and 3% in 2014.

2.7 In September 2013, the Economics Unit also produced long-term revenue projections to 2020. These are based on assumptions of above average performance for the economic variables. As such, and bearing in mind the comments in Section 1, these figures carry a considerable ‘health warning’ and have a range larger than the +/- 5% assumed for the existing income tax forecasts. Figure 14 illustrates the provisional long-term tax forecast to 2020. These suggest a modest increase in income tax growth each year at a rate faster than the 2012–16 period.

Figure 14. Provisional long-term income tax forecast to 2020



Source: States of Jersey Economics Unit

2.8 Neither Table 5 or Figure 14 factor in the reduction in the marginal rate of taxation, which is planned in the 2014 Budget. The reduction, from 27% to 26%, will cost £8m on a recurring basis. To reduce the 27% band down to 20% over time will cost £70m on a recurring basis (it costs more to lower each percentage point down to 20%). It is clear that the Treasury has not intended to do this in one fell swoop which is very sensible; however, it is not clear at this stage if this structural change to the tax system has been considered from an economic perspective.

2.9 It is worth stressing that the primary role of taxation in an economy is to raise revenue for the government for public expenditure. Taxation also allows the government to redistribute income and wealth through the taxation system and thereby reduce inequalities in society. In addition, a government may wish to tax certain items (e.g. tobacco and alcohol) to discourage their consumption in order to achieve social goals. Finally, the taxation system can be used to achieve economic goals by allocating resources, e.g. offering tax incentives to the private sector to encourage foreign direct investment into the economy.

2.10 There are four basic principles of taxation. First, taxation should be **equitable**, i.e. taxation must be enacted in accordance with the ability to pay principle. Second, the taxation should be a **simple** as possible with few taxes. Tax systems become complicated when governments seek to raise revenue from different sources. Third, the tax system should be **efficient**, i.e. the tax administrative system should not be inefficient or corrupt. The fourth principle of taxation is that it should be **progressive**, in other words, the incidence of taxation should fall more heavily on the rich than the poor. Direct taxes, such as an income

tax, are designed to be progressive although there are countless disagreements about how 'progressive' is defined. Likewise, there are disagreements on whether some indirect taxes, such as a sales tax, are progressive or regressive. Governments have been urged by economists to keep a sales tax broad based, low and simple and to help those on lower-incomes through a system of transfers and subsidies. If this is undertaken, the sales tax is less regressive.

- 2.11 Taxation in Jersey is low compared to other jurisdictions in the world. Many people overlook the fact that taxes in Jersey have been low precisely because government expenditure has not been as high as most developed economies. However, over the last fifteen years there have been critics who have argued that government expenditure has risen and with it the need to introduce new taxes (e.g. GST). Others have pointed out that Jersey's tax system has struggled to maintain the four basic principles. Finally, there are those who have argued that taxation policy has been focused on selective social goals (e.g. targeting smokers) to the detriment of economic goals (e.g. not attracting inward economic investment).
- 2.12 To address some of the concerns about Jersey's tax system, the Council of Ministers have done two things over the last four years. First, a Fiscal Strategy Review was published, which was designed to achieve balanced budgets by 2013. This was followed by a Business Tax Review which focused on the technical aspects of corporate tax and set out a few alternative structures to the current regime of zero/ten. Second, a Comprehensive Spending Review was published, which after some modifications, was intended to cut £65 million from government spending by 2013. Neither the personal or business tax reviews addressed many of the key policy debates which had been raised by critics and the intention in both reviews was, as far as it was possible, to keep Jersey's existing tax structure. The Comprehensive Spending Review has been dogged by problems with departments struggling to cut expenditure. In short, the approach has been 'salami slicing' rather than highly differentiated and focused spending cuts.
- 2.13 What has been missing from these reviews is the articulation of a clear vision based on the function of taxation in relation to economic development and how this will incorporate the principles of taxation. The announcement that a long-term tax programme will be published alongside the 2015 Budget is to be welcomed. This review is intended to address how Jersey's tax regime can be modernized; how the personal tax regime can be simplified; how independent taxation can be introduced; and it will consider self-assessment and the current year basis of tax. It is to be hoped that the long-term tax programme will also provide some political vision rather than a technical discussion: it is frequently difficult to ascertain what Jersey's tax policy is trying to achieve, other than raise revenue! During evidence to the Panel, the Assistant Treasury Minister suggested that it was not the purpose of government to determine social choices yet elsewhere in the world this is done and in fact the Council of Ministers has agreed to influence social choices in its justification for raising *impôts* in order to curb drinking and smoking.¹⁰⁸ Why is there not a debate about whether the taxation system could be used to reward marriage and civil partnerships? How can the tax system be made more just? In what ways can it improve incentives to work? Due to the forthcoming review and concomitant changes, any comments relating to personal taxation policy in the Budget will be limited briefly to two areas: independent taxation and the reduction in the marginal rate of taxation.
- 2.14 There are several things to note about the proposed move to independent taxation. First, the States Assembly had a short debate on individual income tax assessments following a proposition brought by Deputy Geoff Southern (P.11/2012). This was opposed by the Treasury and Resources Minister on several grounds but mainly because the Treasury intended to do a thorough review of independent taxation over a 2-3 year period before

