Jersey's Fiscal Policy Panel Annual Report
November 2009 Update

Key Points

- There has been some improvement in the global economic environment since the Panel published its Annual Report in May, but the Panel does not believe that it has reason to revise its central estimate of the outlook for the local economy. Given that a significant fall in banking profits is expected, combined with the prospect of tough trading conditions for the rest of the economy, the Panel is now more confident in its expectation that GVA will fall significantly in 2009 and fall slightly further in 2010. However the Panel believes there is less downside risk to its projections than there was at the time of the Annual Report.

- The Panel notes a larger fiscal deficit is forecast for 2010 and 2011, as a consequence of higher planned States' expenditure than previously envisaged. The Panel urges the States to tackle the deficit and especially not to worsen the position further by increasing spending or reducing income.

- The Panel notes that the Consolidated Fund balance is expected to end 2009 at £43m. In its 2009 Annual Report, the Panel recommended that any excess in the Consolidated Fund above £20m be transferred to the Stabilisation Fund as and when it materialised. However, the excess balance on the Consolidated Fund has not been transferred to the Stabilisation Fund and has instead largely been used to fund additional discretionary spending, which is not consistent with the Panel's previous advice. This may be mitigated to some extent if planned capital expenditure is reduced from 2011, as proposed in the draft Budget.

- As the Stabilisation Fund is expected to be largely exhausted by the end of 2011, no further withdrawals from the Stabilisation Fund are possible. Nor would they be appropriate unless the economic downturn were to be deeper, more prolonged, or have a greater impact on the public finances than previously envisaged. The depleted balance in the Stabilisation Fund risks leaving Jersey unable to respond to a worsening of the current economic downturn or to the next slowdown.

- The Panel remains concerned that much of the deficit may be structural, but is encouraged by moves to develop a strategy to address this, as well as moves to strengthen medium-term control of budgets. However, the Panel will continue to monitor developments on both these fronts with keen interest.

- There remain some very significant pressures that could affect the public finances adversely in the medium- to long-term. The Panel stresses that these must be considered when making decisions concerning revenues and expenditure today. Decisions that undermine the tax base or commit to greater future expenditure should be avoided.

Recommendations

- The Panel does not recommend any transfers into the Stabilisation Fund at this stage, but believes it is vital that fiscal discipline is strong enough to replenish the Fund. Using the Stabilisation Fund for purposes other than to mitigate the impact of an economic downturn should be avoided.
- The purpose of the Strategic Reserve was clarified by the States in December 2006, when it was agreed that it should only be drawn upon in exceptional circumstances, such as the collapse of a major Island industry or a major natural disaster. Given that, the Panel does not recommend any withdrawals from, or transfers into, the Strategic Reserve at this point.
- The Panel recommends that the fiscal stimulus should continue to be implemented. Economic conditions should be kept under review, but the current evidence points to a clear downturn in the economy. The fiscal stimulus should help offset some of the adverse consequences of the downturn. The Panel continues to believe it is vital that the stimulus is timely, targeted and temporary, focussing on projects that represent value for money and are of intrinsic value. The Panel is encouraged that the well-designed evaluation and monitoring process should help ensure that the fiscal stimulus meets its objectives.

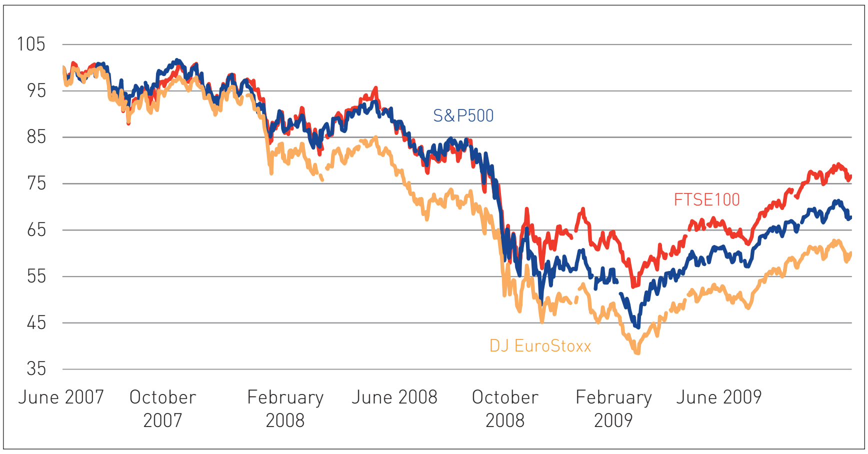
Section 1: Economic Developments

Developments in the global economy

There has been some improvement in the global economic environment since the Panel published its Annual Report in May. Stock markets have rallied from their March trough (Figure 1.1), economic activity has begun to stabilise in some of the major economies and is expected to begin growing again before the end of the year. The latest IMF forecasts for 2009 do not differ significantly from those issued in April, although growth is expected to be slightly stronger. Expectations for world growth in 2010 have been raised by around 1 percentage point, to 3%.

