

STATES OF JERSEY

Corporate Services Scrutiny Panel Fiscal Strategy Review

WEDNESDAY, 27th OCTOBER 2010

Panel:

Senator S.C. Ferguson (Chairman)
Senator F.D.H. Le Gresley
Deputy T.A. Vallois of St. Saviour
Mr. M. Oliver (Adviser)

Witnesses:

Senator T.A. Le Sueur (The Chief Minister)
Mr. B. Ogley (Chief Executive)
Mr. M. MacGregor (Tax Policy Advisor)

Also present:

Mr. S. Le Quesne (Scrutiny Officer)

[11:30]

Senator S.C. Ferguson (Chairman):

How are you, Chief Minister? Welcome to this hearing of the Corporate Services Panel on the Fiscal Strategy Review. You have got the notice there, which I think you possibly know by heart by now.

The Chief Minister:

Yes, practically.

Senator S.C. Ferguson:

I wonder if you could possibly just say who you are for the benefit of the press who are here and the ladies who will be doing the transcribing.

The Chief Minister:

Certainly. Senator Terry Le Sueur, the Chief Minister.

The Chief Executive:

Bill Ogley, the Chief Executive.

Tax Policy Adviser:

Mark MacGregor, Tax Policy Advisor.

Mr. S. Le Quesne:

Sam Le Quesne, Scrutiny Officer.

Deputy T.A. Vallois of St. Saviour:

Tracey Vallois, Deputy of St. Saviour.

Senator F.D.H. Le Gresley:

Senator Francis Le Gresley.

Mr. M. Oliver:

Michael Oliver, Adviser to the Committee.

Senator S.C. Ferguson:

Sarah Ferguson, Chairman. Tracey?

Deputy T.A. Vallois:

Thank you. Firstly, the Fiscal Strategy Review Steering Group was set up to help with the Fiscal Strategy Review. What role did you play in this review and steering group?

The Chief Minister:

A participant with, I hope, a degree of knowledge. I think being Minister for Treasury and Resources some years previously and involved in a previous Fiscal Strategy Review, to which I might refer later on, and just part of a team. Really what we wanted to do is to ensure that what was being proposed was something which was financially sound but also fitted into the overall States policies. So it was a mixture of expertise and co-ordination.

Senator S.C. Ferguson:

How much input did you bring on the Social Security side from your experience?

The Chief Minister:

Again, all experience no doubt helps, particularly when it comes to some of the matters of the interaction between different factors and the overall effect it has on different sections of the community.

Deputy T.A. Vallois:

So what actual role did the Chief Minister's Department play in the group with regard to strategic planning, social policy, with regard to economic issues?

The Chief Minister:

One has got to remember this was primarily to deal with a financial problem, a financial shortfall, and so the lead for that inevitably fell on the Treasury and Resources Department. So the Chief Minister's Department's role was one of support really rather than being in the vanguard of the policy development. Nonetheless, because of the way the steering group worked, with the involvement from people such as myself and other Ministers, there was, I hope, a degree of co-ordination and understanding and additional brains maybe.

Senator S.C. Ferguson:

Given that any review and policy proposed under this would, in fact, have a social impact, was this considered as part of the review you were doing? Did you have a formal review of what is the social impact?

The Chief Minister:

A formal review in respect of the impact which the tax proposals might have at different income levels in the community and how, in particular, some people might be adversely prejudiced by a particular combination of effects. But I think it was clear to me that given the magnitude of the situation and the need for us to find a joint solution, most members of the community will suffer to one extent or another. Clearly you would want to minimise the impact on the least well off. Nonetheless, that is not to say that there will not be any impact at all and that can be both direct and indirect. If there are no wage increases for a year but prices go up, there is inevitably an impact on the wage earner.

Senator S.C. Ferguson:

All right. Going back a bit, are you able to explain to the panel the specific sectors and areas of expenditure that have contributed to the £100 million deficit?

The Chief Minister:

The £100 million deficit was not made up entirely of expenditure increases. It was also in no small measure due to the downturn in fiscal receipts and that is an inevitable consequence of the economic downturn that we have all seen over the last few years. I perhaps ought to stress because sometimes people think that this deficit is all due to Zero/Ten: it is nothing to do with Zero/Ten. That was addressed some time ago. This is simply because of the economic downturn, the effect primarily this has had on the financial services industry. If we look at the out turn for 2009, while the economy generally declined by a factor of about 6 per cent, the financial services industry declined significantly more in terms of its revenue or its output, if you like, and therefore by its tax returns. That inevitably had a significant effect on the States revenues. In addition, there are spending pressures and I think we are probably all aware of that. For example, in Health, we seem to have an inexorable rise in costs due to standards rising, drug costs rising and so on, and to a lesser extent that may be reflected in other sectors of public spending. The fact is one gets conditioned to spending money when times are good and it is quite difficult to change one's thinking when times are not quite so good but changing one's thinking is a necessary part of dealing with a deficit of this nature, particularly when it is quite clearly now a structural deficit rather than a cyclical deficit. I think at one stage people were thinking in terms of cyclical deficits which come and go, which is why we digressed slightly over the stabilisation fund, but what we are facing here is not a cyclical deficit but a structural deficit.

