Jersey's
Fiscal Policy Panel
Annual Report
October 2020

Introduction

This is the thirteenth annual report of the Fiscal Policy Panel (FPP). The current members of the Panel are:

Dame Kate Barker (Chair, appointed 2014),
Professor Francis Breedon (appointed 2016),
Professor Richard Davies (appointed 2018).

The Panel was placed on a statutory basis in 2014. The FPP's statutory role was reiterated in the Public Finances Law (2019), which requires the Panel to comment on Jersey's fiscal policy with reference to:

a. the strength of the economy in Jersey;
b. the outlook for the economy in Jersey;
c. the outlook for world economies and financial markets;
d. the economic cycle in Jersey;
e. the medium-term and long-term sustainability of the States' finances;
f. the advisability of transfers to or from the Strategic Reserve Fund and Stabilisation Fund.

The Panel's work is guided by five key principles. These are:

1. Economic stability is at the heart of sustainable prosperity;
2. Fiscal policy needs to be focused on the medium term;
3. Policy should aim to be predictable, with flexibility to adapt to economic conditions to assist in creating a more stable economic environment;
4. Supply in the economy is as important as demand; and
5. Low inflation is fundamental to the competitiveness of the economy.

In making its recommendations, the Panel is guided by its understanding of the preferences of Islanders. The Panel feels that Islanders want government to be prudent and create the conditions for economic growth while respecting the Island's cultural heritage, maintaining the competitiveness of the economy and keeping inflation low.

In preparation of its reports the Panel has discussions with policymakers, business owners and managers, and representatives of public and private sector workers. The Panel is also grateful for the invaluable support provided by the staff of the Government of Jersey, in particular the Economics Unit and Treasury and Exchequer.

More information about the Panel, including previous reports, can be found at www.gov.je/FiscalPolicyPanel.

Key points

Economic Outlook

- This report is published at a time of extraordinary uncertainty with the ongoing effects of the Covid-19 pandemic affecting normal economic activity and the ongoing negotiations for a trade deal following the UK's withdrawal from the EU.
- World economic output is forecast to fall sharply this year, with Jersey's major trading partners all in recession and facing an uncertain recovery.
- Jersey's economy grew for the sixth consecutive year in 2019, with GVA rising by 2.1%in real-terms, largely due to strong profit growth in the financial services sector. However, the economic effects of the Covid-19 global pandemic mean that a severe recession is inevitable this year.
- High-frequency data provide an indication of recent developments in the local economy. These point to a sharp decline in activity, peaking towards the end of the June quarter, with signs of a recovery in the second half of the year.
- The recession has been uneven between sectors, with those that rely on social contact experiencing a sharper decline and a more gradual recovery. The hospitality industry has suffered most, whilst professional services industries such as finance have found it easier to adjust to remote working. Sectors such as construction and retail initially saw a significant decline but have recovered more rapidly.
- Support from Government has served to limit the damage to the local economy, principally through a wage-subsidy scheme to ensure workers remain employed, but also through innovative measures to boost demand such as the £100 Spend Local card.
- The outlook for Jersey's economy is for a continued recovery, but along a path of lower output. A key factor for the economy is the expectation for continued loose monetary policy settings and an ongoing reduction to banking profits as a result.

Public Finances

- As with the uncertain economic outlook, this Government Plan has been prepared at a highly uncertain time for public finances. The Panel recognises that it is therefore very challenging to plan for a four-year period. Both revenue and expenditure are subject to heightened uncertainty and therefore this will require more flexibility than usual in fiscal policy.
- It is appropriate for Government to plan to run significant deficits to support the economy this year, and in the initial years of the proposed Government Plan, bringing the budget back into balance by 2024.
- The total impact of the spending pressures and reductions to the revenue forecast, compared with Government Plan 2020-23, is £348m in 2020, reducing to £104m by 2023. This would therefore result in a significant structural deficit by 2024 in the absence of any measures.
- However, a range of measures is proposed – including an additional £20m of rebalancing/efficiencies, £13.5m of revenue measures and a reduction in the States Grant. The approach in the early years is to reduce the deficit by cancelling the States Grant to the Social Security Fund. The bulk of the revenue measures are planned for 2024, as is the additional £20m of efficiencies and rebalancing but the ongoing reduction to the States Grant remains the largest measure at £30m in 2024
- The Government Plan sets out a plan for £396m of capital spending over the four-year period including trading funds. Subsidiary companies are projected to spend a further £672m of capital over four years – making a total of £1.1bn for the wider Government Group. This excludes the majority of expenditure on the hospital, which will be set out next year.
- The Government Plan sets out a borrowing requirement of £457m to fund pressures resulting from the Covid-19 pandemic. Borrowing is expected to peak at over £700m in 2022 (14 % of GVA), a significant increase from 5% of GVA in 2019. This excludes any borrowing requirement for the hospital.
- The net asset position is expected to decline from over 150% of GVA in 2019, to less than 140% in 2022-24. The expenditure pressures and projected reductions in revenue will inevitably put pressure on the net asset position. The Panel recognises that these are unavoidable in the short term and that it would be inadvisable to put the economic recovery at risk by hasty action to maintain the net asset position.
- There are a wide range of risks to Jersey's fiscal position, including economic uncertainty, the outcome of Brexit, uncertainty around investment returns and achievability of efficiencies and revenue-raising measures.

Recommendations

1. It is appropriate that the Government Plan does not propose significant new or increased revenue streams in 2021, as large increases in revenue may undermine the economic recovery. However, it is important that Government considers its options for revenue-raising in the future, which is likely to be a key element of any plan to close the structural deficit.
2. The Panel recommends that the next Government Plan includes a clear estimate of the size of the structural deficit and breaks down the measures intended to close it, similar to the breakdown provided for MTFP2. Government should seek to consider what alternative approaches might be developed to close the deficit, if the rebalancing measures fall short of the £120m target.
3. More work should be undertaken to consider how the capital programme can be managed to ensure that it can contribute to the economic recovery but avoiding creating capacity constraints within the construction sector.
4. The combined impact of the deficits in both the Consolidated Fund and Social Security Fund, in addition to the large combined capital programme, provide significant support to the economy, particularly in the early part of the Government Plan period. This support should be unwound as the economy recovers, though this should not be a reason to delay necessary capital expenditure.
5. In the long term, increasing the Strategic Reserve should remain a priority but it is not advisable to make any transfers to the Reserve over the Government Plan period, given the pressure already on the Consolidated Fund.
6. The Panel agrees that it would not be prudent to draw heavily on the Strategic Reserve at the current juncture, unless the Covid-19 crisis has an even more significant impact. The purpose of the Reserve is to insulate the economy against significant structural decline. While Covid-19 has led to a severe recession, it is important to protect the Strategic Reserve to maintain flexibility to deal with further shocks.
7. The plan to borrow to fund the health and economic costs of the pandemic is appropriate under the fiscal framework, which allows borrowing under times of economic duress. With the Stabilisation Fund forecast to be exhausted this year, it remains important that government finances retain the flexibility to respond to changes in both the medical and economic situation.
8. Any review of the Social Security Fund should be taken in the context of the fiscal framework guideline to increase public sector net worth.
9. The establishment of an Infrastructure Fund should be rigorously compared with other options, including further borrowing or the use of reserves.

10. Projects considered for funding under both the Economic Recovery funding and the Fiscal Stimulus Fund should be assessed against their ability to have a permanent positive impact on the productivity of the economy overall.

Section 1 - The Economic Outlook

The disruption to the local and global economies this year has been extraordinary. Whether voluntary or mandated, decisions to restrict physical mobility and economic activity have led to a fall in demand as well as an interruption of regular supply. Whilst policy interventions to support households and businesses have served to limit the economic impact, 'lockdowns' and other restrictions have been damaging to economies around the world, especially for industries that necessarily involve social contact such as hospitality. The recent increase in infection rates and localised restrictions in Jersey's closest neighbours suggest that the disruption to economic activity is far from over.

1.1 International outlook

The International Monetary Fund (IMF) downgraded its forecast for global growth in 2020 significantly compared to their forecast from last year, and now projects an annual fall in global output of 4.4%. This follows an estimated 2.8% rise in world output in 2019. Growth in emerging market and developing economies was stronger last year (3.7%, compared to 1.7% in advanced economies), and their downturn this year is projected to be shallower (-3.3% vs -5.8% in advanced economies).

China was the first country needing to respond to Covid-19 and is now the only major economy predicted to see positive economic growth (1.9%) this year. Other economies closer to home that suffered significant outbreaks in the first half of 2020 are forecast to record sharp downturns (-12.8% for Spain, -10.6% for Italy). In the UK, Jersey's closest trading partner, output is predicted to fall by 9.8% this year. The broader euro area is predicted to contract by 8.3% and the US economy by 4.3%.

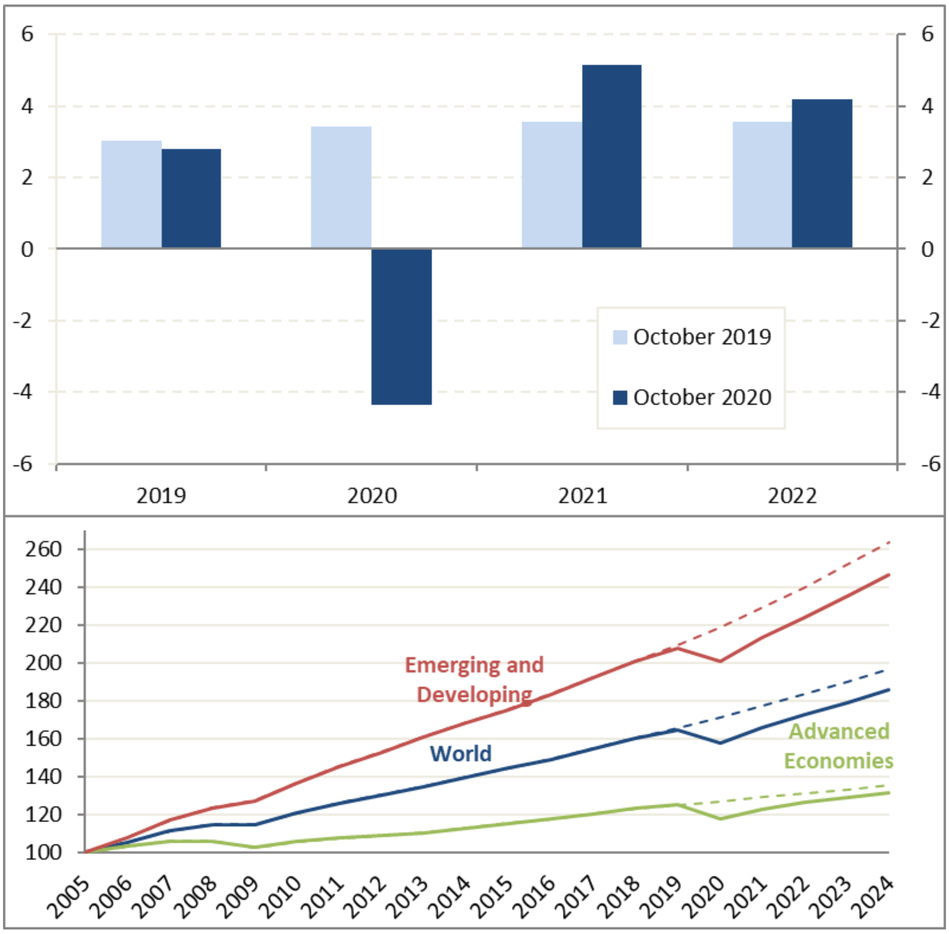
Figure 1.1

Global growth

Top panel: global GDP percentage real growth - October estimates/forecasts;

Bottom panel: index (2005=100) of real-terms GDP - October 2020 estimates/forecasts; dashed lines are October 2019 estimates/forecasts

Source: International Monetary Fund (IMF) World Economic Outlook October 2020, October 2019.



Looking ahead to 2021, the IMF predicts a year of strong growth in world output (5.2%) with all advanced and large economies expected to expand (US: 3.1%, UK: 5.9%, euro area: 5.2%), though recovering only some of the losses endured this year. In the case of China and the ASEAN-5 countries growth may take output to a level above that of 2019. This outlook is marked by a higher-than-usual degree of uncertainty: this includes the duration of social distancing and enhanced workplace safety standards, the long-run effects of unemployment including on young people's future job prospects, policy support and financial conditions as well as commodity prices.

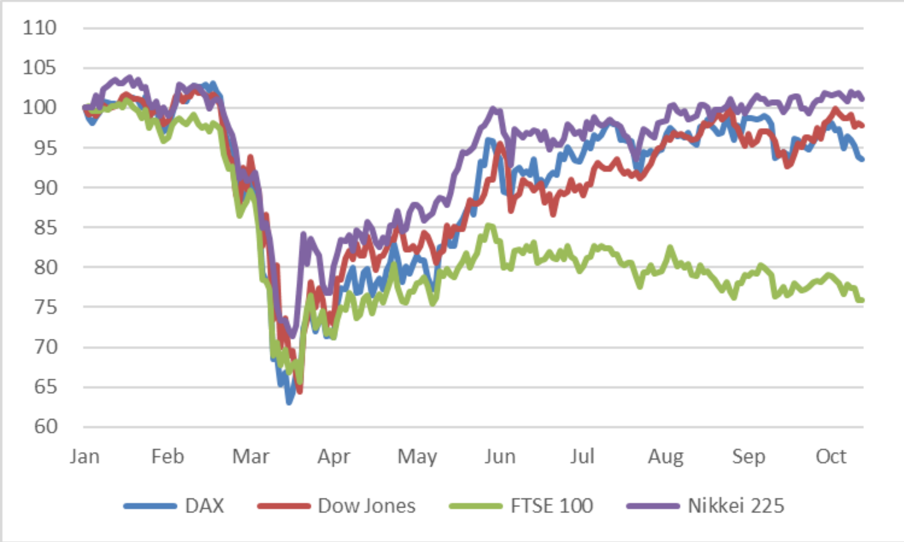
Compared to the global financial crisis in 2008, equity markets appear less correlated with underlying economic prospects in the short term. **Figure 1.2** shows the aggregate share price performance for four major industrialised economies. In most cases the indices shown have largely made up for the losses from early March, with the exception of the UK, which remains roughly 20% below its pre-pandemic peak.

Figure 1.2

Stock market indices

Indices for the New York / NASDAQ, Tokyo, Frankfurt and London stock exchanges (2 Jan = 100)

Source: London Stock Exchange, S&P, Frankfurt Stock Exchange, Tokyo Stock Exchange



The UK's GDP growth outlook (-9.8% in 2020, 3.2% in 2021) is also highly uncertain. Output has been hit hard, with the economy shrinking by 19.8% in the second quarter and more recent Covid-19 restrictions set to continue dampening activity. Moreover, potential difficulties in reaching a trade agreement with the European Union (EU) threaten further disruption in the new year when the withdrawal is set to reach a conclusion. Apart from the logistical challenges that will arise with new customs arrangements at UK borders, there is the risk of sterling volatility as investors react to events. This could be especially difficult for the local Jersey economy, given the strong dependence on imports from Europe and beyond, and might lead to higher inflation.

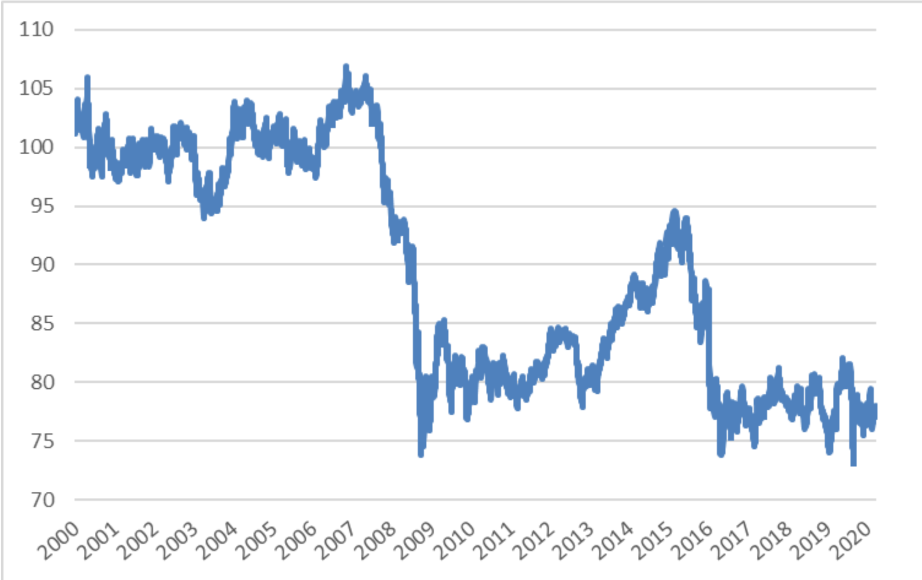
Figure 1.3 below shows the trade-weighted value of sterling in comparison to the currencies of its trading partners. The scale of sharp depreciations coinciding with the global financial crisis of 2008 and the original Brexit referendum result in 2016 could be repeated in the event of a disorderly end to the transitional arrangements with the EU.