While the outlook is generally more optimistic, there remain plenty of reasons for caution. The consensus expectation is that the recovery in growth will be subdued for the next few years as lenders are more cautious and as households, firms and financial institutions rebuild their balance sheets. Some economists fear a 'double-dip', in which economic activity picks up slightly but falls again soon after, and while this is not the consensus expectation, it remains a risk.

Figure 1.1:
Stock markets have rallied since March
Index, 4th June 2007=100
Source: Yahoo! Finance



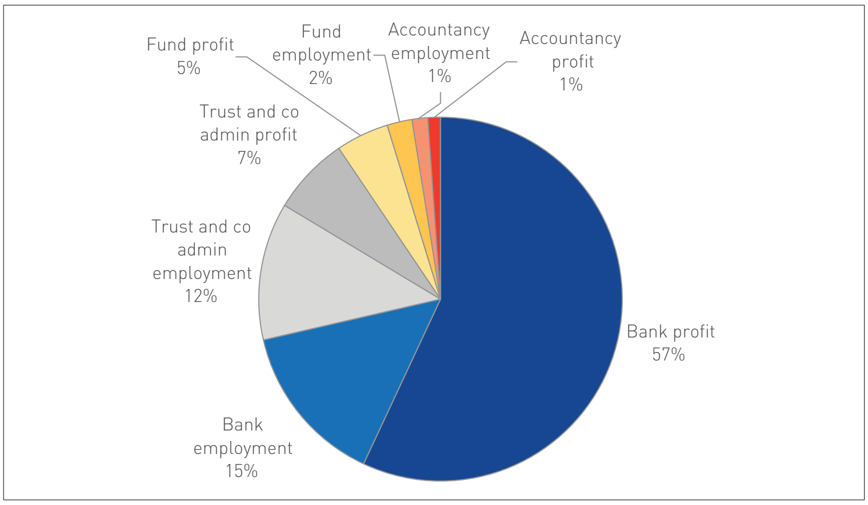
Local economic outlook

GVA growth in 2008 was 2%, slightly below the Panel's estimate in its Annual Report of 3%, but not a significant surprise. The finance sector, a major driver of overall economic performance, saw real growth of just 1%, down from 9% in 2007. The majority of the other sectors saw growth between 1 and 3%. Only Wholesale & Retail and Transport & Communication saw declines in real terms.

Looking forward, despite the greater optimism in the global economic environment, the Panel continues to believe a decline in real GVA in Jersey in 2009 and 2010 remains the most likely scenario. Having assessed the latest economic data and met with representatives from the major industries in the Island, it does not believe that it has reason to revise its central estimate of the outlook for the local economy, although it has revised its assessment of the risks around that estimate.

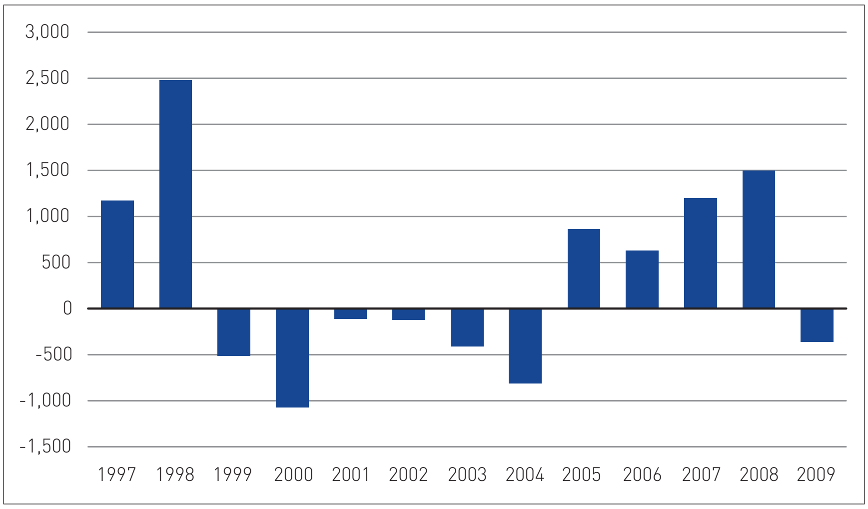
Since the Panel's last report, the Survey of Financial Institutions has been published by the Statistics Unit. This surveyed firms in the first half of the year and showed a very mixed outlook for the sector as a whole in 2009, with banks in particular appearing downbeat. The situation does not appear to have changed much in the intervening months. Although certain types of activity appear to have held up or even seen growth through the downturn – for example litigation – profits from banking have been hit hard as a consequence of low interest rates (as described in Box 1 in the Panel's 2009 Annual Report) and aggressive competition for deposits. While this may have been offset to some extent by growth in income from other activities, net interest income has tended to make up around 70-80% of the income of the Jersey banking sector,[1] so other activities are unlikely to have been sufficient to counteract the fall from interest rate margins. Furthermore, bank profits make up around 57% of financial sector GVA (Figure 1.2).

