Jersey's
Fiscal Policy Panel
Annual Report
September 2015

Introduction

This is the eighth annual report of the Fiscal Policy Panel (FPP). The current members of the Panel were appointed in April 2014 and are Joly Dixon CMG (Chairman), Christopher Allsopp CBE, Tera Allas and Dame Kate Barker. The Panel and its reporting structure were placed on a statutory basis in 2014 and is now required by the public finance law to make recommendations to the Minister for Treasury and Resources and the States on Jersey's fiscal policy with reference to:

(a) the strength of the economy in Jersey;

(b) the outlook for the Jersey and world economies and financial markets;

(c) the economic cycle in Jersey;

(d) the medium and long-term sustainability of the States' finances

(e) transfers to/from, the Strategic Reserve 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 the States 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.

Since it was formed in October 2007, the Panel has visited the Island on many occasions. Its work has benefited greatly from the discussions it has had with many people and institutions on and off the Island: its job would be much more difficult without their generosity. The Panel is also grateful for the invaluable support provided by the staff of the States of Jersey, in particular the States of Jersey Economics Unit and Treasury and Resources Department.

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

Key points

Economic Outlook

- Global growth in 2015 is expected to be at a similar pace to the previous two years, with acceleration in many advanced economies being offset by a slowing in emerging economies.
- Risks remain, with a number of threats to the global economy such as uncertainties in the euro area, the slowdown in China and other emerging markets and disruption from geopolitical tensions. Recent volatility in stock markets on the back of uncertainties in China show just how fragile the global economy remains.
- Jersey's economy stabilised in 2013 and has shown signs of significant growth in 2014 and further growth in 2015. Employment numbers have reached record levels and there has been real earnings growth, thanks in part to low inflation.
- The Panel have increased their estimate for economic growth for 2014, with strong growth of between 4.5% and 6.5%, due to an increase in finance sector profits. Further real growth is expected in 2016 and 2017 which could result in a decrease in spare capacity as the economy catches up with potential.
- Although financial services profits increased in 2014 by significantly more than anticipated at the time of the Panel's Pre-MTFP report, the implications of this for the wider economy and tax revenue are unclear. The Panel's view is that there is no strong evidence at the moment that this has significantly affected the level of spare capacity available in the economy. However, this is an area that the Panel will monitor closely as events continue to unfold and more data becomes available.
- The central estimate is that Jersey's output therefore remains about 5% below its potential level though recent developments may have increased the chances that it will be used up earlier in the 2017-2019 period.

Public Finances

- The Panel considers that their four guiding principles from the Pre-MTFP Report have been followed during the development of the draft MTFP.

- In general, the Council of Ministers has followed the Panel's recommendations in its proposed approach in the draft MTFP.

- The Panel is encouraged that the fiscal framework commits to monitoring the States net asset position on an ongoing basis so that future changes are highlighted. This will give the Panel opportunity to comment in their reports as to whether future changes are in line with the fiscal guidelines, which are: to balance the current budget over the economic cycle and keep States finances on a sustainable medium-term footing.

- The Panel is generally supportive of the "Review of Financial Management" by the Comptroller and Auditor General (CAG). Good financial management and sound fiscal policy are both important and complementary. The Panel particularly supports the CAG's first recommendation:

  "In the future extend the Medium Term Financial Plan to cover all the public finances of Jersey".

- It appears that the proposed measures in the MTFP are aiming to close a structural deficit in the region of £80-145 million, depending on whether the situation is considered before or after the inclusion of additional expenditure for the Strategic Plan priorities, such as health and education.

- The draft MTFP proposes to deal with the £145 million expected funding shortfall by 2019, as advised by the Panel in their third Pre-MTFP recommendation.

- The Panel agrees that securing the economic recovery and improving productivity is a critical part of the approach to balancing the States' finances.

- In line with the Panel's previous recommendations, the draft MTFP proposes to gradually withdraw fiscal stimulus from the economy as it recovers, and to use the States' reserves to pay for this whilst the measures planned to bring the States' finances back into balance are phased in.

- If capital expenditure meets current plans, there is a risk that the States' overall fiscal position could add significantly more to the economy than it takes out in the latter years of the MTFP - a time when the economy could be close to capacity.

- Implementing the £145 million of proposed measures looks challenging, particularly as the expenditure savings have not yet been fully identified. If a significant number of these savings are not achieved, then it increases the risk that the structural deficit will not be dealt with by 2019.

- The Panel is encouraged by the amount of flexibility included in the MTFP and the intention to meet FPP advice on this matter.

- The Panel is pleased that the capital project plans have been progressed and planned well in advance. This is in line with the Panel's 8th recommendation in its Pre-MTFP report. However, as the timing and size of the capital spending is very important, as is how it is delivered (the extent of on and off-island labour and materials content), it is important that the consequences for the local economy are managed taking account of the prevailing economic conditions.

- The Panel welcomes the Council of Ministers' commitments to develop a rolling long term plan and to review the long term sustainability of the Social Security Funds. However, a whole-of-government view is also required, covering all States' income, expenditure and their supporting Funds.

- Improving the Island's productivity and competitiveness is essential to its longer term economic prosperity. The Panel welcomes the Enterprise, Innovation and Skill strategies and the Competition Framework, and considers that removing any unnecessary and costly regulations will be critical to improving the Island's productivity and competitiveness in future. It is also important that concrete action plans are developed and implemented, and progress regularly reviewed, in order to translate these objectives into reality.

- The Panel supports the refocusing and reprioritising of the States' existing budgets that influence economic and productivity growth as an important first step before any new resources are allocated.

Recommendations

1. The analysis of the States' overall fiscal position (including all funds) needs to continue to develop and the 2016 MTFP Addition will be a good opportunity to expand this analysis further.

2. The States should plan how it will deliver capital projects to reduce the risk of a build-up of inflationary pressure in Jersey's economy. To avoid the need to change the timing of important projects or make adjustments to other spending or income, the States should consider whether resources could be imported cost-effectively from outside the island to reduce any bottlenecks within the local economy.

3. The States should also maintain other flexibilities, such as the timing of tax changes or other States expenditure, which could be used to ensure fiscal policy remains counter-cyclical.

4. The draft MTFP and 2016 MTFP Addition should be clearer about how much of the £90 million savings will be due to improving efficiency.

5. As details of the proposed package of measures for the 2016 MTFP Addition are developed attention should be given to ensure that they are sustainable, including their potential distributional impacts.

6. Given the risks to delivering the scale of savings required, the planning around flexibility to address the overall structural position must continue. The States should ensure these measures can be implemented in practice if necessary, and also take care that any short-term flexibility measures carried out do not compromise long-term sustainability or efficiency.

7. A strategy for managing the fiscal consequences of an ageing population should be progressed and take a whole-of-government view, considering the long term sustainability of all States' income, expenditure and their supporting Funds together.

8. The Panel welcomes the additional funding for the economic and productivity growth provision but stresses that strong governance measures should be put in place to control how the £20 million is allocated.

Section 1 - The Economic Outlook

1.1 International outlook

The International Monetary Fund (IMF) July 2015 World Economic Outlook Update estimated that the global economy grew by 3.4% in 2014. While growth in advanced economies accelerated, this was offset by a mild slowdown in emerging economies – such that global growth was largely in line with the previous two years. The world economy is expected to grow by 3.3% in 2015, before accelerating to between 3.8% and 4.0% for the following five years.

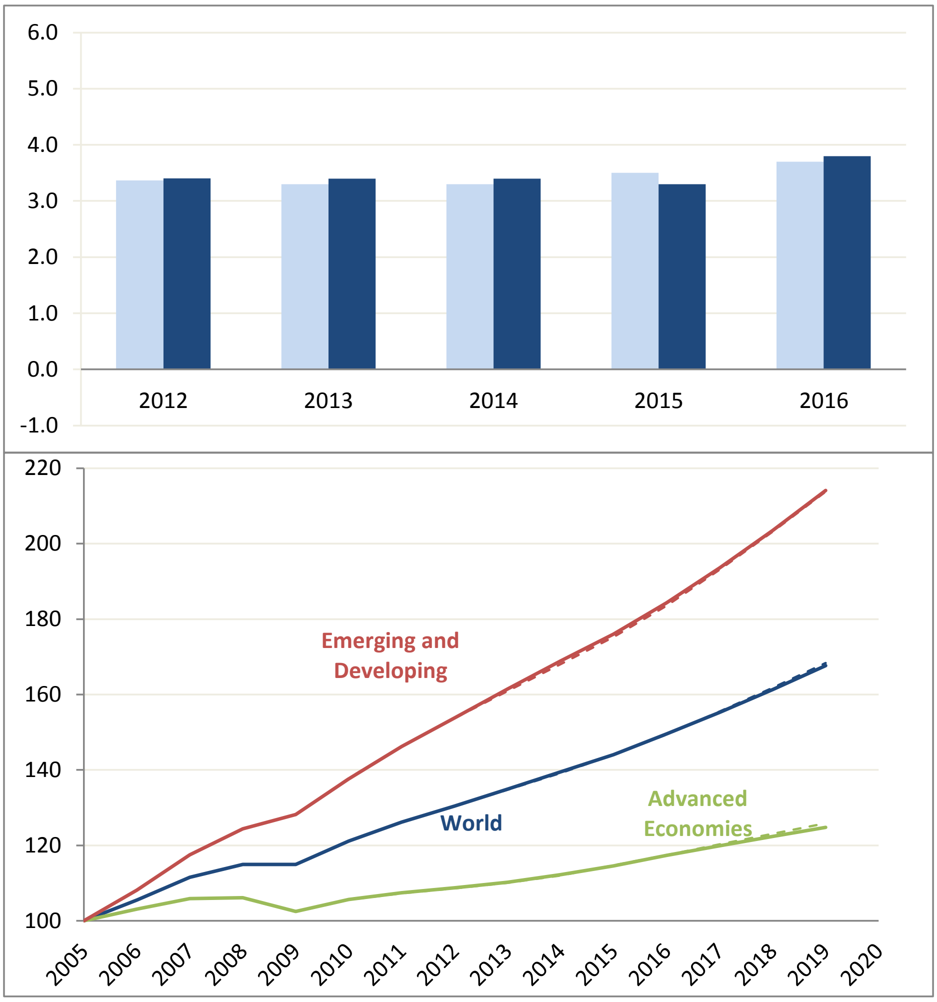
Figure 1.1

Global Growth

Top panel = global GDP real growth – July 2015 estimates/forecasts; pale bars are January 2015 estimates/forecasts

Bottom panel = Index (2005=100) of GDP - July 2015 estimates/forecasts; dashed lines are January 2015 estimates/forecasts

Source: International Monetary Fund (IMF) World Economic Outlook January 2015 update and July 2015 update.



While the aggregate picture is largely unchanged, the short-term outlook for major economies such as the United States and Brazil has worsened – particularly for 2015. The euro area and India are expected to outperform previous forecasts – though growth in the euro area remains sluggish.

There are a number of factors which could pose a risk to this outlook. Continued uncertainty in Greece still has the potential to disrupt the slow return to satisfactory growth in the euro area, while vulnerabilities in global financial markets have yet to be fully resolved. Policy-makers in China appear to be committed to avoiding a hard landing but any slowdown that does occur could have a significant impact on the pace of global growth - recent falls in stock markets on the back of uncertainties in China show just how fragile the global economy remains. Heightened geo-political tensions in recent years have not so far had a major impact on growth but remains a risk.

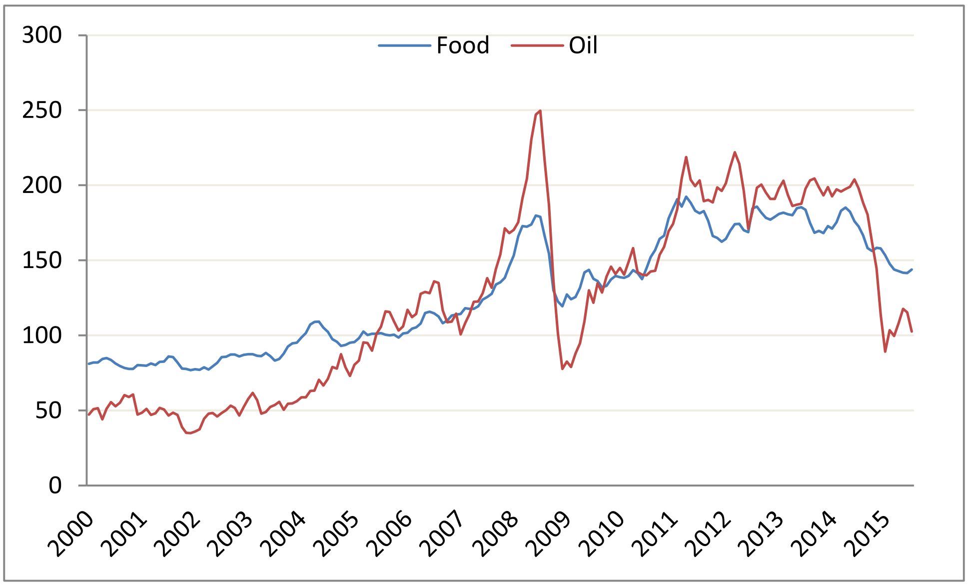
While oil prices rebounded as expected in the first half of 2015, prices have fallen again since and remain approximately 50% lower than one year ago. Markets anticipate modest increases by the end of next year but further falls cannot be ruled out due to strong supply by the Organisation of the Petroleum Exporting Countries (OPEC), the potential comeback of Iran as an oil exporter, and slower growth in energy demand. Food prices have also seen falls over the last twelve months, dropping back to levels last seen in 2010.