Figure 1.3

Sterling's trade-weighted index

The "Effective exchange rate index" shows movements in sterling's foreign exchange value against its trading partners. (2005 = 100)

Source: The Bank of England (BoE) 2020.



Another important source of inflation volatility is the price of energy. Statistical analysis shows crude oil prices to be a significant influence on headline inflation in the Jersey economy. Whilst crude oil prices have recovered from historic lows in April, they remain at significantly lower levels than those seen in recent years and, with futures prices relatively flat, oil prices do not appear to threaten any price pressure for the foreseeable future.

Figure 1.4

Crude oil prices

£, price of crude oil acquired by UK refineries, index (2010=100)

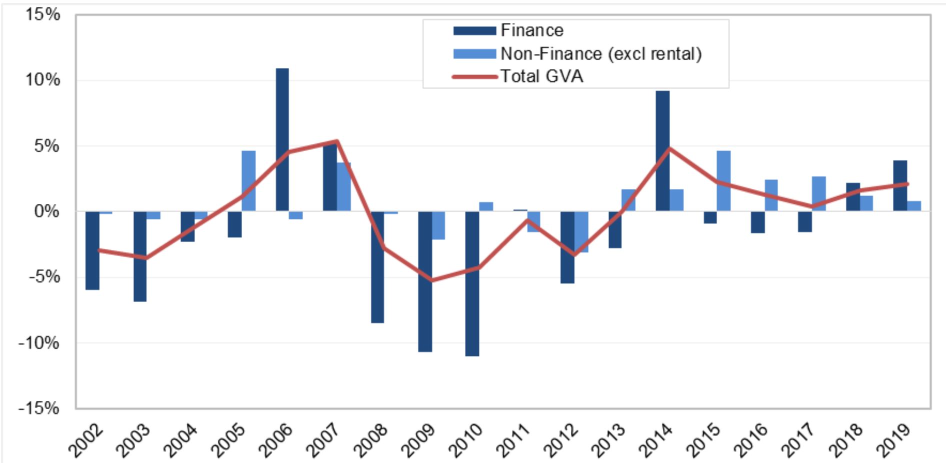
Source: Department for Business, Energy and Industrial Strategy (BEIS) 2020.

Earlier moves towards higher policy interest rates have been reversed in response to Covid-19. In the United States, the Federal Funds Rate has fallen from 1.75% to 0.25% in March. Similarly, the Bank of England cut the Bank Rate to an all-time low of 0.1% in March whilst the European Central Bank has kept its base rate negative (-0.5%) for the sixth consecutive year. There are few signs that monetary policy will have cause to tighten significantly in coming years. This would leave interest rates at the historic lows seen in the past decade, with adverse implications for the interest margins of Jersey-based banks.

1.2 Jersey economic developments

Gross Value Added (GVA) is the headline measure of economic activity in Jersey. The most recent GVA data available are for 2019, before the impact of Covid-19. The Jersey economy grew by 2.1% in real terms last year, the sixth consecutive year of expansion following six years of contraction and better than the Panel's assumption of 0.6% growth. Strong profit growth saw output in the financial services sector grow by 4% in real terms. Other business activities[1] also saw strong growth (4%), whilst hotels, restaurants and bars also expanded (2%); construction (-1%) and wholesale and retail (-1%) had a less favourable year.

Figure 1.5
Jersey GVA
Annual % real terms change
Source: Statistics Jersey



Though official data on output in 2020 are not yet available, other data series help to indicate the health of the economy. Perhaps the most revealing information is the weekly total of those registered as Actively Seeking Work (ASW) with Customer and Local Services (CLS). It shows a rise in this measure of unemployment from late March to a peak of around 2,380 in the latter half of May before falling steadily since. While ASW includes both unemployment and underemployment, and as it is not compulsory to register it will not include all those out of work, the figure is the best (and most timely) measure of unutilised labour resources in the economy. The measure does

[1] Predominantly private sector service industries

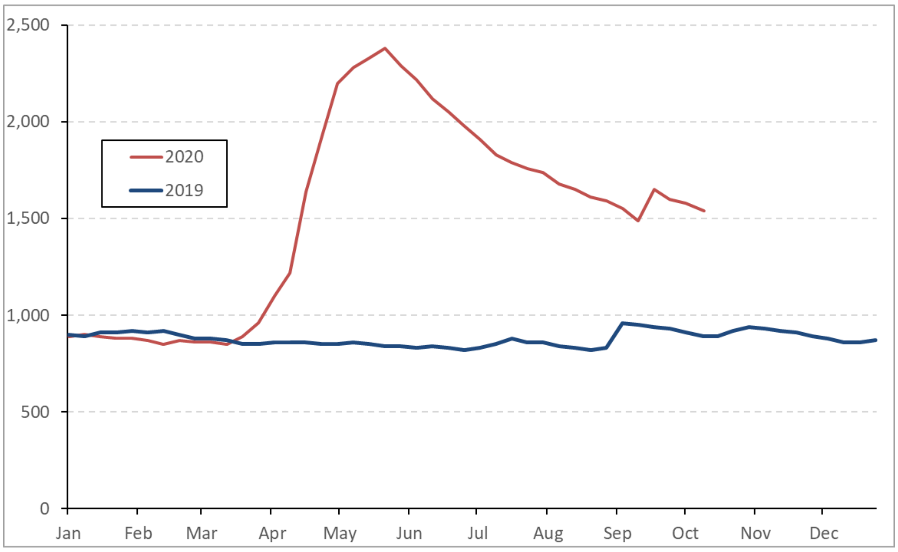
not account for the effects on output of reduced hours or falling productivity due to restrictions, but it does suggest workers are being re-allocated to other opportunities within the economy or returning to old jobs. While ASW numbers were 1,540 higher in May than a year earlier, that difference has now halved to around 650 since early October.

Figure 1.6

Actively Seeking Work

Weekly numbers of those registered as "Actively Seeking Work". (Note: The September jump is a seasonal feature of the data and occurs on the first week of school with a number of parents returning to the labour market)

Source: Statistics Jersey



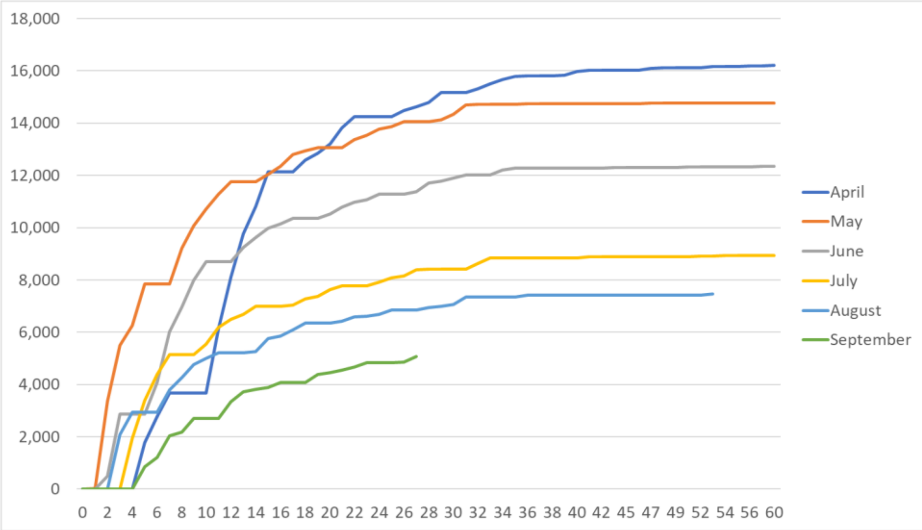
An improvement in economic conditions can also be seen in the reduced claims against the Co-Funded Payroll Scheme (CFPS) in **Figure 1.7** below. The chart shows the cumulative claims per month, allowing for the delays involved in firms filing claims. Whilst the scheme was well subscribed for the months of April and May (the most restrictive phase of the limits on activity), the following months have seen steady declines in the number of firms seeking help in paying staff. The CFPS includes a 'detriment' test based on a 30% fall in turnover in April through to August, and 20% from September onward. Though the opportunity to claim for the month of September had not yet closed at the time of data collection, the sizeable difference between claims at that stage in comparison with prior months is significant.

Figure 1.7

Co-Funded Payroll Scheme

Total cumulative number of jobs supported by days following first eligibility for each month of scheme.

Source: Customer and Local Services



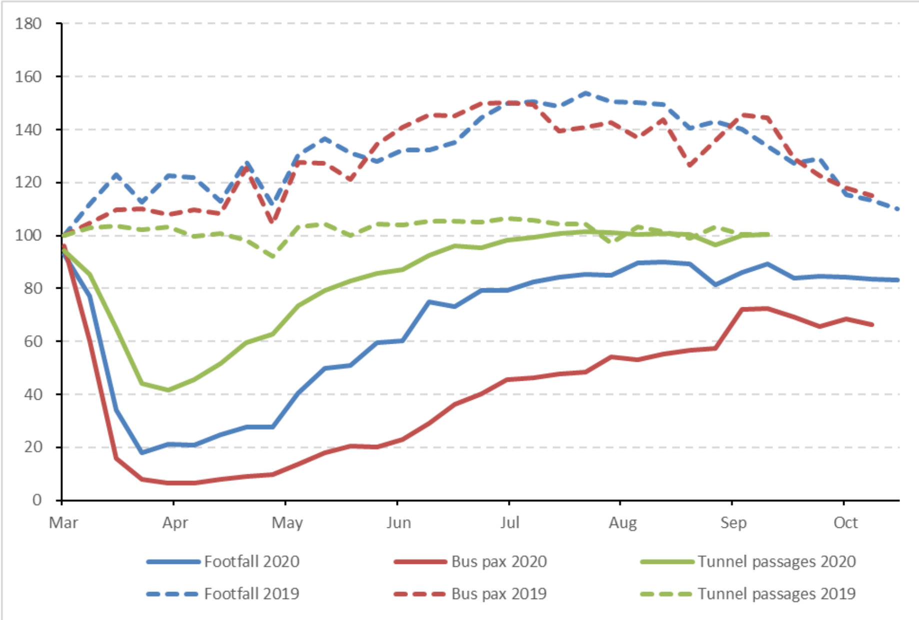
Other high-frequency data are also available that give an indication of physical mobility and, indirectly, the return to normal consumption and production patterns in economic activity. **Figure 1.8** shows comparative data for pedestrian footfall on the high street, passenger numbers on the Liberty Bus network and the number of vehicles passing through the tunnel under Fort Regent from the start of March. Each of these measures is available for the same months in 2019, providing a useful set of benchmarks. It suggests that road traffic has largely recovered to its normal level; usage of the bus network is still far below normal levels but slowly moving up; and visits to St Helier's high street also gradually recovering to previous levels - but still substantially lower. While some of the reduction in movement around the Island will be due to displacement of activity to online retail and homeworking, the data do indicate a major fall against normal economic activity, especially within industries such as 'bricks-and-mortar' retail and hospitality.

Figure 1.8

Footfall, bus passengers and tunnel passages

Index (100 = week ending 10 March 2019)

Source: Statistics Jersey, Springboard



There are also more frequent data available on industry sectors that allow for an appraisal of performance aside from GVA data. They indicate a highly uneven impact of Covid-19 across the economy.

1.2.1 Financial services sector

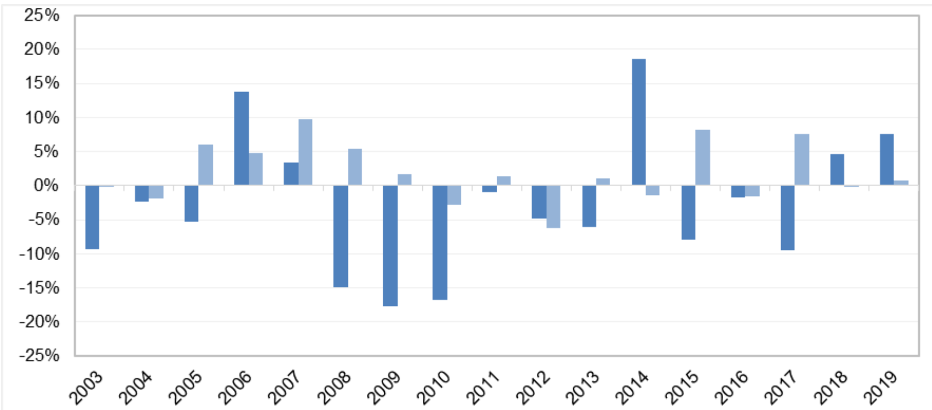
The financial services sector saw a 3.9% rise in GVA in real terms in 2019. This was driven by a sizeable expansion in sector profitability (7.9%, partly a result of rising interest rates in the US and a full year of Bank Rate at an eleven-year high of 0.75%), whilst employee compensation saw more modest real growth of 0.8%.

Figure 1.9

Financial services profit and employment costs

Annual % change in gross operating surplus (dark bars) and compensation of employees (pale bars), constant prices

Source: Statistics Jersey



A return to ultra-low interest rates in 2020 will likely mean a fall in net interest income, which is a substantial proportion of financial services revenue. **Figure 1.10** below shows the recent annual history of financial services revenues. Net interest income rose (by 8.8%) in nominal terms in 2019 along with the Bank of England's Bank Rate, as they did in 2018.

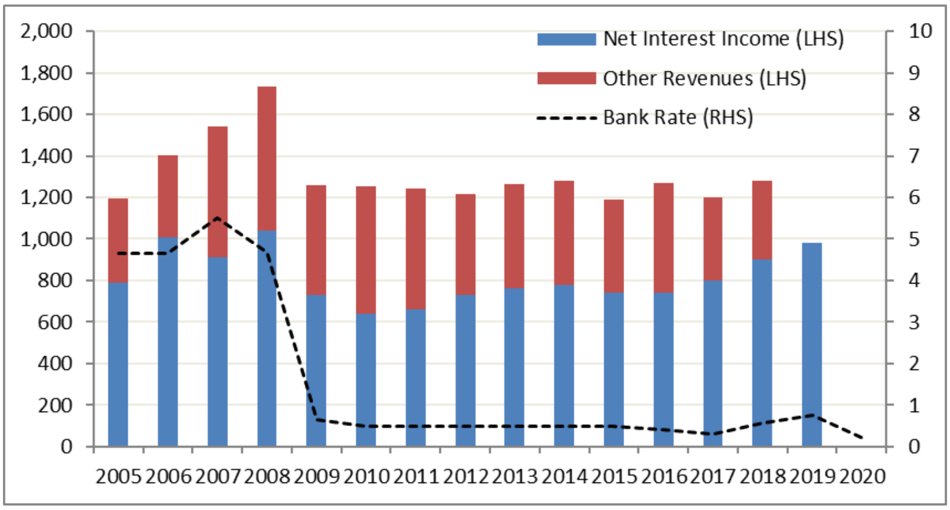
Figure 1.10

Banking revenues

Source of revenue (£m, current prices - left hand side) and annual average for Bank of England Official Bank Rate (% - right hand scale, 2020 until end Oct)

Note: "Other revenue" data unavailable for 2019

Source: Statistics Jersey, Bank of England



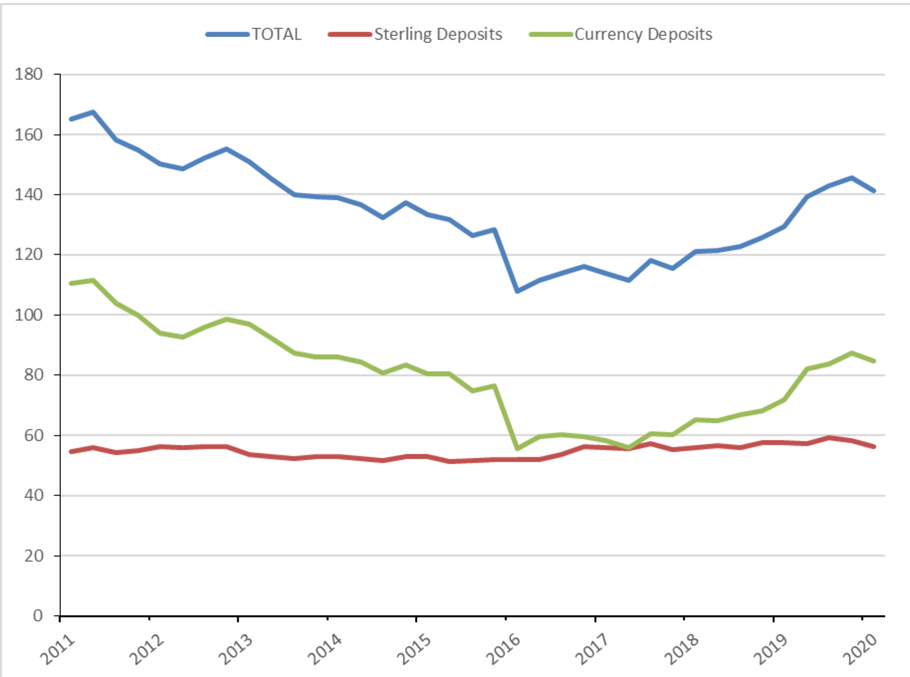
Sterling deposits did not move from their level of long-term stability since last year's report. Deposits of foreign currencies ("currency deposits") are trending upwards, having risen over 50% since mid-2017.

