

Jersey's Fiscal Policy Panel

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

Fiscal Stimulus

Thank you for your letter dated March 13 2009. The Fiscal Policy Panel's role is to give you and States members independent economic advice on matters relating to tax and spending policy and in particular on the use of the Stabilisation Fund. Your questions are both appropriate under the terms of the new Fiscal Framework and justified given the rapid changes in the global economy since our last report in November. In these extraordinary economic times, it makes sense that we should update that advice.

We address the key issues you raise below but would first point out that we operate within the confines of the limited data that is available on both the economic

performance and the fiscal outlook, compounded by the back drop of the most uncertain economic times in recent history.

Economic Conditions

During our visit to the Island earlier this month we met with many businesses and their representatives. We also had the opportunity to discuss the new economic forecasts produced by the Economics Unit. Our preliminary findings are that economic growth in 2008 is likely to have been close to our forecast of 3% year on year. More importantly, the outlook for 2009 has deteriorated more sharply than we had expected previously.

The key points are:

- IMF forecasts have been further revised down and now predict that the world economy will shrink in 2009.
- Financial market turmoil continues.
- With the prospects for the global economy and financial markets bleak, the performance of the financial services industry in Jersey is likely to be weaker than previously thought and this is compounded by the impact of low interest rates on the profitability of the banking sector.
- The discussions we had with Jersey businesses to complement the information provided by Economic Development suggest that key sectors such as retail, construction and tourism will see a fall in activity this year.
- Consumer confidence is likely to have fallen.
- There are recent signs that housing market activity has stalled.

The Panel's best judgement, on the basis of the limited data that is available, is that Jersey will experience a significant cyclical downturn this year which will put Island jobs at risk. There is real likelihood that the economy will decline further in 2010. There is of course significant uncertainty around the Jersey economic outlook, particularly in such uncharted waters.

Fiscal Policy

If our assessment of the economic outlook is correct, such conditions merit offsetting policy action, which the Stabilisation Fund, as part of the new Fiscal Framework, is designed to facilitate.

Discretionary Policy

You asked for advice on whether use of discretionary policy is appropriate, given the economic conditions facing the Island. We consider that discretionary policy is necessary, if your intention is to mitigate the adverse effects of the international crisis on the Jersey economy in the near term.

Discretionary fiscal policy action has already been put in train across the globe. The packages range in size considerably. The IMF has recently estimated that the measures announced in the US amount to nearly 5% of GDP. Those in the UK and France amount to around 1.5% over a two year period.

Given the lack of economic data and the uncertainties related to the effects on the Jersey economy of any given fiscal stimulus, the Panel is not in a position to quantify the size of the stimulus that is appropriate for Jersey. It would however note that measures amounting to 4% of GVA over a two to three year period would amount to £160 million which is about the amount currently in the Stabilisation Fund. It is also worth bearing in mind that in a small open economy like Jersey there will be a risk that any stimulus put into the economy by the States will quickly leak out of the economy through spending on imports. This is primarily a result of the nature of the Jersey economy and may mean that any given policy is less effective than would be the case in larger economies.

The Panel cautions that any discretionary policy action should not allow the States to be distracted from its longer term strategy. The short-term impact of the downturn on

States finances will be exacerbated by lower profitability in the banking sector due to lower spreads as a result of extremely low interest rates. Meanwhile the longer-term picture is clouded by the added uncertainty resulting from the unknown length of the downturn and the risk that a new financial world may be less conducive to offshore business. The preliminary forecasts that we have seen from the Treasury and Resources Department show not only a significant deterioration in the States finances going forward as a result of the economic cycle but also a risk that once the economy recovers the States could be running a structural (i.e. underlying) deficit. This reinforces the necessity to ensure that any policy actions are truly counter cyclical and meet the “3Ts” outlined below. Priority should be given to ensuring that they do not aggravate medium-term fiscal problems either by narrowing the tax base or widening the expenditure base.

It is important to get the timing and content of any discretionary policy right. Although the cyclical impact of the downturn on the States finances will fall mainly in 2010 and 2011, the time to act is now.

Policy Options

The key criteria that should be applied in determining discretionary actions are, as you mentioned in your letter, the 3Ts. That is, policy should be:

- **Timely.** Action should start immediately to have an impact as quickly as possible and ideally within the next 6 to 9 months.