Figure 1.2

Commodity Prices

Nominal US dollar food and oil prices indices, 2005=100

Source: International Monetary Fund, index of primary commodity prices - August 2015



Official interest rates remain at record lows in the US, UK and euro area. Low inflation has weakened the case for rate increases, and growth in the euro area remains sluggish, while the US and UK have not accelerated as much as expected by the IMF at the beginning of the year. While there is still a strong possibility of a rate rise in the US this year, a UK rise now seems unlikely until 2016.

Overall, lower oil prices have helped to boost the performance of advanced economies, while some emerging economies have seen slower growth. While the improvement in advanced economies is welcome, this is uneven between countries and overall trends are below the long-run average. And significant risks remain, with a number of threats to the global economy such as uncertainties in the euro area and Greece, the slowdown in China and other emerging markets or wider disruption from geopolitical tensions.

1.2 Jersey economic developments

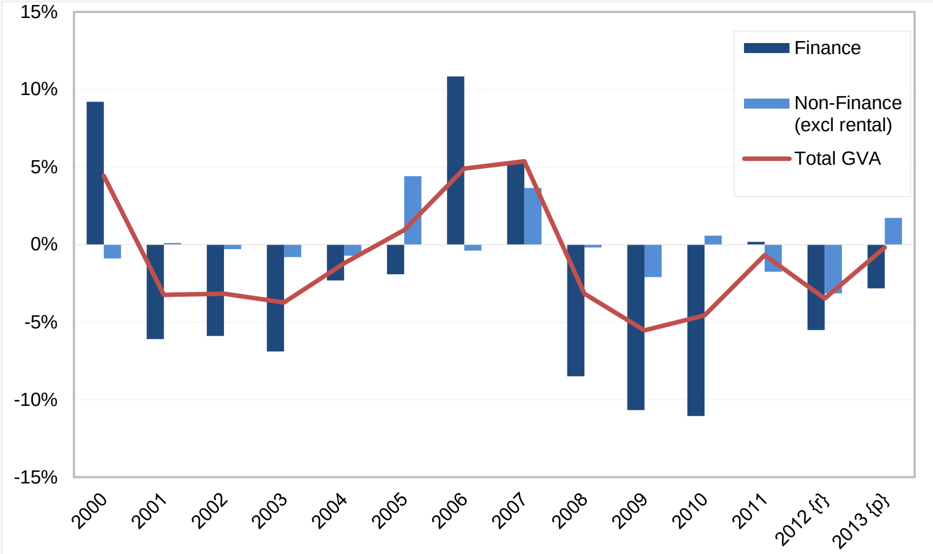
Gross value added (GVA) is the headline measure of economic activity in Jersey. As covered in the Panel's January report, GVA was essentially flat in real terms in 2013, following five consecutive years of decline. GVA estimates for 2014 will be published at the end of September.

Figure 1.3

A breakdown of Gross Value Added growth

Annual % change
{r} = revised
{p} = provisional

Source: States of Jersey Statistics Unit



Financial services sector

The **Survey of Financial Institutions** (SFI) reported that profits increased by more than 20% in 2014. This was primarily due to significant changes for a small number of large banks, due to the end of some restructuring exercises. This is therefore likely to be a one-off movement in profits, though the Panel will continue to monitor future movements in this volatile component of GVA and its implications for the wider economy.

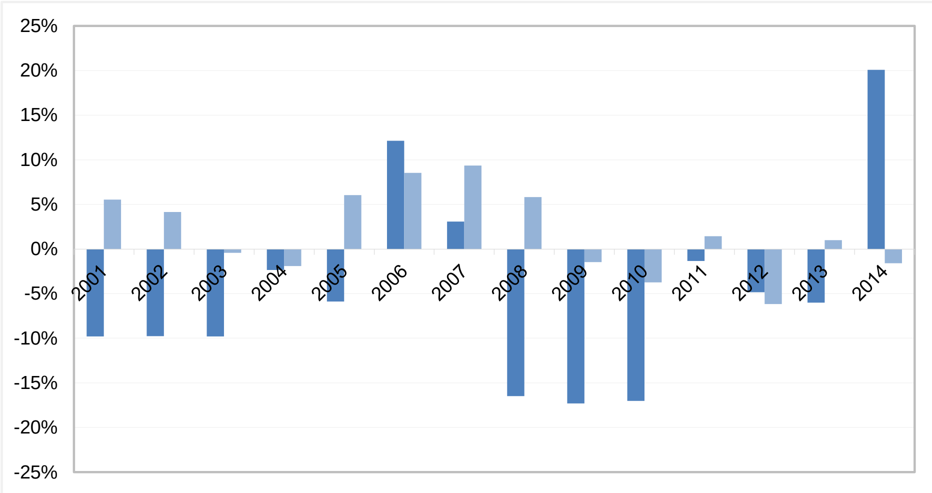
The increase in profits was much larger than expected and by itself suggests that GVA growth in 2014 was stronger than expected. Employment costs in the finance sector have been flat in nominal terms, suggesting a slight decline in real terms. This suggests that finance sector GVA may have increased by almost 9% in real terms in 2014. Given the size of the financial services sector as a proportion of the economy, this would mean that even if the other sectors were flat on average, the economy would have grown by 4% last year.

Figure 1.4

Financial services profit and employment costs

Annual % change in gross operating surplus (dark bars) and employment cost (pale bars), constant prices

Source: States of Jersey Statistics Unit



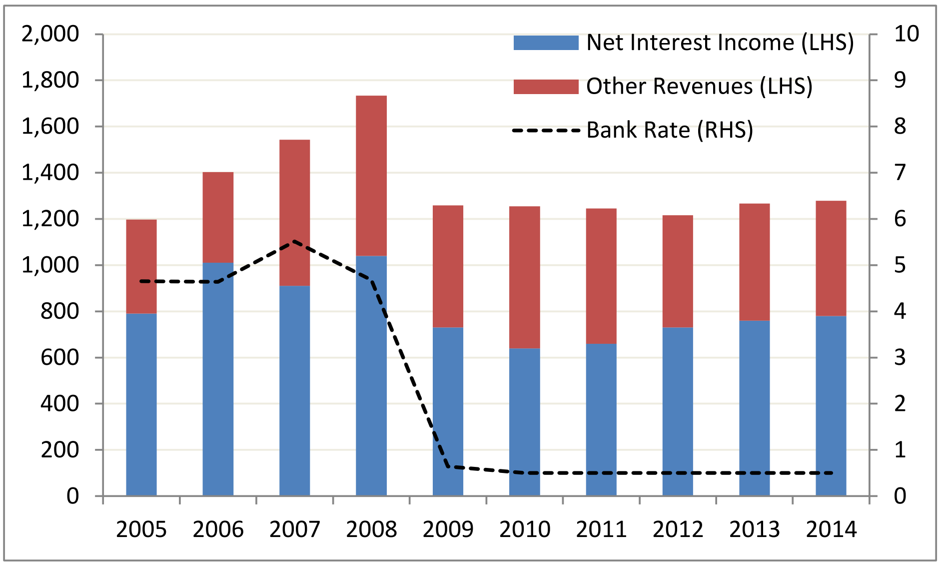
Finance sector revenues were £2.39 billion in 2014, up just 2% on 2013. 53% of revenues came from the banking sector, with the majority of this from net interest income. Net interest income has been hit by the low interest rate environment, falling by 38% between 2008 and 2010. Although interest rates remain low, net interest income has recovered somewhat, but is still 25% below the 2008 peak.

Figure 1.5

Banking revenues

Source of revenue (£m - left hand scale) and annual average for Bank of England Official Bank Rate (% - right hand scale)

Source: States of Jersey Statistics Unit



Net interest income is also related to the level of deposits. The Jersey Financial Services Commission (JFSC) reports that the level of deposits held in Jersey has fallen each year since 2007, by an average of 6.5% per year. Over the last three years, these falls have been driven by falls in the sterling value of currency deposits, with the level of sterling deposits relatively flat since 2011. The majority of currency deposits are held in US dollars or euros and changes in the exchange rate will affect the sterling value of these deposits. Data for the first quarter of 2015 suggest that there has been some recovery, but these data are very volatile from quarter-to-quarter so caution should be exercised in interpreting these trends.

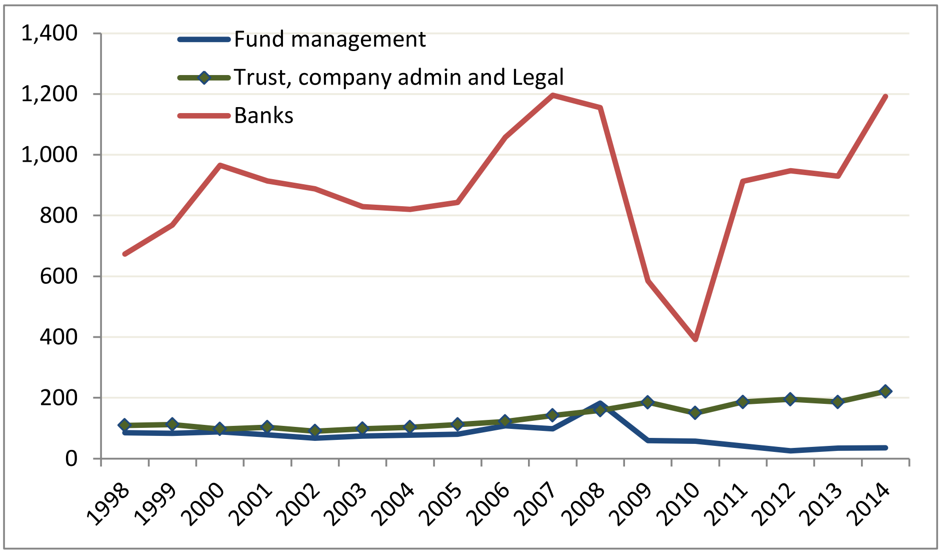
Figure 1.6 shows that net profit in the banking sub-sector has now returned back to the 2007 peak, in nominal terms. By contrast, profit in the fund management sub-sector remains around half the level seen in the mid-2000s. The trust, company administration and legal sectors have seen sustained growth since 2010, with net profit growing at an average 10% per year.

Figure 1.6

Finance subsector performance

Net profit by sector (£m)

Source: States of Jersey Statistics Unit



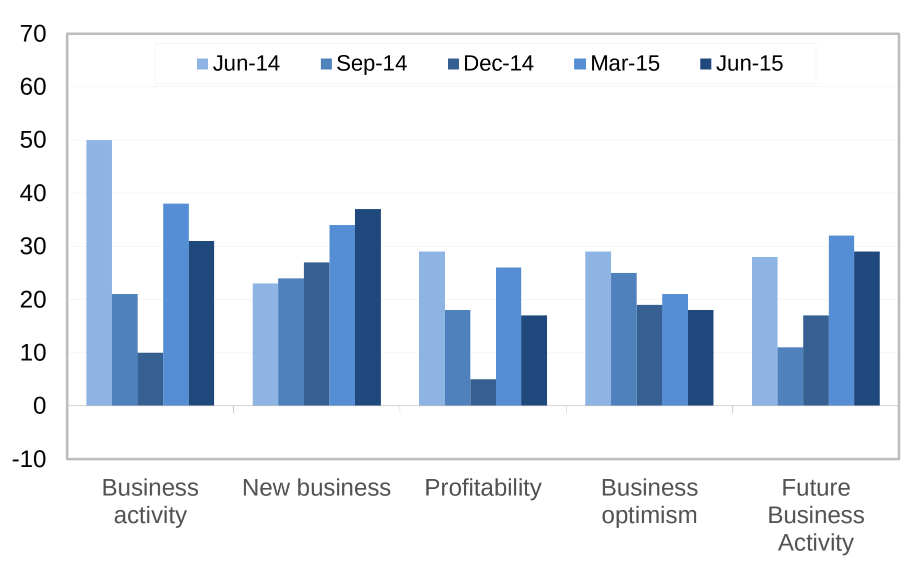
There has also been positive news for the finance sector from the Business Tendency Survey in 2015 with the headline business activity indicator remaining strongly positive. New business, capacity utilisation, profitability and future business activity have all improved since the start of 2015 and remain strongly positive. Business optimism has slowed somewhat since mid-2014 but remains positive.

Figure 1.7

Finance business tendency

% net balance of respondents reporting an increase (weighted by employment)

Source: States of Jersey Statistics Unit



Looking forward, almost half of finance firms (weighted by employment) expected profits in 2015 would increase compared to 2014, while less than a third thought profits would fall. Almost half of firms also anticipated employment to increase, but 38% anticipated falls in employment.

The finance sector is still going through a period of consolidation. The regulatory changes in the UK banking sector will have a differential impact on different institutions, and could lead to significant change for some. There is also continued uncertainty over when UK Bank Rate may start to rise.

Rest of the economy

Figure 1.8 demonstrates that a number of the key indicators in the Business Tendency Survey have improved since the start of the year. The headline business activity indicator has become strongly positive and the new business, business optimism and future business activity indicators all reached their highest levels to date in 2015. The balance of responses on profitability remains negative but has improved markedly and is currently at its least negative level since the survey began in 2009.

