Jersey's Fiscal Policy Panel

Senator Philip Ozouf
Minister for Treasury and Resources
Cyril Le Marquand House
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Dear Minister

Use of Stabilisation Fund

Thank you for your letter dated April 12 2012. You asked for advice on your proposals to use money that might otherwise have been allocated to the Stabilisation Fund in line with our recommendation that balances in excess of £20m in the Consolidated Fund be transferred to the Stabilisation Fund, to support housing capital projects. This is entirely consistent with our remit to give you and States members independent economic advice on matters relating to overall tax and spending policy relative to economic conditions and in particular on use of the Stabilisation Fund.

We address the key economic issues relating to your proposal below, considering in turn:

- the current economic situation
- the need for fiscal stimulus
- better than expected tax receipts in 2011
- key principles for fiscal stimulus
- medium-term sustainability.

However, we remind you that as ever we operate within the confines of the limited data that are available on both the current economic performance and the medium-term fiscal outlook and against the back drop of volatile and uncertain global economic trends, particular surrounding the Eurozone. We will cover these issues in more detail and on the basis of more up to date and complete information when we report on the Medium-term Financial Plan (MTFP) ahead of the debate.

Current economic situation

We have been following developments locally and globally with interest and have noted that since our October 2011 Update Report when we stated that risks to the economic outlook this year were weighted to the downside, these risks have to some extent materialised. JFSC figures suggest that profitability in the banking sector improved in 2011 as net interest income increased for the first time since the onset of the financial crisis. However, the March 2012 Business Tendency Survey showed a small net balance of finance sector firms reporting a fall in business activity compared with three months previously for the first time and the balance expecting an increase in future business activity the least positive to date, while profitability remained negative, though less so than in September at the time of our last report.

The same survey showed that for the non-finance sector as a whole all ten indicators were negative and those for business activity and new business the most negative to date. These data are consistent with the other data you refer to in your letter, in particular falling retail sales volumes, record unemployment, the likely impact of the removal of LVCR on the fulfillment industry from 1 April and continued negative trends in the construction sector.

In summary we feel that these trends in the local economy are more in line with the downside of our previous forecast of growth between 2 and -2% this year.

Fiscal Stimulus

In view of the worsening economy it would be appropriate to follow our advice from October that “should the economic situation deteriorate, the States should be ready to support economic activity without weakening States’ finances”. We support your proposal to fund £27m of additional housing projects in 2011, subject to it meeting the conditions for fiscal stimulus outlined below. However, at only 0.5-1.0% of GVA this additional expenditure may not provide sufficient stimulus if economic conditions deteriorate further. As the States considers the Island’s first MTFP it will be important to include sufficient flexibility in States’ finances to undertake additional fiscal stimulus this year and next if necessary. We will comment more on this issue when we report later in the year.

Better than expected tax receipts in 2011

You mentioned that you are in the position to be able secure funding for these projects because the consolidated fund is £27m higher than expected largely as a result of improved taxation revenues and carrying out the full transfer into the Consolidated Fund from the Stabilisation Fund. Our advice has been consistent over the years that better than expected revenues in one year do not in themselves merit a change in fiscal policy (expenditure or tax) either in the short or medium-term. If economic conditions had not deteriorated since our last report our advice would have been to transfer all these funds into the Stabilisation Fund.

Key principles for fiscal stimulus

We have previously advised about the key principles that should be applied in determining discretionary fiscal stimulus actions – the now familiar 3Ts. If projects can be identified that were going to take place anyway, can be brought forward and that have intrinsic economic value in their own right policy should be:

- **Timely**. Start immediately to have an impact within the next 12 months and preferably as soon as possible.

- **Targeted**. Policy should be targeted toward measures that will have the most impact in terms of supporting economic activity and employment in the Island.

- **Temporary.** The measures chosen should have no negative long-term implications for the public finances either in terms of the tax base or spending commitments.

Medium-term sustainability

The latest trends in the economy should not distract attention from our concern that the States' finances be on a sustainable basis in the medium-term so that when economic conditions improve deficits close and return to surplus when economic activity is performing strongly allowing the Stabilisation Fund to be replenished. Latest developments only intensify the need to look at the States' fiscal position on a consolidated basis. These are issues we will cover in more detail when we report later this year.

We hope these comments are sufficient at this stage and we look forward to receiving all the information on the new MTFP in due course. We have copied this letter to all States members.

Yours sincerely

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Christopher Allsopp
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