Senator S.C. Ferguson:

If it is a structural deficit, then obviously the shape of the economy as it goes forward will be different than the shape it has had before.

The Chief Minister:

Inevitably, yes.

Senator S.C. Ferguson:

Where do you see the differences?

The Chief Minister:

The difference is that the contribution in gross terms from financial services is going to take a while to recover and that is not anything that Jersey can do very much about because it is largely geared to global interest rates and global economic activity. Now for good reason, I suppose, interest rates have stayed low for some considerable time. That has some economic benefit but in terms of tax revenues it is not necessarily so favourable to us when the structure of our economy is quite heavily dependent on the impact of interest rates.

Senator S.C. Ferguson:

Yes. Have we worked out how much we are dependent on interest rates? The markets on which financial firms' profits, their portfolio valuations, portfolio fees, the market values are really quite reasonable.

The Chief Minister:

Yes, they are indeed, and I think this reflects 2 things. Firstly, it reflects the importance of having, as we do have, a more diverse financial services industry than some people think but also the effect that particular banking structure in Jersey creates of being very much geared to deposits and interest yields and the profitability on those interest terms. While there is a need to move into other areas as well, there is no doubt that we are going to maintain a significant proportion of our activities in that sector.

Senator S.C. Ferguson:

Before undertaking the C.S.R. (Comprehensive Spending Review) and the F.S.R. (Fiscal Strategy Review), did you at any point return to the drawing board, as it were, and examine the first principles about how the States runs its accounts, for instance looking at borrowing in capital markets in order to fund capital expenditures? I hesitate to mention the words “energy from waste” but ...

The Chief Minister:

No, by all means mention them because I think the first principle or how the States runs its accounts, I would say ... and we have discussed this in the past, but first of all you need to have decent information on which to base your policies, which is why I think both I, as former Minister for Treasury and Resources, and you I think possibly had this role within the Public Accounts Committee, saw the importance of G.A.A.P. (Generally Accepted Accounting Principles) accounting and the need to have reliable information on which to make informed decisions. So, to that extent, yes, the first principle of how it runs its accounts would be to get good information out in order

that you can make good decisions. In terms of borrowing to fund capital expenditure, that is something which we did look at at the time of the previous fiscal review and we looked at again now and there is no particular problem in funding capital expenditure through borrowing. I am not fundamentally opposed to it except one has to appreciate the consequences of it. Firstly, what it does is transfer a problem from one generation to another. If we take the Energy from Waste plant, instead of it being paid for by this generation, it will be paid for over whatever time period by this generation and the next generation. The long-term effect is very similar although you may think that having cash in hand, it is better to use your own cash rather than borrow it and pay an interest turn to the lender. Certainly that sort of a capital expenditure was considered and that was one of the options for the E.F.W. (Energy from Waste) plant and will continue to be an option in the future for other significant areas of capital expenditure that we have. If you like, we are less fortunate now having the luxury of having spare cash which we can use rather than having to borrow. But in some ways that is quite good because it then does impress upon you the capital cost of an asset and the long-term cost of that asset and the replacement cost of that asset. As I say, I have got no particular fundamental difficulty with the idea of borrowing but, of course, it is a commitment that once started, you cannot get away from. Now, as long as you are accounting for that in the proper way and accepting the fact that there is liability which will stretch over the next 10, 20, however many years it will be, which needs to be reflected in your financial situation, your financial calculations, that is fine. That requires, I think, perhaps a greater financial discipline and greater long-term planning than some States Members currently seem to want to grasp.

Senator S.C. Ferguson:

Yes. What sort of meaningful consultation with the public or debate among States Members on the point about capital expenditures did you have before the various cuts and taxation proposals were put forward?

The Chief Minister:

I think in this particular consultation exercise, there was less importance placed on that. We had done that 5 years ago in the previous fiscal strategy. I think the arguments then would be very much the same arguments as we have today and really, in a place like Jersey, if you are going to borrow, you need to have reasonable certainty of security of revenue going forward. Now a government can always achieve that certainty of revenue going forward by taxation measures but that is not a particularly desirable way to achieve that certainty when you are in a competitive international market.

[11:45]

Senator S.C. Ferguson:

Yes, because technically, according to the economists, in order to stimulate growth, we should be cutting taxes, should we not?

The Chief Minister:

Yes. I am not going to expand on economic theory; there are people that are better qualified to do that than me. While you may want to stimulate activity by cutting taxes, you also have to balance your books. If there was a simple solution, I think we

would not all be sitting around this table and scratching our heads and worrying for months as we all do.