Figure 1.8

Non-finance business tendency

% net balance of respondents reporting an increase (weighted by employment)

Source: States of Jersey Statistics Unit

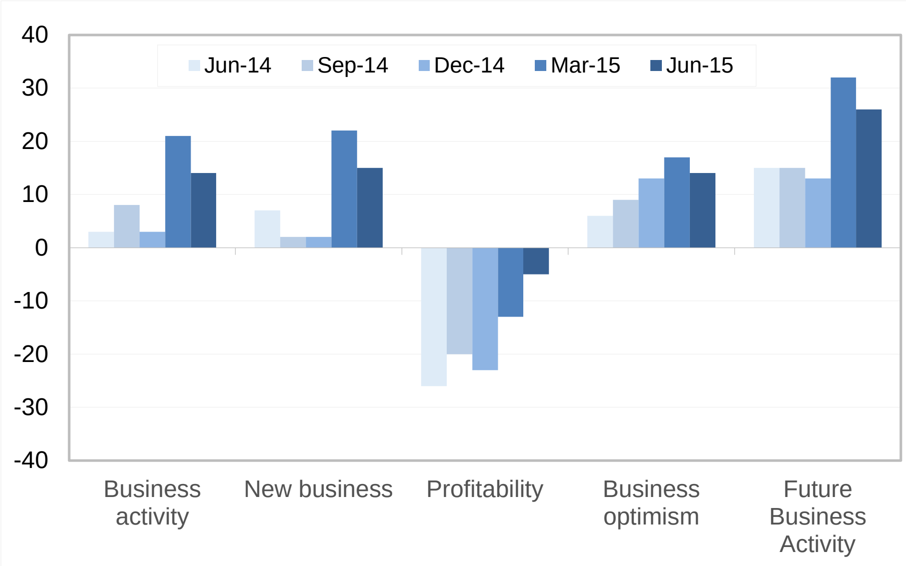


Figure 1.9 compares the responses to the BTS with the growth of non-finance sector GVA (excluding the rental income of private households). This demonstrates the profitability and business activity indicators on the BTS fell in line with GVA in 2012, while the improvement in 2013 saw GVA grow by almost 2%. Survey responses have improved further in relation to both these two indicators, with business activity neutral on average across in 2014, and positive to date in 2015 – which may suggest further positive growth for the non-finance sectors as a whole this year.

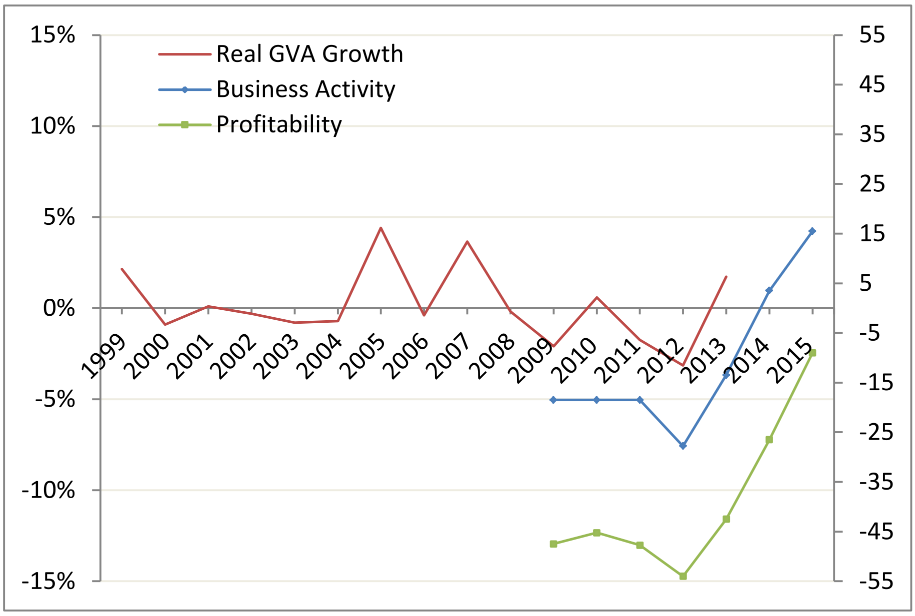
Figure 1.9

Non-Finance GVA Growth

Annual real GVA growth excluding financial intermediation and rental (left-hand scale)

Non-finance responses to business activity and profitability questions averaged over each year (right-hand scale)

Source: States of Jersey Statistics Unit



Sectoral performance

GVA of **the wholesale and retail sector** was flat in 2013, following a significant fall in 2012 which was primarily due to difficulties faced by much of the fulfilment sector following the loss of low value consignment relief (LVCR). The business activity indicator of the Business Tendency Survey improved in the second half of 2014 and has been positive throughout 2015, with a weighted net balance of +11 for the second quarter. The indicators for new business, business optimism and future business activity are positive, while the profitability indicator has become neutral for the first time in June 2015, following almost six years of negative responses to this question.

Retail sales volumes in quarter one were 1.4% higher than the year before, with growth for both food and non-food. Volumes for both parts of the sector have been relatively stable in recent years, within a range of +/-2% for the last four years, Footfall, as measured by a counter in King Street, has been largely stable to date in 2015 when compared with a year previous.

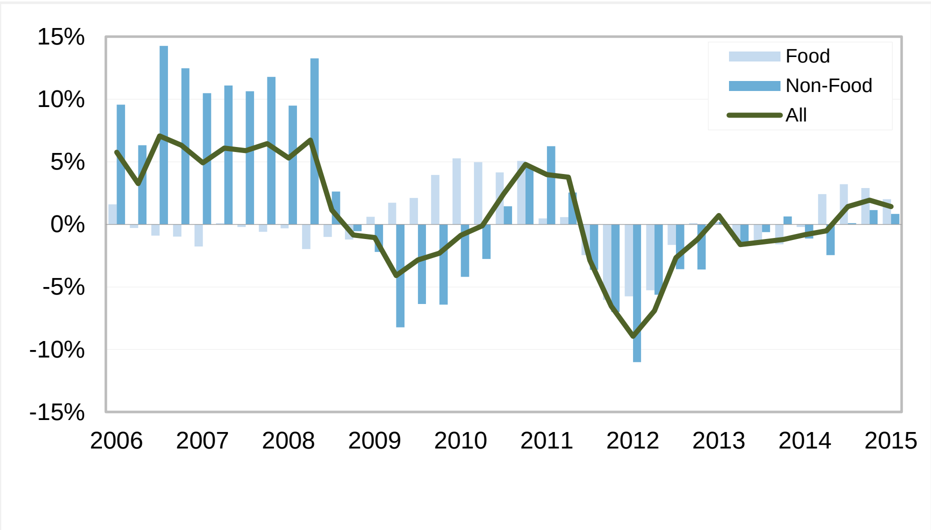
When the Panel met with representatives of the retail sector, there was some confidence returning but this was subject to a number of challenges, particularly in some non-food parts of the sector which are vulnerable to internet competition longer-term. Despite this, the sector anticipates a modest recovery over the next five years.

Figure 1.10

Retail sales

Seasonally adjusted annual change in volume, %

Source: States of Jersey Statistics Unit



For the **hospitality sector**, staying leisure visitor numbers increased by 3.7% in 2014 – returning to a similar level as 2010 and 2011, following two years of decline. Staying business visitors fell by less than 1%, following several years of growth. The first five months of 2015 have seen significant increases in visitors when compared with 2014, with staying leisure visitors up 7% and staying business visitors up 8%. However, it is too early to draw any robust conclusions on annual performance from this as the bulk of visitors arrive between June and September.

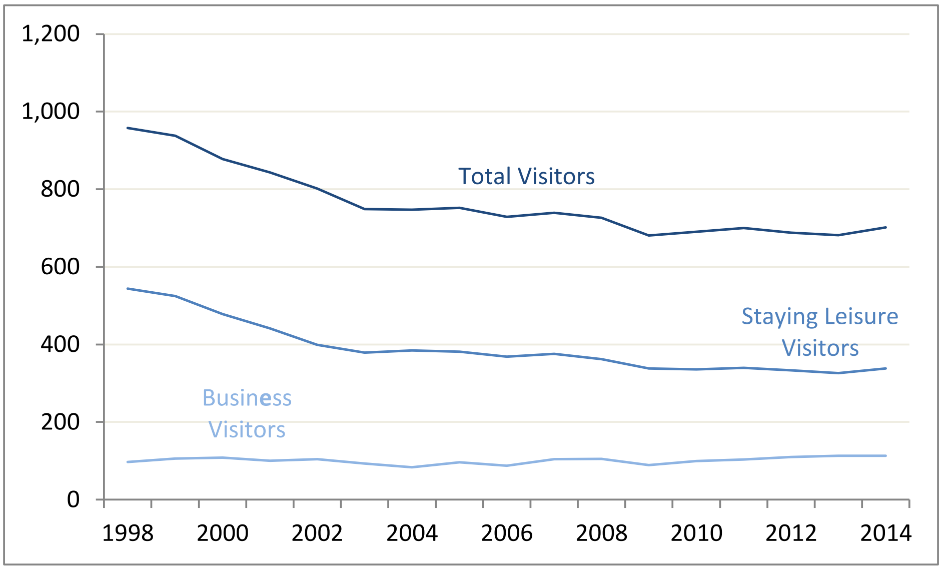
When the Panel met with representatives of the sector in June, there was some cautious optimism. The industry is keen to see what the newly established Visit Jersey can achieve, and there has been an uptick in investment and recruitment. However, the sector is now struggling to recruit and identified skills shortages as the biggest constraint to growth for tourism.

Figure 1.11

Visitor numbers

Annual number of visitors to Jersey, 000s

Source: States of Jersey Statistics Unit



GVA of the **construction sector** fell by 2% in 2013, following two years of more significant falls. The output of the sector has fallen back to levels last seen in 2005. The Business Tendency Survey improved over the course of 2014, and the business activity indicator became positive in 2015. New business, business optimism and future business activity are also positive, and the profitability indicator has improved, though remains negative.

Representatives of the construction sector also expressed cautious optimism when the Panel met with them in June 2015. There was an improved pipeline for the next few years, with work starting on large projects such as the Jersey International Finance Centre and police station and funding secured for the social housing programme and sewage works. However, the industry identified wage pressures resulting from skills shortages as the labour market has become tighter.

1.3 Labour Market

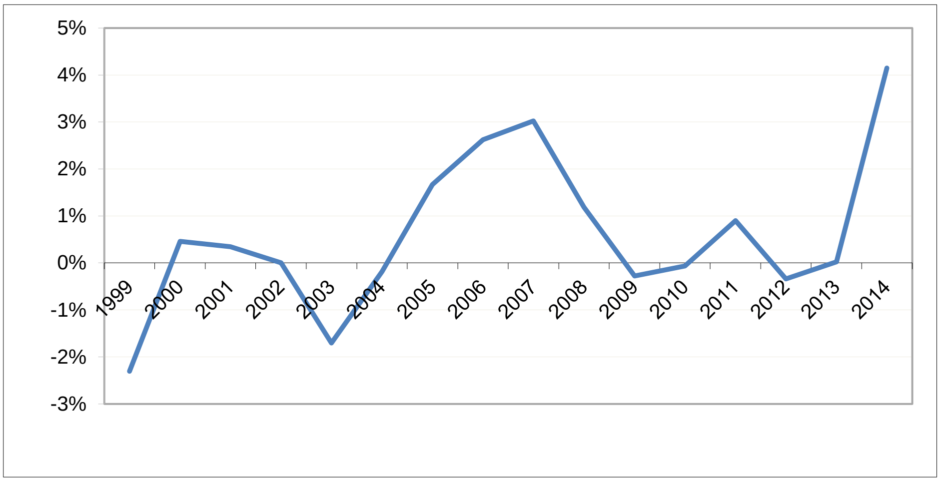
2014 saw record levels of employment, with the highest June and highest December numbers recorded. There were over 57,000 people employed in December 2014 – an increase of almost 4% over twelve months.

Figure 1.12

Employment

Annual change in total private sector employment for December of each year

Source: States of Jersey Statistics Unit



On a sectoral basis, employment in the finance sector increased by 400 (3%), driven by trust and company administration and legal. There were also significant increases in miscellaneous business activities (7%); construction and quarrying (6%); education, health and other services (6%) and wholesale and retail (5%).

Figure 1.13

Employment changes by sector

Total headcount for each sector

Source: States of Jersey Statistics Unit

	Dec-13	Dec-14	Change
Agriculture and fishing	1,440	1,450	+10
Manufacturing	1,040	1,050	+10
Construction & quarrying	4,770	5,080	+310
Electricity, gas & water	520	500	-20
Wholesale & retail trades	7,740	8,100	+360
Hotels, restaurants & bars	5,010	5,160	+150
Transport, storage & communication	2,610	2,690	+80
Computer & related activities	720	700	-20
Financial & legal activities	12,370	12,770	+400
Miscellaneous business activities	4,390	4,690	+300
Education, health & other services	6,420	6,780	+410
Public Sector	8,250	8,280	+30
Total	**55,270**	**57,250**	**+1,980**

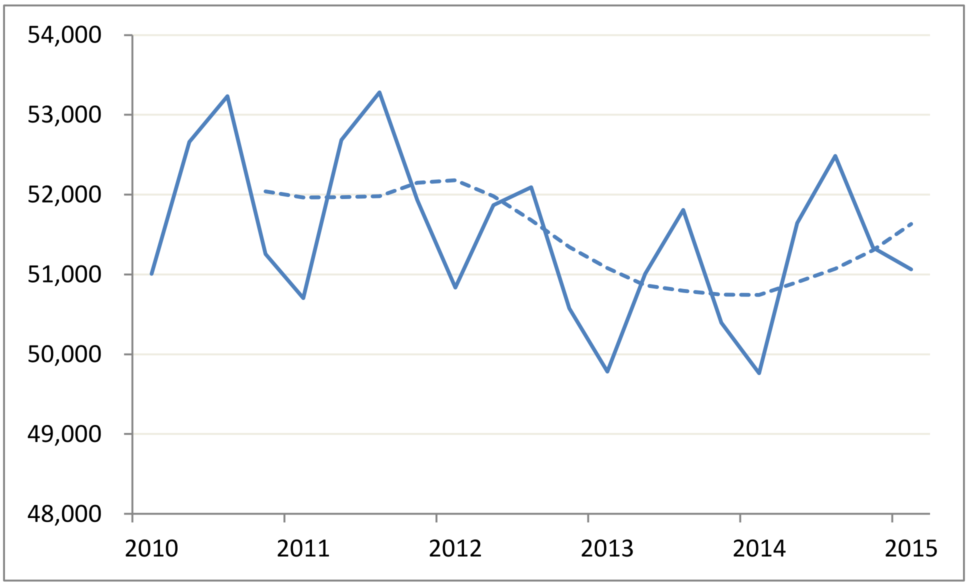
Social Security contribution numbers provide a more up to date picture of employment trends. The most recent data are from March 2015, and show that contributor numbers were up 2.4% when compared with one year earlier. Figure 1.14 shows that the negative trend up to 2013 has now been reversed, which ties in with the broad trends in employment numbers.

