Jersey's Fiscal Policy Panel Annual Report

November 2021

Introduction

This is the fourteenth annual report of the Fiscal Policy Panel (FPP). The current members of the Panel are:

Dame Kate Barker (Chair, appointed 2014),
Professor Francis Breedon (appointed 2016),
Professor Richard Davies (appointed 2018).

The Panel was placed on a statutory basis in 2014. The FPP's statutory role was reiterated in the Public Finances Law (2019), which requires the Panel to comment on Jersey's fiscal policy with reference to:

a. the strength of the economy in Jersey;
b. the outlook for the economy in Jersey;
c. the outlook for world economies and financial markets;
d. the economic cycle in Jersey;
e. the medium-term and long-term sustainability of the States' finances and the States' financial assets and liabilities;
f. the advisability of transfers to or from the Strategic Reserve Fund 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 government 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.

In preparation of its reports the Panel has discussions with policymakers, business owners and managers, and representatives of public and private sector workers. The Panel is also grateful for the invaluable support provided by the staff of the Government of Jersey, in particular the Economics Unit and Treasury and Exchequer.

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

Key points

Economic Outlook

- The Covid-19 disruption to the local and global economies continued in 2021, with many restrictions that had previously been eased being reinstated as second and third waves of the pandemic took hold. The success of vaccination programmes and reduced restrictions have led to a quick recovery in demand, but supply remains temporarily restrained.
- World economic growth is projected to reach 5.9% in 2021, with the IMF upgrading many of its forecasts over the last year. The widespread success of vaccination programmes across advanced economies has led to an improved economic outlook for these nations. Emerging economies facing limited access to vaccines and health care resources have not seen similar upgrades in their economic forecasts.
- Jersey's economy contracted 8.7% in 2020, with much of this driven by reduced profits in the financial services sector, which saw an 11% fall in real terms GVA. The record low UK Bank Rate has impacted the net interest income received by the banking sector. Non-finance sectors, particularly hospitality, also saw significant falls in output – driven by public health restrictions.
- Registered unemployment numbers point to a gradual return to pre-Covid levels of unemployment, whilst vacancies are rising above 2019 levels.
- The recession and subsequent recovery have been uneven between sectors, with those that rely on social contact experiencing a sharper decline and more gradual recovery. The hospitality industry saw the most severe decline in GVA (45%) and has been affected by continued public health restrictions into 2021.
- Inflation outpaced earnings growth, leaving a decrease in real terms income of 0.2% in the year to June 2021.
- Jersey's housing market has seen a rapid increase in prices, similar to many advanced economies, with house prices rising 17.9% in the year to June 2021.
- Jersey's government provided significant support to the economy over the past 18 months, in particular supporting employment in non-finance sectors. This support is becoming more targeted, for example the Co-Funded Payroll Scheme supported around 650 jobs in September 2021, compared to 16,240 in April 2020.
- The economy is expected to be smaller in the long run than it would have been had it followed the path of the pre-pandemic forecast, though the Panel's latest estimate of structural scarring is less than previously indicated.

Public Finances

- The economic outlook remains uncertain. Whilst impacts on government revenue over the past year are now clearer, the future course of the Covid-19 pandemic is uncertain and a requirement for further stimulus could still occur. The Panel recognises that it therefore remains challenging to plan for a four-year period, so it remains sensible to retain flexibility.
- It is appropriate for Government to plan to run deficits to support the economy for the next two years. The latest forecast projects the primary budget being brought back into balance by 2023, but this is due to a temporary suspension of the States Grant to the Social Security Fund – excluding this temporary factor the budget would not return to surplus until 2024.
- When compared to the previous Government Plan 2020-24, revenue forecasts in 2023 have increased by £76m and spending estimates are increased by £56m.
- As a result of the improved forecasts, fewer measures aimed at reducing the deficit are proposed in this year's Government Plan – revenue raising from duty increases are more than offset by income tax thresholds changes and there are no new rebalancing/efficiencies measures or targets.
- Stronger forecasts lead to a surplus in 2023 and 2024 and this year's Government Plan increases the States Grant to the Social Security Fund back to its original formula from 2024 onwards. Previously, it was proposed this transfer would be fixed at £65m. This reversion to the formula means an additional £17m and £19m of expenditure in 2024 and 2025 respectively.
- The Government Plan sets out a plan for £1.1bn of capital spending over the four-year period including trading funds. 65% of this capital spending relates to the Our Hospital Project at £724m.
- Borrowing required to fund pressures from the Covid-19 pandemic is revised downwards to £259m from £457m proposed last year. Pension liabilities of £480m will also be refinanced to take advantage of low borrowing costs. The stock of borrowing is expected to peak at over £1.7bn in 2022 (34% of GVA), a significant increase from 5% of GVA in 2019.
- The net asset position is slightly decreased from 2019, with a fall from 152% of GVA in 2021, to 145% in 2025.
- There are a wide range of risks to Jersey's fiscal position, including economic uncertainty, uncertainty around investment returns and achievability of efficiencies and revenue-raising measures. The future fiscal position could be better or worse depending on interest rate rises and further pandemic related restrictions.