Figure 1.2:
Bank profits make up 57% of financial sector GVA in 2007
Source: States of Jersey Statistics Unit



Conditions in the finance sector, together with general uncertainty and falling employment, is likely to mean the rest of the economy will see difficult times in the next 12 months. Both retail sales and new car registrations have fallen since last year. The number of visitors to Jersey between January and September 2009 was down on the same period in 2008. The Business Tendency Survey for September 2009 suggested firms in the finance and non-finance sectors had become more pessimistic about profitability and employment than they were three months previously. The latest available employment data, which relate to June of this year, showed that the labour market had weakened: total employment declined in the 12 months to June 2009 for the first time in 5 years (Figure 1.3). This corroborates the story told by the rise in unemployment. The latest available information shows that house prices have so far held up, but turnover remains low, suggesting that perhaps confidence remains depressed.

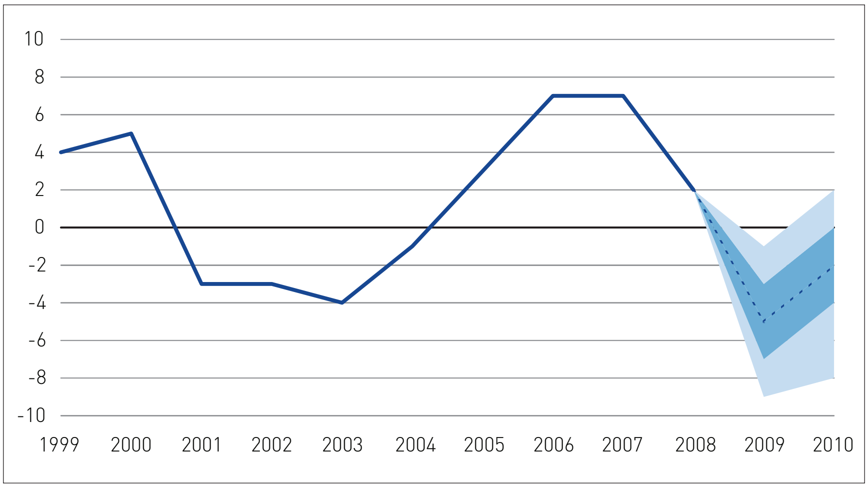
Figure 1.3:
Total employment fell in the 12 months to June 2009, the first such fall since 2004
Change in total employment (June-June)
Source: States of Jersey Statistics Unit



[1] IMF (2009), Financial System Stability Assessment Update: Jersey

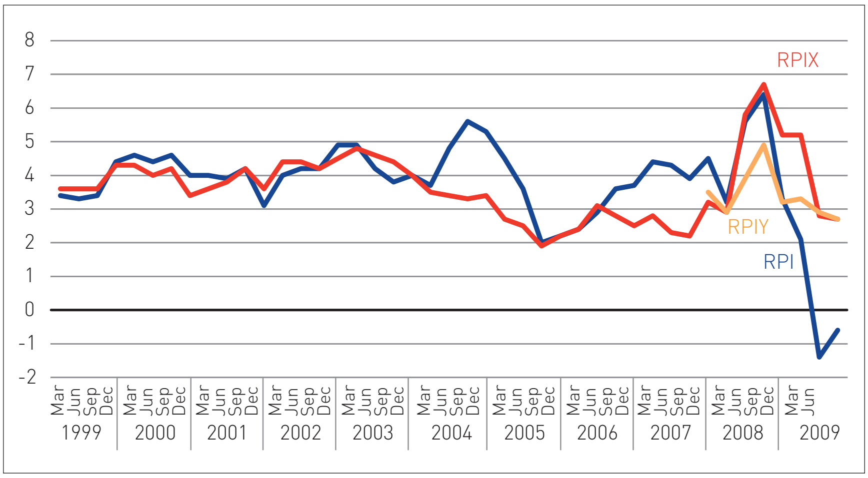
The Panel's current outlook is summarised in Figure 1.4. It is similar to that in the Annual Report, although there are some important differences. The central expectations for 2009 and 2010 are unchanged, but the risks around them have been re-evaluated. Given that a significant fall in banking sector profits is expected, combined with the prospect of tough trading conditions for the rest of the economy, the Panel is more confident in its expectation that GVA will fall significantly in 2009. However the Panel also believes there is less downside risk than there was in the Annual Report in both 2009 and 2010.