¹⁰⁸ Corporate Services Scrutiny Panel 2014 Budget Review Hearing with the Assistant Minister for Treasury and Resources, 11. Oct. 2014.

bringing it forward for debate to the States Assembly. The report by the Tax Policy Unit is therefore a feasibility study rather than a statement of policy. Second, it is unclear why decreasing the marginal rate band by 1% is an 'important step' towards independent taxation (States of Jersey 2013, p. 16). On that same logic, if the marginal rate is raised (which it could be if the public finances deteriorate), would it be a move away from independent taxation?! Moving towards independent taxation is one way of simplifying the tax system but as the experience of the UK has shown, this has not been a quick or totally smooth process. One of the measures, which the then Chancellor of the Exchequer, Nigel Lawson, argued for, was a transferable allowance. Independent taxation was introduced in the UK in 1990 but the transferable allowance was watered down. However, the allowance can be family friendly and can provide a far more cost-effective means of reducing the tax burden on low-income households than can be achieved by an across-the-board increase in personal allowances. Third, there were three main objectives for the UK government to move to independent taxation: to give married women the same opportunity for privacy and independence in tax matters as their husbands; to remove discrimination against marriage and the family and to be able to raise tax thresholds in a cost-effective way so as to reduce the tax burden on families with low incomes. The low tax thresholds many such families faced were contributing to employment and poverty traps. There needs to be a far more thorough analysis of which taxpayers in Jersey would be better or worse off with a move to independent taxation with the inclusion of a transferable allowance.

- 2.15 Turning to the proposed reduction in marginal taxation. As noted in 2.8 above, there is no discussion in the Budget whether the public finances allow for a reduction in the marginal rate of tax. As discussed in Section 1, there are currently considerable downside risks for the economy. As the FPP (2013, p. 49) have noted, there is a possibility of a structural deficit in the public finances (indicated by the extent to which capital expenditure is being funded by borrowing, both internal and external, and running down funds established for other purposes). The FPP have always cautioned that structural change in the taxation system needs to be carefully considered, which it is not in the 2014 Budget. All of this cautions against the assertion that the public finances are on a 'strong and sustainable footing' (States of Jersey 2013, p. 18).
- 2.16 The cut in the marginal rate of taxation will not provide an immediate fiscal stimulus to the economy for two reasons. First, one problem with using fiscal stimulus (as opposed to monetary stimulus) is the time lag between a decision to ease fiscal policy and the full effect on the economy. The reduction in the marginal rate of taxation is a classic example of this: for 75% of taxpayers who pay on a prior year basis, the impact of the cut will not affect them until 2015. It will only be the 25% of those who pay on a current basis who will receive the tax cut immediately and it is difficult to see how. From January 2015, any tax cut is then partly countered by the introduction of the new Long Term Health Charge of 0.5%, rising to 1% in 2016. Second, it is incorrect to assume that a tax cut on its own can deliver confidence and influence expectations in a positive way. In his evidence to the Panel, the Treasury Minister remarked that:

If people are confident that they are going to have their tax reduced, then they are going to be more confident about their spending. They are going to feel better about house prices, I hope. They are going to feel better about security of their jobs. They are going to feel better about being able to ensure that their incomes are rising.¹⁰⁹

Given the fall in GVA during 2012, the high levels of unemployment and widespread feelings of job insecurity, there is limited confidence in the Jersey economy. Managing expectations against such a backdrop is challenging. It is one thing to announce, for example, a rise in GST from 5% to 7% for twelve months time which will encourage people to bring forward their expenditure decisions. It is quite another to announce a tax cut which

¹⁰⁹ Corporate Services Scrutiny Panel 2014 Budget Review Hearing with the Minister for Treasury and Resources, 24 Oct. 2014.

will not affect the majority of people for thirteen months and at the same time introduce another tax and to increase it by another percentage point twelve months later, cancelling out any cut in the marginal rate of tax!

- 2.17 On balance, from an economic perspective, there seems to be significant dangers associated with reducing the marginal rate of income tax, which has recurring costs, largely because of the state of the public finances. The continuing poor performance of the Jersey economy and the subsequent downward deterioration of the income forecasts suggest that the optimistic income forecasts made in the MTFP are misplaced. If the reduction in the marginal rate of tax was part of a fiscal stimulus there could be some merit in what is being proposed; however, the delay in the impact of the changes for the bulk of taxpayers until 2015, when the Long Term Health Charge begins, suggests that what is being proposed is a very weak fiscal weapon. As the Fiscal Policy Panel (2013, p. 42) have noted, the tax cut is neither timely nor temporary. This criticism could be extended to the Budget generally: where is the mapping of any stimulus against the 3Ts (temporary, timed and targeted) or an explicit discussion on how it will create jobs?

3. THE SUPPLY SIDE OF THE ECONOMY

3.1 Section 1 discussed the current state of the Jersey economy. One area that was not discussed was productivity. Productivity is one of the most important concepts in measuring the supply-side performance of an economy and with it, the efficiency of labour. In technical terms, real income growth in an economy is made up of changes in productivity plus or minus the terms of trade. In other words, productivity is the main determinant of living standards.

3.2 Higher productivity should lead to several positive outcomes for an economy. First, as workers are more efficient businesses make more profit and can re-invest this into their business leading to a virtuous circle of internal growth. Second, businesses can afford to pay higher wages. Third, it leads to increased competitiveness and enables firms to compete more effectively in global markets. Finally, cost savings by firms are passed onto consumers in the form of lower prices which in turn encourages demand, more output and increases in employment.

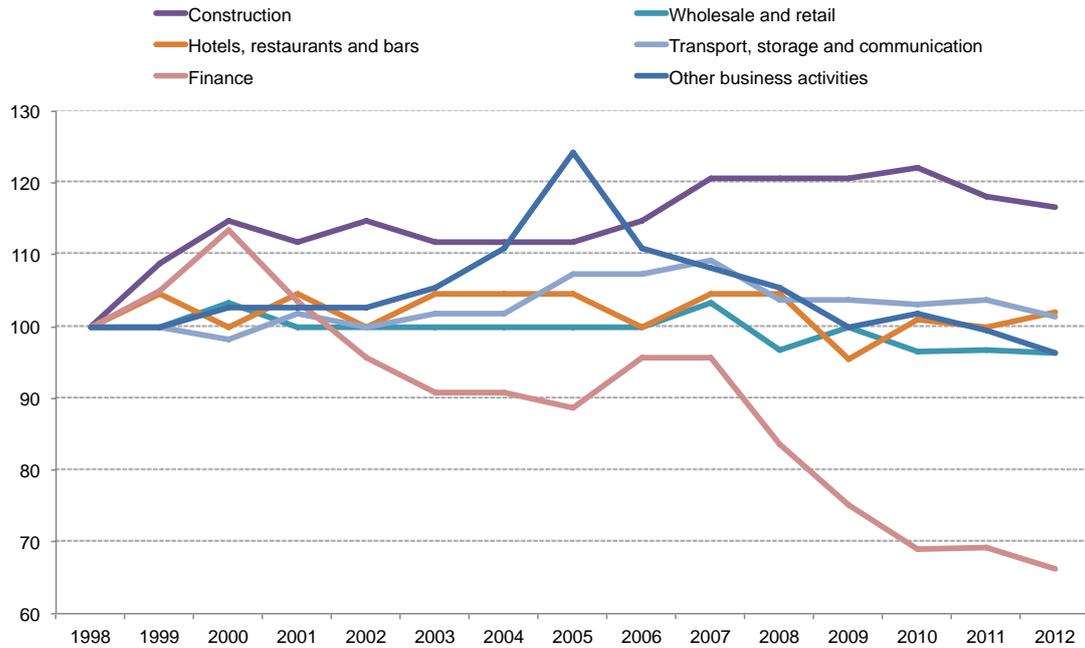
3.3 The FPP's Annual Report drew attention to productivity when it noted that:

The longer-term outlook is clouded by the continued weak productivity performance across the economy; the continued regulatory and competitive pressures on financial services; and the future impact of the ageing society.

(Fiscal Policy Panel 2013, p. 42)

3.4 A decade ago a former Chief Executive of the States, Bill Ogle, recognized that outside of financial services, productivity in Jersey's private sector was in danger of faltering. This was followed by an initial series of publications on productivity by the Economics Unit which linked to the anti-inflation strategy and first Economic Growth Plan. Since then, the debate about productivity has faded. This is unfortunate. It should be stressed that the best proxy Jersey has for measuring productivity is GVA per full-time equivalent employee. Figure 14 shows the change in productivity since 1998 for the six largest private sectors in Jersey. This illustrates why the former Chief Executive was right to be worried about productivity. Overall GVA per FTE has fallen by about 14% in real terms over the period 1998 to 2012: in the finance sector it has decreased by a third (34%). Aside from construction, no other sector has seen a sustained growth in productivity over the period. The most worrying item on the chart is the fall of over 3% per annum in the finance sector.

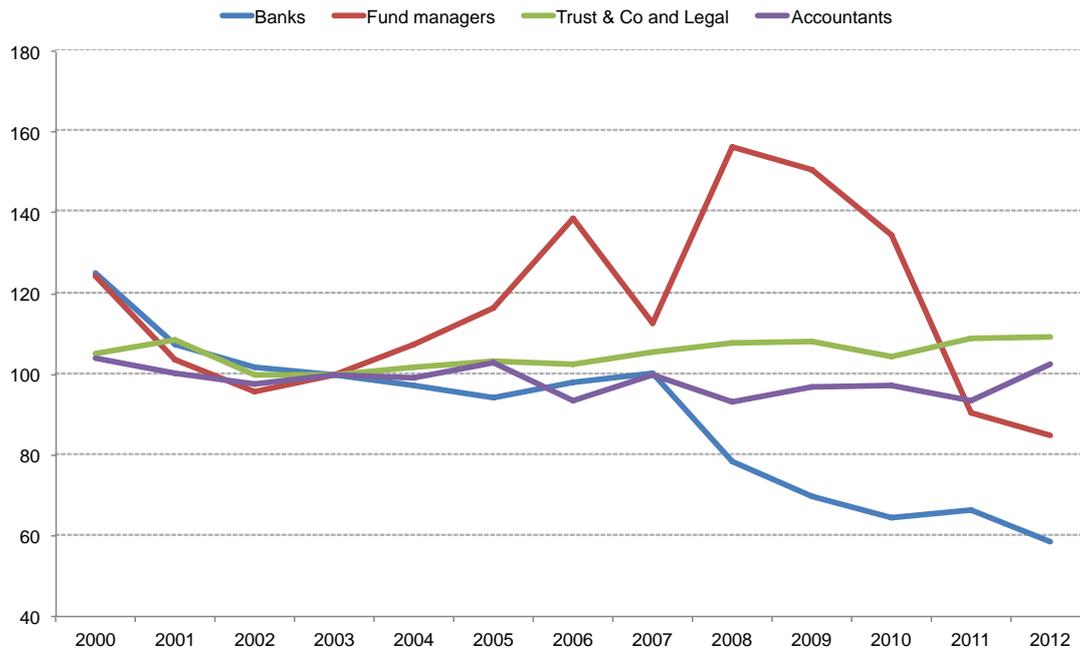
Figure 14. GVA per FTE by sector, constant prices (index, 1998 = 100)