Senator S.C. Ferguson:

Yes. If the Green Paper consultation exercise for the F.S.R. showed anything, it was that the public has grave misgivings concerning any proposed increase in G.S.T. (goods and services tax). How have you factored these concerns into your final proposition?

The Chief Minister:

I am not sure that the consultation exercise highlighted the misgivings about G.S.T. I would say that what the consultation exercise highlighted was the desire by the public to see the States get its spending under control before we raise more taxes. The issue of which taxes those might be if there had to be tax measures as well was, I think, a secondary one to that of getting spending under control. Now, in terms of which tax measures to adopt, as you will be aware from the consultation different tax measures have different impacts on the economy and on the public and whereas income taxes and payroll taxes may look nice and progressive, they may have an adverse effect on economic growth. So what you have got is a conundrum that there is no perfect tax. The tax which is good for economic activity is not necessarily the tax which is so good socially and vice versa. So what you need overall is a balance of tax measures which achieve, I suppose, a middle of the road outcome.

Deputy T.A. Vallois:

Your point with regard to the consultation process, how people think that the States should get their spending under control before more taxes are introduced, from the supporting research document the principal aim of the tax system is to finance the level of public expenditure chosen by society. So, from the results of that actual consultation I would suggest, or maybe you would like to comment, as to whether, in actual fact, the level of taxes that are being paid and the services that we are providing are they chosen by society and, if so, how?

The Chief Minister:

The level of taxes is, I suppose, chosen by society insofar as you have got this balance. The more services you want the government to provide, the more fiscal revenues you have to take to generate that revenue to pay for them. Now, it is certainly true that Jersey has a relatively low effective tax rate compared with many countries in the Western world and there may well be scope in that sense to have a higher level of overall effective taxation and a higher level of public services. The effect of that, of course, is that you risk undermining your competitive position and how far do you go along that route before your competitive position gets seriously and permanently undermined. There is, I think, the danger, which I think we all can see, of simply saying: "Look, if we have got a spending pressure, let us simply raise a bit more taxes to solve it," rather than saying: "Let us get our spending under control." So, to that extent, the fact that Jersey has a relatively low tax base could be counterproductive in that some people see it as an easy way out. The reality is that we are in, as I say, a very competitive international environment. We are not competing so much with the Scandinavians or the Germans of this world; we are competing with other offshore financial centres. So it is also against them that one has to have a

comparison and in comparison with many of those offshore financial centres, our effective tax rate is sort of just competitive and not necessarily a huge competitive advantage.

Senator S.C. Ferguson:

Yes, but Deputy Vallois was asking about the social drivers of expenditure. Now, has government just allowed the social drivers to encourage it to expand into areas where it should not be?

The Chief Minister:

Quite possibly yes. Government tends to provide services to the extent that society feels a strong need for them. What it is less good at doing is deciding if new pressures come along, as they do, what older ones might no longer be quite so important. So it tends to be a one-way street, that new services get provided over and above what was previously existing but old less important ones are harder to remove. If that is the case, then government spending will inevitably continue rising, I suppose indefinitely, and the only way to overcome that is to have some sort of discipline in overall spending.

Senator S.C. Ferguson:

How are you going to encourage that discipline among your Ministers to look at what they are doing and decide what they should not be doing or even what government should not be doing as a whole?

The Chief Minister:

I think that is where this process this year, which I have to remind you has started but is by no means complete, of having fundamental reviews of some of the major spending departments becomes so important, particularly when those reviews are also guided and influenced to some extent by non-States Members. There is a danger that politically we get drawn into a mindset, if you like, which is a physical mindset rather than a commercial or a social mindset and sometimes it takes an outside view just to question at least - not necessarily to say we are wrong - whether things should or should not continue to happen. So I am optimistic that over a period of time those reviews will, in fact, show a need to transform our major spending departments. I think a clear one there is Health where the advent of a new chief executive and a new hospital manager and their view that a review of the Health provision in the Island is of paramount importance to setting our future plans is something which I would very much welcome because I do see, I am afraid, Health as being an ongoing challenge politically for several years to come.

Senator S.C. Ferguson:

All right.

Senator F.D.H. Le Gresley:

Could I ask the Chief Minister whether he considers that our personal taxation system is fair?

The Chief Minister:

Yes, I do. A person at today's meeting went back to the paper which I presented in 2005 about the principles of taxation which ought be adopted and the key issues of

progressivity and inclusion, and I have always been very much of the view that our tax system does need to be progressive or probably mildly progressive. What I often have difficulty in conveying to my colleagues and some of the public at large is that the tax system as a whole needs to be mildly progressive in my view but individual elements of it may well be regressive or may well be highly progressive but so long as the overall package for all sectors of the community remains progressive then that would achieve one of my key objectives. There are other objectives, which I set out in that document some years ago, of efficiency and simplicity and diversification and supporting the economy. All those principles need to be brought together but I think the idea of a progressive tax system is one which is necessary if you are going to get public acceptance of it and thereby hopefully political acceptance as well, or maybe it is the other way around.