Figure 1.14

Social Security contributions

Number of Class 1 and Class 2 contributions, quarterly average (solid line) and four quarter moving average (dotted line)

Source: Social Security Department



Unemployment, as measured by the internationally comparable ILO rate, fell to 4.6% in June 2014 - a significant fall from 5.7% in June 2013.

The number of people registered as **actively seeking work** (ASW) can be seen as an indicator of the trend in unemployment, although it cannot be seen as a comprehensive measure of unemployment as there is no statutory requirement for unemployed residents to register. ASW peaked in early 2013 and had fallen 30% (seasonally adjusted) by the time of the Panel's last report in January 2015. Figure 1.15 shows there has been a small increase since January. However, much of this increase was due to a change in the Income Support criterion relating to Long-Term Incapacity Allowance so it may be fairer to say the ASW numbers appear to have stabilised in 2015. While the number registered as ASW remains high, part of the increase is likely to be due to the introduction of Income Support in 2008 which means that the current series is not strictly comparable with the previous series.

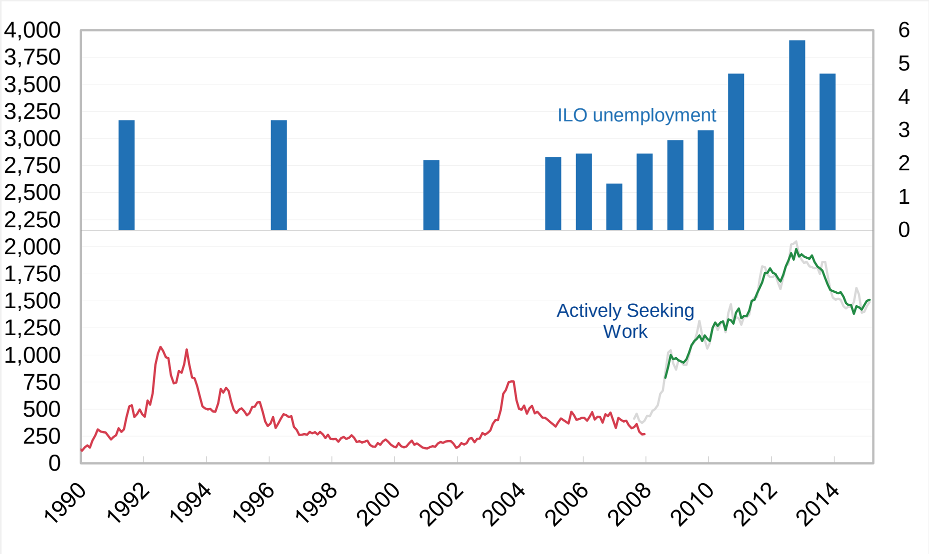
Figure 1.15

Changes in unemployment

Upper Panel: ILO unemployment (% of working age population)

Lower Panel: number registered as actively seeking work. Red line is historic series. Grey line is new series, not seasonally adjusted. Green line is new series, seasonally adjusted

Source: States of Jersey Statistics Unit



The most recent Business Tendency Survey which was carried out in June 2015 showed that 42% of finance firms reported no change in employment compared to the previous quarter, with 27% reporting an increase and 31% reporting a fall in employment. The net balance was therefore slightly negative, following four quarters of positive responses. The net balance for future employment improved in the most recent quarter, to its highest level since the survey began in 2009.

For the non-finance sector, 62% reported no change in employment with 17% reporting an increase and 21% reporting a fall in employment. The net balance is slightly negative but has seen significant improvement since 2013. Expectations for future employment were positive throughout 2014 and have seen further improvements in 2015 to date.

Figure 1.16 demonstrates that the employment indicator has improved considerably in recent years for both finance and non-finance and there is strong optimism for future employment. However, the chart also shows that strong optimism has not always resulted in the employment indicator being positive the following quarter. Overall, the combination of the employment, Social Security, Actively Seeking Work and Business Tendency Survey data suggest a relatively positive picture for employment trends in 2014 and 2015.

Figure 1.16a

Employment trends in finance sector

Weighted net balance reporting increase in employment, compared to weighted net balance reporting an increase in future employment one quarter earlier

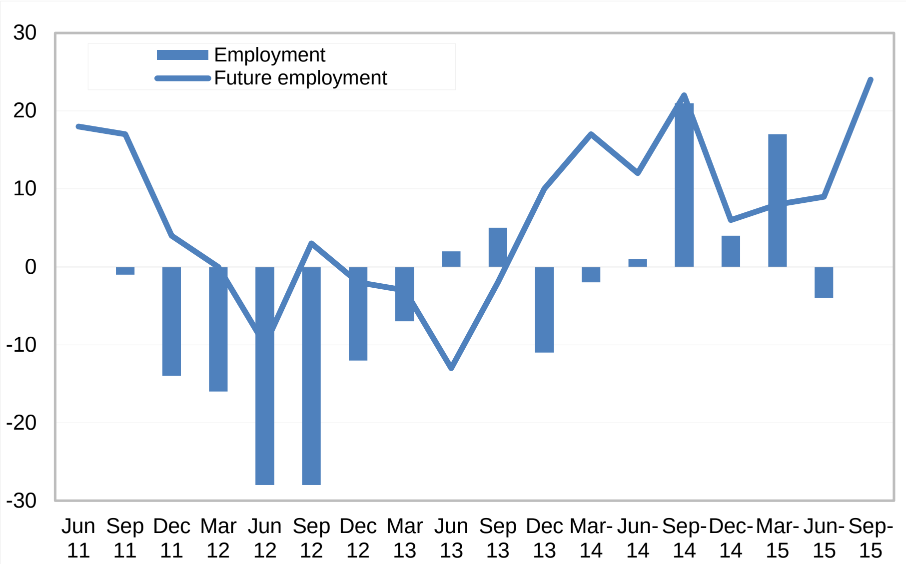
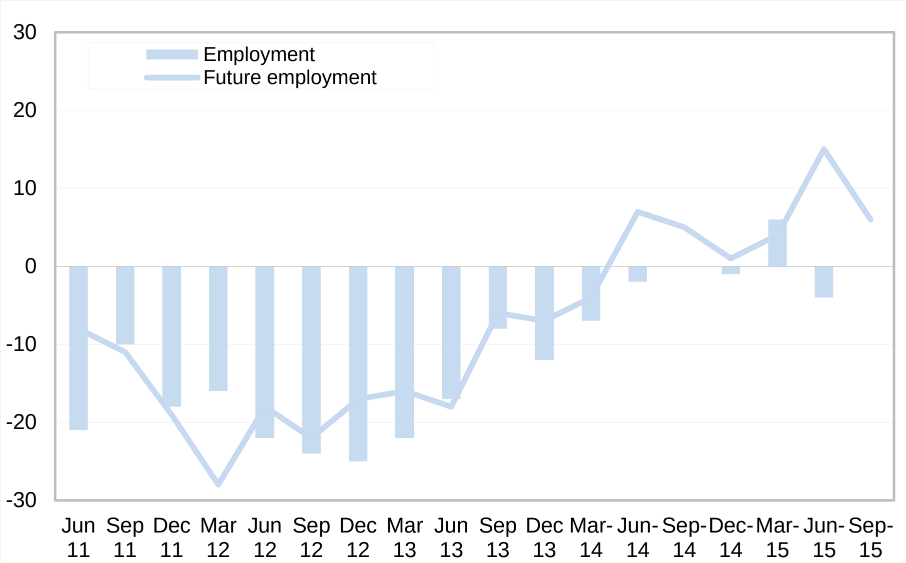


Figure 1.6b

Employment trends in non-finance sector

Weighted net balance reporting increase in employment, compared to weighted net balance reporting an increase in future employment one quarter earlier



Source: States of Jersey Statistics Unit

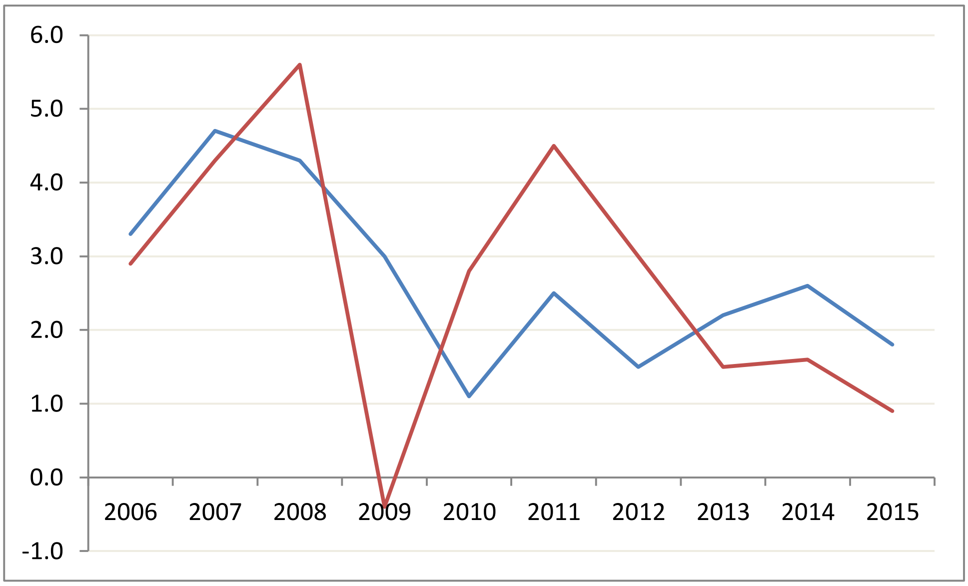
Average earnings increased by 1.8% in the year to June 2015, representing the third successive year in which earnings increased faster than inflation. Private sector wages grew by 2.2% with public sector earnings flat (representing a fall in real terms). The increase in private sector earnings is similar to that of the last four years, but lower than the 4% annual average between 2002 and 2009. The largest increase was in the finance sector, where wages rose by 3.2% on average – the largest increase in this sector since 2008.

Figure 1.17

Average earnings and inflation

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

Source: States of Jersey Statistics Unit



1.4 Inflation

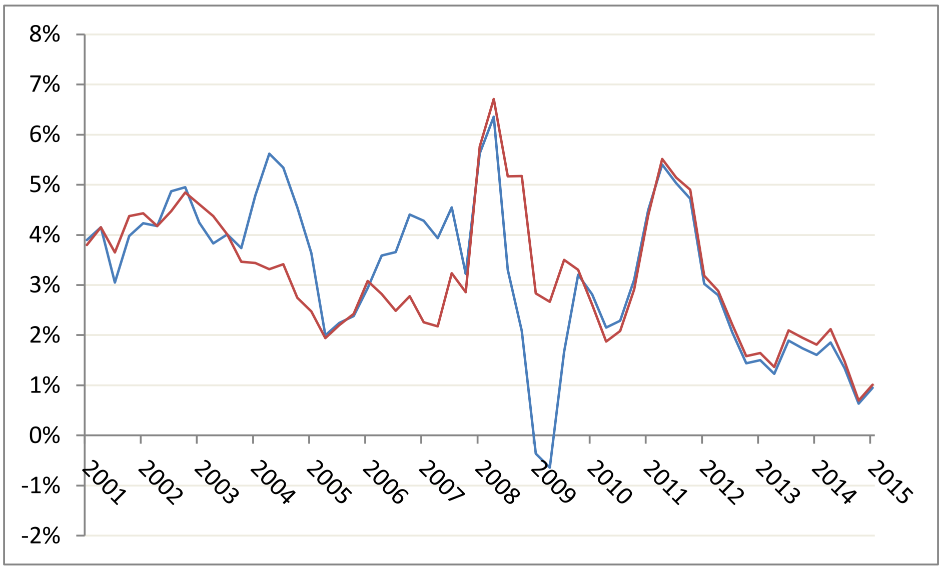
Following two years of relatively low inflation, retail price index (RPI) inflation slowed further to 0.6% in March 2015, with RPIX inflation (excluding mortgage interest payments) slowing to 0.7% - its lowest rate since at least 2000. June 2015 saw a small increase in both measures of inflation but they remain significantly lower than longer term averages. This fall in the rate of inflation is heavily influenced by global factors, such as the fall in oil and food prices which has seen inflation in developed countries (as measured by the consumer prices index (CPI) in member countries of the Organisation for Economic Cooperation and Development) fall from 2.1% in June 2014 to 0.6% in June 2015.