Figure 1.11

Banking deposits

Total bank deposit values (£bn current prices) in sterling and foreign currencies ("Currency Deposits")

Source: Jersey Financial Services Commission



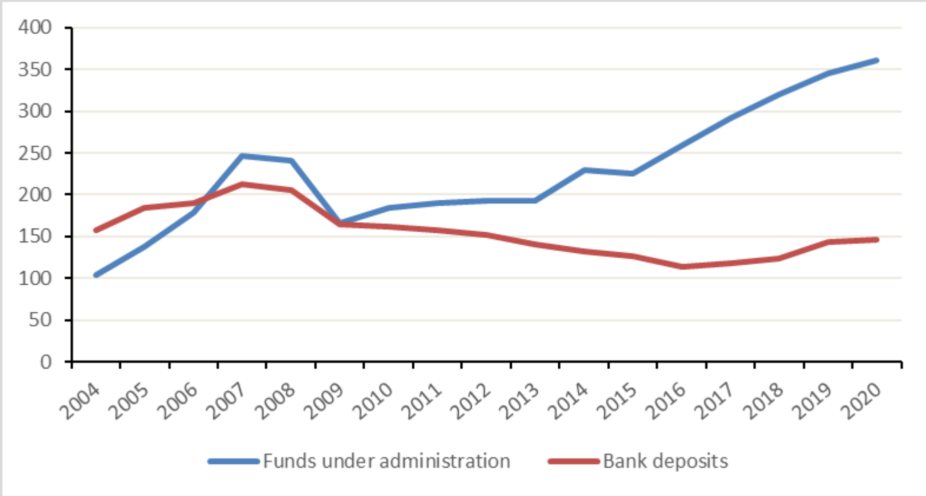
While deposits with Jersey banks have been relatively stable this year, the value of funds administered from Jersey has continued to rise. The total was £362bn at the end of June 2020, 60% higher than in 2015.

Figure 1.12

Deposits and funds

£bn, total banking deposits held in Jersey (red line) and net asset value of regulated funds under administration (blue line); 2004-2019 is year-end, 2020 is June.

Source: Jersey Finance



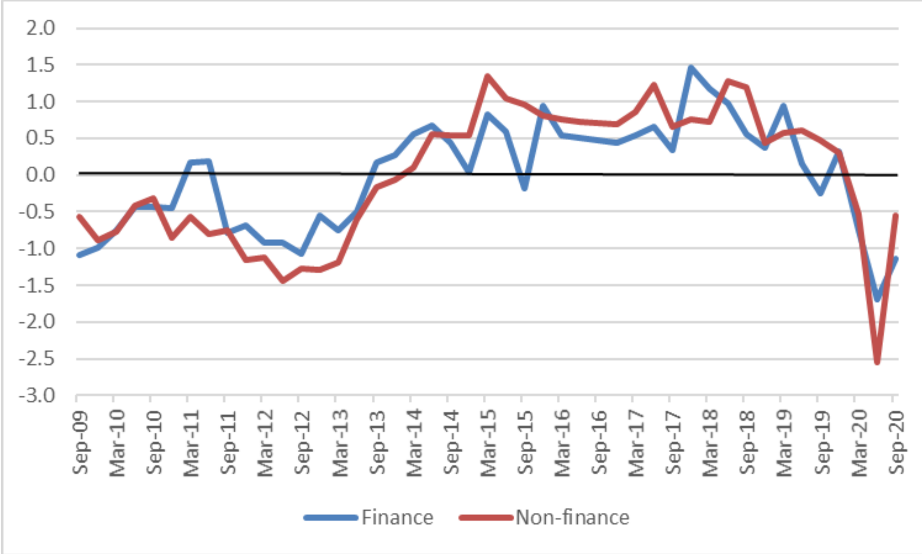
The **Business Tendency Survey (BTS)** from June 2020 suggests the slowdown significantly affected the financial services sector as well as other parts of the economy. Both business activity and expectations for future business were negative for the first time in the survey's 11-year history. This shows more respondents were reporting a slowdown in business (and expectations of business) than those reporting, or expecting, growth. Reported business conditions have since recovered significantly, suggesting the June quarter marked a low point in the current economic situation and future expectations. For the financial services sector, the headline business activity indicator was neutral, recovering in the September survey from the record low of the previous quarter. **Figure 1.13** presents a composite indicator (principal component, see discussion under **section 1.6 The output gap** below) for the history of BTS results for both finance and non-finance sectors. Though not experiencing as dramatic a fall as the non-finance sector, sentiment in the industry can be seen to have reached its lowest point since the start of the survey in 2009 before recovering sharply in the September quarter.

Figure 1.13

BTS summary indicator

Summary indicator incorporating responses from finance and non-finance sectors to BTS

Source: Statistics Jersey, Panel calculations



The **outlook for the financial services sector** was similarly downbeat in the June 2020 BTS. The weighted proportion of firms expecting profits to fall in 2020 in comparison with 2019 was 30 percentage points higher than those expecting growth. Similarly, for employment expectations, the weighted proportion of firms foreseeing a fall in numbers in 2020 was 19 percentage points higher than those expecting to take on more employees. These longer-term expectations may have recovered in the September quarter, along with overall sentiment, and may be reflected in the December survey results, when the question is next put to respondents.

Figure 1.14

Finance employment and profit expectations

% net balance of respondents (weighted by employment) expecting an increase in employment (pale bars) and profits (dark bars). Results from June are in-year expectation and results from December are expectations for the following year.

Source: Statistics Jersey

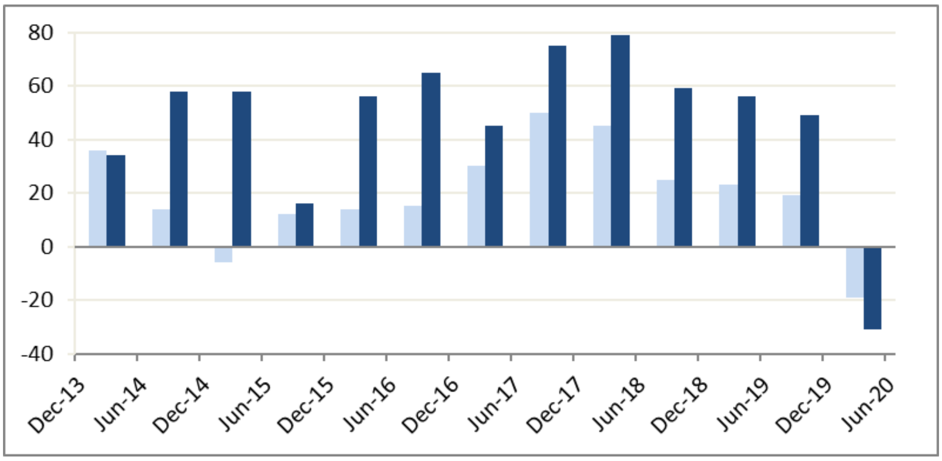


Figure 1.15 compares the responses to the BTS with the growth of financial services sector GVA. Whilst the business activity indicator is the lowest it has been since 2009, note that it has not proved to be a good predictor of final outturns.

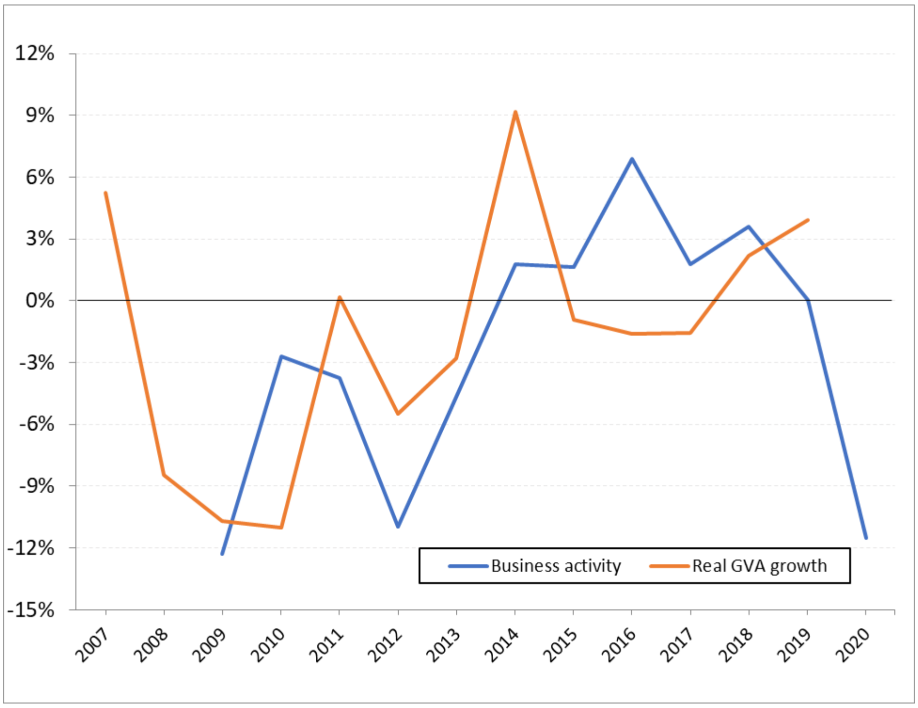
Figure 1.15

Finance GVA growth vs BTS results

Annual real GVA growth of financial services sector and financial services responses to business activity question averaged over each year with mean and variance aligned to those of data for growth in real GVA.

Note: 2020 is the average of responses to "business activity" in March, and September plus "future business activity" from the September survey.

Source: Statistics Jersey



During the Panel's recent factfinding meetings, representatives from banks reported strong growth in activity at the beginning of the year with increased profits due to the move towards higher interest rates. These favourable margins, however, were reversed with a return to looser monetary policy as central banks responded to Covid-19. This will act as a drag on profits this year. Of some concern is the possibility of the Bank of England deciding to implement a negative Bank Rate, which is now judged more likely, potentially lowering interest income and raising operational and business model concerns.

While Jersey's finance sector is not immune to disruption in the global economy, much of the sector relies primarily on the movement of global finance and therefore continues to see strong levels of activity. Exposure to local credit risk does not affect a large proportion of revenues. While finance providers had seen a rise in repayment holidays and expected some defaults, this was not as significant as that seen in other jurisdictions, in either the household or corporate sector. The potential impact on profits of this credit risk is expected to be considerably less than the fall in interest margins.

The experience of remote working and broader movements within finance have highlighted the importance of digitisation to the industry. The transition has now accelerated and will likely lead to some shedding of 'back-of-house' administrative staff. However, Jersey's business is largely based on client relationships and job losses overall will likely be limited. The sector adjusted well to new ways of working and felt that Jersey's strong digital connectivity was likely to prove a competitive advantage for new business.

More broadly, those in the private wealth sector, especially trust administration, have reported increased levels of activity. This is reflected in the higher value of funds under management on island.

1.2.2 Rest of the economy

The non-finance sectors grew for the seventh consecutive year in 2019. Real output rose by 0.8% in comparison to 2018. A strong contribution was made by the other business activities sector[2] (4% growth), driven by an expansion in employment. Hotels, restaurants and bars also grew (2%), through a combination of higher productivity and increased headcount. Output in the construction and wholesale and retail sectors both contracted by 1%.

As seen above in **Figure 1.13,** the BTS results for the non-finance sectors in the June quarter were the worst since the survey began in 2009 despite the March responses having been quite strong, at a time when anxiety about the European spread of Covid-19 was only nascent. However, expectations of future business activity were less negative, and the balance of firms reporting an expectation of a decrease in the three months until end September was only 6 percentage points higher than those expecting an increase. This was considerably better than for the financial services sector where the balance was 32 percentage points in favour of those expecting a decrease.

The September BTS results also showed a marked improvement on those of June for the non-finance sector. However, there were differences with results from the finance sector, where survey balances were significantly more positive.

[2] Examples of firms in this sector include private care homes, IT and business support companies.

Figure 1.16

Non-finance business tendency

% net balance of respondents reporting an increase (weighted by employment). Average of quarterly results

Note: 2020 covers just March, June and September

Source: Statistics Jersey

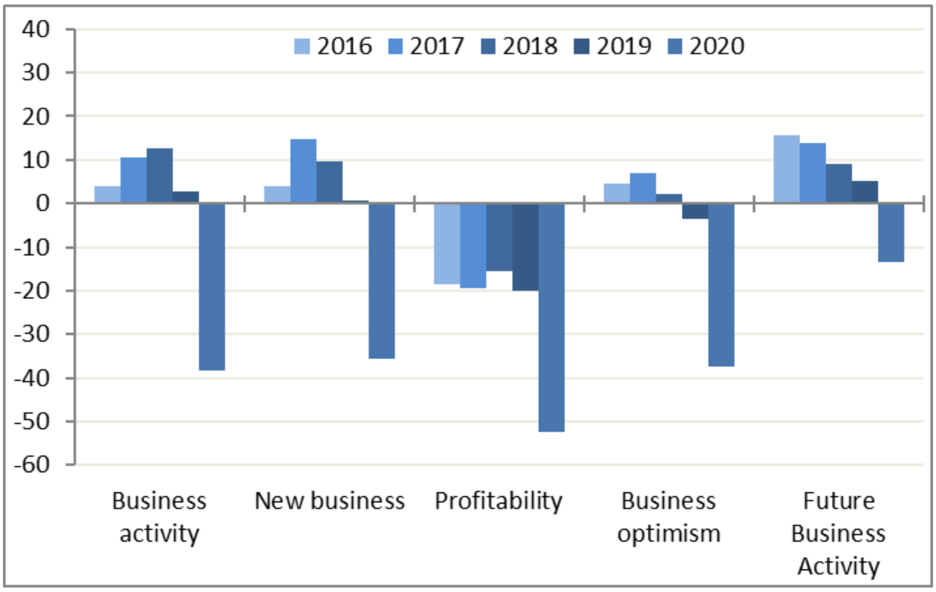


Figure 1.17 compares the responses to the BTS with the growth of non-finance sector GVA (excluding the rental income of private households).

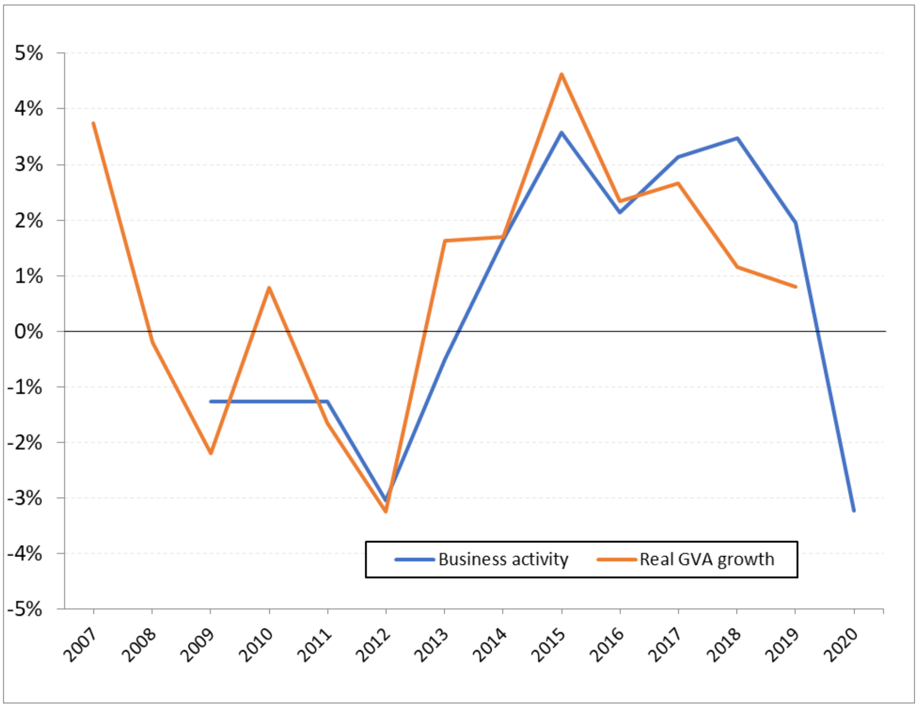
Figure 1.17

Non-Finance GVA Growth vs BTS results

Annual real GVA growth excluding financial services and rental and non-finance responses to business activity question averaged over each year with mean and variance aligned to those of data for growth in real GVA.