Figure 1.4:
Real GVA expected to contract in 2009 and 2010
% change on previous year
Source: States of Jersey Statistics Unit and Panel's forecast



The Panel remains sanguine about the inflation outlook. The growth rate of the RPI – the headline rate cuts reducing mortgage interest payments (MIPS) and the effect of GST falling out. RPIX (RPI excluding MIPS) inflation has also fallen due to the latter. RPIY inflation – which excludes both MIPS and indirect taxes like GST – is the best indicator in the current circumstances. This saw a slight rise during 2008 as a result of food and fuel prices, but has fallen again to come broadly in line with the States' 2½% inflation target (Figure 1.5) and is expected to remain close to target for the near future. The Panel anticipates neither a sustained period of falling prices nor significant upside risks to inflation.

Figure 1.5:
Underlying inflation is broadly in line with target
Annual % change
Source: States of Jersey Statistics Unit



Section 2: Public Finances

In its Annual Report, the Panel included financial forecasts from Budget 2009, adjusted for the estimated impact of the economic downturn. Since then, there have been two major developments: the Business Plan 2010, which contained new plans for States' expenditure; and the draft Budget 2010, which contained new forecasts for States' income.

Business Plan 2010

Figure 2.1 shows the forecast for total States' expenditure. At the time of the Panel's Annual Report, total States' expenditure was expected to rise steadily from £597m in 2009 to £651m in 2013.

Since then, the Business Plan has been prepared. In 2009, total States' expenditure is expected to be broadly in line with the previous estimate. Within the total, though, there were counterbalancing changes: additional unbudgeted spending approvals of £5m have been largely offset by a £4m saving from the public sector pay freeze. The Panel understands that there are further potential expenditure approvals for 2009, which would significantly worsen the fiscal position if adopted without offsetting savings.

In 2010, total States' expenditure is currently expected to be £14m higher than previously estimated. Within this, net revenue expenditure is slightly higher and the net capital expenditure allocation is much higher than previously planned. The Council of Ministers proposed additional net revenue expenditure of £17m and offsetting savings of £17m in the draft Business Plan. But amendments to the Business Plan passed by the States added £2m to net revenue expenditure. The expenditure total in Figure 2.1 also includes £12m additional net capital expenditure, of which £10m is for the creation of a new town park.

From 2011 onwards, total States' expenditure is expected to be higher than previously planned, although the Treasury and Resources Minister has confirmed his intention to re-prioritise existing capital expenditure plans in the 2011 Business Plan to reduce them by the equivalent of the cost of the town park.

Draft Budget 2010

Figure 2.1 also shows the forecasts for total States' income. At the time of the Panel's Annual Report, total States' income was expected to fall from £640m in 2009 to £555m in 2010, before gradually recovering. The decline was due to loss of income from the introduction of the 0/10 corporate tax regime and the economic downturn.

Since then, the draft Budget has been prepared, which forecasts that total States' income will be slightly higher than previously expected but follow a broadly similar pattern of a large fall in 2010, before a gradual recovery. In 2009, total States' income is expected to be £13m higher than previously estimated, mainly as a result of stronger income tax revenue. In 2010 and 2011, total States' income is expected to be slightly above the previous estimate. In 2012 and 2013, total States' income is expected to be £8m and £22m higher than previously estimated, as a result of higher income tax revenue (due to a smaller estimated loss from 0/10), higher Impôts Duty revenue (as a consequence of higher rates) and higher Stamp Duty revenue.

Overall fiscal position

Figure 2.1 summarises the changes in the States' fiscal position since the Panel's Annual Report. Reflecting the changes described above, in the central scenario the fiscal surplus is larger than expected in 2009 by £12m, but the fiscal deficit is larger by £11m at £60m in 2010 and larger by £7m at

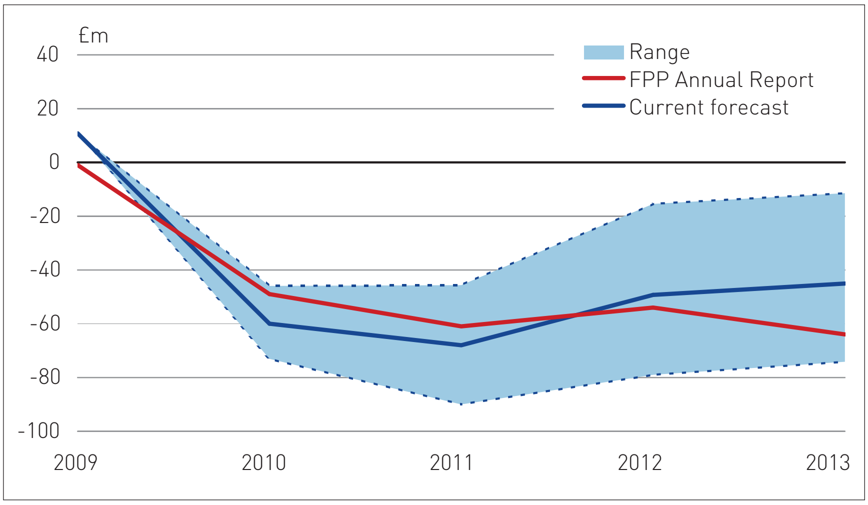
£68m in 2011. The fiscal deficit is slightly smaller than previously expected in the central scenario in 2012 and 2013, but it is still substantial at £49m and £45m. Although the scale is somewhat uncertain, because the deficit persists well beyond the two-year cyclical economic downturn expected, it is likely that much of it is structural. This is considered further in Section 4. The considerable uncertainty around the forecasts for the fiscal deficit is illustrated in Figure 2.2 by the wide range of possible outcomes in the blue band around the central scenario.