Senator F.D.H. Le Gresley:

Could I just follow up? On that basis, do you think that once again we have missed the opportunity in this budget proposal to look at personal taxation and that we have avoided dealing with personal taxation and the fairness of it?

The Chief Minister:

I do not think we have. I think this is a philosophical argument where even my view has changed over the years since the time I was the President of Social Security. But in terms of pure economics, I think it is fair to say that social security contributions are, as far as the contributor is concerned, a form of taxation and as far as an economist is concerned it is regarded as a form of taxation. In fact, it is currently a form of taxation linked to a certain level of benefits and a direct linkage and a direct

personal connotation but nonetheless, from a purely economic point of view, social security contributions are a form of taxation. The proposals of the Minister for Treasury and Resources in the forthcoming budget to increase the social security charge on incomes above £44,000 a year is effectively, in terms of economic impact, a form of taxation, a progressive form of taxation on higher incomes. So I think, yes, the answer is we have looked at personal taxes. We looked at that. We looked at income tax and rates of personal income tax and had to decide on balance which was likely to have more economic impact, which was like some of the other measures or principles I spoke about might be adversely affected even if we still achieve progressivity in the same old different ways. I believe that the social security element of the proposals of the Minister for Treasury and Resources are progressive and that, combined with the other measures he is putting forward, the overall package is and remains mildly progressive.

Deputy T.A. Vallois:

Can I ask on what basis you believe that the tax structure, as it is at present, is sustainable in the long term?

The Chief Minister:

The tax structure I think is certainly sustainable. Whether existing rates remain sustainable is going to be very much a political question. I believe that they can be and if we are going to achieve some of our success by maintaining economic prosperity, will need to be. There is a grave danger, I think, that we can generate so much tax revenue that we lose all our business.

Senator S.C. Ferguson:

Which would be somewhat of a pyrrhic victory.

The Chief Minister:

Yes.

Senator S.C. Ferguson:

Yes. What research and risk analysis have you undertaken with regard to the impact that a rising G.S.T. will inevitably have on Income Support payments?

The Chief Minister:

Therein you have got the similar impact problem that you had when G.S.T. was brought in 3 years ago and measures were proposed initially to shield the less well-off from the effect of G.S.T., and in particular in relation to the fact that in Jersey we felt that it was better to have a simple G.S.T. system with no exceptions for things like food or the various other ones which we debated ad nauseum in the past, and that therefore some other mechanism was required to support those initially receiving Income Support. It was then appreciated that there could be people still relatively poor but not in receipt of Income Support who might also need some support in a different manner, and that created the slightly artificial but simple solution of having a bonus paid to those not in receipt of Income Support but who nonetheless did not have an income sufficiently high to fall into the income tax bracket.

[12:00]

Bearing in mind that we still have over 25 per cent of potential taxpayers who do not fall into the income tax bracket, that is a significant number of people. I have not got the up-to-date figures, possibly you could ask the Economic Adviser at some stage, but when we did this in 2005 and tried to look at that in comparison with income quintiles from the income distribution survey it was quite difficult to get a perfect correlation but we were satisfied that it was probably as good as one could get in that sort of situation. The cost at that time was estimated to be in the region of £2 million or just under for a 3 per cent rate. My guess is that if you extrapolate that in simple terms, the additional 2 per cent, it will probably require between £1.25 million and £1.5 million allowing for a slight measure of inflation and so on, and that has been built into the forecasts for additional Income Support that would need to be provided. If you look at the budget document you will see that although there is a figure for gross yield from G.S.T. there is also an offsetting figure for the counterbalance of additional Income Support required of about £2 million. So, yes, I think the financial effect in global terms has been covered and built into these things. In terms of the personal impact on every individual consumer, no, it has not been revisited and I would assume that the same principles as applied when G.S.T. was introduced will still hold good.

Senator S.C. Ferguson:

Yes. Given that 18 per cent of personal taxpayers produce 60 per cent of the income, which is something like 12,000 people, we have something like 37,500 people in the marginal rate and I think it is something like 18,000 in the nil rate. Are we going to have to rebalance that a bit?

The Chief Minister:

In the same way as they say you cannot get blood out of a stone, it is very difficult to get taxation out of people who have got no income, or in fairness to them, living on very low incomes. Jersey can be a quite expensive place in which to live and there will be some people who are going to struggle at the margins here as elsewhere. So I think from a social point of view there will always be people for whom it will be difficult to make a realistic contribution to tax revenues. On the one hand I want to see inclusivity and as far as possible that everyone should contribute to these services that the Island provides, and to that extent or to some extent those on lower incomes do that through the contribution they pay on indirect taxes, be that on G.S.T. or on tobacco and alcohol duties, petrol, impôts duties. We have to accept that policy is not purely one of tax raising but people have to live, and people have to live as a society. So, yes, there will always be some people. Whether you reduce that 27 per cent down to 20 per cent, 15 per cent or raise it to 30 per cent is going to be a matter of political judgment and the amount of revenue that one needs.