Figure 1.18

Inflation in Jersey

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

Source: States of Jersey Statistics Unit



1.5 Economic growth forecast

The Panel's revised economic growth forecast is set out in Figure 1.19. The economy is estimated to have grown by between 4.5% and 6.5% in 2014, a significant increase from the Panel's previous estimate, thanks primarily to a the financial services sector reporting much stronger profits growth than previously expected (see section 1.2), combined with strong growth in employment and real growth in average earnings. The Panel forecast growth of 0.5% to 3.5% in 2015 due to further growth in employment and low inflation.

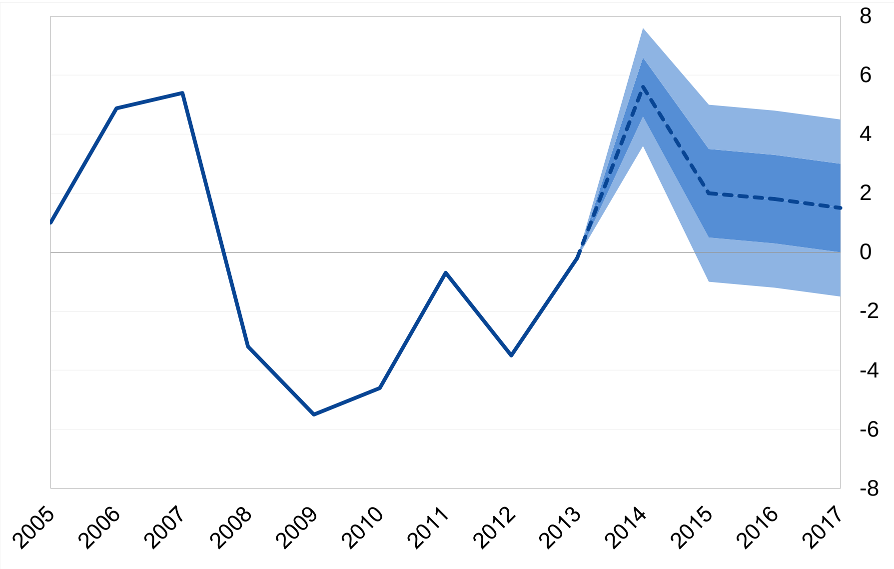
While the Panel's estimate of GVA growth in 2014 has increased, this is largely due to the increase in financial services profits (a volatile component of GVA) driven by largely one-off factors. Given that the implications of this for the wider economy and tax revenue are unclear, the Panel's view is that at this stage it has not thought to have significantly affected the level of spare capacity available in the economy. However, this is an area that the Panel will monitor closely as events continue to unfold and more data becomes available. Further modest real growth is expected in 2016 and 2017. This estimate is based on weaker growth in financial services profits (in effect, excluding the one-off factors experienced in 2014), continued real earnings growth and further modest employment growth.

Figure 1.19

Economic growth forecast

% change in real GVA on year before

Sources: Panel judgement; States of Jersey Statistics Unit



The economic assumptions that underpin the central scenario are summarised below. These estimates are before the impact of fiscal policy changes, discussed in the next section.

Figure 1.20

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: Economics Unit calculations and Panel judgement

	2014	2015	2016	2017
Real GVA	5.6	2.0	1.8	1.5
RPI	1.6	1.1	2.0	3.0
RPIY	1.6	1.1	1.8	2.5
Nominal GVA	7.2	3.0	3.6	4.0
Company profits	11.2	2.1	3.0	3.7
Financial services profits	22.0	1.1	3.1	3.3
Compensation of employees(a)	4.1	3.8	4.0	4.3
Employment	1.5	2.0	0.5	0.5
Average earnings	2.6	1.8	3.0	4.0
Interest rates (%)	0.5	0.5	0.8	1.3
House prices	3.0	2.9	4.0	5.0

(a) Total employment costs

1.6 Spare capacity and trend GVA

The assessment of spare capacity in the Pre-MTFP Report (sections 2.4 and 2.5) suggests that there is currently spare capacity in the Jersey economy, though as described above recent developments suggest this may be being used up more quickly than anticipated. If external conditions remain favourable and fiscal policy provides support, Jersey could therefore expect growth to be positive in the near term, as the economy catches up with potential (estimated to happen by around 2019, or earlier).

It remains likely that the output of the finance sector will improve over the time horizon of the MTFP as international demand and UK interest rates increase, provided that it can attract the people it needs from the local labour force or from inward migration. However, the sector is unlikely to recover to pre-crisis levels over this time.

The non-finance sectors of the economy should also recover and probably return to their trend levels, again, provided there are no bottlenecks between demand and supply.

The States should therefore continue to plan on the basis of the Panel's central assessment from the Pre-MTFP report - that Jersey's output is currently about 5% below its potential level and that spare capacity will be used up between 2017 and 2019, though recent developments may have increased the chances that this will occur earlier in the 2017-2019 period. This assessment is subject to great uncertainty relating mainly to: the speed and stability of global economic growth, the competitiveness of Jersey financial services and the ability of businesses to employ people locally and internationally.

The Panel's central assessment of trend GVA in the Pre-MTFP report (sections 2.2 and 2.3) suggests a risk of a flat trend for GVA and productivity growth from 2018 onwards. These projections should be treated with extreme caution, because of the nature of the Jersey economy (a significant proportion of GVA is made up of financial sector profits, which can be very volatile) and the period over which the assessment was made (which includes the global "great recession"). However, there is no current evidence to suggest that the trend rate of growth in Jersey will be significantly positive. Therefore, the FPP continues to advise that future fiscal trends should be tested against a trend rate of real economic growth of 0% a year, as has been the case in the MTFP.

Section 2 – The Fiscal Outlook

2.1 Introduction

In this section, the Panel discusses whether the MTFP follows their four guiding principles and ten recommendations as described in their Pre-MTFP report[1].

This section is organised as follows:

- Principles and recommendations for the MTFP
- Developments this year
- MTFP improvements
- Fiscal outlook
- Public sector measures
- Flexibility in the MTFP
- Capital projects
- Risks to achieving the MTFP
- Longer term challenges of the ageing population and productivity

2.2 Principles and recommendations for the MTFP

The Panel described four guiding principles for fiscal policy in their Pre-MTFP report:

1. Aim to balance the budget over the economic cycle.
2. Aim to ensure long-term fiscal sustainability.
3. Adopt practical and realistic assumptions for future trends in income and expenditure.
4. Include flexibility within a clear framework for expenditure.

The Panel considers that their four guiding principles have been followed during the development of the draft MTFP.

The Panel also made ten specific recommendations, which are repeated in Appendix 1, to help shape the overall fiscal approach of the MTFP 2016-2019.

In general, the Council of Ministers has followed all the Panel's recommendations in its proposed approach in the draft MTFP.

[1] This can be found at www.gov.je/fiscalpolicypanel. Link to the pre-MTFP report.

The details of this assessment are covered in the rest of this section.

2.3 Developments this year

Before looking at the draft Medium Term Financial Plan in detail, it is worth outlining the important fiscal developments that have taken place so far in 2015.

Strategic Plan 2015-2018

In April, the States Assembly approved the Strategic Plan which will set the strategic direction for States policies and delivery of public services over the next four years. The five strategic priority areas are: Health and Wellbeing, Education, Economic Growth, improving St. Helier and Sustainable Public Finances. The Resources Statement for the Strategic Plan sets out that the States will reprioritise spending, make savings, improve efficiency, and introduce fees and charges in order to provide funding for improvements in the five priority areas.

2014 States' Accounts

The States published its Financial Report and Accounts for 2014 in June. It explains the States' financial performance in 2014 and the important events that have taken place during the year. For example, securing the £250 million bond to build new social housing in the future and the start of the Long Term Care Scheme. The accounts have also been improved by including an analysis of spend against the approvals made by the States Assembly, following advice from the Comptroller and Auditor General.

Jersey's fiscal framework

The Minister for Treasury and Resources has committed to setting out an updated fiscal framework before the MTFP debate that will underpin the fiscal decisions that need to be taken over the next few years.

The Panel have been consulted on the development of this framework and see it as a further positive development, not least as it consolidates all the existing States policy and rules that cover fiscal decisions.

However, a number of existing rules and legislation such as that covering the Consolidated Fund and limits on what the States can borrow and lend, still run the risk of being counterproductive in certain circumstances. For example, the conservative limits on what the States can borrow could stop, or delay, large capital projects.

If decisions are made within the context of the fiscal guidelines and in line with the Panel's advice, these risks should be minimised. The Panel will highlight through its usual reporting structure whether these risks are materialising and if so, what further action is required.

States income forecasting improvements

The governance and transparency around States income forecasts has also been improved. A new Income Forecasting Group has been established on a formal basis with a clear remit and timetable for the preparation of income forecasts. The draft MTFP clearly sets out the history of what the Income Forecasting Group has done and the timeline of States income forecasts and forecast updates.

The Panel have also agreed to endorse the economic assumptions used for income forecasts.

Review of financial management

In April, the Comptroller and Auditor General (CAG) published her report "Review of Financial Management" which reviews and reports on the effectiveness of financial management in the States and makes recommendations on how to make improvements.

The Panel is generally supportive of the review and its recommendations. Good financial management and sound fiscal policy are both important and complementary.

The Panel particularly supports the CAG's first recommendation:

In the future extend the Medium Term Financial Plan to cover all the public finances of Jersey.

The CAG's second recommendation is also in line with the Panel's previous recommendations and this has been implemented in the draft MTFP:

"In the future include depreciation and impairment in the measure of expenditure for which funds are allocated by the States Assembly."

Updated States income forecasts

The States income and expenditure forecasts were produced in March 2015 to support the development of the Strategic Plan. These used the economic assumptions published in the Panel's Pre-MTFP report.

The financial forecasts were updated for the draft MTFP in June 2015. These forecasts used updated economic assumptions that were endorsed by the Panel, in accordance with the Panel's second recommendation in the Pre-MTFP report.

2.4 MTFP improvements

The Treasury department has made several improvements to how this MTFP has been developed, building on the experience of the first MTFP 2013-2015.

The most important improvement is that Treasury has included more flexibility in the plans so that any unexpected changes can be managed more easily, for example if States' income does not increase as quickly as expected. This is discussed in more detail in the section on flexibility (Section 2.7).

Rolling forecasts for States' income and expenditure for the next four years will also now be published each year to help manage and smooth policy development and expectations between MTFP periods.

For the first time, the MTFP also sets out an assessment of the key risks that the States must manage, including the strategic, financial and operational risks.

2.5 Fiscal outlook

Overview

The draft MTFP sets out the States' overall tax and spending envelope for the next four years and departmental expenditure limits for 2016.

In June 2016, the Council of Ministers will publish an MTFP Addition that will propose the remaining details for departmental expenditure limits between 2017 and 2019 that fit within the overall spending limits that will be agreed in this draft MTFP.

Figure 2.1 shows the central MTFP expectation for total States income (blue bars) and States expenditure (States "net revenue expenditure") (red bars) between 2015 and 2019.

States income includes a proposed health charge that will raise £15 million of income for the States in 2018 and £35 million in 2019. States expenditure includes the government's spending on public services, but does not include capital expenditure. Instead, it includes depreciation (as advised by the Panel) which is an estimate of how much money is needed to maintain the Island's major infrastructure at its present levels.

Together, these measures of States income and States expenditure (including depreciation) help to show whether the States' finances are sustainable looking into the future.

Total States income (including the proposed health charge) is projected to increase from £665 million in 2015 to £793 million in 2019 (a 19% increase).

States net revenue expenditure, including depreciation, is expected to increase from £781 million in 2015 to £789 million in 2019 (a 1% increase).

These projections are in nominal terms. Taking inflation into account, States income is expected to increase by 7% in real terms by 2019, while States net revenue expenditure including depreciation is projected to fall by 9% in real terms by 2019.

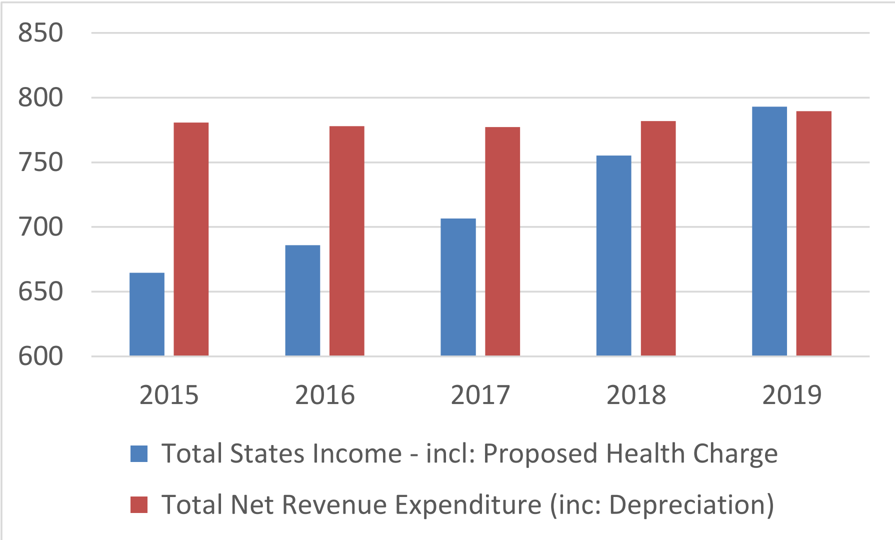
Figure 2.1

States income (central forecast) and expenditure including an allowance for depreciation

£m (current prices)

Source: States Treasury. Based on Figure 16, page 43 of Draft MTFP.