Figure 2.1:
Summary of changes in States' income, expenditure and fiscal balance
Source: Treasury and Resources

Note: £44m allocated to the Fiscal Stimulus package has been subtracted from the Revised Surplus/Deficit line for 2009

Probable estimate		Forecast			
2009		2010	2011	2012	2013
£m		£m	£m	£m	£m
	Total States' Income				
640	FPP Annual Report	555	560	582	587
653	Draft Budget	558	564	590	609
13	Difference	3	4	8	22
	Total States' Expenditure				
597	FPP Annual Report	604	622	636	651
598	Draft Budget	618	632	639	654
1	Difference	14	10	3	3
	Revised Surplus/(Deficit)				
(1)	FPP Annual Report	(49)	(61)	(54)	(64)
11	Draft Budget	(60)	(68)	(49)	(45)
12	Difference	(11)	(7)	5	19
38	Energy from Waste adjustment	33	8	2	0

Figure 2.2:
Fiscal balance projections, excluding Energy from Waste adjustment
Source: Treasury and Resources



The Energy from Waste (EfW) plant is a very large capital project, which was budgeted to cost £103m in total. The Treasury and Resources Department allocates all of the funding for a capital project in the year that it is approved. As a result, the total budgeted cost of £103m was included in the net capital expenditure allocation for 2008. But this does not represent the profile of the spending on the project. Figure 2.1 shows that large expenditure on EfW is expected to occur in 2009 and 2010, with smaller spending in 2011 and 2012. The Panel has previously focussed on the fiscal balance after making an adjustment for EfW because this better reflects the actual impact of States' spending in the economy. Including the EfW adjustment increases the fiscal surplus by £81m in 2008 (not shown in Figure 2.1) and increases the fiscal deficit by £38m in 2009 and by £33m in 2010. This expenditure has already been funded though, so it does not add to the States' financing requirement. A similar situation occurs with the discretionary stimulus expenditure: £44m was allocated in 2009, most of which will be spent in 2010.

Figure 2.3:
Consolidated Fund forecast
Source: Treasury and Resources

Probable estimate		Forecast			
2009		2010	2011	2012	2013
£m		£m	£m	£m	£m
51	Consolidated Fund opening balance	43	20	20	(29)
55	**Forecast/(Deficit)**	**(60)**	**(68)**	**(49)**	**(45)**
44	Fiscal Stimulus package	-	-	-	-
11	**Revised Surplus/(Deficit)**	**(60)**	**(68)**	**(49)**	**(45)**
(63)	Transfer to Stabilisation Fund	-	-	-	-
44	Transfer from Stabilisation Fund	37	68	-	-
43	**Consolidated Fund closing balance**	**20**	**20**	**(29)**	**(74)**

Figure 2.3 presents a forecast of the Consolidated Fund position under the fiscal deficits contained in the draft Budget. In its Annual Report, the Panel recommended that a working balance of £20m should be kept in the Consolidated Fund to cover unexpected contingencies and that any balance over this amount should be transferred to the Stabilisation Fund as and when it occurred. The aim of this recommendation was to rebuild the Stabilisation Fund and constrain future spending.

By the end of 2009, the Consolidated Fund balance is likely to contain £43m, which would be £23m of in excess of the £20m minimum necessary balance. The excess is explained by two factors: first, at the time of the Panel's Annual Report, the Consolidated Fund already had an expected excess of £11m, which the Panel recommended be transferred to the Stabilisation Fund; second, since then, the fiscal balance in 2009 has increased by £12m, due to higher States' income (as shown in Figure 2.1).

The fiscal deficit is expected to be £11m higher in 2010 and £7m higher in 2011 than expected in the Annual Report (Figure 2.1), an increase in the deficit over the two years of £18m. The deficits are larger than expected due to higher discretionary expenditure agreed in the Business Plan 2010 (as amended).

As noted, the Panel recommended that excess Consolidated Fund balances should be transferred to the Stabilisation Fund to rebuild the Stabilisation Fund and constrain future spending. In this instance, the excess balance on the Consolidated Fund has not been transferred to the Stabilisation Fund and has instead been used to fund additional discretionary spending, which is not consistent with the Panel's advice. This may be mitigated to some extent from 2011 if the spending of £10m on the town park is offset by a reduction in other capital expenditure, as is proposed in the draft Budget.

