Jersey's Fiscal Policy Panel

Interim Report

September 2010

Introduction

As required by the States' Fiscal Framework, the Panel advises the Minister for Treasury and Resources and the States on Jersey's fiscal policy and on additions to or subtractions from the Stabilisation Fund and the Strategic Reserve.

The Panel notes that large falls in financial services profitability have been recorded in 2009. As these may have a significant effect on measured GVA, the Panel has decided to wait until the new GVA data is published before updating its forecasts and publishing its annual report. In the meantime it is publishing this interim report on the fiscal position ahead of the Business Plan debate.

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 stable and predictable;
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 continues to be guided by its understanding of the preferences of Islanders. The Panel feels that Islanders want the States to be prudent, avoid government borrowing 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 a number of occasions in order to keep up with local developments. In this it has greatly benefited 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. It is also grateful for the invaluable support provided by the staff of the States of Jersey, in particular the States of Jersey Economics Unit.

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

Key Points

- The Panel notes that the current fiscal stance is mildly supportive of the economy. Elimination of deficits is planned to be gradual and not complete until 2013. This projected path for medium-term fiscal tightening is broadly appropriate given the Panel's previous economic forecasts but this will have to be reviewed as more data becomes available and these forecasts are updated.
- The Panel notes that the balance in the Stabilisation Fund would now be £34m higher had its recommendation to transfer any surplus in the Consolidated Fund been followed.
- The 2010 Budget amendment that removed all impôt duty increases was clearly against the Panel's advice in its 2009 update that decisions should not be taken to undermine the tax base. It was particularly unwise in an environment where increases in expenditure have taken place whilst significant pressures remain on the public finances.
- The States must control expenditure or the overall level of taxation will have to increase. Especially in the context of Jersey's unique political system, there has been a tendency for expenditure to ratchet upwards as temporary rises in revenue have been used to finance permanent increases in expenditure.
- The Comprehensive Spending Review (CSR) is a good opportunity to tighten expenditure control processes, and the Panel is encouraged by progress in this area. However, the CSR could fail to achieve its objectives if it is not accompanied by a change in culture and attitude.
- The Panel welcomes the Fiscal Strategy Review. International and domestic pressures are likely to put continued pressure on the current structure of taxation. The States should keep in mind that taxes have supply as well as demand effects on the economy. Care should be taken to ensure that as far as possible revenue raising measures do not harm the longer-term competitiveness of the economy. With this in mind the Panel notes the merits of a broad-based consumption tax.
- The Panel believes it is important to set out some guiding principles for Jersey as it faces up to the structural deficit and a post crisis world. In particular:

- Fiscal consolidation should have regard for the consequences for economic growth
- Focus now should be on a credible medium-term fiscal plan
- Balancing the books will not be enough and the plan should be to run surpluses once the economy recovers to rebuild the Stabilisation Fund.

1. Background to the public finances

Income and Expenditure

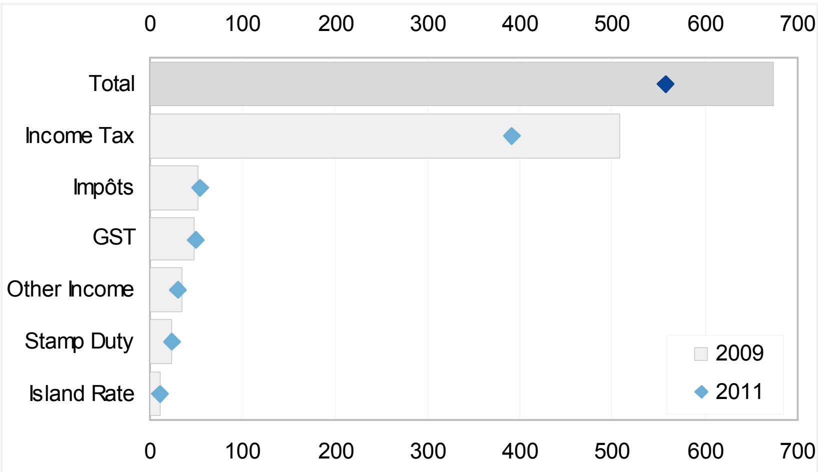
In 2009 the States received £674m in income. Income tax continues to be by far the largest source of revenue, contributing nearly £507m, or 75% of the total. Of this, income tax on salary and wages makes up around 49%, on companies 43% and self-employed and investment income the remaining 8%. Impôts and GST both bring in around £50m each (around 8% of total revenue each). The remaining 10% comes from the Island Rate, stamp duty and other income. In 2011, income tax is expected to fall to £391m as a consequence of the introduction of zero-ten and the economic downturn (Figure 1).

Figure 1

States income by source

2009, 2011, £m

Source: States of Jersey Treasury Department



Total net revenue expenditure (NRE) in 2009 was £603m.[1] Nearly 70% of this – around £415m – went to three departments: Social Security, Health and Social Services and Education Sport and Culture. The remaining 30% was divided among the other ministerial and non-ministerial departments (Figure 2).

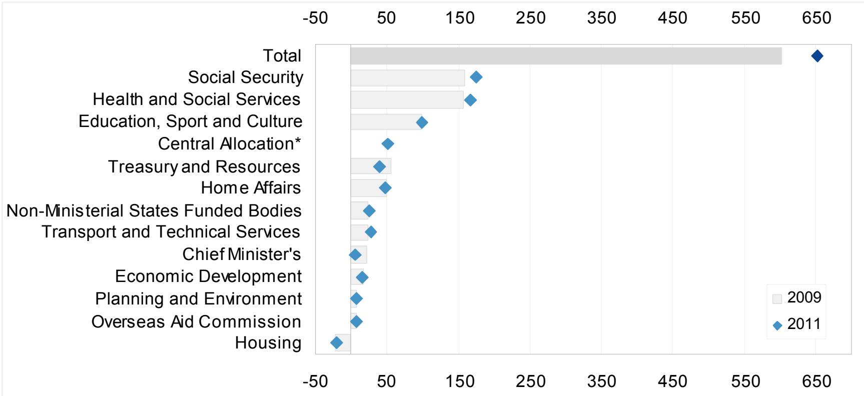
[1] Net revenue expenditure is current expenditure (i.e. excludes capital spending) and offsets any income received by departments against their expenditure.