Note: the y-axis starts at £600 million and not at zero.



The difference between States income and expenditure each year - the surplus or deficit is shown in Figure 2.2.

By 2019, States income and expenditure (including the allowance for depreciation) are expected to move back into balance. There is expected to be a deficit of £106 million in 2015 (3% of GVA) which falls slightly in 2016 and 2017, then sharply in 2018, before turning into a small surplus of £4 million by 2019.

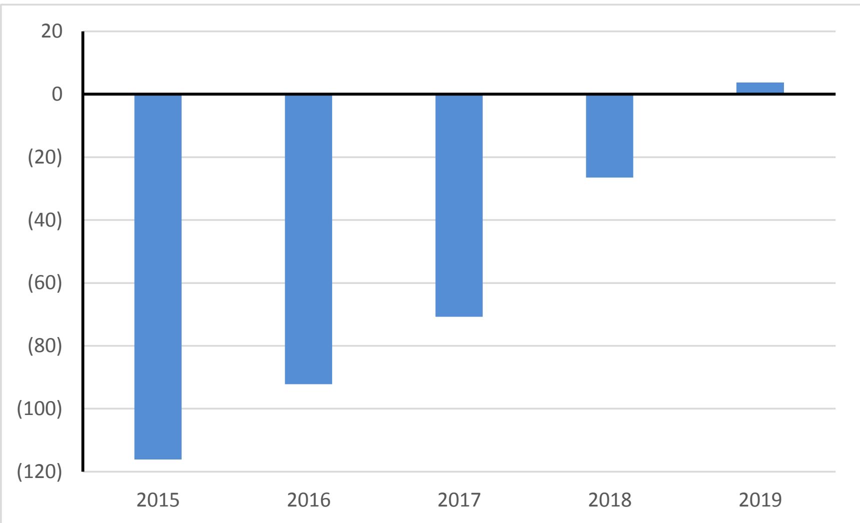
Figure 2.2

States projected fiscal position 2015-2019

The difference between States income and expenditure: deficits 2015-2018, surplus 2019

£ million (current prices)

Source: States Treasury



These plans for States expenditure and income (and the profile of deficits and a surplus) are based on implementing a number of measures to meet the funding shortfall by 2019 that would exist if current policy were simply rolled forward. These measures are described in more detail in the next section.

The potential funding shortfall

The Panel previously warned that:

> *"Based on the current structure of taxation and expenditure, it appears that there is a significant risk of a structural deficit. The size of any structural deficit will depend on the decisions made for the MTFP."*

The draft MTFP shows that a funding shortfall of about £83 million by 2019 would be forecast if no changes were made to current policy, including maintaining the Island's infrastructure at its present standard (Figure 2.3 light and dark grey bars).

In addition, the draft MTFP includes plans to increase total annual spending on health (£40 million), education (£9 million) and other services (£13 million) - a total of £62 million by 2019 - to achieve the Strategic Plan objectives (Figure 2.3 red, blue and orange bars). This increases the expected funding shortfall to about £145 million by 2019.

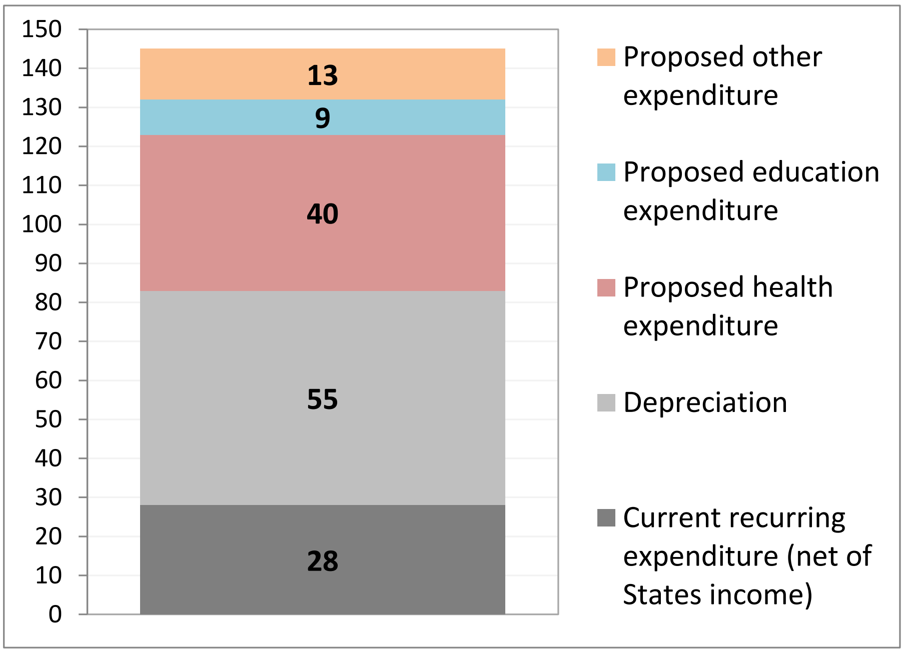
It therefore appears that the proposed measures in the MTFP are aiming to close a structural deficit in the region of £80-145 million, depending on whether the situation is considered before or after the inclusion of additional expenditure for the Strategic Plan priorities, such as health and education.

Figure 2.3

Breakdown of the potential funding shortfall in 2019

£ million

Source: States Treasury. Based on draft MTFP Figure 30, page 81



Planned measures to address the shortfall

Section 11 of the draft MTFP considers the sustainability of States finances between 2016 and 2019. In particular, it considers the Panel's third recommendation from their Pre-MTFP report:

> *"The States should develop a plan that will address any structural deficit by 2018 and 2019. Care should be taken to ensure that the range and timing of the measures minimises the risk to the economic recovery, which, in the early stages, may involve using the States' reserves."*

The draft MTFP sets out a three-part approach to balancing the States' finances by 2019 (Figure 2.4):

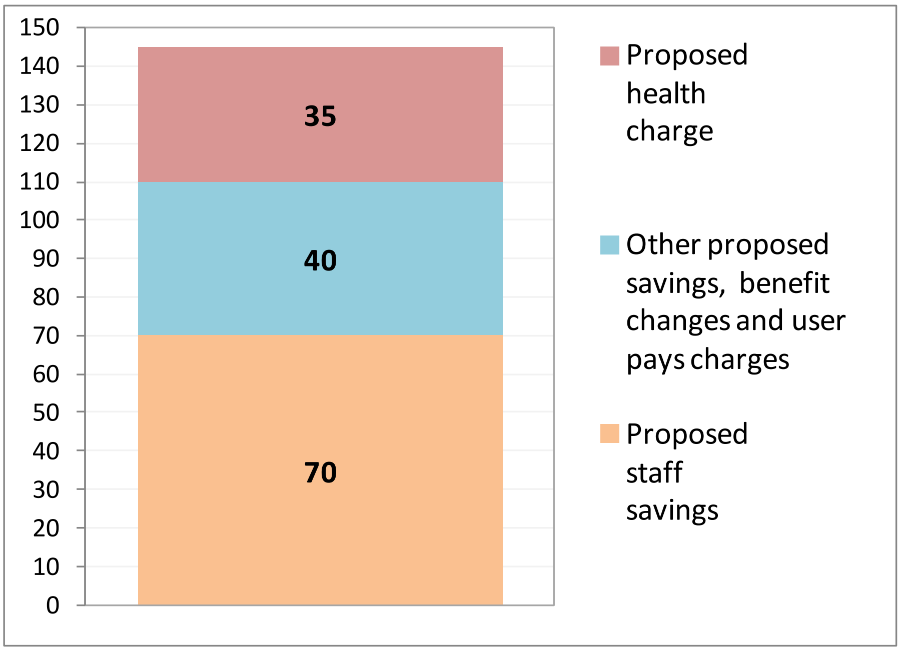
1. Secure the economic recovery and lay the foundations for raising productivity and the underlying rate of economic growth.
2. Focus on a programme of savings, efficiencies and expenditure constraint. Consider the level of benefits, and fees and charges for services.
3. Introduce an additional charge for Health.

Figure 2.4

Proposed measures to meet the potential funding shortfall in 2019

£ million

Source: States Treasury. Based on draft MTFP Figure 30, page 81



Securing the economic recovery

The first part of the approach set out in the draft MTFP is to secure Jersey's economic recovery, and lay the foundations for raising productivity and the underlying rate of economic growth.

The Panel agrees that securing the economic recovery should be the first part of the approach to balancing the States' finances.

As described in the previous section, the draft MTFP proposes that the States will run significant deficits in 2015, 2016 and 2017, before the public finances are brought back in to balance by 2019 (Figure 2.2).

Adjusting this picture to include all the States funds and the timing of capital spending in cash flow terms (rather than the depreciation estimate) gives an indication of whether the States as a whole is planning to spend more in the Jersey economy than it takes out by raising revenue.

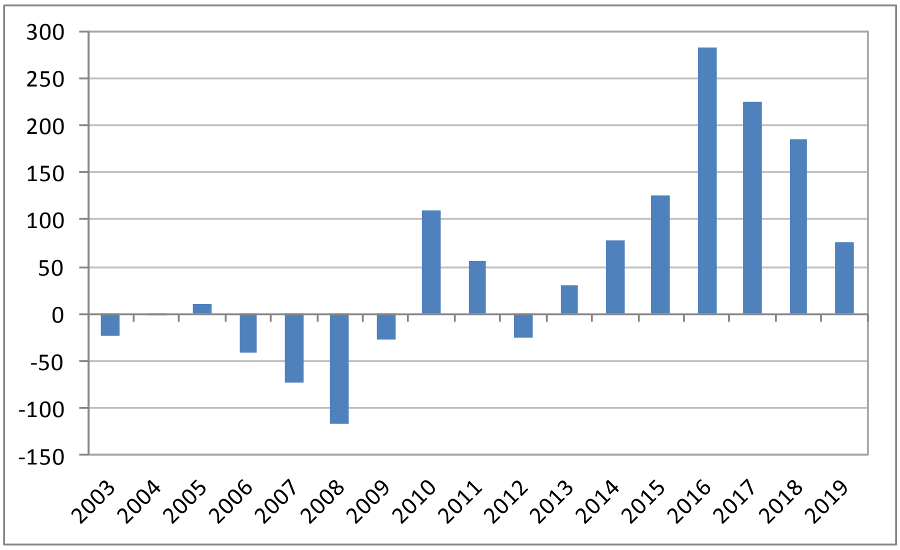
Figure 2.5 shows that the States (including traders, Andium and the States of Jersey Development Company (SOJDC)) is planning to put a lot more into the economy than it is planning to take out, particularly in 2016 (£280 million - the equivalent of 7% of the size of the economy) although this is highly dependent on how much of the planned capital expenditure over the next few years takes place on the intended timeframe

Figure 2.5

Estimates of how much the States has spent and will spend in excess of raising revenue 2015-2019.

£ million (current prices) including States trading departments, Andium and SOJDC (SOJDC not included in historic figures)

Source: States Treasury (draft MTFP Figure 65, page 171) and Panel estimates



Experience over the last few years has suggested that the outturn for capital expenditure has generally been well below the plans for capital spending. This is covered in more detail in the Capital projects section 2.8.

Looking instead at a scenario where the States capital expenditure (including Traders, Andium and SOJDC) continues at the level seen in 2014 (£75 million), the trends might be as set out in Figure 2.6. This could also be a proxy for the impact if, for example, most of the major capital projects have a high imported labour and material content.

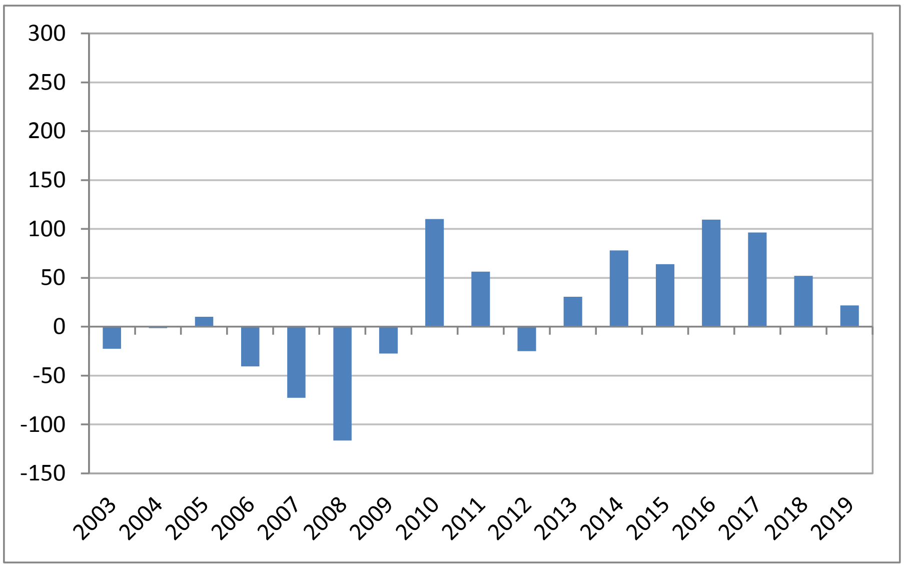
This shows that the States would still put more into the economy than it would take out - approximately £100 million in 2016 (2% of the size of the economy), £90 million in 2017, £40 million in 2018 and £10 million in 2019.

Figure 2.6

Estimates of how much the States has spent and will spend in excess of raising revenue. Lower estimate 2015-2019.