In its Annual Report, the Panel recommended that the Stabilisation Fund should be used to cover the fiscal deficits thought likely to arise in 2010 and 2011 as a result of the expected contraction in the economy in 2009 and 2010, which totalled £112m at that time. The Panel continues to consider that the Stabilisation Fund should be only used to cover the fiscal deficits that occur in 2010 and 2011 as a result of the economic downturn. The draft Budget proposes transfers from the Stabilisation Fund of £37m in 2010 and £68m in 2011. Allowing for this, and the fiscal stimulus of £44m allocated in 2009, the Stabilisation Fund, which had a balance of £156m at the beginning of 2009, is now budgeted to be run down to just £7m by the end of 2011. If additional discretionary spending had not been approved in the Business Plan 2010 (as amended), the remaining balance on the Stabilisation Fund would have been higher.

In the absence of measures to offset the fiscal deficits, the Consolidated Fund would record a negative balance from 2012 onwards. Under the Public Finances (Jersey) Law 2005, it is not permitted for the Treasury and Resources Minister to propose a budget in which the Consolidated Fund balance is expected to be negative at the end of the budget year. The Panel notes that the Treasury and Resources Minister has announced that, if this situation materialises, he will address it in the Budget 2011.

The Panel notes a larger fiscal deficit is forecast for 2010 and 2011, as a consequence of higher planned States' expenditure than previously envisaged. The Panel also notes that it is planned to use the Consolidated Fund to finance these larger deficits. The Panel urges the States to tackle the deficit and not to worsen the position further by increasing spending or reducing income.

As the Stabilisation Fund is expected to be largely exhausted by the end of 2011, no further withdrawals from the Stabilisation Fund are possible. Nor would they be appropriate unless the economic downturn were to be deeper, more prolonged, or have a greater impact on the public finances than previously envisaged. The depleted balance in the Stabilisation Fund risks leaving Jersey unable to respond to a worsening of the current economic downturn or to the next slowdown. It is therefore vital that fiscal discipline is strong enough to replenish the Fund.

The purpose of the Strategic Reserve was clarified by the States in December 2006, when it was agreed that it should only be drawn upon in exceptional circumstances, such as the collapse of a major Island industry or a major natural disaster. Given that, the Panel does not recommend any withdrawals from, or transfers into, the Strategic Reserve at this point.

Section 3: Fiscal Stimulus

On 13 March 2009, the Treasury and Resources Minister wrote to the Panel, asking whether economic conditions justified the use of the Stabilisation Fund for a discretionary fiscal stimulus. On 26 March 2009, the Panel replied, concluding that on the evidence available, it would be appropriate to draw down from the Stabilisation Fund to help mitigate the adverse effects of the economic downturn. The Panel stressed the importance of any fiscal stimulus measures being timely, targeted and temporary – the 'three Ts'. The Panel also noted the need to ensure that specific projects represented value for money and were of intrinsic value.

Since the Panel's Annual Report, the States approved the Economic Stimulus Plan on 19 May 2009 and the Corporate Services Scrutiny Panel published its report on the stimulus, which endorsed the plan subject to some provisos, on 10 June 2009. There have also been developments in economic conditions, the stimulus process and the stimulus projects.

Economic conditions

Local economic conditions, described in Section 1, appear to be evolving in line the Panel's expectation earlier in the year. The Panel's forecast remains that Jersey will see a contraction in real GVA in both 2009 and 2010. The Panel believes that, given the evidence on the economic outlook, it remains appropriate to draw down from the Stabilisation Fund to provide a discretionary stimulus. The Panel previously noted that the proposal to use £44m for the stimulus was consistent with its advice to implement a significant stimulus. The Panel has seen no evidence to cause it to change that advice.

Stimulus process

The Panel notes the process put in place by the Treasury and Resources Minister to ensure that stimulus projects meet the objectives, which is summarised in Box 1.

Box 1: Process for fiscal stimulus bids

1. The project sponsor, such as a States department, submits a stimulus bid with a business case.
2. Treasury and Resources Department officers score the project against six criteria (timely, targeted, temporary, value for money, economic benefit and achievability).
3. The Fiscal Stimulus Steering Group of senior States officials challenges the scores and the business case for each project, awarding amber light (provisional) status to appropriate projects.
4. The project sponsor provides any follow-up information requested by the Fiscal Stimulus Steering Group to allow it to make an informed assessment of the project.
5. Subject to satisfactory follow-up information, the Fiscal Stimulus Steering Group recommends giving the project green light (committed) status to the Treasury and Resources Minister.
6. The Treasury and Resources Minister has the opportunity to further challenge the project, before he awards it with a green light.
7. The Fiscal Stimulus Steering Group also monitors implementation once a project is underway.