Figure 2

Net revenue expenditure

2009, 2011, £m

Source: States of Jersey Treasury Department



* Includes funds allocated for depreciation, contingency funds and restructuring costs

Figure 3 shows States' income and expenditure between 1999 and 2009. Between 2001 and 2007 expenditure increased by less than 1% a year in real terms, while income exhibited cyclical fluctuations. Since 2007 income and expenditure have grown sharply in real terms.

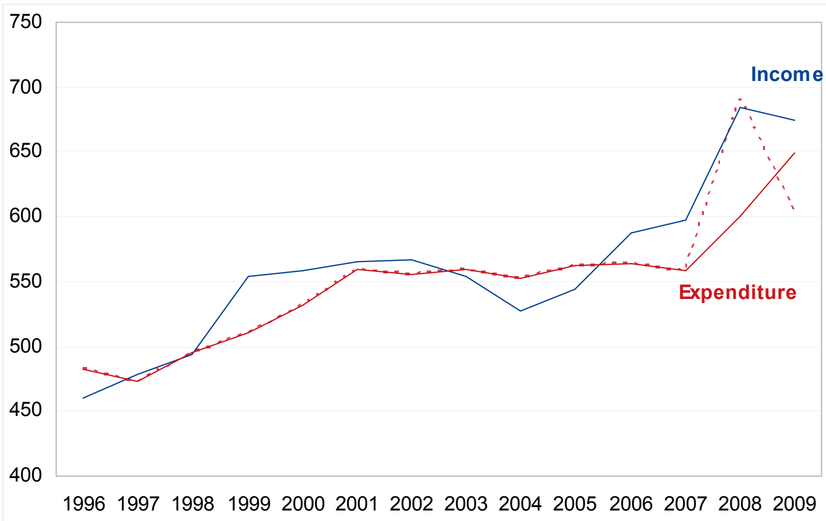
Figure 3

Real income and expenditure

£m in 2009 prices (deflated using RPIX)

Broken red line includes EfW expenditure as allocated. Solid red line adjusts to represent spending profile

Source: States of Jersey Treasury Department



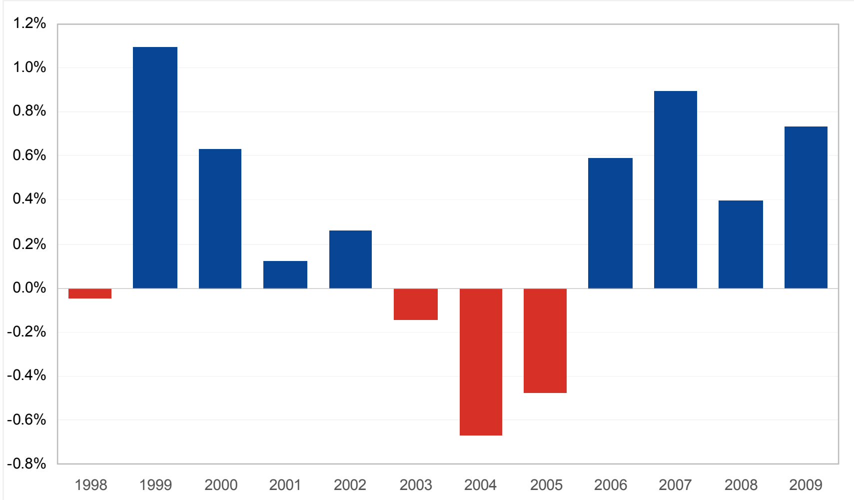
Note: To ensure a consistent series, the expenditure lines in 2009 exclude £40m of NRE due to capital repayments being included in expenditure limits.

Figure 4 depicts the annual surpluses and deficits run by the States between 1996 and 2009 as a proportion of the economy (*after* the timing adjustments discussed below). Surpluses have tended to occur after years when the economy has done well – reflecting lags in tax collection – and deficits after the economy has been weaker. The largest annual surplus over this period was 1.1% of GVA (1999), while the largest annual deficit was just over 0.6% of GVA (2004).

Figure 4

Annual surplus/deficit as a % of GVA

Source: States of Jersey Treasury Department



Note: Expenditure has been adjusted to more accurately reflect actual expenditure rather than allocations

Strategic Reserve

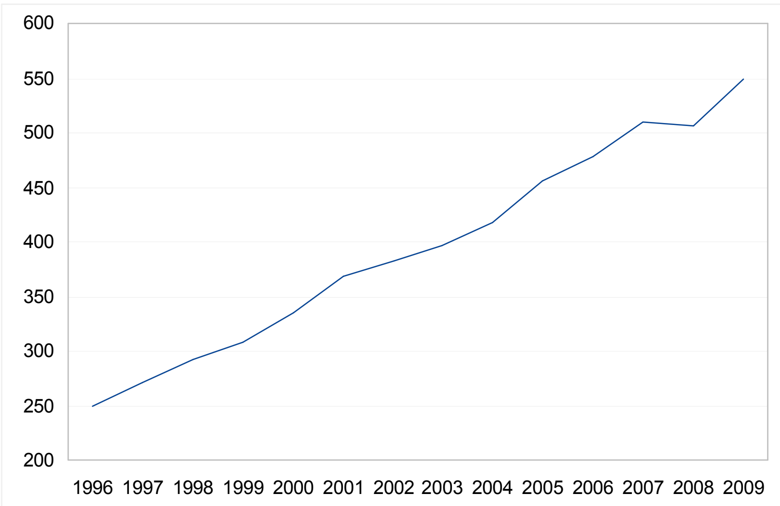
The Strategic Reserve has existed since 1986, and is intended to be used in unusual circumstances such as a natural disaster or a significant, permanent or long-lasting economic change. Figure 5 shows how the balance in the Strategic Reserve has grown steadily since 1996, and now stands at £550m.