Senator S.C. Ferguson:

I was just considering should we be reviewing the marginal rate band, which is not understood by many people.

The Chief Minister:

It is certainly not understood by many people. It did get regularly reviewed but because it is misunderstood people seem to think it is a higher rate of tax, whereas the reality is that even though numerically it is a higher rate of tax than 20 per cent, the effective rate of tax that people pay is always going to be less than 20 per cent and if

they were better off on the 20 per cent rate they would be assessed under the 20 per cent rate. So, yes, you can adjust the marginal rate and it does have an effect on tax revenues. It has also an effect on the transition point between one and the other and it does get reviewed, or it used to get reviewed certainly in my day, on an annual basis. You would have to ask the current Minister for Treasury and Resources whether he still does that.

Senator S.C. Ferguson:

We shall. Do you have anything at the moment?

Senator F.D.H. Le Gresley:

I have a question, but it can wait if you want.

Senator S.C. Ferguson:

What would you say was your long-term strategy?

The Chief Minister:

Long-term strategy I suppose follows very much the Strategic Plan, that firstly you need to maintain balanced budgets and we need to get back to that as soon as possible. We need to maintain a strong and diverse economy and as a personal long-term strategy I would like to see us in the longer term returning to a situation of having surpluses that we could put back into a stabilisation fund to follow the excellent principle that we had of being able to provide for economic downturn in a way which, going back to an earlier question, enables the economy to survive and not be so adversely affected in those times when spending might be reduced otherwise. At the

present time it seems to me unlikely from our figures that we will get to budget surpluses we can put away, but certainly my longer term strategy would be to achieve that objective.

Senator S.C. Ferguson:

Yes. Will any of the proposals that you are putting through in the F.S.R. provide fundamental sustainable solutions to our long-term problems, such as the rising cost of long-term care and supplementation and so forth?

The Chief Minister:

Supplementation I might deal with separately because it to some extent has been addressed by the Social Security changes which will have the effect of reducing the demand for supplementation, but in terms of the longer term issues such as you mention I would like to address those straight away but the reality is that we have spent the last couple of years addressing a significant economic downturn. My first objective has got to be to go back to a balanced budget situation which we currently do not have. In that situation to suggest major new areas of expenditure at the same time would be perhaps a bridge too far as they say. That is not to say that they are not being planned for and I think one of the things we would have to do is to see different ways of funding some of those particularly significant capital expenses which I know are going to arise in the future. Going back to our earlier conversations, that funding may be by way of user pays charges, it may be by way of borrowing, whatever it is it is going to have an impact and that impact needs to be planned, and perhaps now is not the time to be incurring significantly higher charges, either in terms of taxation or

borrowing. What we have to do first is get back to a stable situation, a stable platform on which then to go forward.

Senator S.C. Ferguson:

Yes, but we have also got to look at, at the same time, surely, proposals such as increasing the retirement age?

The Chief Minister:

Yes, absolutely. That is something which has taken the minds of people here and elsewhere and there is no doubt in my mind that the retirement age for Social Security purposes is going to need to go up over the years to come to some extent or another, be that 66, 68, 70. That takes time to manage, it needs actuarial advice, but also we are in a situation in Jersey where you have got a transition in the current imbalance between male contributors and female contributors and the different arrangements there which do not fully wash out of the system until 2020. It would therefore make more sense from a social and fairness point of view that any increase in retirement age would probably come into effect by 2020 or very shortly before, around that time. But that is not to say one should not start planning for it now. There are a number of issues facing Social Security over the next few years. We have spoken already about retirement care. There is the actuarial change as longevity seems to increase and investment yields seem to be flat or maybe falling slightly under flat. You have to rely on the advice from the actuary rather than myself on those matters. Certainly there are significant challenges facing Social Security and which are being addressed by Social Security. But they are not short-term fixes. The measures proposed when I was Social Security President in 1998 for increasing the Social Security contributions

then was to deal with the problem which I foresaw in 2015 and we have got the same sort of long-term planning that we need to have in those matters, because pension matters are a long-term planning issue. So, yes, you start planning early.

Senator S.C. Ferguson:

The French have started already.

The Chief Minister:

The French have started already, but they have got a little bit of a catch-up to do.

Senator S.C. Ferguson:

So what are the Council of Ministers' over-arching political objectives in terms of income tax, social security and G.S.T.?

The Chief Minister:

They are the ones which we have had for many years now, that you need to have a balance and I think at the present we are still quite heavily dependent on direct taxation in one form or another. G.S.T. going up to 5 per cent will achieve a slight change in that balance, but we need to have a variety of measures in order that we can choose the appropriate one at the appropriate time. G.S.T. or Social Security may be appropriate ones for the 2011 budget. It may well be in a couple of years' time because of other social security pressures that that would not be a suitable measure to use, if one were to require further tax-raising measures. I said perhaps naively a couple of years ago that G.S.T. could stay at 3 per cent for many years now provided we kept our spending under control. The fact is we did not keep our spending under

control, for one reason or another, and G.S.T. is not planned to stay at its current rate for the length of time that I would have hoped. We have got to accept the fact that there will be competing pressures.