£ million (current prices)

Source: States Treasury and Panel estimates



The actual balance of States income and expenditure over the next four years is likely to be very dependent on the ability of the States to deliver the planned capital expenditure and also the shape of the plans for the new hospital.

If capital expenditure does fully meet current plans there is a risk that the States' overall fiscal position could add significantly more to the economy than it takes out at a time when the economy is close to capacity. This could lead to a build-up of inflationary pressure but is dependent on actual fiscal and economic trends.

The States should plan how it will deliver capital projects to reduce the risk of a build-up of inflationary pressure in Jersey's economy, particularly if there is some bunching of expenditure or if it coincides with a period a limited spare capacity in the economy.

To avoid the need to change the timing of important projects or make adjustments to other spending or income, the States should consider whether resources could be imported cost-effectively from outside the island to reduce any bottlenecks within the local economy. Similarly, if there is spare capacity in the construction sector the States could look to do more on-island.

The States should also maintain other flexibilities, such as timing of tax changes or other expenditure that could be used to ensure fiscal policy remains counter-cyclical.

Income and expenditure measures (parts 2 and 3 of the plan)

The draft MTFP proposes to deal with the £145 million expected funding shortfall by 2019. This meets the first part of the Panel's third Pre-MTFP recommendation.

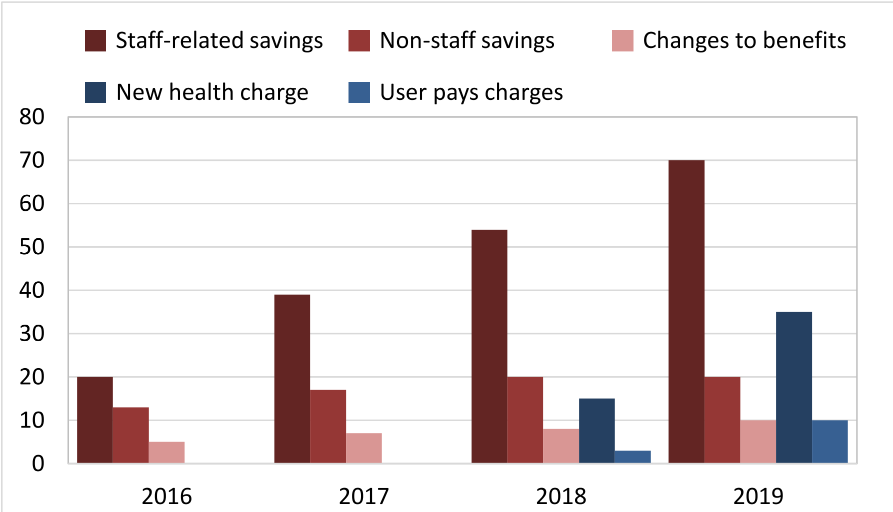
The plan is made up of five sets of measures which in the earlier years involve savings, efficiencies and changes to benefits (altogether £100 million) and in the later years, revenue raising measures including a new health charge and user pays charges (adding up to £45 million) (Figure 2.7).

Figure 2.7

Timing of the planned measures to address the £145 million shortfall

£ million (current prices)

Source: Draft MTFP 2016-2019, based on Figure 31 page 81



Funding the shortfall between income and expenditure until 2019

Whilst these planned measures are being phased in, the States will still need to finance the shortfall between income and expenditure each year until 2019.

The draft MTFP proposes to do this mainly by using the Strategic Reserve (£141 million), the Health Insurance Fund (£30 million) and the Criminal Offences Confiscations Fund (£8 million). As is discussed below, these are relatively small transfers relative to the total size of the States' largest funds.

A change in accounting policy for income tax revenue has also increased the flexibility in the Consolidated Fund to help finance the shortfall (£60 million) (Figure 2.8). In addition to these measures, the transfer from the Consolidated Fund to the Social Security Fund each year to support the pension costs of lower earners will be held constant, saving a further £20 million.

The intention is also to put £70 million back into the Strategic Reserve, mostly in 2019. Overall, this means that it is planned to use £71 million of the Strategic Reserve by 2019 to fund the shortfall.

In line with the Panel's previous recommendations, the draft MTFP proposes to gradually withdraw fiscal stimulus from the economy as it recovers, and to use the States' reserves to pay for this whilst the planned measures to bring the States' finances back into balance are being phased in.

Figure 2.8

Plans to pay for the shortfall between income and expenditure until 2019

£ million (current prices)

Source: Draft MTFP 2016-2019, Summary Table I

	2015 £ m	2016 £ m	2017 £ m	2018 £ m	2019 £ m
Consolidated Fund opening balance	5	46	21	23	24
Forecast operating surplus/(deficit)	(66)	(49)	(28)	21	58
Measures to manage 2015 shortfall	53				
Change in accounting policy - income tax	60				
Capital programme funding	(65)	(27)	(65)	(43)	(33)
Agreed transfer from Strategic Reserve	24				
Proposed transfers from Strategic Reserve	10	51	80		
Proposed transfers to Strategic Reserve			(20)		(50)
Proposed transfer from Currency Fund	25				
Proposed asset disposals			20		20
Proposed transfer from HIF			15	15	
Proposed transfer from COCF				8	
Consolidated Fund closing balance	46	21	23	24	19

Figure 2.9 shows the projected net asset positions for the States' largest funds - an indicator of States reserves - from the end of 2014 through to the end of 2019 in real terms.

The projection includes the income (including an estimated 2% real investment return) and expenditure of the Strategic Reserve, the Social Security Funds, the Consolidated Fund, the Health Insurance Fund and the Stabilisation Fund.

It also includes the impact of the plan to use £198 million of States' reserves to pay for the shortfall between income and expenditure until it is addressed by 2019.

This suggests that the States' reserves will remain broadly level in real terms between 2015 and 2018, before growing again in 2019. Within this the capital value of the Strategic Reserve is being protected in real terms.

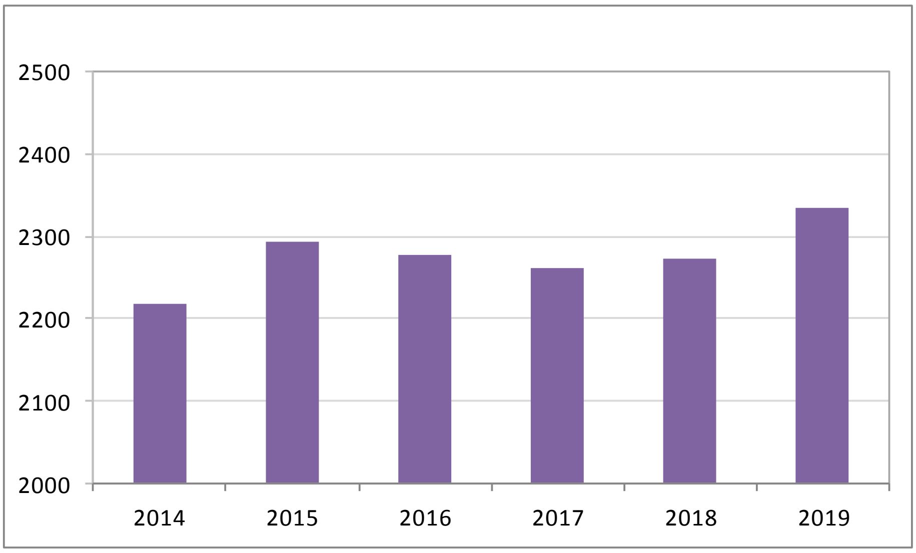
Figure 2.9

States reserves projections in real terms

Total year end net assets £ million (real, 2014 £) projections for the States' largest Funds (Strategic Reserve, Social Security, Consolidated, Health Insurance and Stabilisation Funds)

Source: States Treasury and Panel estimates

Note: the y-axis starts at £2,000 million and not at zero



The Panel is encouraged that the fiscal framework commits to monitoring this net asset position on an ongoing basis so that future changes are highlighted.

This will give the Panel opportunity to comment in future reports as to whether future changes are in line with the fiscal guidelines to balance the current budget over the economic cycle and keep States finances on a sustainable medium-term footing.

2.6 Public sector measures

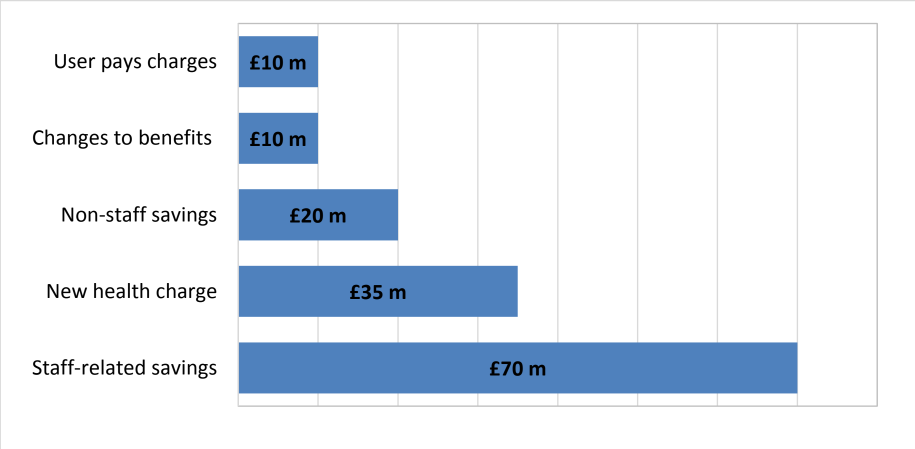
The majority (£90 million of the £145 million) of the planned measures to bring income and expenditure back into line by 2019 involve savings, efficiencies and expenditure constraint in the public sector. This is shown by the categories "Staff-related savings" and "Non-staff savings" in Figure 2.10.

Figure 2.10

Measures to bring income and expenditure back into balance by 2019

£ million (current prices)

Source: Draft MTFP 2016-2019, based on Figure 31 page 81



The Panel previously recommended that:

"The States should always be looking for ways to improve its efficiency and that of the wider economy, irrespective of the stage in the economic cycle. Particularly in the public sector, such changes may be more readily achieved now, especially if the alternatives are to cut expenditure on public services or to increase taxes."

It is important to distinguish between cost savings made by improving efficiency in the States and cost savings made by reprioritising, reducing or stopping expenditure on public services and transfers (for example, reducing benefits).

Improving efficiency means that Jersey people are generally better off - they can get the same level of public services for a smaller tax contribution. However, reprioritising, reducing or stopping States expenditure will result in some Jersey people gaining and others losing.

The draft MTFP and 2016 MTFP Addition should be clearer about how much of the £90 million savings will be due to improving efficiency.

The draft MTFP summarises the proposed staff savings as:

- Managing staff attrition as people leave their jobs through retirement or finishing a contract, for example.
- Pay restraint over the next four years.
- Voluntary release scheme for staff who are doing a job that is not, or will not be needed after service redesign.
- Service redesign – restructured departments, simpler processes and investment in e-government, for example.

The draft MTFP summarises the proposed non-staff savings as:

- Service redesign.
- Including no inflation in budgets for non-staff costs to make departments offset increases in supplier costs by efficiency savings.
- Office consolidation.
- Limiting growth in grants and subsidies to outside organisations, for example, for the rural sector, air route development and sports clubs.

If these measures result in reducing the number of people employed in the public sector overall over the next few years, then it is best to do this as the private sector recovers and is looking to employ more people.

Implementing the £145 million of proposed measures looks challenging, particularly as they are very dependent on unspecified future staff and other savings. This is a key risk to the delivery of the proposed plan. If a significant number of these measures are not achieved, then it increases the risk that the structural deficit will not be dealt with by 2019.

The Panel acknowledges that if this were to happen, there is some flexibility (discussed in the next section), for example the growth areas of expenditure might not be released in the later years of the MTFP. However, this would be more difficult if other contingencies arose at the same time. Moreover, the States should ideally not restrict those future agreed growth areas of expenditure that are more than self-financing, i.e. that would generate more economic benefits than costs in the long run.

There is also an important risk attached to relying on restraining public sector pay increases over a prolonged period of time and particularly if this is significantly below trends in the private sector. It is not clear in the draft MTFP how much public sector pay will increase, if at all. (The 2015 average earnings statistics indicate that since 2001 private sector earnings have increased by 1% in real terms, while public sector earnings have decreased by 3% on the same basis).

Constraining or cutting the public sector wage bill is not the same as increasing public sector productivity, which is particularly difficult to measure and monitor.

2.7 Flexibility in the MTFP

The Panel previously recommended that:

"It is important that the MTFP should include the flexibility (or contingency plans) to address the structural deficit more or less quickly, according to the

economy's performance. There is a role for the Panel in subsequent reports to help in informing and refining the adjustment process."

Section 14 in the draft MTFP discusses contingency planning in the event that States income turns out to be lower than that forecast.

The extra flexibility has been built in as follows:

- Re-establishing a £20 million working balance on the Consolidated Fund (an increase of £10 million over the previous MTFP).
- £38 million of funding will be held centrally to allocate during 2017 to 2019 if the States financial situation allows.
- The option to accelerate existing savings or revenue raising measures.
- The option of annual Budget measures, for example, to increase States income.
- The option to use capital asset disposals to provide temporary flexibility.
- Considering the States ownership of utilities and the level of their returns to the States.
- The Council of Ministers will develop further plans ahead of the MTFP Addition being published in 2016.

It will be important that this flexibility can be used to change the speed and scale of the structural adjustment on the basis of new information on the fiscal position and/or the economy's performance. Future FPP advice (either in annual reports or through formal supplementary advice) will be critical in determining whether any changes to the adjustment profile are required and in what manner.