Figure 5

Strategic Reserve net assets

£m, current prices

Source: States of Jersey Treasury Department



Stabilisation Fund

The Stabilisation Fund was created in 2006. It is intended to be used over the course of the economic cycle for facilitating counter-cyclical fiscal policy so that, when the economy is strong, excess revenues are transferred to the Stabilisation Fund and when the economy is weak, the money in the Stabilisation Fund is used to finance either budget deficits arising from unchanged fiscal policies (the automatic stabilisers), discretionary fiscal measures, or both. Figure 6 shows the balance of the Stabilisation Fund since its inception in 2006 up until 2012. Between 2006 and 2009 the balance increased as money was put aside when the economy was doing well. From 2009 onwards the balance drops as funds are used to pay for the fiscal stimulus package agreed by the States (£44m in 2009) and budget deficits arising from the downturn (estimated at £92m in 2010[2] and £50m in 2011, after Fiscal Strategy Review measures). After this money has been used up there is forecast to be around £5m remaining in the Fund from 2011 onwards. In order that the Stabilisation Fund can continue to play a role in counter-cyclical fiscal policy it will be necessary to rebuild the Stabilisation Fund as and when the economy begins to grow again.

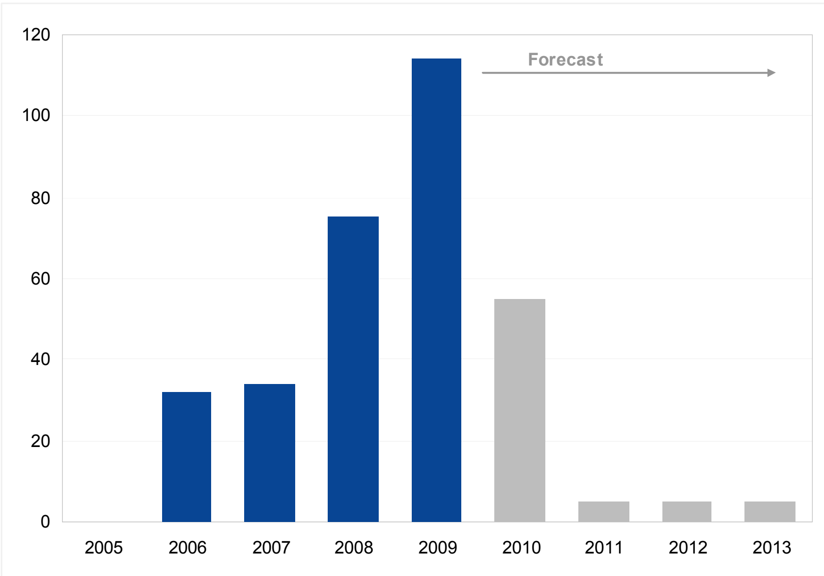
Figure 6

Stabilisation Fund net assets

£m, current prices

Source: States of Jersey Treasury Department

Note: Figures refer to year end, so for 2009 include a transfer out of £44m for fiscal stimulus



In order that the Stabilisation Fund can continue to play a role in counter-cyclical fiscal policy it will be necessary to rebuild the Stabilisation Fund as and when the economy begins to grow again.

[2] £59m of the £92m deficit will be taken from the Stabilisation Fund. £33m will be funded from the excess balance over £20m in the Consolidated Fund at the beginning of 2010.

2. Putting the public finances on a sustainable long-term footing

In its 2009 Annual Report, the Panel highlighted risks and uncertainties with respect to the States' finances and recommended that (a) no decisions should be taken that undermine the tax base or commit to greater permanent expenditure, and (b) a strategy should be developed during 2009 and 2010 that would set out how the States would deal with any structural deficit that remained once the economy had recovered.

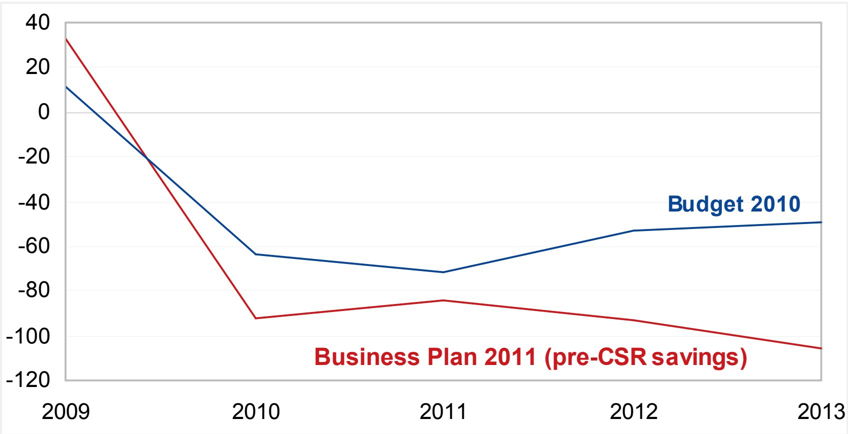
Figures available in the Draft Business Plan 2011 show that the financial forecasts have deteriorated since the Panel's last report, particularly for 2011 onwards. This is due to the additional spending pressures that have been identified as part of the Comprehensive Spending Review process; in particular, restructuring costs, court and case costs and the creation of contingency funds. Therefore a significant structural deficit is increasingly likely unless action is taken (Figure 7).