Senator F.D.H. Le Gresley:

Could I ask the question about the effect of these budget proposals on middle income earners, given that the 20 means 20 withdrawal of allowances, the final year is next year, 2011 and then we are going to introduce, if this is approved, an extra 2 per cent on earnings over £44,000. Do you feel that middle income earners are being targeted fairly or unfairly?

The Chief Minister:

I think they are being treated very fairly. There is always someone who is going to produce an anomaly, their situation does not quite fit the general pattern, and for them it is going to be unfair. Other people would describe a fair tax as anything which taxes the other person but not me. We have to accept the fact that as the Chairman was pointing out earlier a significant part of our tax revenues is generated by a relatively small number of people and conversely that much about tax revenues follows a sort of 80-20 rule, if I can put it in crude terms. Now with that sort of situation it is going to be very difficult to please everyone.

[12:15]

If one looks at the analysis which the Economic Adviser did in the course of the Fiscal Strategy Review, I am not sure whether the graphs have been provided to the

panel but if not I am sure they can be made available. They show what the effect of the overall elements of the package are on different sectors of the community at different income rates. We did try to ensure that there were no anomalies, as certainly has happened in the past over income tax and Social Security, for example you might be better off out of work and claiming benefits than working and so on. You have got the poverty traps. The aim throughout this has been to ensure that there are no poverty traps, no apparent inequities or glitches in the overall progressivity and you impact on different sectors of the community and therefore the more you earn the more you pay, but also the more you earn the more you retain.

Senator F.D.H. Le Gresley:

Given that the 20 means 20 provisions have removed mortgage interest relief for a lot of middle income earners, was any thought given to abolishing mortgage interest relief completely?

The Chief Minister:

Yes. I recall, and you may recall, it was considered some years ago by a former Finance Committee President before my time and did not receive particular public approval. What we have seen, I proposed some years ago capping it at a certain level, and that level has stayed constant ever since. The effect, if you like the fiscal drag, means that it will have less impact as years go on. I hate to think that we will be in the year of £1 billion mortgages, but the reality is that so long as it does not increase and it may well be that there will be calls for it to come down to £200,000 or £100,000 you have to accept the fact that yes, it may impact on middle income Jersey. It may also impact on lower income Jersey as well and so it is quite difficult. You

cannot tailor mortgage interest relief to a certain class of people. What you have to do is to ensure as I say and keep saying that the overall system remains broadly progressive.

Deputy T.A. Vallois:

Mortgage interest relief was an option within the Green Paper as the other tax options. It is suggested that its existence is not in keeping with policy to make housing more affordable, since the evidence suggests that such tax relief simply gets capitalised into house prices. So if it is not in line with the policy why has it not been proposed as being removed?

The Chief Minister:

You will probably have to ask the Minister for Treasury and Resources on that one. I think in any budget proposals, policy proposals, you have got to look at an overall package and you have got measures here to increase G.S.T., you have got measures to increase Social Security contributions. You can try and attack on too many areas at once and the danger is it is difficult then to identify, if there are particular issues, what has caused them. It may well be that that is something to reconsider next year or the year after, but I think in the current situation the measures that are proposed are probably enough in themselves. You also I think have got to look at the revenue impact and just how much the revenue impact of that would be. I cannot give you an answer offhand but certainly it is less significant perhaps than one might think.

Deputy T.A. Vallois:

I think it was suggested roughly about £20 million, was it not?

Senator F.D.H. Le Gresley:

Yes, it was £20 million.

The Chief Minister:

If it were removed completely, but I am not sure politically if you would want to remove it completely all at once. You might want to do it over a period of years.

Deputy T.A. Vallois:

How does that fit in with the Strategic Plan if it supports the aim of the States Assembly to make housing more affordable?

The Chief Minister:

If it is a policy only to make housing more affordable I do not think that removing mortgage interest relief at this stage would necessarily achieve that. There are other economic factors to bring into account such as the availability of supply and availability of bank lending, so the difficulty is, it is a great economic argument which I fully endorse that mortgage interest relief tends to get capitalised into house prices, but to reverse that takes time to filter through. It was suggested that removing the Superannuation Fund relief on purchases of commercial property would mean that pension funds would no longer invest in Jersey properties. That has not proved to be the case and it has not equally proved to be the case that prices have dropped by 20 per cent or that yields have changed by 20 per cent. The market corrects to a small extent, but it takes time to see the full effect.

Senator S.C. Ferguson:

Given that a man earning I think it is nearly £40,000 a year with 2 children, a non-working wife and a mortgage does not pay any tax until as I say something like £40,000, is that sort of fair and progressive in the context of the overall tax system?