Note: 2020 is the average of responses to "business activity" in March, June and September plus "future business activity" from the September survey.

Source: Statistics Jersey



1.2.3 Sectoral performance

The GVA of the **wholesale and retail sector** fell by 1% in 2019 in real terms, repeating its 2018 performance. This brings the fall in real output to over 18% since a peak in 2007.

Responses to the BTS have been strongly negative and worsened considerably from March to June. There was, however, an overall expectation among business for the outlook to pick up over the three months to the end of September. In the September quarter, however, there was a striking rebound in the balance for business activity (from a balance of 79 percentage points more firms reporting a slowdown as compared with 21 percentage points more reporting a rise). This improvement was also reflected in the new business and profitability indicators.

In stakeholder meetings with the FPP, the retail sector reported particular business stress caused by Covid-19. Whilst food retailers reacted well to the initial changes and saw a rise in business, they have since seen a fall in typical sales volumes due to greater online shopping. Other retailers were forced to close for an extended period, and are worried about shopper footfall with concerns over the impact of further restrictions on mobility and the requirement to wear masks.

The **hotels, restaurants and bars sector** expanded by 2% in 2019 due to a rise in productivity, and has now grown 29% since 2009. The strong performance in 2019 was helped by a 6% rise in visitor numbers for the year.

Disruptions to normal activity due to Covid-19 have affected data collection on visitor numbers this year. However, one indication of the extent of the downturn in the ‘visitor’ economy can be gathered by overall passenger volume numbers through the air and sea terminals in **Figure 1.18**. Local demand substituted for tourists to salvage some of the summer trade and, following a lifting of travel restrictions on 3 July, there was some pickup in August. However, August volume was still roughly 75% down in comparison with the same month last year and September’s numbers were proportionally lower.

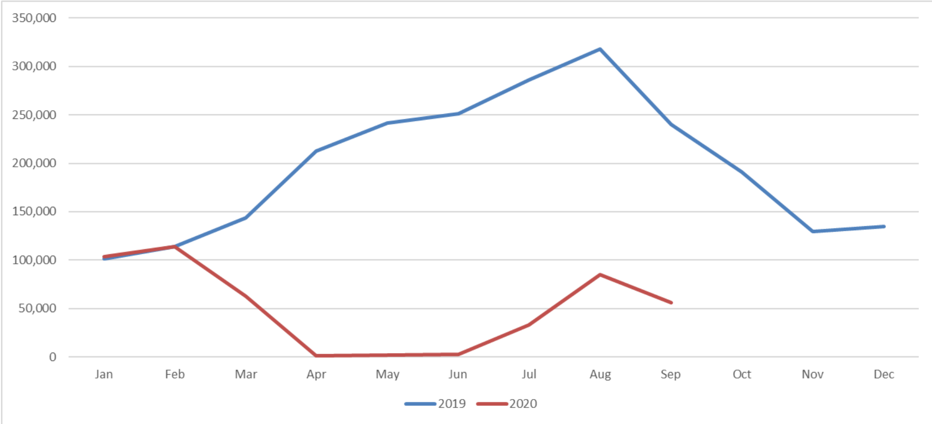
Hospitality representatives reported that the loss of the summer season meant the sector was set to pass through ‘three winters’, as witnessed by June BTS responses that were the worst for any sector (every respondent reported lower business activity, new business activity and profitability). Beyond cancellations due to Covid-19, industrial action amongst stevedores in St Malo also served to reduce tourist numbers. The September BTS results showed some improvement in business conditions for the sector, but business activity remained deeply negative with a balance of 44 percentage points more firms reporting a fall than a rise, a worse result than in March.

Figure 1.18

Port volume numbers

Number of departures from and arrivals at Jersey air and sea terminals

Source: Ports of Jersey



GVA of the **construction sector** fell by 1% in 2019 in real terms, driven by a 3% drop in productivity. However, output remained at over 35% above its level in 2013 with productivity[3] still more than 5% higher.

September's BTS showed a sharp bounce from record lows in June. For example, business activity rose from a balance of 92 percentage points more firms reporting a fall to only 3 percentage points. Employment and business optimism recovered but remained negative, near 6-year lows, but balances on future business activity and employment turned positive and close to pre-crisis levels.

Representatives of the sector reported suffering from a reduction in the government's capital programme due to the budgetary pressures of the Covid-19 response, but reported consulting with government to help ensure a pipeline of work until the end of next year. They were hopeful this would be enough to at least keep larger firms operating in the short term. They needed certainty on future work programmes in order to take on and train staff due to the lead times involved with resourcing and training staff.

As a supplement to the usual questions asked within the BTS, responses were also sought in the June survey on the overall change in turnover between that quarter and the March quarter. **Figure 1.19** below shows the results for the three non-finance sectors covered in this section, as well as the other non-finance sector and finance for the sake of comparison. Whilst both the wholesale and retail and construction sectors showed a fall in turnover for the majority of firms, with a typical response of a 20-50% fall for both sectors, the hotels, restaurants and bars (hospitality) sector fared far worse with 88% claiming turnover to have at least halved. Turnover in the finance sector was far less affected by Covid-19, with comparatively fewer (21%) claiming to have experienced a comparative fall in the quarter.

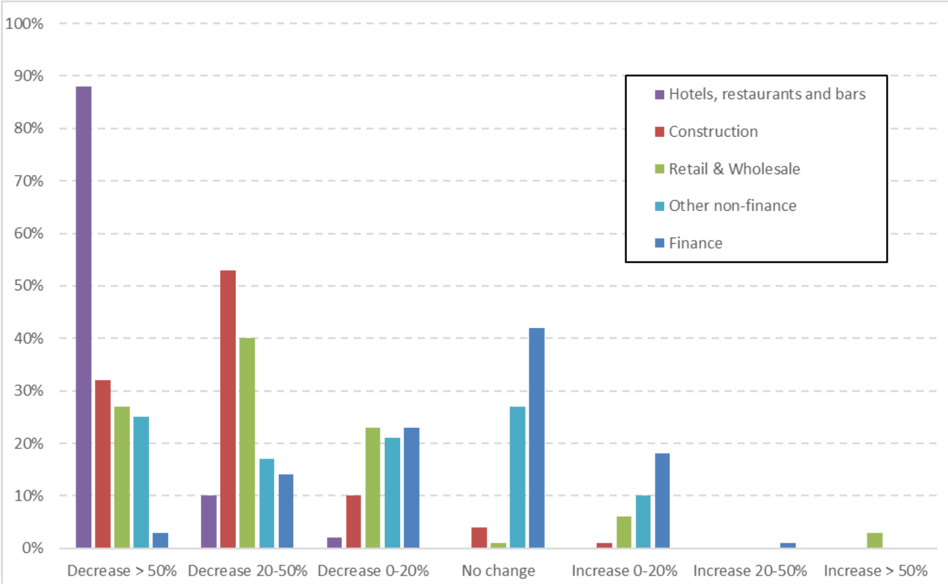
[3] Measured as real GVA per full-time equivalent employee.

Figure 1.19

Change in turnover

Weighted percentage of firms experiencing a change in turnover from March to June quarter

Source: Statistics Jersey



1.3 Labour Market

Statistics Jersey have delayed the publication of the June 2020 labour market report in order to achieve a greater response rate for the manpower information submitted by businesses to Customer and Local Services, as required by the Control of Housing and Work Law.

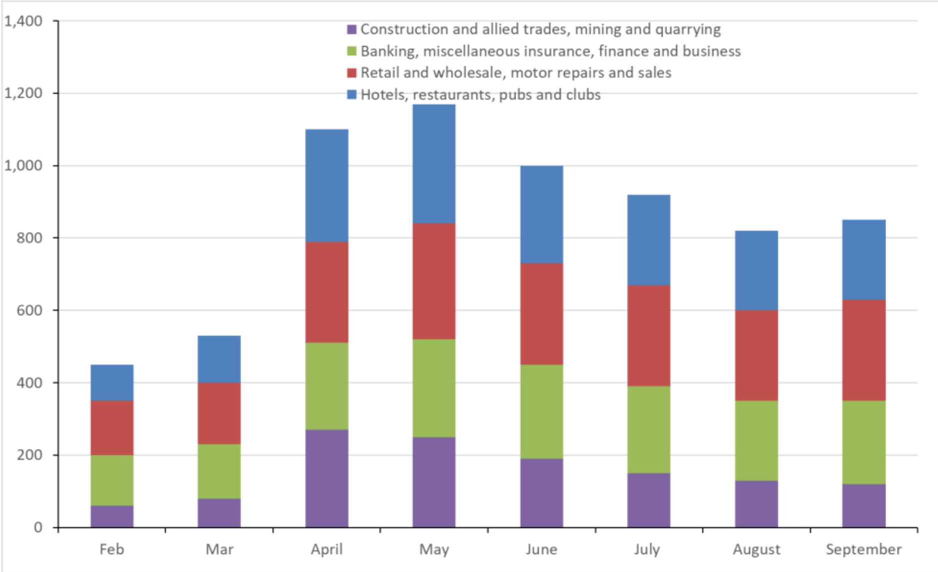
The ASW data provided by Customer and Local Services also contain information about sector of last employment for over 90% of those registered, providing some indication of the sectoral split of job losses across the economy. The sector definitions differ slightly from those used by Statistics Jersey, but the data show a disproportionate rise in unemployment from the hospitality and construction sectors whilst the finance and retail sectors, though seeing more than a doubling in ASW numbers, were relatively less affected. The proportions within the ASW total have moved closer to their pre-crisis state as the total of government-registered jobseekers (ASW) fell over recent months, suggesting the some of the newly unemployed may have already moved back into employment.

Figure 1.20

Actively Seeking Work by industry of last employment

Number of those registered as Actively Seeking Work with Customer and Local Services on the last calendar day of each month, 2020 (July reading from 26th, September reading from 20th) for construction, financial services, wholesale and retail and hospitality industries.

Source: Customer and Local Services



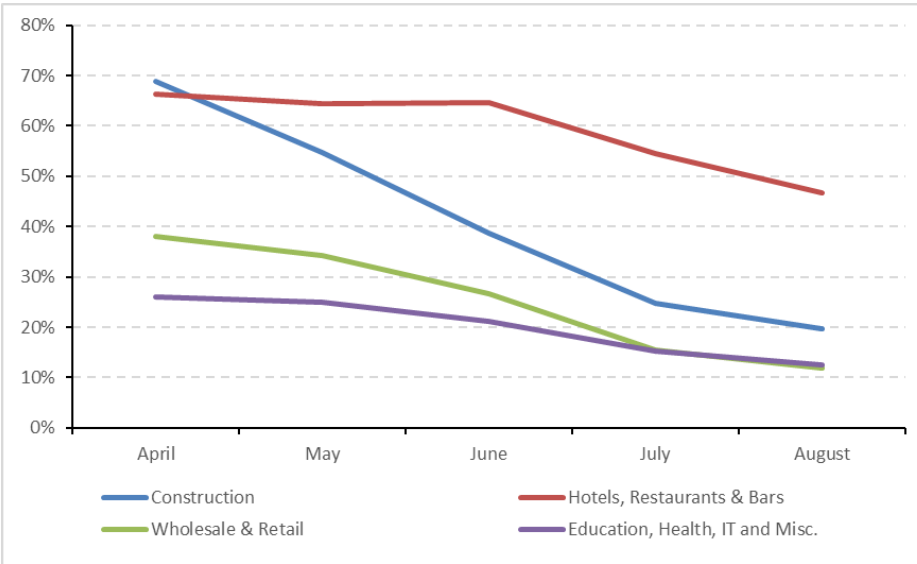
A further illustration of the uneven impact across sectors comes from an analysis of claims made under the Co-Funded Payroll Scheme. Unsurprisingly, the hospitality industry has claimed the most support, with well over half of staff having their wages directly subsidised by government for the first four months of the scheme. The scheme was also used by many in the construction industry, with well over half of employees having their wages directly supported by the government initially, but with a more rapid decline in claims since than in hospitality. Take up within the finance industry was very low, with around 1% of employees supported from April to July, but this was largely due to the restrictions on eligibility within the sector as a whole.

Figure 1.21

Co-Funded Payroll Scheme by sector

Jobs supported as proportion of December 2019 total job count.

Source: Customer and local services, Statistics Jersey



As well as seeing the problems of unmet supply in the labour market, we can also learn about the state of the economy by looking to online job vacancy data by month to see how demand for labour has shifted. The data company Geek Talent compile data with online job postings by industry each month and **Figure 1.22** below shows how these have fallen dramatically since the start of the year. The most dramatic shift is in the reduction in vacancies, and likely labour demand, in the hotels and restaurants sector. Wholesale and retail postings have also fallen sharply to return slowly in recent months. Finance positions fell, but appear to be returning, and jobs in the education, health and other services sector held steady until recent months where they have fallen. The available data for 2019 demonstrate that a return to seasonal normality may have been reached with hiring volumes in August and September.

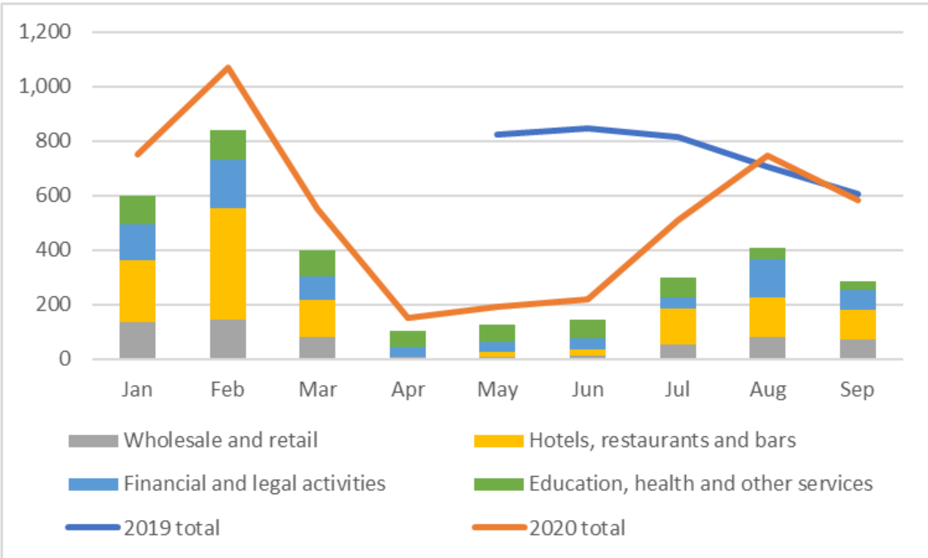
Figure 1.22

Online job vacancies by sector

Jersey job postings on the internet by industry sector.

Source: Geek Talent

Note: Complete data only available from May in 2019.



Despite the labour market weakness, average weekly earnings in June 2020 were 1.1% higher than at the same time in 2019. A 0.5% rise in the Retail Price Index over the same period means this is around a 0.5% rise in real-terms earnings. However, after strong growth through the 1990s average earnings have stagnated over the subsequent period, and in real terms are now just 0.7% higher than in 2001.

Figure 1.23

Average earnings and inflation

% increase in average earnings (blue line) and retail price index (red line) - June each year.

Source: Statistics Jersey

1.4 Inflation

The Retail Price Index (RPI) increased by 0.9% in the year to September 2020 – this was well below the six-year inflation peak of 4.5% in June 2018 but a slight rise from the rate of 0.5% recorded in the year until June.