Figure 7

Forecast surpluses and deficits

£m, current prices

Source: States of Jersey Treasury Department



The Panel is therefore pleased to note that the Draft Business Plan contains fairly detailed proposals about how these forecast deficits will be dealt with; namely the Comprehensive Spending Review (CSR) and the Fiscal Strategy Review (FSR).

The balance between raising taxes and reducing expenditure employed to deal with the deficit is ultimately a political decision, and not one that the Panel is in a position to comment on. Neither is it within the remit of the Panel to get into the specific details of these proposals. However, the Panel does believe it appropriate to comment on the principles of the proposed approach. As such, the CSR and the FSR are discussed individually in more detail below.

Comprehensive Spending Review (CSR)

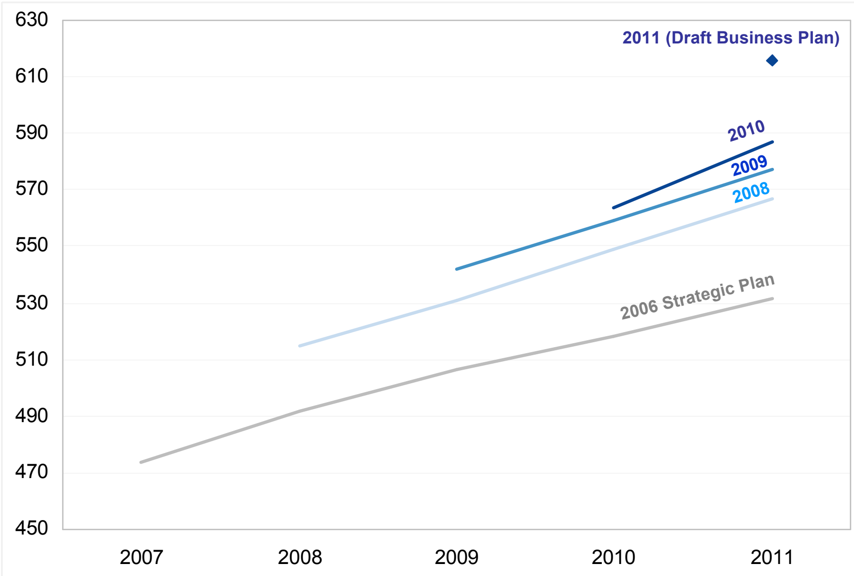
In the Panel's November 2009 update, it drew attention to concerns that the States' expectations of expenditure tended to be significantly lower than the eventual outturn, particularly several years in advance. The chart that was used to illustrate this is reproduced as Figure 8 below, and has been updated to include the 2011 Draft Business Plan.

Figure 8
Expenditure drift between 2006 and 2010

Net revenue expenditure, £m

Source: States of Jersey Treasury Department

Note: Figures refer to Business Plans (as amended) unless otherwise stated



Of the £84 million increase in expenditure for 2011 between the 2006 Strategic Plan and the 2011 Draft Business Plan, approximately £12m is due to amendments to Business Plans lodged in the States. £24 million is due to a £48m gross increase in Department allocations suggested by the Council of Ministers in Business Plans, offset by £24m of savings, of which £12m is a consequence of the CSR. £12.6 million is due to pay and price changes and around £12m to additional income support payments as a consequence of the economic downturn and the uprating of benefits. The introduction of contingency funds is responsible for £9m (Figure 9).

Figure 9

Drivers of expenditure drift by category

Net revenue expenditure, £m

Source: States of Jersey Treasury Department

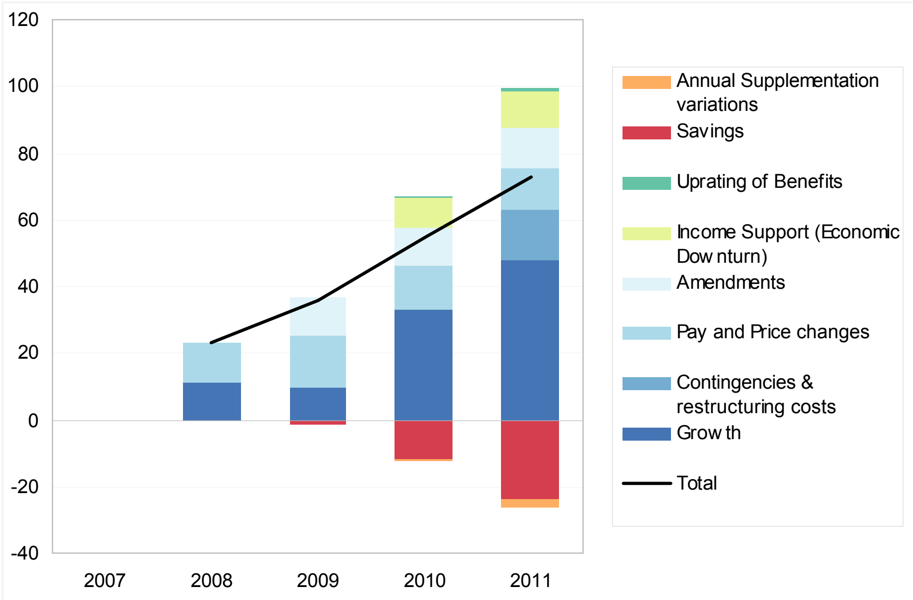


Figure 10 breaks down the net rise in expenditure above plan by department (the sum of the sections labelled 'growth', 'savings' and 'amendments' in Figure 9). A large proportion of the extra expenditure was allocated to the Health and Social Services (HSS) department (£16.5m net by 2011). £7m of this was to fund 2% real terms growth in the HSS budget, £3.5m was to replace the Reciprocal Health Agreement with the UK, and £3m was to fund the States' response to the Williamson review of Children's Services.