The Chief Minister:

The simple answer is yes, and is it capable of improvement, could one squeeze more out of that particular taxpayer group? Possibly, yes. I sit here in relative comfort, no longer having children to bring up. If I had 2 children at school, of teen age, and a house to maintain would I regard £40,000 a year as excess revenue? I do not know. I agree from the point of view of inclusivity that sort of person might well need to be contributing something in terms of our income tax system, but in terms of the overall income tax system I think there are always going to be anomalies where you can point to that person and say: “Hmm, he looks relatively well off” or: “Hmm, that person looks adversely penalised” and yet the system as a whole has to function in a simple way. I think sometimes that simplicity generates anomalies.

Senator S.C. Ferguson:

Yes, so would you summarise what you think to be fair in terms of the distributional impact and the inclusiveness of the tax system?

The Chief Minister:

Inclusiveness, currently the income tax system only includes the top 75 per cent, if you like, of taxpayers. The Social Security system takes revenue off anyone who is earning. The impôts system takes taxation from people who smoke, drink or drive

and G.S.T. takes a tax off those who spend which is everybody. So in effect there are 100 per cent of the Island population in a tax paying net. It is very simple and very simplistic to say that a quarter of them do not pay tax. What we mean is a quarter who do not pay income tax. That might well be an excuse for saying: "Well, in that case we should be less dependent on income tax and more dependent on other forms of revenue in order to maintain that balance." That ideal that we are all trying to seek and that is something which I would support, that we do need to have our tax system maybe still more balanced in favour of indirect taxation. Does that mean that we should jump to 20 per cent G.S.T. and 10 per cent income tax? I think perhaps not at this stage. But you can see that coupled with the economic theory of what is best you have got the practical reality of what you can deliver.

Senator S.C. Ferguson:

Given that in the U.K. (United Kingdom) there is quite a lot of work going on I understand looking at a flat rate of tax - I have heard figures of 9 per cent and 11 per cent with a very much simplified tax system talked about - what would be your view of that over here?

The Chief Minister:

It achieves one objective of simplicity very well. It creates an additional burden on lower income groups who at present are shielded either by the exemption rates or by the marginal rates, to a greater extent than they would be under a flat tax system. So you have to balance what is your key objective, or what are your conflicting objectives. If I wanted simplicity I would go for a flat tax rate tomorrow. If I wanted fairness and social justice I might be less inclined. So if you are going to have a flat

tax rate, and I am not saying that one should not, if one does have that sort of flat rate tax system one has to have an alternative way of providing income support in some way or another. Now, how one achieves that ... it can be done but again I think because of some of the difficulties that we have between different families in the community, even the differences that we have between the rent charged in the public sector and the private sector, it gets very difficult to achieve fairness for everybody. Have we achieved it now? Probably not entirely but I think we have got quite a way towards it. So I am satisfied that what we have got at the present time is something that is socially realistic as well as economically sensible.

Senator S.C. Ferguson:

What approach would you prefer? The more immediate gains of economic growth or the arguably slower process of diversification? Can we do them both at once?

The Chief Minister:

Being greedy, I would like to do both at once. I do not see them as being mutually exclusive. Diversification is necessary and is happening. Economic growth is desirable and I would like to see it happen and I would like to find policies which ensure that economic growth remains a viable option and if you like a stimulated option. The more we can generate from economic growth the less we need to generate from taxation or by cutting spending. But one cannot necessarily generate the economic growth that one would like in a time when the world economy is still gradually creeping out of the recession we have had for the last couple of years. So one has got to be realistic. If we could achieve levels of economic growth of 5 per cent per annum that would probably be great from an economic point of view. On the

other hand we did see in 2007 and 2008 significant levels of economic growth which were creating pressures which by the middle of 2008 were probably getting to be in danger of becoming overwhelming, pressures on house prices, pressures on wages, pressures on labour and so on. So in a finite Island like Jersey one has to be realistic about the level of economic growth which is sustainable over a longer term period. The plan has always been to try and get economic growth and on average of 2 per cent or 3 per cent a year, I forget what our current policy is. I should know but at the moment it is a little bit idealistic when any economic growth would be very desirable. So can we achieve significant economic growth at the present time? Quite difficult given the working environment. Can we achieve diversification? Yes, we can. I think very often people do not appreciate the diversification that already exists in the Island.

[12:30]

Not just within the financial services industry but in some of the other activities which are perhaps less well known. One talks about the big banks. One does not talk for example about the various patent firms that are in the Island. Without naming names, between the major players, they probably employ getting on for 1,000 people and contribute significant levels of expertise and income and play their part in the community as well. That is just one example. There are other very often quite small firms, 10 and 20 people, that we do not know exist and they do not particularly want to advertise their wares. They are probably working almost entirely outside the Island, generating external revenue which is what we want, providing different employment opportunities, and we are not aware of them. So I think sometimes this

idea that Jersey is a one-economy activity is a bit misunderstood. But yes, we do need to encourage that further diversification, partly for its economic benefit and also for its social benefit of providing different job opportunities for different sectors of the community, not all of whom want to work in a financial institution.