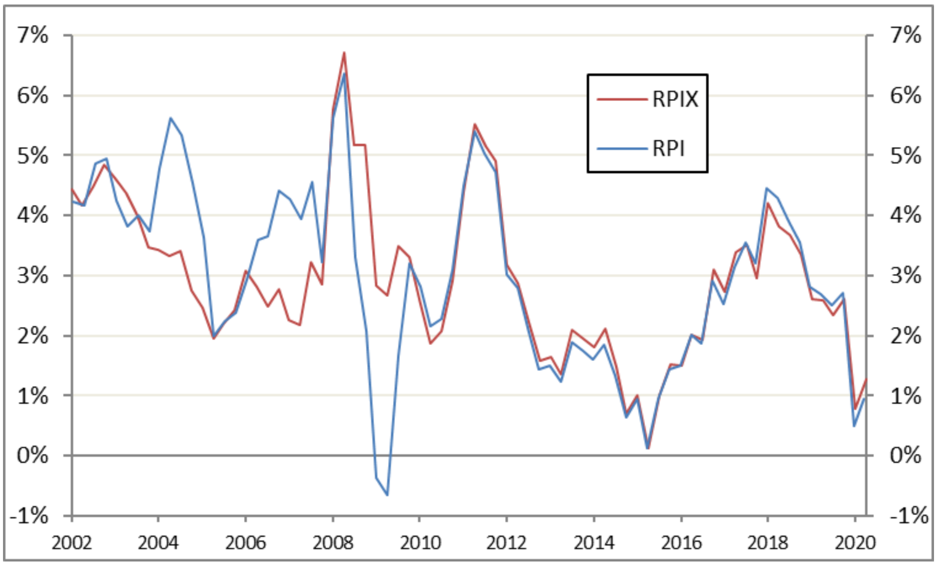
The June result was largely due to a fall in prices of 1.5% in that quarter, driven by reduced housing costs (partially due to the Bank of England's cuts to Bank Rate in March) and the lower prices of personal goods and services (including GP charges, reduced to £20 per visitation by government- and fares and other travel (largely the suspension of parking charges in Government owned car parks). In the UK, the latest inflation data point to Covid-19 so far being broadly disinflationary, supporting expectations that Bank Rate will remain held at its historic lows.

Figure 1.24

Inflation in Jersey

Annual % change in retail prices index (blue line) and retail prices index excluding mortgage interest payments (red line)

Source: Statistics Jersey



1.5 The housing market

Expectations at the beginning of the Covid-19 pandemic were for a fall in global house prices in most economies as occurred in the last recession of 2008. These expectations were confounded as prices broadly continued along their prior growth paths, or even accelerated in some markets (German year-on-year house price growth was 11% in August).

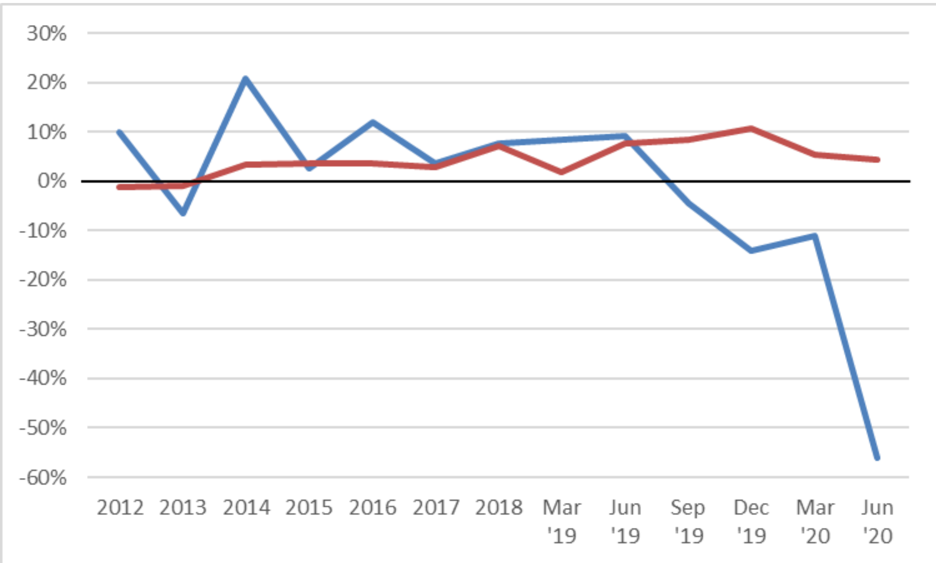
The experience in Jersey's housing market has been similar, with prices continuing to rise despite a fall in transaction volumes. Statistics Jersey's House Price Index was 4% higher in the June quarter in comparison to the same quarter of 2019, despite an annual 56% fall in transactions for the quarter. This was largely due to the disruptions to mobility and viewings. **Figure 1.25** below shows how transaction volumes have not had any clear relationship to prices in recent history: turnover has been falling for a year now with no discernible effect on prices. The December quarter of 2019 saw 14% fewer sales than in the equivalent three months of 2018 but with 11% price growth across the same period.

Figure 1.25

Housing market

Annual percentage change in House Price Index (red line) and transaction numbers (blue line)

Source: Statistics Jersey



1.6 The output gap

With increased capital stock, workers and improved technology, the productive capacity, or "potential output", of an economy grows. Aggregate demand can draw output above this potential (leading to an above-usual use of resources as with, for example, overtime hours worked). This results in upward pressure on inflation as firms react by either paying greater input costs (for example through higher wages) to expand output and/or raising prices to profit. When aggregate demand is weak, these effects are reversed and there is downwards pressure on inflation. The rate of growth in the inflationary-neutral potential output is referred to as the trend rate of growth and the difference between this level and that at which the economy is performing is known as the "output gap".

The trend rate of growth (and thus the output gap) cannot be measured or observed, only estimated. One method of estimating the extent to which resources are over- or under-utilised is Principal Component Analysis (PCA). This draws on a set of indicators (such as earnings data, vacancies data, unemployment numbers, BTS results) and supposes a common, unobserved factor (the "principal component") driving changes amongst them all.

The results for the PCA method show that a slow reduction in capacity utilisation (or overutilisation) gathered pace rapidly this year. The issue of capacity under the conditions of enforced lockdowns is problematic. Whereas a newly unemployed worker could potentially be re-deployed and begin working from home in another job, it can also be argued that the restrictions imposed lead to a fall in capacity. These forms of underutilisation are harder to measure and have a less predictable impact on labour costs and inflation.

Given the uncertainty surrounding the prospect for further restrictions on mobility, and the full extent of the consequences of Covid-19, we will revisit this idea of capacity in future. For the time being, given inevitable delays in re-allocating resources and adjusting to new working patterns, we can be very confident with our assessment that the local economy will have been operating far below capacity this year.

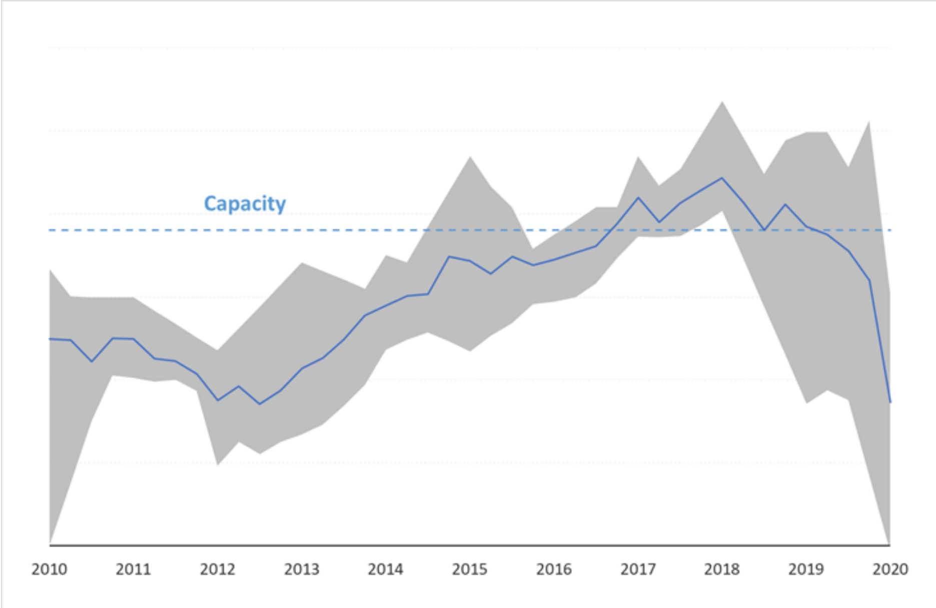
1.7 Economic growth forecast

Figure 1.26

Output Gap estimate based on PCA

Blue line is Principal Component, grey swathe is minimum and maximum of scaled series used in PCA

Sources: Statistics Jersey, Government of Jersey, Panel calculations



The outlook for 2020 is for a deep recession with a fall in output of 7.6% in real terms. The main driver of this is likely to be reduced financial services profits (-18.6%), largely caused by the return of ultra-low interest rates. Total compensation of employees is also set to fall somewhat (-0.6%), dragged down by non-finance sector earnings and a fall in employment (-1.6%).

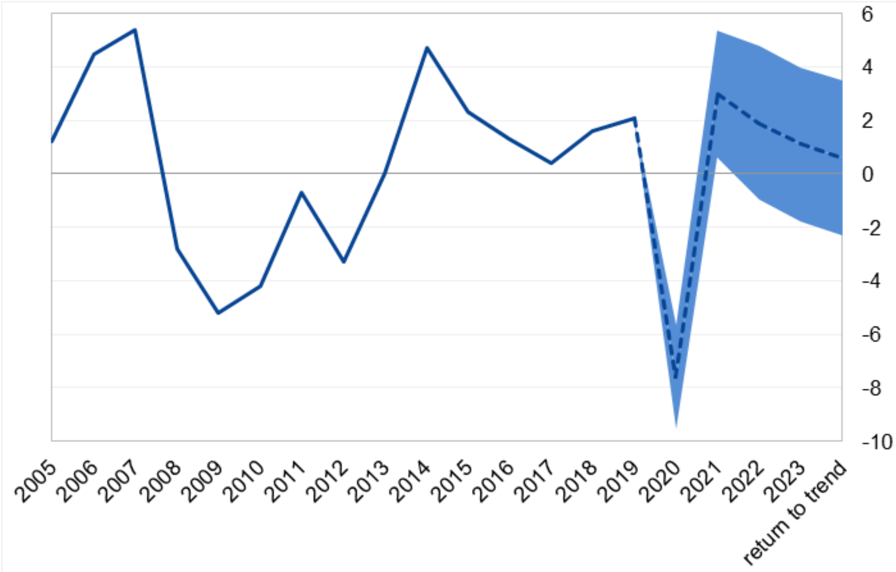
The recovery, whilst involving a stronger than usual growth rate (3.0% in real terms), will nevertheless be slow in returning output to its 2019 level. There is likely to be only a partial return to prior levels of employment (1.2%) and profits (7.1%) next year as consumption regains some of its prior strength. Average earnings growth, however, is unlikely to exceed inflation (1.1% vs 1.5% RPI in 2021) with real earnings thus stagnating or falling slightly across the next few years. The forecast is subject to a high degree of uncertainty, with further developments in the pandemic unclear as Europe faces a second wave and the terms of the UK's exit from the EU still largely unresolved.

Figure 1.27

Economic growth forecast

% change in real GVA on year before

Sources: Panel judgment; Statistics Jersey



Beyond the forecast period, the assumption is for real GVA growth to have fallen to its trend rate of 0.6% in 2024. We will revisit the issue of capacity and trend growth as we will gradually gain a clearer idea of post-pandemic development of dynamics within the economy. Our assumption for the time being is that the current outlook is for an ongoing reduction in capacity of the local economy and a permanent reduction in output as compared to the path of growth expected last year. This is reflected in an illustrative quarterly profile of our updates to the real GVA annual forecast below in **Figure 1.28**.

Figure 1.28

Economic output forecast

Illustrative shape of quarterly, indexed FPP forecasts of economic output

Sources: Panel judgment

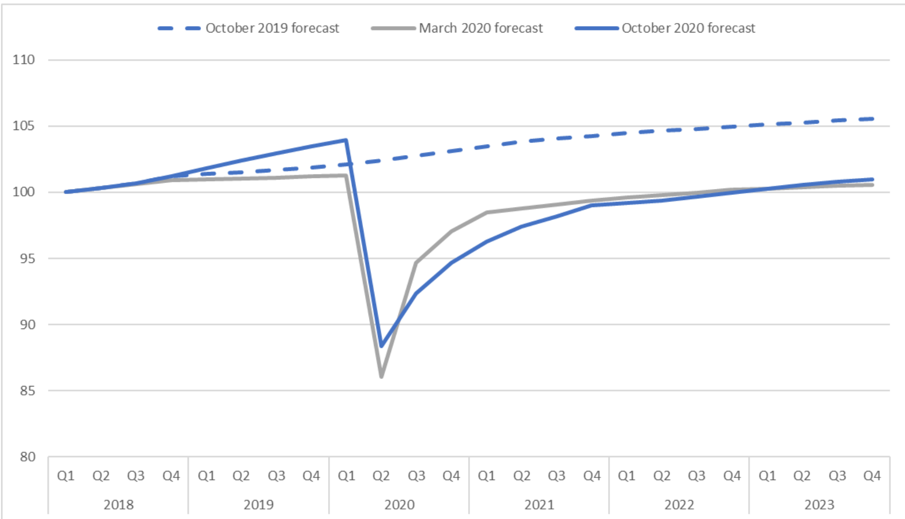


Figure 1.29 below shows the Panel's assumptions for the main economic variables across coming years. They are essentially unchanged since August, given the lack of strong data results in the last two months that would warrant a significant revision to our August forecast.

Figure 1.29

Central economic assumptions

% change year on year unless otherwise stated, bordered numbers indicate outturns.

Note: Changes in profits, earnings, employment costs and house prices are in nominal terms

Sources: Panel judgement

October 2020 forecast

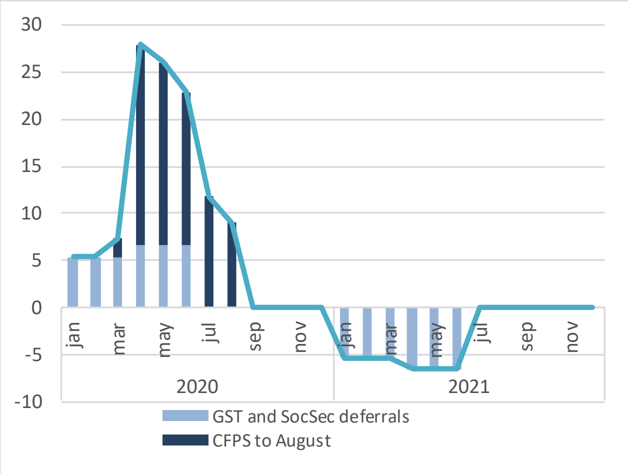
% change unless otherwise specified	2017	2018	2019	2020	2021	2022	2023	Trend 2024+
Real GVA	0.8	1.4	2.1	-7.6	3.0	1.9	1.1	0.6
RPI	3.1	3.9	2.9	1.3	1.5	2.4	2.5	2.6
RPIY	3.2	3.6	2.6	1.5	1.4	2.3	2.4	2.5
Nominal GVA	4.1	5.9	5.5	-6.4	3.9	3.2	2.9	3.1
Gross operating surplus (including rental)	-0.3	7.5	7.7	-13.1	7.1	3.3	2.6	3.2
Financial services profits	*-6.4*	*9.6*	*10.1*	*-18.6*	*8.0*	*6.0*	*4.0*	*3.4*
Compensation of employees (CoE)	8.1	4.6	3.6	-0.6	1.5	3.2	3.1	3.1
Financial services CoE	*10.0*	*2.5*	*3.1*	*3.0*	*0.0*	*2.7*	*2.9*	*3.1*
Non-finance CoE	*7.0*	*5.8*	*3.9*	*-2.6*	*2.4*	*3.4*	*3.2*	*3.1*
Employment	2.3	1.4	1.2	-1.6	1.2	0.9	0.6	0.4
Average earnings	2.6	3.5	2.6	1.1	1.1	2.3	2.5	2.7
Interest rates (%)	0.3	0.6	0.8	0.2	0.0	-0.1	-0.1	0.0*
House prices	2.9	7.1	7.0	0.0	-2.0	2.7	2.7	2.7
Housing transactions	3.6	7.5	-1.0	-20.0	10.0	1.5	1.5	1.5

* Bank Rate forecast for 2024 only

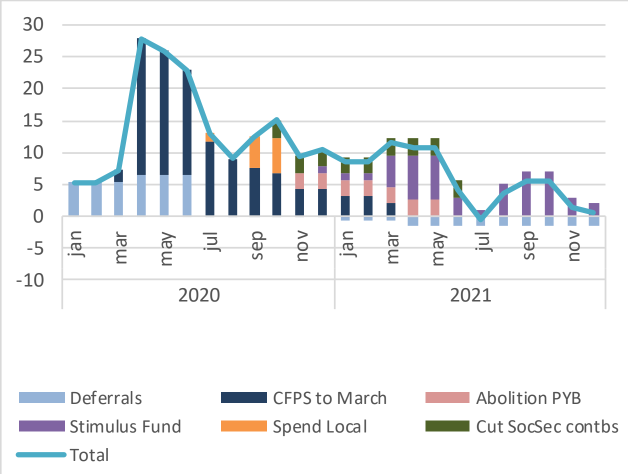
Box 1: Fiscal stimulus

In common with other advanced economies, Jersey acted quickly to put in place a range of measures to support the economy through the height of restrictions. This included the deferral of Social Security contributions and GST payments for the first half of the year, and the Co-Funded Payroll Scheme (CFPS). However, with the deferrals ending in June and the CFPS in August, this left a potential cliff-edge of support at a time when the recovery was starting to take hold, as shown in the left -hand panel:

Fiscal impact of initial support to economy
£m impact per month



Fiscal impact of initial support plus stimulus



The Panel's March letter urged Government to consider a temporary package of fiscal stimulus. This was agreed in July to include:

- Extended time to pay existing deferrals, and the abolition of the prior-year-basis of calculating personal income tax
- Spend Local: direct payments to low-income households (£1.3m) and prepaid cards to all Islanders (£11m)
- A temporary reduction in employee Social Security contributions (£26m)
- A £50m Fiscal Stimulus Fund

The CFPS was also extended, providing tapered support to March 2021. The combined impact of these decisions was to ensure that government support continues into next year, extended through the period where the economy is likely to be significantly below trend.