- **Targeted.** Policy should hit the intended target whether it is to support activity and employment in the Island, support those most adversely affected by the downturn or implement projects which have intrinsic benefit.

- **Temporary.** There should be no negative long term implications for the public finances, i.e. no long term damage to the tax base and no long term spending commitments.

You asked for further advice on six policy options that either you might be considering or might be put forward by other States members. Each of the policy options you put forward is considered in turn below.

1. Supporting people on low incomes

This type of policy can be timely, provided that the income support system can be altered quickly. It is by definition targeted on the least well off and therefore those who are most likely to spend. However, it is difficult to see how such a measure would be temporary as it would be hard to reverse such a decision unless it was directed only to the newly unemployed.

2. Direct tax cuts

Given the lags in the Jersey tax system it is hard to see how such a policy could be timely and impact in 2009, without being complex. It may also be harder to target the less well off or those worst affected by the downturn because quite simply they may not pay tax. It would then be less effective at holding up demand in the economy than direct support for the less well off. A pre-announced commitment to reverse the cut would be essential to meet the temporary criterion, but this is unlikely to be credible, and without a credible commitment, this proposal carries a serious risk of aggravating medium term budget problems.

3. Indirect tax cuts

This type of tax change could be timelier than a direct tax change. But such a tax change would not be well targeted as it would benefit everybody, rather than those most

likely to spend on the Island. It would be less effective at holding up demand in the economy than direct support for the less well off. Furthermore a pre-announced commitment to reverse the cut would be essential to meet the temporary criterion, but is unlikely to be credible.

Like direct tax cuts, this option carries a serious risk of aggravating medium term budget problems and a real risk of undermining the tax base. Changes to GST so soon after introduction should be avoided.

4. Spending on skills/training

This option may be timely, especially if it only requires changes to existing policies. Spending on the programme itself has immediate benefits. It can be targeted on Jersey residents, those losing their jobs or low income groups. If measures also included support payments to participants, these could be targeted towards those most likely to spend. Care would have to be exercised to ensure that those elements of such schemes that do not bring lasting benefits could be made credibly temporary.

Investment in skills – if done effectively - should bring lasting economic benefits beyond the life of this downturn. Improving the skills base is important for supporting future productivity and economic growth. However, there will be permanent budgetary implications.

5. Additional infrastructure/maintenance expenditure

If these options are to meet the timely criteria, then it is vital that projects are identified that are ready to go in the next few months i.e. are 'shovel ready'.

The most likely projects to meet this requirement are maintenance expenditure. Such measures should also meet the targeting criterion since maintenance projects are likely to utilise local labour. The scale is dependent on the amount of spare capacity in the

local construction sector. It is important to avoid excess demand pushing up prices. Making sure maintenance of the infrastructure (including public housing stock, schools, and hospitals) is up to date and bringing forward maintenance scheduled for the near future does not increase the overall cost to public finances, and so meets the temporary criterion.

Large infrastructure projects may struggle to be timely. They score better on the targeting criterion as it should be possible to target such spending on supporting local employment in the Island and the scale of the intervention should consider the amount of spare capacity in the local construction sector. Any such interventions should be designed to be temporary, and each policy should be assessed for any future expenditure commitments such as ongoing maintenance or further investment.

As maintenance and infrastructure investment leads to improvements in the stock of States assets, it can be considered as an investment in the supply-side of the economy that will bring returns beyond the life of this downturn. The basic question to address is do the projects have intrinsic merit?


6. Small business support

This option may be timely especially if it only requires changes to existing policies. Policy could be targeted on businesses particularly affected by this downturn for example by focusing on those that are not able to obtain or maintain credit solely as a result of problems in the financial sector. Policy would have to be designed carefully to be temporary and not stand in the way of inevitable structural change.

We hope that these answers to the questions you pose are informative and assist you in developing your proposals for a fiscal stimulus package for Jersey. We will of course expand on many of the issues we raise in this letter in our annual report when it is published on May 5 2009. We hope that too will assist you and other States members

in agreeing the policies that are in the best interests of the Jersey economy and Islanders.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Joly Dixon', with a horizontal line extending from the end of the name.

Joly Dixon (Chairman)