Source: States of Jersey Statistics Unit

3.5 Although in current income terms, GVA per FTE in the finance sector is almost double the average of all other sectors, there is no room for complacency for two reasons. First, as finance is such a big contributor to Jersey's GVA, with falling productivity, standards of living in Jersey will fall. Secondly, productivity cannot be looked at purely in terms of the domestic economy: faltering productivity should be examined by a comparison to what is happening in other jurisdictions. As economists have shown, stark differences in productivity across countries account for a substantial amount of the differences in average per capital income; over time, country X will become poorer relative to other countries (Hall and Jones 1999; Jones and Romer 2009). Figure 15 makes sober reading.

Figure 15. GVA per FTE by Finance sub-sector, constant prices (index, 2003 = 100)



Source: States of Jersey Statistics Unit

In the banking sub-sector, which is the most profitable part of finance, there has been a significant fall in productivity of around 6% per annum since 2000. Although some have argued that this is due to the low interest rate environment and that profitability and productivity will return to banking when interest rates are raised, the fall in productivity began before the implementation of unconventional monetary policy in 2009. As is recognized by outside experts, including McKinsey, the adverse market trends for the finance sector include ongoing external and regulatory challenges, not all of which can be quantified. This suggests that any significant renewal in productivity growth and output is not a forgone conclusion.

3.6 Given this backdrop, the 2014 Budget has missed an opportunity to discuss the economic implications of why productivity matters. Not only could this have linked to some of the references in the 2011 Economic Growth and Diversification Plan but more importantly, it could have introduced some radical incentives to bolster the supply-side of the economy. The discussion above about productivity should not have caught people unawares: the welter of reports and comments from independent experts over the last decade has suggested that future high levels of income growth should not be taken for granted in Jersey. Many other countries have recognised that the challenges and opportunities provided by globalization require a new focus by their governments on the supply-side of the economy.¹¹⁰

3.7 In evidence to the Scrutiny Panel, the Institute of Directors called for a Seed Enterprise Investment Scheme.¹¹¹ Jersey's Economic Development Department (EED) are considering this and a Venture Investment Programme. £5 million (out of a promised £10 million) has been allocated to an Innovation Fund administered by EDD. However, all of

¹¹⁰ For example, a quick review of 2014 Budget statements by the Canadian, Irish, Maltese, Malaysian and Singaporean governments illustrates the emphasis given to boosting productivity and competitiveness in their economies.

¹¹¹ Corporate Services Scrutiny Panel 2014 Budget Review Hearing with the Institute of Directors, 21 Oct. 2014.

this is arguably very modest when compared to the announcement by the Treasury Minister in Singapore in his Budget in February 2013. Recognizing that productivity increases were not an option but a necessity for businesses, the government announced support to businesses of about \$5.3 bn (1.7% of GDP) for the next two years. This included a Wage Credit Scheme, where firms reward workers for productivity improvements and motivate them to further increase productivity. There was a boost to Singapore's Productivity and Innovation Credit scheme, which since 2010 has provided significant tax deductions for investments in a broad range of activities along the innovation value chain. Local firms were also given a rebate of 30% of the Singapore corporate tax. There were also enhanced productivity incentives announced as well which included an Intellectual Property Financing Scheme to foster growth among knowledge-intensive, asset-light SMEs and the promotion of technology and innovation in the construction sector.