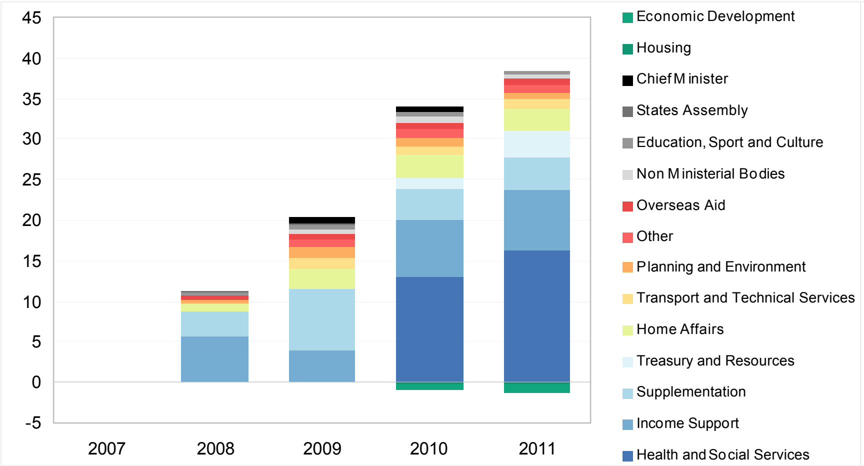
The next largest contributors were income support and supplementation – annually managed expenditure that is largely rules-based and that the States cannot control from year to year. The other two areas that received significant extra funds were Property Holdings (£2.6m, mainly to pay for structural under funding of maintenance) and Home Affairs (£2.8m net of savings, most of which was for La Moye Prison to increase staffing levels and other necessary revenue expenditure).

Figure 10

Drivers of expenditure drift by department
£m

Source: States of Jersey Treasury Department

Note: Property Holdings is included under Treasury and Resources



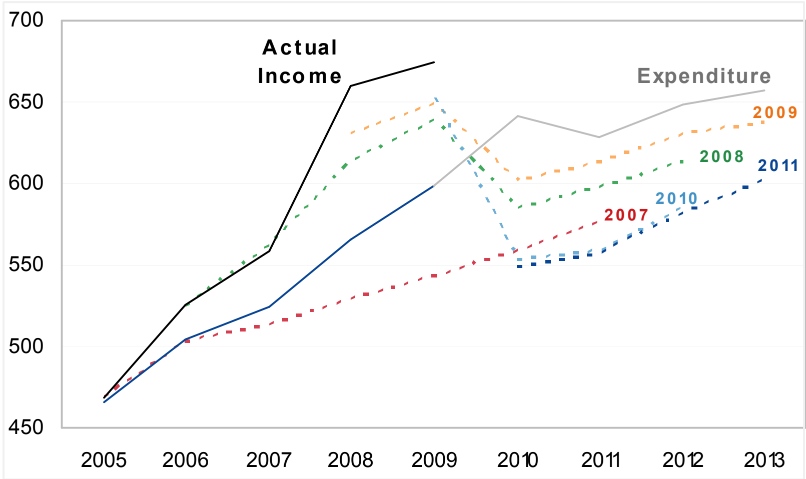
While many of the items that constitute this spending growth – particularly the large ones – are important, they should have been foreseeable to some extent. It would be prudent to plan for potential investment and other expenditure items on a more forward-looking basis. Figure 3 above would suggest that perhaps some of the expenditure growth of the past two years has been a consequence of spending growth being constrained over the preceding six years, when expenditure growth in real terms was less than 1% a year. In other words, another contributing factor to the current problems might be that necessary expenditure has simply been delayed until now.

Figure 11 illustrates how forecasts of income have changed between the 2007 Budget and the 2011 Business Plan. It can be seen from this that higher income than expected between 2006 and 2008 was built into forecasts of income going forward, which in turn was used to finance permanent increases in expenditure. However, with the benefit of hindsight it is apparent that much of this income growth was likely to have been cyclical rather than structural: from 2010 onwards income is expected to be significantly lower than had been forecast in 2008 and 2009.

Figure 11
The evolution of income forecasts and actual expenditure

£m, 2005-2013, dotted lines refer to budget **income** projections

Source: States of Jersey Treasury Department



Note: One-off expenditure on the Energy from Waste plant in 2008 has been excluded from the expenditure figures

The principles behind the CSR of longer-term financial planning and greater discipline are in line with international best practice and movements in this direction are to be welcomed. Three-year spending envelopes and dedicated funds set aside for unforeseen contingencies should strengthen the ability of the States to control spending. But they are necessary, not sufficient.

Changing processes can only go so far. The CSR rightly has the aim of changing the culture of spending among both officials and politicians. The Panel believes three aspects in particular are important. First, it must be understood that all expenditure decisions need to be justified with a robust case on either financial or policy grounds. Second, if the public finances are not running a structural surplus then permanent increases in expenditure need to be met either by permanent increases in taxes or permanent reductions in expenditure in other areas. And finally, contingency funds introduced as part of the new financial control framework under the CSR should have strict controls and not be used as an additional source of revenue for in-year discretionary expenditure. These principles apply equally to the States Assembly and to the Council of Ministers: all parties must change their behaviour on spending and cannot rely on the processes of the CSR to be the panacea. Jersey's unique political system means that it is imperative the change in culture extends to all decision makers, otherwise the CSR will fail to control expenditure.

With respect to the proposed savings it is important that, as far as possible, spending reductions do not have a significant adverse effect on the supply-side of the economy. In a small island economy constrained by land and labour availability, investment in the future economic capacity is particularly vital.