This support tapers out towards the end of 2021, which is appropriate as the economy recovers. However, given the degree of uncertainty it is important that the stimulus programme remains flexible and can respond to changes in the economic outlook.

Section 2 - **The Fiscal Outlook**

2.1 Introduction

This section considers the proposed Government Plan for 2021-24 ('the Government Plan'), which was lodged in October and will be debated by the States Assembly in December. This is the second Government Plan under the framework set out in the Public Finances Law 2019[4]. This Government Plan has been prepared at a highly uncertain time for the global and local economies, as outlined in Section 1, and the outlook for public finances is equally uncertain. The Panel recognises that it is therefore very challenging to plan for a four-year period. Both revenue and expenditure are subject to heightened uncertainty and therefore this will require more flexibility than usual to respond to spending pressures and to changes in the economic outlook and the consequent outlook for government revenues.

Proposed Government Plan 2021-24

The proposed Government Plan sets out:

- Fiscal deficits in the initial years, as a result of significantly reduced income forecasts and temporary increases to expenditure.
- £20m of additional annual efficiencies/rebalancing from 2024 to close the deficit
- A reduction in the States Grant to the Social Security Fund.
- £3.5m of revenue-raising, from 2021, with a commitment to set out a further £10m in next year's plan to take effect from 2024.
- New borrowing, peaking at £457m in 2022
- Capital expenditure of £396m over four years.

Public Finances Law

The Public Finances Law 2019 (the 'PFL') requires the FPP to prepare an annual report on the state of the economy and on government finances as set out in the government plan. The report is required to comment on:

a. the strength of the economy in Jersey;
b. the outlook for the economy in Jersey;
c. the outlook for world economies and financial markets;
d. the economic cycle in Jersey;

[4] Public Finances (Jersey) Law 2019

e. the medium-term and long-term sustainability of the States' finances in light of the States' financial assets and liabilities; and

f. the advisability of transfers to or from the Strategic Reserve Fund and Stabilisation Fund

Fiscal framework

Last year's Government Plan set out a number of guidelines that form part of Jersey's new fiscal framework and these guidelines continue to underpin this year's Government Plan. They are:

- seek to increase the Strategic Reserve and public sector net worth, while following the advice of the Fiscal Policy Panel on borrowing and net financial assets.
- run a primary structural current balance or surplus in the long term until the Strategic Reserve is judged large enough to meet its mandate.
- borrow only to finance investment (or refinance liabilities), except under times of economic duress, and monitor the impact on net financial assets.

The Panel will assess the extent to which the Government Plan follows the fiscal framework guidelines.

The remainder of this section is set out as follows:

- Income and expenditure, including the approach to closing the deficit by 2024 (section **2.2**)
- The adjusted fiscal position, i.e. the aggregate impact of government activity on the economy (section **2.3**)
- Net asset position, including the forecast for reserves (section **2.4**)
- Borrowing (section **2.5**)
- The Panel's previous recommendations (section **2.6**)
- Risks to achievement of the Government Plan (section **2.7**)
- Long-term challenges (section **2.8**)

2.2 Income and expenditure

The measure of the budget surplus/deficit position used in the Government Plan is the 'operating balance'. This measure includes current spending and income but excludes capital spending, rather including depreciation to represent the expense of the capital stock being 'used up' to deliver services each year. The Panel is supportive of the inclusion of depreciation in this definition as it removes the incentive to cut capital budgets in order to achieve a balanced budget.

The measure used in the fiscal framework is the primary structural balance. This differs from the operating balance in two ways:

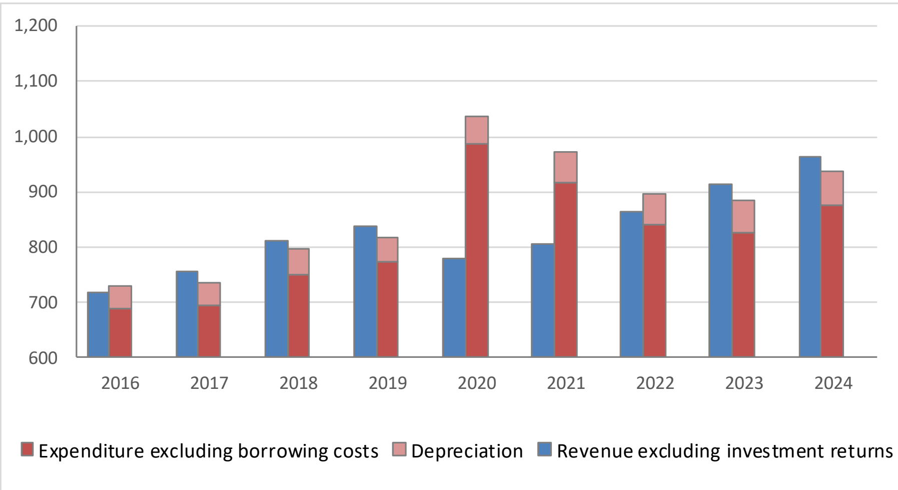
1. It would include an adjustment for the economic cycle (i.e. it is a structural balance, that aims to remove any cyclical component in expenditure and revenue). This relies on the judgement of the Panel, as set out in section 1.
2. It excludes investment returns and borrowing costs. The operating balance includes both borrowing costs (for the revolving credit facility and the housing bond) and some investment returns (on the Consolidated Fund and Currency and Coinage Fund).

While the structural budget balance is more of a question of judgement, it is possible to produce the primary budget balance using figures in the Government Plan. Figure 2.1 sets out recent outturns and a forecast to 2024 for the primary balance / primary budget position.

Figure 2.1
Income and expenditure forecasts

£m (current prices)

Source: Panel calculations based on data from Treasury and Exchequer



The primary budget was in surplus from 2017-19, in line with FPP advice during this period when the economy was above trend. However, this position is reversed during 2020, with a significant increase in expenditure and a fall in revenue, which results in a primary deficit of almost £260m.

It is appropriate for Government to plan to run significant deficits to support the economy this year, and in the initial years of the proposed Government Plan, bringing the budget back into balance by 2024. This is in line with Fiscal Policy Panel advice from August.

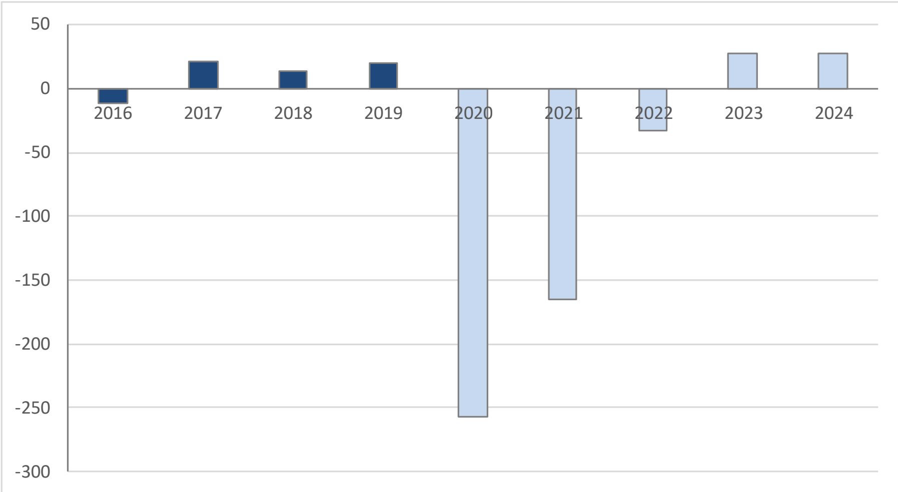
Figure 2.2

Primary surplus/deficit

Primary budget surplus - £m (current prices)

Outturn (dark blue bars) and forecast (light blue bars)

Source: Panel calculations based on data from Treasury and Exchequer



The deficits would be much larger if the transfer to the Social Security Fund (the 'States Grant') were not cancelled in 2020-23. The Social Security Fund receives annual grants from the Consolidated Fund, in addition to the contributions received from employers, employees and the self-employed. The aggregate value of this transfer is calculated using a formula set out in law, though last year's Government Plan reduced the payment during 2020-22. The States Assembly has since made a decision to cancel this transfer for 2020 and the Government Plan is now based on an assumption that the States Grant is not paid in 2021-23. Further, it is assumed that from 2024 onward the formula is revised so that the States Grant is fixed at £65m per year rather than the current formula, which would have seen an estimated £95m in 2024 and increasing thereafter. However, after adjusting for this, the budget would still be balanced in 2024, in line with FPP advice.

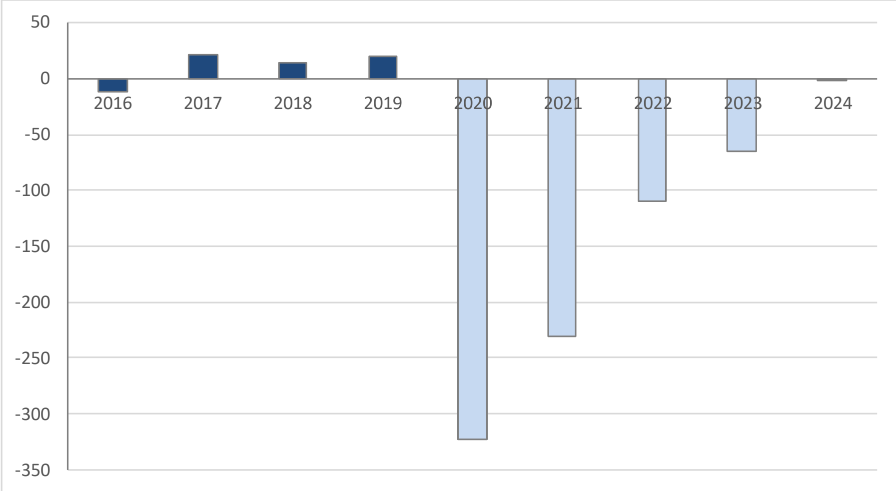
Figure 2.3

Primary surplus/deficit if States Grant was not reduced

Primary budget surplus - £m (current prices)

Outturn (dark blue bars) and forecast (light blue bars)

Source: Panel calculations based on data from Treasury and Exchequer



The States Grant represents a transfer between funds - it supports expenditure in the Social Security Fund and 'savings' in the Social Security Reserve, rather than representing expenditure in its own right. While reducing the States Grant reduces the pressure on the Consolidated Fund, resulting in smaller deficits in 2020-22 and a surplus by 2024, the reduction creates an annual deficit in the Social Security Fund, requiring drawdowns from the Social Security Reserve. The outlook for the Social Security Funds is covered in more detail in section 2.4, but the Panel notes that the Government Plan commits to a review of the funding arrangements for the Social Security Fund. The Panel will review the appropriate level of transfers between the Social Security Fund and the Consolidated Fund when the review is complete.

The Government Plan also sets out a forecast of the 'Government of Jersey Group' surplus, which includes the income and expenditure of all funds. This shows that, including investment returns and borrowing costs, the balance of income and expenditure shifts dramatically over the 2021-24 period, from a deficit of £284m in 2021 to a surplus of £147m in 2024. However, this compares to a surplus of £415m in 2019. Moreover, part of the swing from a large deficit in 2021 to a large surplus in 2024 is because 2021 and 2022 assume 0% returns on equity investments, whereas subsequent years are based on recent average rates of return. The level of investment returns in individual years, and over the long term, is highly uncertain and while the assumptions used in the Government Plan appear prudent there is a risk that investments could perform significantly differently from past performance, this risk is considered further in section 2.7.

Figure 2.4

Government of Jersey Group forecast

£m

Source:

2019-20 from Treasury and Exchequer;

2021-24 from Government Plan: Table 45;

	2019	2020	2021	2022	2023	2024
Operating surplus	18	-267	-178	-51	14	14
Trading operations surplus	2	3	2	3	4	4
Special Funds surplus	10	-78	-151	-87	-101	-44
Group operational surplus	31	-342	-327	-135	-83	-26
Investment returns	384	-144	43	42	167	173
Group surplus	415	-487	-284	-93	84	147

2.2.1 Expenditure related to Covid-19

A large part of the increase in expenditure is due to one-off/temporary spending pressures related to mitigating and dealing with the impact of the Covid-19 global pandemic. This includes both costs associated with reducing the spread of the virus, treating cases of the virus and supporting the economy.

Figure 2.5

Covid-19 expenditure

£m

Source:

2020 from Treasury and Exchequer;

2021-24 from Government Plan: Table 6.

	2020	2021	2022	2023	2024
Nightingale field hospital	18	8	0	0	0
Cofunded Payroll Scheme	127	11	0	0	0
Income support costs	11	7	5	4	5
Economic recovery	0	16	12	12	0
Education costs	4	1	0	0	0
Test and tracing programme	30	30	0	0	0
Vaccine	7	5	0	0	0
Fiscal stimulus	12	0	0	0	0
Other	43	4	2	1	0
Total Covid costs	252	84	19	17	5
Covid-19 costs as a proportion of GVA	**5%**	**2%**	**0%**	**0%**	**0%**

The Panel notes that Covid-19 related costs continue into 2024. As set out in section 1, the economy should not be expected to return to its pre-pandemic path and therefore any ongoing increase in costs in later years should be considered permanent/structural impacts. In particular, it is not clear why the increase in income support costs in 2024 should be considered Covid-19 related.

2.2.2 Rebalancing

The Government Plan sets out a target for 'rebalancing' in each year of the four-year period. The Plan states that a wide range of fiscal measures will be required and therefore rather than describing these as 'efficiencies' as in the previous Government Plan, this has been broadened to include efficiencies as one of a number of approaches including revenue-raising measures. For example:

- A reduction in spend, delivering better quality services for less.
- More efficient collection of existing income and better debt management
- Increasing the Government's revenue through further recovery of existing costs, moving towards full cost recovery of services where appropriate
- The extension and increase of existing charges or the introduction of new charges as revenue-raising measures.

Of the £40m of efficiencies targeted for 2020, £28m is expected to be achieved on a recurring basis, and the remaining £12m has been met through one-off expenditure reductions. It is understood that the full £40m reduction to budgets will be carried forward into 2021, i.e. it will result in £40m of recurring reductions relative to the 2019 expenditure limits. This is in addition to the target of £20m of efficiencies and other rebalancing measures for 2021, for which detail is set out in the Government Plan.

The largest measures for 2021 are £5m from a zero-based budget exercise in Health and Community Services; £4m from a reduction in costs associated with the health estate; £3.7m from managing inflationary pressures and contract management; and £1.3m of revenue from enhanced tax compliance.

Beyond 2021, there is less detail provided on efficiencies and revenue raising but there are a number of broad opportunities identified regarding the modernisation of government – for example in relation to the public sector estate, the use of technology and the delivery of technical services. However, the target of £100m of rebalancing measures by 2023 has been maintained, with a further £20m added for 2024.

In last year's Annual Report, the FPP recommended that efficiencies should be sought regardless of the stage of the economic cycle, and that a deterioration in economic conditions should not result in any divergence from the efficiencies programme. **The Panel welcomes that the efficiencies target has been maintained, in line with its previous recommendation.**

However, the target remains ambitious and efficiency gains can often be challenging to achieve in practice. Due to the impact of the pandemic, there have been some delays in achieving the efficiencies for 2020. The Panel has previously recommended that detailed, realistic and time-bound targets should be built into the four-year Government Plan. While these have been identified for 2021, the detail has not yet been fully worked up regarding how the rebalancing from 2022-24 might be achieved. The ability to achieve this level of rebalancing, including the revenue-raising measures, is made potentially more challenging by the disruption caused by the pandemic and therefore there is a risk to achieving balanced budgets by 2024.