Senator S.C. Ferguson:

Yes, and feedback from the public and from commercial parties has shown that there is a concern that the F.S.R. proposals may just be about plugging holes. What is your long-term vision to drive the sort of tighter purse strings philosophy beyond 2013?

The Chief Minister:

The vision is going to be one of more fundamental change but those sorts of changes take quite a lot of planning and quite a lot of implementation. As I say at the moment we need to do one thing properly and the one thing properly that we need to do at the moment is to get back to balanced budgets. I would like to see more significant changes in the longer term, so I do not see 2013 and the return to balanced budgets as the end of the road. I see it as a milestone from which one can then go on to produce maybe some of the more significant things that we are talking about, and at the same time address some of the longer term issues that we are talking about. But I do believe in taking one step at a time and making sure that the next step is firmly entered.

Senator S.C. Ferguson:

So if we are talking about big government big spend, small government and small spend where would you see yourself on it if it is a scale of 10 for big government and zero for small government? Where do you reckon you see yourself?

The Chief Minister:

I am a typical middle of the roader. Are we not all?

Senator S.C. Ferguson:

No.

The Chief Minister:

But I suppose towards the small end of the spectrum, but what is small to one person is quite large to another person. So if I say I am a more towards the small government man it is all relative, is it not?

Deputy T.A. Vallois:

Can I just ask what you mean by long term?

The Chief Minister:

Long term, sadly, means 5 to 15 years. I would like to think longer than that but the reality is that times have changed and it seems to change more quickly as I get older than it did in the past.

Senator S.C. Ferguson:

That is just time going faster.

The Chief Minister:

The time is going faster, so my horizons may be slightly shorter. As I say, Social Security I used to think in terms of 30-year horizons with no difficulty at all but in terms of overall Government policy I think 5 to 15 years is more like it. That is the timescale I am thinking of.

Senator F.D.H. Le Gresley:

Your Minister for Treasury and Resources described in his budget paper the increase in G.S.T. from 3 per cent to 5 per cent as moderate. Would you agree that that term is appropriate?

The Chief Minister:

Yes. I suppose ironically when we were doing the planning on G.S.T. 4 or 5 years ago the figure at 5 per cent at that time was in the back of my mind and I think in the back of the mind of many people in the Island. But G.S.T. was brought in to generate a certain revenue, £45 million or thereabouts as part of the solution of Zero/Ten and being a man of my word in that respect when £45 million can be generated by a 3 per cent rate it would have been unfair to bring in a 5 per cent rate, even though it would have generated more revenue which in hindsight would have been quite handy to have. So do I regret not proposing the 5 per cent to start with? Only to the extent that it would have given us a better cushion to deal with where we are now. But no, that was the right policy at the right time and as I said earlier if we could have kept our spending under control it would have remained the right policy for the foreseeable future. It is a fact that spending keeps increasing, which has been one of our

downfalls and one of the things that we need to correct and which the fiscal policy and the C.S.R. policy does seek to correct.

Deputy T.A. Vallois:

Just quickly, in terms of competitiveness of G.S.T. it was suggested in the supporting research that there would be in due course a case study of the impact of a tax rise on wages from the introduction of G.S.T. Has that case study been completed?

The Chief Minister:

Not that I am aware of.

Deputy T.A. Vallois:

Okay. It also suggests that there is not yet a sufficient run of data to provide firm evidence on whether there was real wage resistance to the introduction of G.S.T. So it is inconclusive as to whether there was a change to the international competitive position of firms as a result of the introduction of G.S.T.

The Chief Minister:

I think in terms of relative impact of different fiscal measures to generate an equivalent amount of revenue G.S.T. is probably the best way of supporting the economy and I think the consultation paper indicated that. There were certain measures which could be quite harmful from an economic growth perspective but G.S.T. was judged less harmful in that respect. It had the drawback of in itself being slightly regressive but that was offset by the fact that there were other counterbalancing measures. So I think the short answer is it is difficult to say. In

terms of the impact on wage negotiations I would say again that that is as much driven by the current economic climate as by any G.S.T. charges or impôts duty charges or anything else.

Senator S.C. Ferguson:

All right. Super. I am sorry, we have overrun slightly, Chief Minister, for which I apologise.

The Chief Minister:

Perhaps I talk too much.

Senator S.C. Ferguson:

Far be it for me to agree with you on that. We are very grateful to you for the time and thank you very much indeed to you and Mr. Ogley and Mr. MacGregor and we will be sending you the transcripts in due course just to check the factual accuracy.

The Chief Minister:

Very good.

Senator S.C. Ferguson:

But anyway, if you had put it up to 5 per cent 3 years ago I am quite certain that your fellow Ministers would have found ways to spend it.

The Chief Minister:

I could not possibly comment. **[Laughter]**.

[12:38]