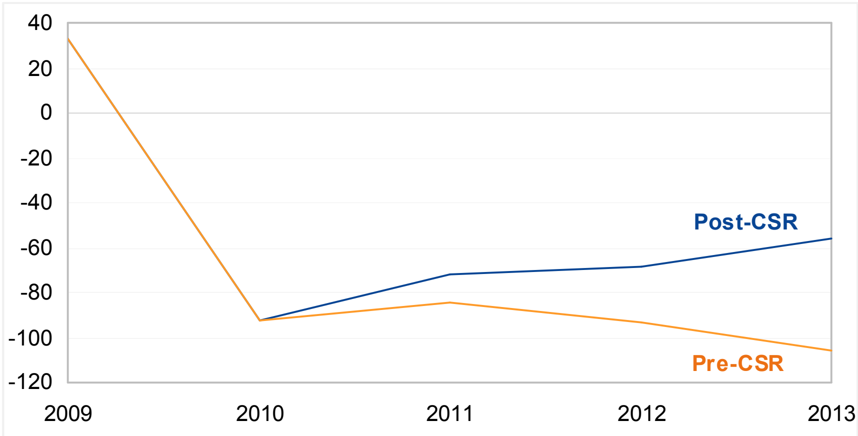
Figure 12 depicts the deficit that is forecast after savings from the CSR have been realised. It is clear that, while these savings, and the associated changes in culture and processes, are significant, they are not going to be sufficient on their own to address the deficit.

Figure 12

Forecast deficits before and after the CSR

£m

Source: States of Jersey Draft Business Plan 2011



The Comprehensive Spending Review (CSR) is a good opportunity to tighten expenditure control processes, and the Panel is encouraged by progress in this area. However, the CSR could fail to achieve its objectives if it is not accompanied by a change in culture and attitude. Especially in the context of Jersey's unique political system, there has been a tendency for expenditure to ratchet upwards as temporary rises in revenue have been used to finance permanent increases in expenditure. Either this will have to be reversed or the overall level of taxation will have to increase.

Fiscal Strategy Review (FSR)

As the Council of Ministers has acknowledged, the CSR alone is unlikely to be sufficient to close the whole of the deficit that is forecast. As a result, the second part of their strategy is the Fiscal Strategy Review. This has two strands: one looking at personal taxes, and the other at business taxes.

Personal Taxes

The review of personal taxes needs to carefully consider the effects of any change on the supply side of the economy. From this perspective there are certain economic benefits of raising funding through a broad-based GST. It is efficient and simple to administer, and it is unlikely to harm competitiveness. There are greater economic risks of amending income tax and social security since these can have detrimental effects on competitiveness, which can manifest itself in lower employment.

The Panel notes that while an increase in GST poses fewer risks to the competitiveness of the economy than other potential tax increases, this is especially true for a broad based tax with few or no exemptions and zero rates which create distortions and administrative difficulties. From an economic point of view, distributional concerns can be more effectively addressed through other aspects of the tax and benefit system.

Business Taxes

The review of business taxes is welcome as it faces up to one of risks highlighted in the Panel's previous reports – that pressure on financial centres in the aftermath of the financial crisis might require changes to the zero-ten regime. The economic importance of the finance industry for the Island hardly needs repeating, and the primary consideration for business taxation is that it retains and enhances Jersey's competitive position as an offshore centre.

The Panel are encouraged that, in response to their request that the Island develop a strategy to address the likely structural deficit, the Council of Ministers has put in place the Comprehensive Spending Review and undertaken the FSR consultation on personal tax. The CSR will not be sufficient by itself to address future deficits and it is important that the Island examines how it should spread the burden of any tax increases.

3. Current Situation

Figure 13 shows the latest fiscal projections for income, expenditure and the deficit inclusive of the CSR measures, but exclusive of any revenues raised from the FSR.

Figure 13
How the situation has changed since the Panel's previous report

£m

Source: States of Jersey Treasury Department

Outturn 2009	Estimate 2010		2011	2012	2013
			<--Forecast-->		
		Income			
674	549	**Draft Business Plan 2011 (June 2010)**	557	581	601
653	558	**Draft budget 2010 (October 2009)**	564	590	609
21	-9	**Difference**	-7	-9	-8
		Expenditure			
641	641	**Draft Business Plan 2011 (June 2010)**	629	649	657
642	618	**Draft budget 2010 (October 2009)**	632	639	654
-1	23	**Difference**	-3	10	3
		Deficit			
33	-92	**Draft Business Plan 2011 (June 2010)**	-72	-68	-56
11	-60	**Draft budget 2010 (October 2009)**	-68	-49	-45
22	-32	**Difference**	-4	-19	-11

Note although States expenditure in 2009 in Budget 2010 was £598m, this excluded £44m of fiscal stimulus. This has been added back in to reach the £642m total shown

In 2009 the surplus was £22m higher than was previously expected. While expenditure was broadly similar, income was £21m higher than expected. This increase in income was mainly due to income tax (£19m). Tax from employees was £7m higher than expected, tax receipts from self-employed and investment-holders was £6m higher and tax from companies was £2m higher. Higher than expected stamp duty and other income of £6m was largely offset by £4m fewer GST and Island Rate revenues (Figure 14).

Figure 14
Change in income between budget 2010 and business plan 2011

£m

Source: States of Jersey Treasury Department

	2009	2010	2011	2012
Income Tax	19	0	0	0
Goods and Services Tax	-3	-3	-3	-3
Impôts	0	-1	0	-1
Budget Amendment (Removal of impôts increase)	0	-4	-4	-4
Stamp Duty	5	0	0	0
Other Income	1	-2	0	0
Island Rate	-1	0	0	-1
Total Income	21	-10	-7	-9

Expenditure is due to be £23m higher in 2010 than previously expected. £8m is expenditure carried-forward from 2009 and reallocated to departments for 2010. The remainder is mainly due to an Article 11(8) request[3] in relation to the CSR for £8.5m for court and case costs, £6m for a voluntary redundancy scheme and £500,000 initial funding for a procurement project. This additional expenditure was effectively

[3] P64/2010. Article 11(8) of the Public Finances Law (Jersey) 2005 states that, "the States may, at any time, amend an expenditure approval on a proposition lodged by the Minister on the grounds that –
(a) there is an urgent need for expenditure; and
(b) no expenditure approval is available.

paid for from the extra income received in 2009, and goes against the Panel's recommendation that extra income accruing to the Consolidated Fund be transferred to the Stabilisation Fund. Whilst the Panel recognise the need to properly account for legal costs and that the other elements represent one-off expenditure integral to the CSR process, such expenditures would not be an appropriate use of the Stabilisation Fund.