This process is supported by dedicated resources in the Treasury and Resources Department. The Panel believes that this is a thorough and well-designed process that should help ensure that the fiscal stimulus meets its objectives.

The Panel understands that the Steering Group is considering evidence on the amount of spare capacity in the sectors of the economy that would be directly delivering the stimulus. This, and the phased approval of projects, is important to avoid projects pushing against capacity limits and so avoid creating inflationary pressure.

Stimulus projects

Figure 3.1 summarises the current position of the fiscal stimulus. So far, projects totalling £7m have been given a green light (committed), while projects totalling £40m have been given an amber light (provisional). The total cost of all possible projects is £47m, although some amber light projects might not eventually be given green lights, if they are not timely enough for example, and the total fiscal stimulus implemented will not exceed the £44m approved by the States. Although the fiscal stimulus of £44m was allocated in 2009, most spending is likely to occur in 2010 and some spending is likely to occur in 2011.

In its Annual Report, the Panel supported in general terms the priorities set for the fiscal stimulus of: maintenance and infrastructure spending; supporting those most affected by the downturn; and business and skills support. The range of projects summarised in Figure 3.1 is consistent with this advice. The Panel is encouraged that the fiscal stimulus is focussed on investment, in skills and infrastructure, both of which should bring lasting economic benefits, beyond the life of the downturn.

Figure 3.1:
Fiscal stimulus situation report

	Committed "Green Light" £	Provisional "Amber Light" £	Total £	%
Skills and training	1,896,950	6,429,800	**8,326,750**	18
Support for individuals	1,490,300	-	**1,490,300**	3
Support for business	1,000,000	480,000	**1,480,000**	3
Civil infrastructure works				
Highways	1,928,452	2,578,548	**4,507,000**	10
Drainage	15,000	2,063,000	**2,078,000**	4
Sea Defences	70,000	1,430,000	**1,500,000**	3
	2,013,452	6,071,548	**8,085,000**	17
Construction and maintenance works				
Maintenance backlog - States property and Social Housing	133,200	11,346,800	**11,480,00**	24
Replacement/refurbishment projects	-	975,000	**975,000**	2
Construction capital projects	-	15,022,838	**15,022,838**	32
	133,200	27,344,638	**27,477,838**	58
Programme management	200,000	-	**200,000**	0
Total	6,733,902	40,325,986	**47,059,888**	100

The Panel recommends that the fiscal stimulus should continue to be implemented. Economic conditions should be kept under review, but the current evidence points to a clear downturn in the economy. The fiscal stimulus should help offset some of the adverse consequences of the downturn. The Panel continues to believe it is vital that the stimulus is timely, targeted and temporary, focussing on projects that represent value for money and are of intrinsic value. The Panel is encouraged that the well-designed evaluation and monitoring process should help ensure that the fiscal stimulus meets its objectives.

Section 4: Medium-Term Outlook

One of the Panel's five guiding principles – set out in its Preliminary Report in April 2008 – is that fiscal policy should be focussed on the medium-term. The Panel believes it important to stress a forward-looking approach to budgeting, with an eye on the medium- and long-term as well as the immediate future, and using this to ensure contingent plans are in place to react to events as they occur. Another of the principles is that sound fiscal management requires running budgetary positions that are consistent with macroeconomic stability and economic growth. This means avoiding persistent budget deficits that would be unsustainable in medium-term.

In practical terms, this requires two things. Firstly, spending priorities must be fully financed from tax revenues. This does not mean that budgets must be always in balance, but it does mean that committing to expenditure greater than that which can realistically be raised from tax revenues over the course of an economic cycle should be avoided. Secondly, it requires flexibility to adapt to shocks and changing circumstances, both unforeseeable and predictable.

The current fiscal framework is designed to facilitate this. Used appropriately, the two reserve funds – the Stabilisation Fund and the Strategic Reserve – allow the flexibility to react to both temporary and more persistent shocks, while at the same time constraining discretionary expenditure that is not funded from ongoing tax receipts.

Structural balance

Despite changes in the global economic situation, the fiscal outlook has not changed much since the Panel wrote its Annual Report in May. The financial forecasts still suggest the possibility of a structural deficit. Economic downturns are not the time to rein in public expenditure or raise taxes, since this would harm the economy further. However, in order to avoid the running down of reserves or resorting to borrowing, the Panel continues to recommend that a strategy be put in place by the end of the year for addressing a structural deficit should one arise. Announcements of a Fiscal Strategy Review and a Comprehensive Spending Review by the Treasury and Resources Minister are positive developments, and discussions with officials in the Treasury have reassured the Panel that work on these is well underway. The Panel will be following developments closely.