The Panel is encouraged by the amount of flexibility included in the MTFP and the intention to meet FPP advice on this matter.

Given the risks to delivering the scale of savings required, the planning around flexibility must continue. The States should ensure these measures can be implemented in practice if necessary and also take care that any short-term flexibility measures carried out do not compromise long-term sustainability or efficiency.

2.8 Capital projects

This section looks at the MTFP's proposals to fund capital projects (the capital allocations and other sources of funding) and how much is expected to be spent on capital projects each year.

Funding of capital projects

The Panel previously recommended:

Given the strength of Jersey's public sector net asset position, financing issues should not be a reason to delay or postpone important investments, particularly those which support productivity improvements and competitiveness.

Capital allocations are the funding committed to future capital projects, and not the amount of money spent on capital projects each year.

The MTFP proposes the indicative capital allocations of funding for 2016, 2017, 2018 and 2019 and an indicative capital programme (Figure 2.11).

The detail of the capital programme will be agreed in the Budget for that year. For example, the capital programme for 2016 will be agreed in the 2016 Budget in December 2015.

The other projects with funding allocated include the £40 million Les Quennevais School project in 2016 and 2017, and the £8 million Prison improvement project in 2018.

Figure 2.11

States total indicative capital allocations 2016-2019

£ million (current prices)

Capital programme	2016 £ m	2017 £ m	2018 £ m	2019 £ m
Annual programme	26	26	35	33
Other projects	1	39	8	
	27	65	43	33

Source: draft MTFP 2016-2019, Summary Table B

The draft MTFP plans to fund the routine annual capital programme with £35 million a year from the current revenues of the Consolidated Fund, and use its reserves to support extra capital investment in other projects, particularly investment which could contribute to the competitiveness and productivity of the island (Figure 2.12).

Figure 2.12

Sources of funding for the indicative capital allocations 2016-2019

£ million (current prices)

Funding source	2016 £ m	2017 £ m	2018 £ m	2019 £ m
Consolidated Fund	26	26	35	33
Strategic Reserve	1	39		
Criminal Offences Confiscation Fund			8	
	27	65	43	33

Source: draft MTFP 2016-2019, Summary Table E

The £40 million Les Quennevais School project will be funded from the Strategic Reserve temporarily, rather than being delayed, **which is consistent with FPP advice.**

The Prison improvement project is dependent on there being £8 million in the Criminal Offences Confiscations Fund in 2018 which will not be known until nearer the time. Although this is only a small element of the capital programme the Panel do not think it is appropriate that capital projects should be planned on the basis of such uncertain future revenues and would not like to see this type of funding arrangement becoming more prevalent.

The proposal for the new hospital has not been finalised and therefore not included in the draft MTFP. The Panel understands that it is important for the States to make the right decision for the Island, but the situation should be clarified when the additional detail on the MTFP is provided next year.

The funding requirements for the office consolidation project and Fort Regent has also not been included in the draft MTFP and will require subsequent approval.

Projected capital expenditure

The economic impact of capital expenditure is important for managing the level of demand in the economy and the economic impact of the States' fiscal position in any one year.

Figure 2.13 shows the Treasury's projections for capital expenditure which includes that relating to departments and Traders (funded by current and future capital allocations), other major projects (for example sewage treatment works, Les Quennevais School), and those of the social housing provider Andium and the States of Jersey Development Company (SOJDC).

It is worth noting that the issue of the bond to provide funding for more social housing will increase Andium's potential for future capital expenditure and this has been included in the forecast.

As mentioned before, this does not include projections for the new hospital, the office consolidation projection or Fort Regent, so when they are agreed, this would add to, and change the profile shown below. Given the size of the hospital project, the changes could be very large in some years.

Figure 2.13

Forecast capital expenditure 2015-2019

£ million (current prices)

Source: draft MTFP 2016-2019, Figure 66, page 172

Forecast capital spending	2015 £ m	2016 £ m	2017 £ m	2018 £ m	2019 £ m
Current capital allocations	71	62	0	0	0
Future capital allocations	0	48	42	56	45
Other major projects	19	51	24	17	16
Andium	42	54	82	81	35
SOJDC	5	33	54	54	34
	138	248	203	208	130

Figure 2.14 shows this forecast capital expenditure in the context of past capital expenditure up until 2014.

Figure 2.14

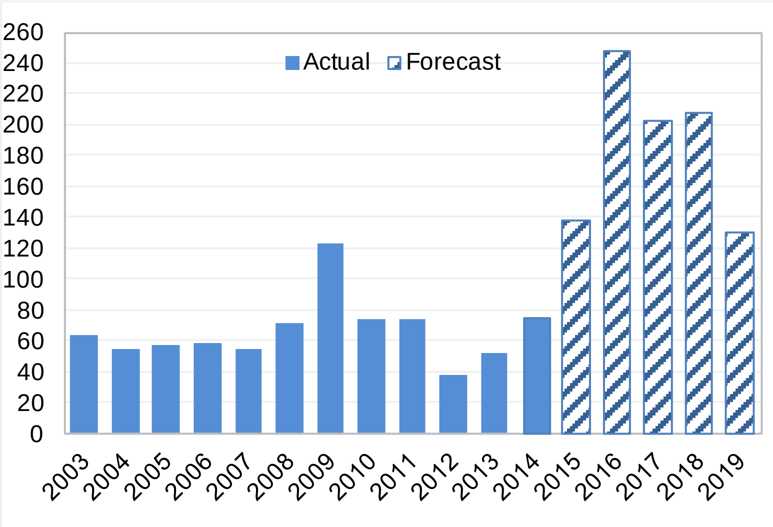
Capital expenditure

£ million (current prices)

Source: States of Jersey Treasury data and forecast

Notes: Past capital expenditure includes the States, Traders and Andium (but only forward projections include SOJDC).

Forecast also includes subsidiary SOJDC.



The Panel is pleased that the capital project plans have been progressed and planned well in advance. This is in line with the Panel's 8th recommendation in its Pre-MTFP report.

However, as the timing and size of the capital spending is very important, as is how it is delivered (the extent of on and off-island labour and materials content) it is important that the consequences for the local economy are managed taking account of the prevailing economic conditions.

2.9 Risks to achieving the MTFP

There are several risks to successfully delivering the draft MTFP over the next four years.

Controlling expenditure

First, the plans that essentially limit total net revenue expenditure at 2015 levels until 2019, represent a challenging target. The plan proposes just 1% growth in total expenditure in nominal terms over the next four years, compared to 12% growth between 2011 and 2015, for example. Bearing in mind inflation, the plans propose total expenditure in 2019 that is 9% lower in real terms than in 2015.

Underpinning this are all the planned measures required to address the funding shortfall discussed in Section 2.5.

Department expenditure plans not outlined for 2017-2019

The draft MTFP only includes detailed expenditure plans for 2016. The plans for 2017-2019 will be developed and published as part of an MTFP Addition in June 2016.

This is not ideal, but it is understandable in the context of the huge task undertaken in the draft MTFP. There is clearly a risk that departments will not be able to develop achievable plans within the overall envelope set out in the draft MTFP.

Proposed changes may not be sustainable

There is also a risk that the changes proposed in the draft MTFP may not be sustainable.

The draft MTFP does not describe the distributional consequences of the proposed measures to address the funding shortfall, not least as not all of the detail of the measures has been decided (see above). So there is a risk these changes may not be seen to be "fair", particularly if the distributional consequences are that some groups in society face a larger share of the burden than other groups. **As details of the proposed package of measures to meet the 2016 MTFP Addition are developed attention should be given to ensure that they are sustainable, including their potential distributional impacts.**

Population policy and immigration

How population policy is implemented will be very important to the success of the draft MTFP. There is a risk that if immigration is too constrained, or does not prioritise the skills and occupations that are most important, it will have a detrimental impact on the economy and public finances, particularly in the longer term.

Uncertainty around future States income growth

It is very difficult to forecast how States income will change in the future and given this inevitable uncertainty there are risks, particularly to income tax revenue, to the downside as described by the IFG in their latest forecast.

2.10 Longer term challenges

The ageing population

The draft MTFP aims to balance the public finances by 2019. However, this will not be enough to maintain the structural balance on the public finances in the longer term, given the demographic changes that are going to take place.

The fact that people are now living longer will have significant consequences for Jersey and the States' public finances.

The impacts of an ageing population will be gradual - taking place over the next twenty years or so. The States will need to make sure that it can make any necessary policy changes in time to address the pressures that will emerge.

The Panel previously recommended that:

"The States should develop a strategy for managing the fiscal consequences of an ageing population. All other things equal, the ageing population will mean that the public finances will move out of balance over the next 20 years, as spending in areas such as health and the state pension increases faster than revenues."

The draft MTFP report discusses the demographic challenges and population projections and includes the following statement from the Council of Ministers:

"The Council has committed to the development of a new, rolling, long term plan which will set a planning horizon 15-20 years ahead. The new planning process will provide for better insight into the impact of demographic change, informed appraisal of migration planning assumptions and proper evaluation of the long term progress in key areas such as education and skills, health, economic participation, productivity, urban living and quality of life."

Section 18 of the draft MTFP also discusses the ageing of the population in the context of future pensions and the sustainability of the Social Security

Funds. There will be a detailed review in 2016 to ensure the long term sustainability of this aspect of the public finances.

The Panel welcomes the Council of Ministers' commitments to develop a rolling long term plan and to review the long term sustainability of the Social Security Funds.

Although these will be positive steps, a strategy for managing the fiscal consequences of an ageing population should take a whole-of-government view and consider the long term sustainability of all States' income, expenditure and their supporting Funds together.

Increasing productivity

Jersey's future productivity growth will play a vital role in raising Jersey's economic performance and competitiveness, improving the public finances and ultimately raising the standard of living and quality of life – particularly as the underlying demographic changes start to have more of an effect.

The Panel recommended in their pre-MTFP report that:

"The States should act now and develop a clear strategy for raising productivity (in both the public and private sectors) and competitiveness in the Jersey economy. Ongoing improvements in these areas will help to manage the fiscal consequences of an ageing society and make it more likely that Jersey's economy will grow in the future."

The Strategic Plan sets out some key objectives to optimise economic growth:

- Promote jobs growth in high value added sectors
- Improve productivity across the economy
- Develop a new Enterprise Strategy and a new Innovation Strategy
- Assess the costs and benefits of regulation to identify barriers to enterprise
- Improve the existing Skills Strategy
- Develop a new Competition Framework
- Identify and remove barriers to work

In the draft MTFP, there are proposals to:

- Improve economic growth, productivity, skills and job opportunities - £20 million drawdown facility for targeted measures that will achieve this aim, overseen by an Economic Policy Group made up officers and politicians.

- Improve education - £9 million a year more on education by 2019.

The draft MTFP also acknowledges that improving productivity will mean that the States' existing budgets that influence economic and productivity growth will need to be refocused and reprioritised.

The co-ordination and detail of the Enterprise, Innovation and Skill strategies and the Competition Framework, as well as removing any unnecessary and costly regulations will be critical to improving the Island's productivity and competitiveness in future. It is also important that concrete action plans are developed and implemented, and progress regularly reviewed, in order to translate these objectives into reality.

The Panel supports the refocusing and reprioritising of the States' existing budgets that influence economic and productivity growth as an important first step before any additional resources are allocated.

The Panel welcomes these developments and stresses that strong governance measures should be put in place to control how the £20 million is spent to improve productivity.

Appendix 1: FPP's 2015 Pre-MTFP Report advice and recommendations

1. Based on the current structure of taxation and expenditure, it appears that there is a significant risk of a structural deficit. The size of any structural deficit will depend on the decisions made for the MTFP.

2. The economic assumptions set out in this report should be used to update the revenue and expenditure forecasts, and the expected position of the States' finances in 2018/2019. This will illustrate the expected underlying structural position.

3. The States should develop a plan that will address any structural deficit by 2018 and 2019. Care should be taken to ensure that the range and timing of the measures minimises the risk to the economic recovery, which, in the early stages, may involve using the States' reserves.

4. The States should always be looking for ways to improve its efficiency and that of the wider economy, irrespective of the stage in the economic cycle. Particularly in the public sector, such changes may be more readily achieved now, especially if the alternatives are to cut expenditure on public services or to increase taxes.

5. It is important that the MTFP should include the flexibility (or contingency plans) to address the structural deficit more or less quickly, according to the economy's performance. There is a role for the Panel in subsequent reports to help in informing and refining the adjustment process.

6. Once Jersey is on a sound path to structural fiscal balance, the States should aim to balance its tax revenues and current expenditure over the economic cycle, including an appropriate allowance for depreciation.

7. New public sector capital expenditure should be treated separately based on its economic costs and benefits, and its impact on the States' net asset position. The funding of such investment is a secondary consideration that will depend on the cost of alternative sources of finance (e.g. borrowing from reserves or the market).

8. Given the strength of Jersey's public sector net asset position, financing issues should not be a reason to delay or postpone important investments, particularly those which support productivity improvements and competitiveness.

9. The States should develop a strategy for managing the fiscal consequences of an ageing population. All other things equal, the ageing population will mean that the public finances will move out of balance over the next 20 years, as spending in areas such as health and the state pension increases faster than revenues.

10. The States should act now and develop a clear strategy for raising productivity (in both the public and private sectors) and competitiveness in the Jersey economy. Ongoing improvements in these areas will help to manage the fiscal consequences of an ageing society and make it more likely that Jersey's economy will grow in the future.