In future years it might be appropriate for the Panel to comment and provide advice before in-year decisions are taken relating to the use of unexpected surpluses.

The Panel notes that this is in addition to the £11m additional (capital) expenditure agreed in amendments to the 2010 Budget and funded from better than expected 2009 income receipts. Therefore had the Panel's recommendation to transfer surplus funds to the Stabilisation Fund been followed, there would have been £34m more in the Stabilisation Fund. Although the £10m of this allocated for the Town Park has been offset by lower capital expenditure in 2011 and 2012, strictly speaking it should also mean that an additional £5m in each of these years is transferred from the Consolidated Fund to the Stabilisation Fund.

Forecasts for income for 2010-2012 have also been revised downward slightly. This is mainly due to an amendment to the budget that removed all impôt duty increases in 2010 – reducing income by £4m a year from 2010 onwards – and lower GST revenues in 2009 being carried forward into forecast years (Figure 14). The amendment that removed all impôt duty increases was clearly against the Panel's advice in their 2009 update that decisions should not be taken to undermine the tax base. It was particularly unwise in an environment where increases in expenditure have taken place whilst significant pressures remain on the public finances.

Figure 15 gives a more comprehensive picture of the latest projections, and includes revenues that are expected to be raised from the FSR as well as the forecast balance on the Consolidated Fund.

Figure 15

Financial forecasts and timing adjustments

Source: States of Jersey Treasury

Outturn 2009 £m	Estimate 2010 £m		<--Forecast--> 2011 £m	2012 £m	2013 £m
		Income			
674	**549**	**Total States Income**	**557**	**581**	**601**
		Expenditure			
603	586	Net Revenue Expenditure	616	635	637
	23	Additional Expenditure			
38	32	Net Capital Allocation	13	14	20
641	**641**	**Total States Expenditure**	**629**	**649**	**657**
		Timing Adjustments (TA)			
46	27	Energy from Waste	11	1	
-36	31	Fiscal Stimulus	2		
		Surplus/Deficit			
33	**-92**	**Before FSR and timing adjustments**	**-72**	**-68**	**-56**
23	**-150**	**Before FSR (inc. timing adjustments)**	**-85**	**-69**	**-56**
		Fiscal Strategy Review	22	48	56
33	**-92**	**Final Surplus/Deficit (ex. TA)**	**-50**	**-20**	**0**
23	**-150**	**Final Surplus/Deficit (inc. TA)**	**-63**	**-21**	**0**
		Consolidated Fund			
51	53	Opening Balance	20	20	0
33	-92	Final Surplus/Deficit (ex. TA)	-50	-20	0
-12		Technical Adjustments			
-63		Transfer to Stabilisation Fund			
44	59	Transfer from Stabilisation Fund	50		
53	**20**	**Closing Balance**	**20**	**0**	**0**

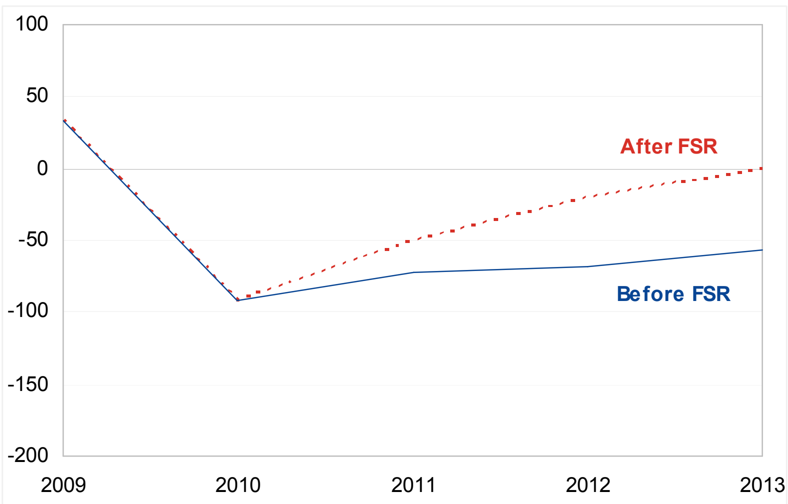
Figure 16 depicts the overall surpluses and deficits on the basis used in the Business Plan. The red line shows the path of decreasing deficits between 2010 and 2013 as revenue is raised from the measures introduced as a consequence of the FSR.

Figure 16

Forecast deficits <u>excluding</u> timing adjustments

£m

Source: States of Jersey Draft Business Plan 2011



One of the things that the Panel is interested in is the degree to which fiscal policy is counter-cyclical: that is, whether the government is helping to stabilise the economy by taking money out in times when growth is strong and putting it back in when the economy is weak. In order to assess this it is necessary to make certain adjustments to the expenditure figures in the Draft Business Plan. This is because expenditure is included in the year that it is allocated and not necessarily the year in which it is actually spent and has an impact on the economy. Two large items in particular need to be re-allocated: the first is the Energy from Waste plant, which the Panel has adjusted for on previous occasions. This time the Panel have also made an adjustment for the timing of the fiscal stimulus spending in order to get a more accurate picture of how government expenditure is supporting the economy.