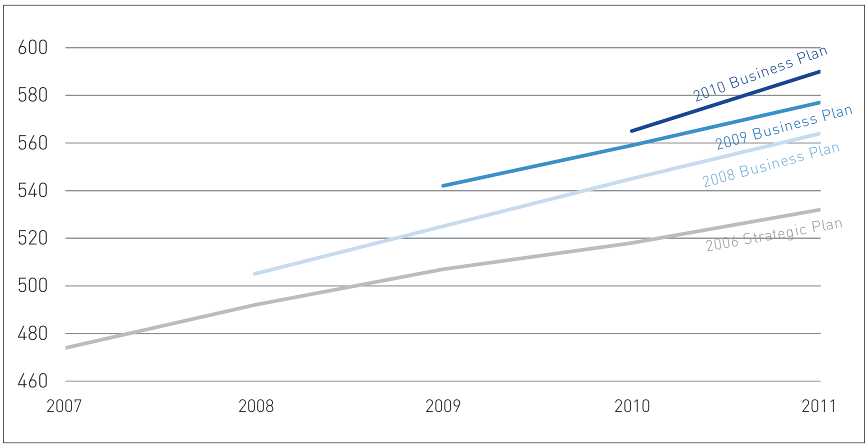
Expenditure control

Business plans and budgets should be a credible statement of government intent. Generally the States does well in terms of spending within annual budgets, but it is much less good at remaining within Business Plan spending envelopes. Although Business Plan figures for 2-3 years ahead are meant to be indicative rather than binding, the Panel is concerned that consistent upward drift potentially creates structural problems in the medium term where these increases are not matched by commensurate structural increases in revenues.

Figure 4.1 illustrates this trend. It can be seen from this that expenditure in 2011 was envisaged to be around £530m in the 2006 Strategic Plan, but by the 2010 Business Plan this had grown to £590m – an increase of £60m, or 11%.

To the extent that this drift is the result of expenditure that is not adequately resourced from structural increases in revenue, it is likely to be storing up problems further down the line, regardless of the cause of the drift. However, it is helpful to distinguish between three types of event: those that are external and foreseeable, those that are external and unforeseeable, and those changes that are internal or discretionary. These three different causes require quite different responses. Where this drift is caused by foreseeable events that have not been appropriately planned for, it is a weakness in forward planning

Figure 4.1:
Expenditure drift between 2006 Strategic Plan and 2010 Business Plan
Net revenue expenditure, £m
Source: Treasury and Resources



and risk management. Where it is due to unforeseeable, unavoidable events, it is inevitable, but it is the Panel's contention that a small financial contingency should be built into future years to allow for such events. Where drift is the result of discretionary expenditure that is not funded by reprioritisation or savings elsewhere, it would be of concern to the Panel.

The Panel is encouraged by proposals to strengthen medium-term budgeting and expenditure prioritisation capacity as recently announced by the Treasury and Resources Minister. The Comprehensive Spending Review should enable a separation of the different types of spending pressures and allow them to be managed appropriately. The Panel will follow these developments with interest, and will comment further as and when more details are confirmed.

Long-term pressures

As the Panel has noted on previous occasions, there are a variety of foreseeable pressures that are likely to affect the Island and its public finances in the medium- and longer-term that need to be considered. The appropriate response to these pressures is to look ahead and plan for them, and ensure that they are factored into decisions around revenue and expenditure today.

On the expenditure side, the ageing population and need for significant infrastructure spending (for example in waste management and property maintenance) are the main concerns. An ageing population generally means lower tax revenues, as there are fewer people of working age, and higher expenditure on public services such as healthcare and pensions. Significant infrastructure expenditure, while not necessarily an ongoing cost, needs to be financed somehow. These pressures are acknowledged in the Strategic Plan and 2010 Business Plan.

There are also significant risks to revenue. The Panel noted in its Annual Report that pressure on financial centres stemming from the aftermath of the financial crisis might require changes to the 0/10 tax system or result in action to reduce offshore activity. Such events could reduce the tax base permanently, making it more difficult to raise revenue. Recent developments suggest that the EU is unlikely to accept that Jersey's current business tax system complies with its code on harmful tax practices. Although it is too early to say for certain, this could mean that Jersey must make changes to the way it taxes businesses, which could have significant impacts on the public finances in the future. The Panel are encouraged that recent statements from Ministers already indicate that the research is underway to respond to these new challenges.

Finally, lower than expected productivity growth could mean slower than expected growth in the tax base, which would make raising revenue more difficult.

The Panel remains concerned that a large portion of the current deficit might be structural, but is encouraged by moves to develop a strategy to address this, as well as moves to strengthen medium-term control of budgets. However, the Panel will continue to monitor developments on both these fronts with keen interest.

There remain some very significant pressures that could affect the public finances adversely in the medium- to long-term. The Panel stresses that these must be considered when making decisions on revenues and expenditure today. Decisions that undermine the tax base or commit to greater expenditure should be avoided.