- 3.8 The comments above are not intended to downplay two potentially significant investments in Jersey which could unleash important productivity gains. First, Digital Jersey, which has a very ambitious Business Plan for 2014.¹¹² Secondly, the money being spent by Education, Sport and Culture in its 'Vision for IT in Education 2013 – 2015, "Thinking Differently" '. It just seems unfortunate that an opportunity was missed in the Budget to reinforce and highlight the productivity improvements that these could generate for the economy, which in turn begs the question of whether policymakers really appreciate the significance of productivity enhancements for the Jersey economy.

¹¹² <http://www.digital.je/news/strategy-business-plan-for-2014>

4. OVERALL CONCLUSIONS AND OBSERVATIONS

- 4.1 Jersey's economy has contracted for five consecutive years. Although there are some signs that the economy has improved slightly in places during 2013 compared to 2012, at the time of writing it is premature to talk about an economic recovery talking hold.
- 4.2 The 2014 Budget has been described as a budget for jobs and economic growth. Given that the economy was in need of some form of economic stimulus in 2012 and 2013 it is unfortunate that this Budget was not presented to the States Assembly in 2011 or 2012.
- 4.3 The report for the Panel from CIPFA has identified some of the problems with expenditure going forward; a specific criticism from an economic perspective is that there is no clear explanation of how any short-term stimulus will immediately affect the economy and meet the '3Ts' (temporary, timely and targeted).
- 4.4 A government budget should play a central role in economic and financial policy making. In place, the 2014 Budget reads more like an accounting exercise rather than a statement of economic policymaking backed up by accounting. Many commentators welcomed the introduction of the MTFP but the FPP noted that its economic impact was not considered fully. The same criticism can be made of the 2014 Budget which does not provide any clear macroeconomic framework through which the impact of the Budget can be measured.
- 4.5 Aside from a minor upward adjustment in the income forecast for 2014, the figures published in the MTFP have not been revised for the Budget. It needs to be remembered that the central forecasts in the MTFP formed the basis for expenditure decisions: it is unclear how policymakers will pay for these if income is not received.
- 4.6 Given the weakened fiscal position it is unclear why the marginal rate of tax is being cut now. It will not provide an immediate fiscal stimulus and the introduction of the Long Term Health Charge will partially reduce the impact of the tax cut from 2015. In addition, there is no evidence that with recurring costs of £8m each year, the structural change to the tax system have been considered from an economic perspective.
- 4.7 The Budget recognizes that Jersey's taxation system is overdue for reform. However, a thorough analysis is needed of which taxpayers in Jersey would be better or worse off with a move to independent taxation with the inclusion of a transferable allowance.
- 4.8 This report has drawn attention to Jersey's poor productivity record in the private sector and the steep falls in GVA per FTE in finance and the banking sub-sector since 2000. This should be of serious concern to policymakers.
- 4.9 Economic theory suggests that if real wages are higher than underlying productivity of the economy can support then some people will be made unemployed. This has happened in the private sector over the last four years as Figure 6 can attest. Productivity in the public sector has not been discussed in this report but as Figure 5 has shown, the growth of employment continues to rise in the public sector. Whilst some commentators will argue that during an economic downturn more jobs should be created in the public sector, in reality there appears to have been little serious appetite to reduce public sector employment during economic recovery. The time has come for a careful and considered assessment on the growth of the public sector.
- 4.10 As public expenditure in Jersey continues its inexorable rise, significant sums of money are planned for public infrastructure over the next decade or so. Arguably, without a vibrant and growing economy producing high value jobs, public infrastructure investment on the scale planned for in the 2014 Budget is potentially a luxury that the Island cannot afford.

References

Fiscal Policy Panel. (2008), *Jersey's Fiscal Policy Panel Annual Report*, September.

Fiscal Policy Panel. (2013), *Jersey's Fiscal Policy Panel Annual Report*, November.

Hall, Robert, and Charles Jones. 1999. "Why do some countries produce so much more output per worker than others?", *Quarterly Journal of Economics*, Vol. 114, No. 1, pp. 83–116.

Jones, Charles I., and Paul M. Romer (2010). 'The new Kaldor facts: ideas, institutions, population, and human capital', *American Economic Journal: Macroeconomics*, Vol. 2, No. 1, pp. 224-45.

States of Jersey. (2013). 'Draft Budget Statement 2014', October.