2.2.3 Revenue forecast

This Government Plan is based on a revenue forecast that is around £115m lower for 2021 than the forecast from the previous Government Plan. There are also significant reductions in the forecast for beyond 2021. The revenue forecast is conditioned on the FPP economic forecast from August and therefore follows a broadly similar path of a significant decline in the short term and only a gradual recovery such that revenue is forecast to be permanently lower than the pre-pandemic forecast.

Of the £85m variation that remains by 2023, the majority relates to a fall in the forecast for income tax (personal and corporate) of £59m, with the GST forecast reduced by £9m, stamp duty by £8m, impôts by £4m and other income by £5m.

Figure 2.6
Income forecast

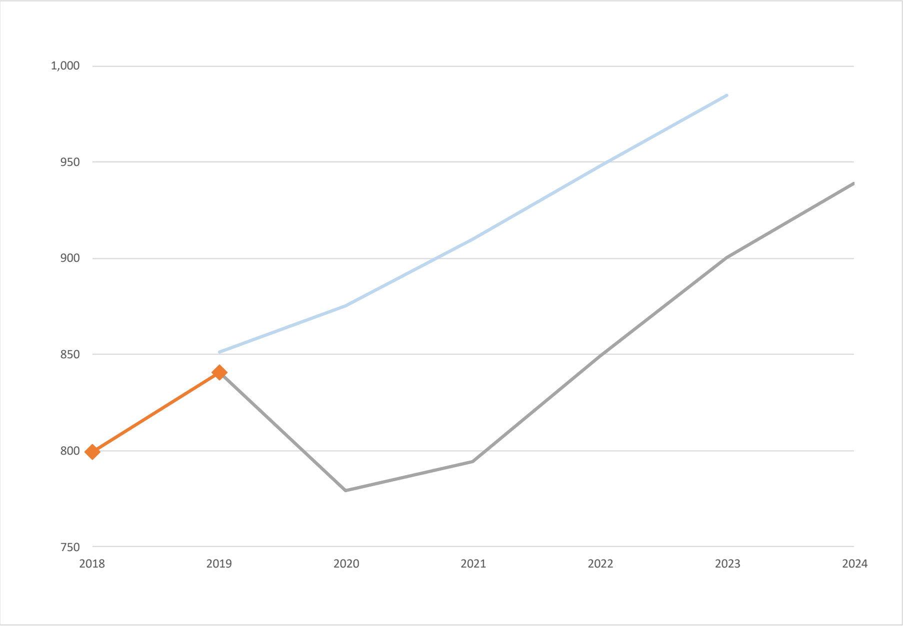
£m, forecast for general revenue income

Blue line is Government Plan 2020-23 forecast (Autumn 2019)

Grey line is Government Plan 2021-24 forecast (Autumn 2020)

Orange line is outturn

Source: Government Plan: Table 19



2.2.4 Revenue measures

In line with the Panel's advice to avoid implementing significant new revenue streams too quickly, revenue-raising in 2021 is limited to an increase to fees paid by International Service Entities (ISE fees). This is expected to raise an additional £3.5m annually from 2021.

No other significant changes have been made to 2021 revenue, with tobacco and road fuel duties increased in line with existing policies, including £895k of road fuel duty increases that are hypothecated to the Climate Emergency Fund. Alcohol duties have been frozen, to support the hospitality sector.

Figure 2.7

Government Plan revenue-raising measures in 2021

Estimated additional revenue compared to base

Proposed Measures		Est. 2021 revenue (£'000)
Personal income tax	Increase in personal income tax thresholds	-1,200
Stamp duty	Changes for first time buyers purchasing through 'assisted ownership'	-500
ISE Fees	Increase in ISE Fees	3,500
Impôts:	Tobacoo	877
	Road fuel	1,020
Total Financial Implications		3,697

Source: Government Plan: Table 26

In addition, the Government Plan sets an initial target of approximately £10m of further new revenue from several sources, with measures to be brought forward in Government Plan 2022 for implementation by 2024:

- Broadening the corporate income tax base
- Taxation of medicinal cannabis growing and processing
- Reviews of commercial and residential stamp duty

It is appropriate that the Government Plan does not propose significant new or increased revenue streams in 2021, as large increases in revenue may undermine the economic recovery. However, it is important that Government considers its options for revenue-raising in the future, which is likely to be a key element of any plan to close the structural deficit.

The revenue measures outlined in the Government Plan do not include the £8.6m of additional revenue from 'domestic compliance' in 2021, rising to £13.5m in 2024. This is included in the 'rebalancing' totals covered in section 2.2.2.

2.2.5 Closing the deficit

The total impact of the spending pressures and reductions to the revenue forecast, compared with Government Plan 2020-23, is £348m in 2020, reducing to £104m by 2023. This would therefore result in a significant structural deficit by 2024 in the absence of any measures.

However, a range of measures is proposed - including an additional £20m of rebalancing/efficiencies, £13.5m of revenue measures and the reduction in the States Grant. Figure 2.8 sets out a summary of the measures used to reduce the deficit in each year and to close it in 2023 and 2024. The approach in the early years is to reduce the deficit by cancelling the States Grant to the Social Security Fund. As discussed in section **2.2.4**, revenue measures are relatively limited initially, increasing to £13.5m from 2024 - at the same time as the additional £20m of efficiencies and rebalancing. However, the reduction to the States Grant remains the largest measure at £30m in 2024.

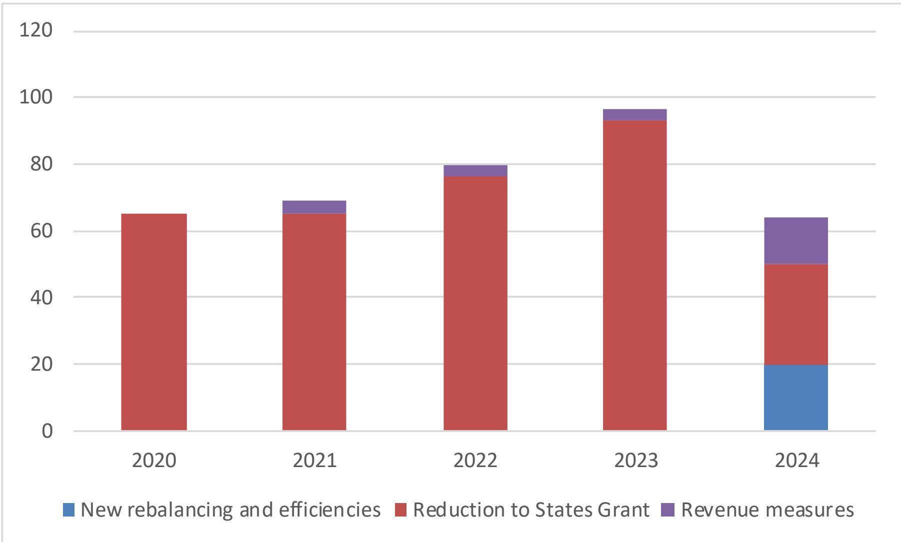
Figure 2.8

Closing the deficit

Revenue and expenditure measures by year

(£m)

Source: Treasury and Exchequer



The second Medium-Term Financial Plan (MTFP2) clearly set out an estimate of the structural deficit and the proposed approach to close it, in a similar way to Figure 2.8. An approach such as this provides clarity on what will be required and helps to focus on the target to reduce the structural deficit. There is considerable uncertainty at this stage regarding the extent to which the deficit is structural. As the economic picture becomes clearer and the Panel continues to develops its judgement of the cyclical and structural impact of the pandemic on the economy, it will be possible to have a better estimate of the size of the structural deficit and a clear breakdown of the measures, similar to what was provided for MTFP2. **The Panel recommends that the next Government Plan includes a clear estimate of the size of the structural deficit and breaks down the measures intended to close it, similar to the breakdown provided for MTFP2.**

2.2.6 Capital

The Government Plan sets out a plan for £396m of capital spending over the four-year period, including £25m from 'trading funds'[5]. This is concentrated towards the start of the four-year period, with £127m planned for 2021, falling gradually to £80m planned for 2024. This excludes the majority of expenditure on the hospital, which will be set out next year. It also excludes £23m of capital investment in a new benefits system, to be funded from the Social Security Fund.

The main areas of capital spend relate to estates including new schools (£146m), IT (£90m) and infrastructure including repairs and maintenance (£63m). The largest individual projects include:

- Phase 2 of the hospital design and planning (£20m in 2021)
- Integrated technology solution (£9.2m in 2021)
- Cyber Security (£6.5m)
- Health services improvements including IT (£5m)
- Fort Regent early phase work (£4.8m)

The majority of these have been designated as 'major projects' and therefore will span multiple years.

Figure 2.9

Capital spending

£m

Source: Government Plan: Table 12, Table 29, Table 30

Capital programme area	2021	2022	2023	2024	Total 21-24
Central Planning Reserves	4	0	0	0	**4**
Disc Law, safeguarding, Reg of Care	4	3	2	2	**11**
Schools extensions/improvements	6	7	2	1	**16**
Infrastructure incl Rolling Vote	13	19	16	15	**63**
Information Technology	36	31	17	6	**90**
Replacement Assets	10	7	10	7	**34**
Estates including new Schools	43	29	33	41	**146**
Reserve for Risk and Inflation	1	2	2	2	**7**
Trading Funds	10	5	5	6	**25**
Total	**127**	**103**	**87**	**80**	**396**

This represents a large increase in capital spend from £20.9m delivered in 2018 and £73.5m in 2019. In both years this was much less than planned at the beginning of the year, demonstrating the challenges with delivering capital plans.

The latest forecast for 2020 is that £111m will be delivered, significantly in excess of the 2020 allocation of £90m. This excess is due to capital allocations from previous years being spent in 2020. There still remains a considerable amount of earlier allocations unspent that may be spent in future years.

[5] The Car Parking Trading Fund and the Fleet Management Trading Fund

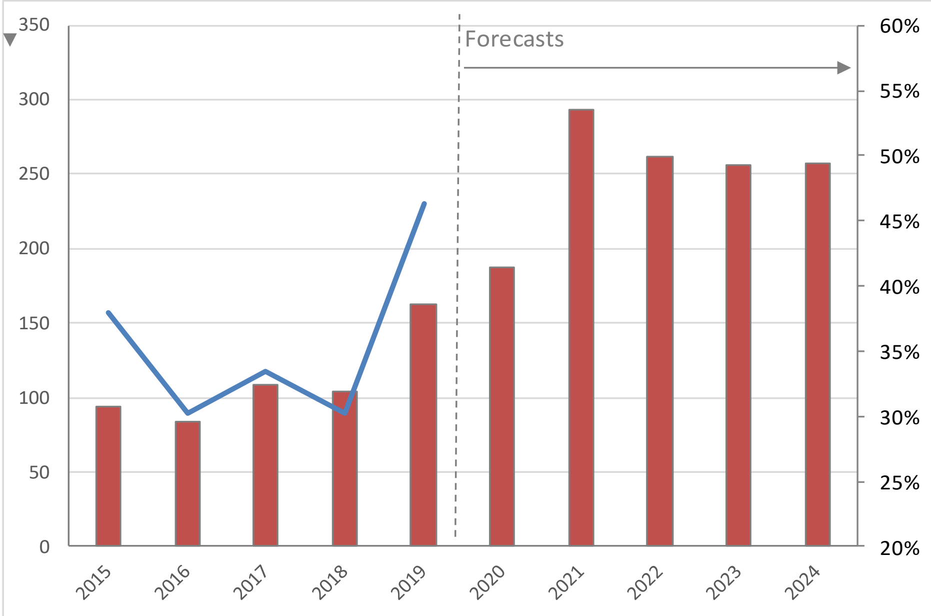
A large part of the government capital programme appears to relate to IT and therefore may have a limited impact on the local construction sector. However, subsidiary companies (i.e. public corporations such as Andium Homes, the States of Jersey Development Company and the Ports of Jersey) are projected to spend £672m of capital over four years – making a total of £1.1bn over four years for this wider 'Government Group'.

Figure 2.10
Capital spending - outturn and forecast cashflow

£ million (current prices) including trading operations and subsidiary companies: Andium, Ports of Jersey and SoJDC (LHS).

% of construction GVA, current prices (RHS)

Source: Treasury and Exchequer; Statistics Jersey



In the 2019 Annual Report, the Panel set out a recommendation to undertake further work to set out how the capital programme can be delivered without exacerbating capacity constraints in the local construction industry. The economic outlook has deteriorated and in the short term there may be some spare capacity in the construction sector, but it is not entirely clear that this would remove concerns around the capacity of the local construction sector to deliver the scale of the wider government capital programme in future years. The Panel continues to recommend that **more work should be undertaken to consider how the capital programme can be managed to ensure that it can contribute to the economic recovery but avoiding creating capacity constraints within the construction sector.**

2.3 The adjusted fiscal position

The Panel's reports also set out an indication of how supportive the overall fiscal position is to the economy, i.e. how much demand is government putting 'into the economy' as current and capital expenditure; and how much government is 'taking out' of the economy in taxes and contributions.

Overall, as outlined in the previous sections, government is continuing to provide significant support to the economy through the overall fiscal balance:

1. A large current deficit in the early years, reducing as the economy recovers.
2. The operating deficits in the 'special funds', primarily from the Social Security Fund
3. The significant government capital programme.
4. Further capital spending from the subsidiary companies – in particular Andium Homes and the States of Jersey Development Company.

This overall support to the economy is appropriate to support demand during a period when a high degree of spare capacity is expected to persist. However, **the combined impact of the deficits in both the Consolidated Fund and Social Security Fund, in addition to the large combined capital programme, provide significant support to the economy, particularly in the early part of the Government Plan period. This support should be unwound as the economy recovers, though this should not be a reason to delay necessary capital expenditure.**

2.4 Net asset position

The fiscal framework sets out a guideline that Government should seek to increase public sector net worth, i.e. the overall net asset position including both physical assets and net financial assets. This is the key, long-term objective for achieving fiscal sustainability. The Public Finances Law therefore requires the FPP to comment on the sustainability of public finances in light of the States' financial assets and liabilities.

The expenditure pressures and projected reductions in revenue will inevitably put pressure on the net asset position. The Panel recognises that these are unavoidable in the short term and that it would be inadvisable to put the economic recovery at risk by hasty action to maintain the net asset position.

Figure 2.11 sets out how the net asset position will change over the 2021-24 Government Plan period. The forecast has been expanded, compared to the previous Government Plan, to include balance sheet forecasts for the subsidiary companies (Andium Homes, Ports of Jersey and States of Jersey Development Company). This provides a more complete picture of the net asset position and is in line with previous Panel recommendations.

Figure 2.11

Net asset position

£ billion (current prices)

Source: Treasury and Exchequer

	2019	2020	2021	2022	2023	2024
Physical assets	3.9	4.0	4.1	4.1	4.2	4.2
Financial assets	3.7	3.1	2.8	2.8	2.9	3.1
Total	7.6	7.2	6.9	6.9	7.0	7.2
as % of GVA	**152%**	**154%**	**144%**	**138%**	**137%**	**137%**

The total net asset position is forecast to remain significantly below the position at the end of 2019. As a proportion of the economy, i.e. gross value added, the net asset position is forecast to remain relatively stable in 2020 as the economy contracts sharply. Looking ahead, the net asset position is expected to decline from over 150% of GVA in 2019, to less than 140% in 2022-24.

Financial assets are held in funds including the Strategic Reserve, Consolidated Fund, Stabilisation Fund and a number of 'Social Security Funds'. Over the Government Plan period, the aggregate value of these funds is significantly reduced when compared to the position at the end of 2019.

Figure 2.12

Reserves

Size of selected funds, balance at end of year, £m

Source:

2019 and 2020 from Treasury and Exchequer;

2021-24 from Government Plan: Table 32

	2019	2020	2021	2022	2023	2024
Consolidated Fund	161	-89	0	0	0	0
Strategic Reserve	906	876	890	905	953	1,004
Stabilisation Fund	50	0	0	0	0	0
Social Security Reserve	1,983	1,736	1,667	1,610	1,635	1,751
Social Security Fund	92	93	92	86	75	67
Health Insurance Fund	108	98	79	63	47	35
Long Term Care Fund	26	31	35	40	44	46
Total	**3,327**	**2,744**	**2,764**	**2,703**	**2,754**	**2,903**
Total as % of GVA	*67*	*59*	*57*	*54*	*54*	*55*

The Consolidated Fund can be seen as the government's day-to-day fund for revenues and expenditure, including capital expenditure. Over the Government Plan period the size of this fund becomes negative this year and is forecast to be zero at year end in the following years. The Consolidated Fund is prevented from running much larger negative balances through a combination of borrowing and reducing transfers to other funds.