While many smaller items may not by spent in the year that they are allocated, they are harder to disentangle. Given that they will be of minor significance, a decision has been made to assume that all other expenditure is spent in the year that it is allocated.

As in many other countries, there are risks to cutting expenditure and raising taxes too quickly, however the current plans do not appear to be too aggressive. The spending cuts and tax rises do not begin until 2011 by which time the economy is expected to be growing again. Further more, both spending cuts and tax increases are set to be phased in over 3 years such that the full effect – in the region of £100m (around 2.5% of GVA) – is not felt until 2013.

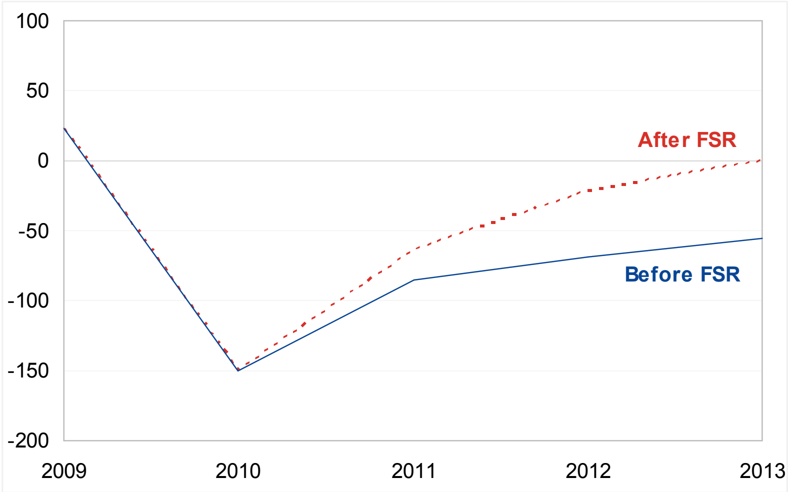
This is illustrated by the red line in Figure 17, depicting the overall fiscal stance taking into account the timing adjustments discussed above. It shows that in 2010 the States will put around £150m more into the economy than it will take out. This is equivalent to approximately 3.5% of GVA and is a good example of counter-cyclical fiscal policy. In 2011, even after taking into account spending cuts and tax increases, the States is forecast to put a net £60m into the economy (c.1.4% GVA). This net contribution decreases towards zero by 2013 as the economy recovers.

Although this suggests that, given forecasts of economic growth, there is a risk that fiscal policy could be mildly pro-cyclical in 2011 and 2012, given uncertainty around the forecasts and the fragility of the local and international economies, the Panel does not believe that this requires further action at this stage. The priority is to implement a credible medium-term strategy and should the economic and financial forecasts prove to be correct, appropriate fiscal adjustment could be undertaken in future budgets.

Figure 17
Forecast deficits <u>including</u> timing adjustments

£m

Source: States of Jersey Draft Business Plan 2011



The Panel notes that the current fiscal stance is mildly supportive of the economy. Elimination of deficits is planned to be gradual and not complete until 2013. This projected path for medium-term fiscal tightening is broadly appropriate given the Panel's previous economic forecasts but this will have to be reviewed as more data becomes available and these forecasts are updated.

4. Guiding Principles for the Medium-term

The Panel is encouraged by the moves to address the structural deficit. However, it believes it important to set out some guiding principles for Jersey as it faces up to the structural deficit and a post-crisis world. In particular:

1. **Fiscal consolidation should have regard for the consequences for economic growth**

   This principle should be at the centre of efforts both to control expenditure through the CSR and to raise additional revenue though the FSR. Spending reductions should be targeted as far as possible at interventions that improve the efficiency of the public sector and do not reduce the supply-side capacity of the economy. For example education expenditure, provided it is being spent effectively, can raise skills and therefore the productivity of the economy in the longer term. While it might cure short-term deficits, cutting this type of expenditure could be costly in terms of longer-term prosperity.

   With respect to taxation, growth and competitiveness should also be central for the same reason. Taxes that are conducive to economic growth are those that do not negatively affect competitiveness and those that encourage supply-side investment where there is an economic rationale for doing so.

2. Focus now should be on a credible medium-term fiscal plan

As Jersey has no debt, it does not have to be concerned about adverse financial market reactions to its fiscal policy decisions. However, it should still have a credible medium-term fiscal strategy. Not only is this prudent macroeconomic management but also it is likely to help build confidence in the economy and attract investment.

A commitment to tightening control on expenditure and to bring the budget back into balance over the medium-term is probably sufficient at this stage given the uncertainty about the economic and financial outlook. However, as time progresses and the outlook becomes more certain, this advice will be adjusted accordingly.

3. Plan to run surpluses once the economy recovers to rebuild the Stabilisation Fund

Running deficits over the cycle is not sustainable or consistent with the Fiscal Framework. For the Fiscal Framework to work properly, surpluses in the good times need to be saved so that they can be used to support the economy in the lean times. Therefore at the very least, a balanced budget needs to be run over the economic cycle, which means running sufficient surpluses in the good times to cover deficits in downturns.

Some countries go further than this and aim for a surplus over the economic cycle. Sweden is a good example of this, as its legislation requires that it runs a surplus over the economic cycle of 1% of GDP. Its Fiscal Policy Council recommends that two measures are used to assess the balance over the cycle: a backward-looking indicator that measures the degree of surplus over past economic cycles, and a forward-looking indicator – based on forecasts – that measures the likely degree of surplus over future economic cycles.[4]

While the Panel is not recommending an explicit target for surpluses over the economic cycle, or that ways of measuring this need to be developed, it

[4] Swedish Fiscal Policy Council Report 2010, available at www.finanspolitiskaradet.se

endorses the principle of looking at the financial position over the cycle rather than from year to year or over a set planning period.