The following sections consider three of the funds in more detail.

Stabilisation Fund

The Stabilisation Fund is intended to act to smooth the economic cycle, receiving transfers when the economy is performing 'above trend' and then using these resources to support spending when the economy is 'below trend'.

In recent years the Government has transferred some surpluses into the Fund and a further £8m was planned to be transferred this year. However, the economy has now moved into what is likely to be a protracted period below trend and therefore **it is appropriate that the £50m balance on the Stabilisation Fund is transferred to the Consolidated Fund to support expenditure this year.**

In the 'Advice for the Government Plan' report, the Panel advised that **when the balance on the Stabilisation Fund is not sufficient, it is appropriate to consider alternative methods of funding counter-cyclical fiscal policy, including borrowing.**

The Panel does not recommend any transfers to the Stabilisation Fund during the Government Plan period. This is in line with the Panel's advice that the government should plan on the basis of the economy not returning to its trend level of output until 2024. The ability to draw on the £50m of past surpluses this year is valuable and demonstrates the importance of the Stabilisation Fund in supporting counter-cyclical policy in Jersey. Therefore, in the longer term it will be important to consider a plan to rebuild the Stabilisation Fund during future periods when the economy is above trend.

Strategic Reserve

The Strategic Reserve has seen some investment losses in 2020. Going forward, the Government Plan sets out an aim to bolster the Strategic Reserve through retaining both the capital value and any investment returns in the fund.

The Panel previously recommended that the Government should set out a plan to increase the Reserve. Based on analysis of the fiscal impact of crises in other small economies, the Panel suggested that a Strategic Reserve of over 30% of GDP would have been prudent in those cases. The Government Plan forecasts would see the Reserve remain broadly stable at 18%-19% of GVA over 2019-2024. **In the long term, increasing the Strategic Reserve should remain a priority but it is not advisable to make any transfers to the Reserve over the Government Plan period, given the pressure already on the Consolidated Fund.**

However, to maintain the Strategic Reserve requires the Government to significantly increase borrowing instead to pay for the costs of the pandemic. Borrowing is covered in more detail in section **2.5**. The Panel considers that borrowing now rather than drawing on the Strategic Reserve provides more flexibility and retains the option to use the Reserve in the event of a future shock – when borrowing could be more difficult than it currently is.

The Panel agrees that it would not be prudent to draw heavily on the Strategic Reserve at the current juncture, unless the Covid-19 crisis has an even more significant impact. The purpose of the Reserve is to insulate the economy against significant structural decline. While Covid-19 has led to a severe recession, it is important to protect the Strategic Reserve to maintain flexibility to deal with further shocks.

The expectation is still for Jersey's economy, including its financial sector, to return to health following the pandemic. The mandate of the Strategic Reserve is better aligned to long-term structural threats, for example a severe and permanent contraction in the financial services sector.

Social Security Fund / Social Security Reserve

With a combined value of over £2bn at the end of 2019, the Social Security Fund and the associated Social Security Reserve Fund represent the majority of Jersey's financial assets. Policy over the last twenty years has been to build up the reserve so it can be used in the future to smooth the impact of meeting the pension needs of the future demographic challenges.

Over this period, the Social Security Fund has generally been in surplus each year, with surpluses subsequently transferred to the Reserve Fund. These transfers over a long period of time have accumulated alongside investment returns so that the initial target of achieving a balance worth five times the annual expenditure has now been exceeded. The latest actuarial review was published in 2019[6] and estimated that the fund balance represented 7.6 times annual expenditure in 2017, and projected that at current contribution rates assuming net migration of +700/year the fund would remain above five times annual expenditure throughout the projection period to 2077.

[6] Report by the Government Actuary on the financial condition of the Social Security Fund as at 31 December 2017

However, the outlook for the balance of the Fund (including the Reserve Fund) has now deteriorated for a number of reasons:

1. The temporary cancellation of the States Grant to the Social Security Fund, and the subsequent reduction from the 'formula' calculation of this transfer (see section **2.2**).
2. The temporary reduction to employee Social Security contributions as part of the fiscal stimulus programme (see Box 1).
3. Investment losses in 2020 and an assumption that investment returns in 2021 and 2022 will be lower than average, and below those assumed in the 2019 review.

The combined Social Security Fund and Reserve Fund remains in a relatively strong position even after these changes but falls from around 42% of GVA in 2019 to 33% in 2023. If contributions are unchanged and the States Grant is set at £65m from 2024 (as assumed in the Government Plan), the outlook beyond 2023 is for a further decline – both as a proportion of GVA and in nominal terms. Contributions are forecast to be £218m in 2024, with benefit spend of £313m so a States Grant of £65m would leave an annual deficit of around £30m.

The Government Plan commits to a review of funding arrangements for the Social Security Fund and the forecast for the Fund includes £29m of 'sustainability measures' from 2024. **The Panel recommends that any review of the Social Security Fund is taken in the context of the fiscal framework guideline to increase public sector net worth.**

Figure 2.13
Social Security Fund income and expenditure

£m; excludes capital expenditure and transfers to/from Social Security Reserve

	2021	2022	2023	2024
Contribution income	183	206	212	218
Sustainability measures	0	0	0	29
States Grant	0	0	0	65
Benefit expenditure	-279	-287	-300	-313
Annual surplus / deficit	**-96**	**-82**	**-88**	**-1**

Source: Adapted from Government Plan: Table 36

2.5 Borrowing

A notable feature of Jersey's public finances is that for many years there has been little to no external borrowing. However, in 2014 the States of Jersey issued a £250m bond to finance a ring-fenced fund to lend to affordable housing providers in the Island. Since then consideration has been given to the suitability of borrowing to fund the construction of a new general hospital, and it is understood that borrowing is still under review for this purpose.

Following the completion of an updated revenue forecast, a revolving credit facility for up to £500m was agreed in May with a consortium of five local banks. In the Government Plan, £336m of this is to be utilised in addition to £50m of borrowing for the Fiscal Stimulus Fund. Borrowing to fund the pressures from the pandemic is expected to peak at £457m in 2022. Including the existing £250m borrowing this means that total borrowing is expected to peak at over £700m in 2022 (14% of GVA).

The Fiscal Framework sets a guideline that government should *'borrow only to finance investment (or refinance liabilities), except under times of economic duress, and monitor the impact on net financial assets'*. On this basis therefore the Panel's view is that **the plan to borrow to fund the health and economic costs of the pandemic is appropriate under the fiscal framework, which allows borrowing under times of economic duress.**

The Panel has considered borrowing in a number of previous reports, and in the FPP August 2020 letter to the Treasury Minister set out the following conditions under which borrowing may be appropriate in response to the current crisis:

> *To attempt to smooth the economic cycle. This means that in the absence of a substantial balance on the Stabilisation Fund, Government should consider financing both the automatic stabilisers and discretionary fiscal policy such as the Covid-19 stimulus through borrowing. This is preferable to excessive fiscal consolidation, which would intensify the structural impact of the very sharp short-term fall in economic activity.*
>
> *Borrowing remains a sensible option to fund investment. If this results in a physical asset that either provides a financial return or provides services that Islanders need over time, then it need not reduce the overall net asset position (it reduces net financial assets but increases physical assets). In Jersey examples include a new hospital, infrastructure and housing.*
>
> *Some of the reduction in revenues is due to the Government of Jersey deferring the collection of some taxes and contributions that*

would have otherwise been due this year. This includes the deferral of businesses' GST and Social Security contributions due for the first half of the year, and the personal tax liabilities of those previously on the 'prior-year-basis' (PYB) approach to calculating tax liabilities. It could be appropriate for Government to borrow to fund these cashflow measures as they will result in additional revenues in the future when these liabilities are repaid.

It is clear that without borrowing the only other way to avoid excessive fiscal consolidation would be to draw down on financial reserves.

The Government Plan does not set out to draw down the Strategic Reserve to pay for the one-off costs associated with the pandemic. The reasons for this are outlined in section **2.4** and relate to the need to maintain the option to use the Reserve for a severe structural impact such as the loss of a key industry.

The fiscal framework requires government to follow the advice of the Fiscal Policy Panel on borrowing and net financial assets, and to monitor the impact of any borrowing on net financial assets. Where the choice is between use of reserves and borrowing, the impact on net financial assets should be very similar in the short term but the impact on future risk and return on those assets will be different. In particular, whilst borrowing may appear cheap in terms of low interest rates it also increases the leverage of the government balance sheet and so increases risk. Effectively, debt creates a fixed claim on government resources so that any variation in those resources (due for example to negative equity returns) will fall more heavily on Jersey taxpayers. This means that even if rates of return on investments appear greater than interest rates on borrowing it does not follow that borrowing should be maximised to increase the size of reserves and their investment returns. This would be a very high-risk strategy and a prudent approach would require the risk profile of investments to be reduced in turn to reduce the risk that reserves were insufficient to repay borrowing.

The Government Plan states that one of the reasons for borrowing rather than use of reserves is that the cost of debt will be far lower than the long-term returns on reserves. However, the Panel does not entirely support this justification for borrowing due to the reasons above – but advises and agrees that there are other strong arguments for borrowing.

Government will seek to limit the amount of borrowing required through a combination of:

- Unused and uncommitted capital allocations at the end of the year
- Any unspent Covid-19 allocations from 2020
- Any uncommitted Fiscal Stimulus allocations
- Property disposals

The next Government Plan will set out a medium-term debt strategy, including any additional borrowing for the Our Hospital project. The approach to repaying the borrowing will be set out in the medium-term debt strategy. This is expected to include ring-fencing the repayment of the prior-year-basis (PYB) tax liability for 2019, and the use of receipts from property disposals.

It is also proposed to bring a proposal to the States Assembly in 2021 to create an Infrastructure Fund. This is intended to "*widen the participation of third-party investors who wish to take an holistic view of the long-term success of the Island*." The Panel understands that the pandemic has resulted to a delay in the development of the Fund but continues to recommend that **the establishment of an Infrastructure Fund should be rigorously compared to other options, including further borrowing or the use of reserves.**

2.6 Panel's previous recommendations

The Panel made a number of recommendations in the previous Annual Report from October 2019 and has since given further advice in response to two requests from the Treasury Minister in March 2020 and August 2020. The achievement of each of these recommendations is considered below: The recommendation from August to continue to run deficits in the early years of the Government Plan appears to have been followed, as does the recommendation to plan to close any deficit by 2024. The Panel further recommended that government should retain flexibility to revise the pace of fiscal consolidation in either direction. **With the Stabilisation Fund forecast to be exhausted this year, it remains important that government finances retain the flexibility to respond to changes in both the medical and economic situation.**

The Panel's recommendation that the Government Plan should include more detail on the efficiencies to be achieved over the full four-year period has been partially followed, as detail is only provided for 2021. However, the Panel recognises that there have been challenges with resources this year, and that a framework has been developed, including extending the definition of efficiencies to a broader package of 'fiscal rebalancing'. The Panel continues to recommend that clear plans are developed and set out for rebalancing to be delivered beyond 2021.

Funding new spending through hypothecation was set out as a guiding principle of the previous Government Plan. In response, the Panel recommended that hypothecation should only be introduced where revenue and spending are likely to be justifiably related. While this remains a guiding principle, the Panel note that no new hypothecated revenue streams have been proposed – though there are indications that some revenue streams (principally repayments and asset disposals) may be hypothecated to repay the proposed borrowing. The Panel's view remains that risks remain around hypothecation, and these risks are exacerbated now that public finances are facing a structural deficit, and so would continue to advise caution around hypothecating any new revenue streams. The hypothecation to repay borrowing is likely to represent less risk, where the quantum of potential revenue streams is relatively well defined.

The October 2019 Annual Report recommended that funding should be made available in future Government Plans to support initiatives with genuine potential to raise private sector productivity. Around £40m has been proposed in the Government Plan over 2021-2023 to cover both support measures in 2021 and new economic growth initiatives, such as those recommended by the Economic Council. **The Panel recommends that projects considered for funding under both the Economic Recovery funding and the Fiscal Stimulus Fund should be assessed against their ability to have a permanent positive impact on the productivity of the economy overall.**

Three of the Panel's previous recommendations have been addressed earlier in the report;

1. The recommendation around growing the Strategic Reserve has been covered in section **2.4** and this remains a long-term priority.
2. The recommendation to set out how the capital programme can be delivered without exacerbating capacity constraints in the local construction industry has been covered in section **2.2.6** and remains a key recommendation.
3. In the Annual Report, the Panel recommended that in the event of a downturn, the automatic stabilisers should be allowed to work, with discretionary fiscal support provided if necessary. Further advice was given on fiscal support/stimulus in the two letters in 2020. This is covered in Box 1.

A number of the Panel's recommendations from October 2019 have been superseded by updated advice issued in the Panel's letters in March and August 2020. In particular, the recommendation to run surpluses while the economy remains above trend, and the recommendation for larger transfers to the Stabilisation Fund. Both of these recommendations are now no longer appropriate given the stage of the economic cycle.

2.7 Risks to achieving current plans

As noted at the beginning of this section, there is an extensive degree of uncertainty around the prospects for the global and local economies and consequently around the outlook for public finances – making it therefore very challenging to plan for a four-year period. Previous sections have identified a number of risks and these are highlighted here.

The Economic Outlook

It is clear that Jersey has experienced a severe recession this year, in common with other countries across the world. However, there remains considerable uncertainty around how deep the recession will be and how quickly the economy might recover. Further, the uncertainty around the permanent and structural impacts on the economy represent a particular risk to fiscal policy.

Financial markets

Given the significant size of Jersey's financial asset position, uncertainty around the future performance of financial markets represent a risk to the strength of Jersey's public finances. While Jersey is primarily a long-term investor and investment returns are not typically relied upon to finance spending, significant investment losses could result in challenges to the sustainability of Jersey's public finances in the long term.

Brexit

While Jersey was not a member of the European Union prior to Brexit, it has been part of the single market for goods under the terms of the UK's former membership. The transition arrangements between the UK and the EU expire at the end of 2020 and no agreement has been reached yet on the future trading relationship. The direct impact on Jersey's economy may be limited but the impact on the economy of the UK, as Jersey's largest trading partner, remains a significant risk.

Rebalancing measures

A large element of the Government Plan approach to closing the deficit relies on the achievement of rebalancing measures (including efficiencies), many of which are still in development. A framework that has been set out to categorise rebalancing measures, but there remains a risk round delivering them. **Government should seek to consider what alternative approaches might be developed to close the deficit, if the rebalancing measures fall short of the £120m target.**

Revenue measures

The Panel recommended that no significant revenue or expenditure measures are introduced quickly to close the structural deficit. The Government Plan follows this recommendation, with only £3.5m of revenue in the initial years but a further £10m of new revenue measures to be identified and implemented by 2024. Development and implementation of these revenue measures represents a risk, given that the revenue is already included in the fiscal forecast for 2024. Moreover, the total size of the revenue measures to be developed is modest, at less than 0.2% of forecast GVA, and therefore makes a relatively limited contribution to closing the overall deficit.

Capital expenditure

The Government Plan sets out £371m of departmental capital spending over four years, plus £25m from trading funds. There are challenges around achieving this scale of spending, which is much greater than the typical capital expenditure amounts delivered in recent years. Moreover, this excludes the majority of the capital expenditure associated with the construction of the new hospital, which is still to be set out. Subsidiary companies, particularly Andium Homes and the States of Jersey Development Company, have a further £672m of planned capital expenditure over the four years of the Government Plan. There is a risk that this may prove challenging for the local construction industry to deliver. This does not mean that capital projects should be deliberately delayed - as precise management of the timing of a portfolio of capital projects is unlikely to be achievable. It does however mean that, conversely, there may be a risk that if delivery falls well short of plans then there is a risk of fiscal policy providing significantly less support to the economy than currently expected.

Borrowing

The Government Plan sets out a requirement for £457m of borrowing to partially cover the health and economic costs of the pandemic. On balance, this appears to be lower risk and more prudent than funding these costs through using a large proportion of the Strategic Reserve, but risks remain around borrowing – and it would be risky to borrow solely on the basis that the interest rate on borrowing is lower than the rate of return expected on investments. However, this is not the only argument for borrowing rather than using reserves – in fact there are a range of other factors that support the use of borrowing rather than drawing down significantly on reserves at the current time.

2.8 Longer-term challenges

The Panel set out several long-term challenges in its *Advice for the Government Plan* report in March 2019. While it is appropriate that the Government Plan focusses on addressing the immediate challenges of the Covid-19 pandemic, these longer-term challenges remain:

- Risks to the financial services sector
- Productivity growth
- Ageing demographics