Recommendations

The Panel are pleased to note that many of our previous recommendations have been followed. We recognise that this continues to be an uncertain time for the economy – nevertheless it is important to retain focus on medium-term fiscal objectives and resilience.

1. **Tax revenue: short and medium term.** The economy is recovering, but is still weakened and the outlook remains unclear. Whilst inflation is forecast to be higher over the next year, revenue raising steps, including higher taxes, impose a burden and would not be appropriate at present. Yet raising revenue over the medium-term is important and the Government should clarify how it will do so in its next Government Plan.
2. **Higher inflation.** The structure of Jersey's economy and budget suggest that higher than expected inflation will tend to improve Jersey's fiscal position. However, since the current surge in inflation is expected to be temporary it is important that short term high inflation does not feed into longer term earnings growth. Higher prices do not warrant indiscriminate compensation for households or businesses. Conversely, this should not be seen as a reason for significant fiscal consolidation.
3. **Unwinding crisis support while delivering strong capital investment.** Temporary economic support should be unwound gradually as the economy recovers. Expenditure relating to long term capital projects should not be delayed or held up if Covid-related spending has to be stepped up again.
4. **Strategic Reserve.** Current forecasts suggest the Strategic Reserve will remain below the desirable range of 30-60% of GVA for the next 40 years. This does not meet the Panel's previous recommendations. A long-term plan is needed to increase the size of the Reserve and the Government should set this out.
5. **Use of funds and borrowing**. In the face of uncertainty, prudent uses of Jersey's funds will be important. In the event of temporary economic distress, fiscal deficits should be financed by borrowing rather than drawing down the Strategic Reserve. If the economy performs better than expected, surpluses generated from better budgetary outturns should be transferred to the Stabilisation Fund.
6. **Review of funds**. The economic objectives for Funds should be clear. One example is reviewing whether the objective for the Social Security Fund should be 5x annual expenditure in the long run. The proliferation of separate funds is undesirable e.g. the new Technology Fund. Thorough consideration should be given towards the consolidation of funds and no further funds should be proposed without strong rationale.

7. **Rebalancing.** Efficiencies should be sought regardless of the state of the economic cycle and the government should continue to search for efficiencies in future years.
8. **Debt Framework.** The Debt Framework aims are sensible and should be built upon in future iterations. The government should modify the coverage ratio and debt-to-GDP target levels to apply across the business cycle such that not achieving these aims during economic downturn won't be unduly scrutinised. The Strategic Reserve risk profile should give due consideration to the forecast debt position.
9. **Net Zero.** Achieving net zero will require a careful use of both taxes and expenditure to create the right economic incentives. It is important that the existence of a Climate Emergency Fund does not create a presumption that revenue received in the Fund should be equal to climate related spending.

Section 1 - The Economic Outlook

1.1 International outlook

The International Monetary Fund (IMF) has upgraded its forecast for global growth in 2021 compared to its forecast from last year, now projecting an increase in global GDP of 5.9%. The 2021 forecasts for advanced economies have improved more than those for developing economies. Most advanced nations have seen significant success with their Covid-19 vaccination programmes, whilst the vaccine supply reaching developing nations is limited. Lack of access to health care and vaccines will increase the likelihood of further mutations of the virus and extend the duration of the pandemic for many developing economies. The IMF is now forecasting global growth of 5% in 2022, followed by growth of 3-4% continuing through to 2026, subject to the risks discussed above.

The UK saw one of the largest falls in economic output among comparable developed economies, falling almost 10% in 2020, a decline not seen even during the Great Depression. Swift progress in the UK vaccination programme and the easing of restrictions through summer 2021 has improved the UK economic outlook. Over the course of the past year the IMF significantly upgraded its forecast for UK growth from 5.3% to 6.8% for 2021, one of the fastest expected growth rates among major advanced economies. Whilst other G7 countries are expected to outperform their autumn 2019 forecasts by 2024, the OBR expects the UK's post pandemic scarring of potential output to be 2%. The UK has recently been experiencing supply chain constraints due to the end of the Brexit transition period and Covid-19 related travel restrictions, some of which have been translated into problems in the local economy.

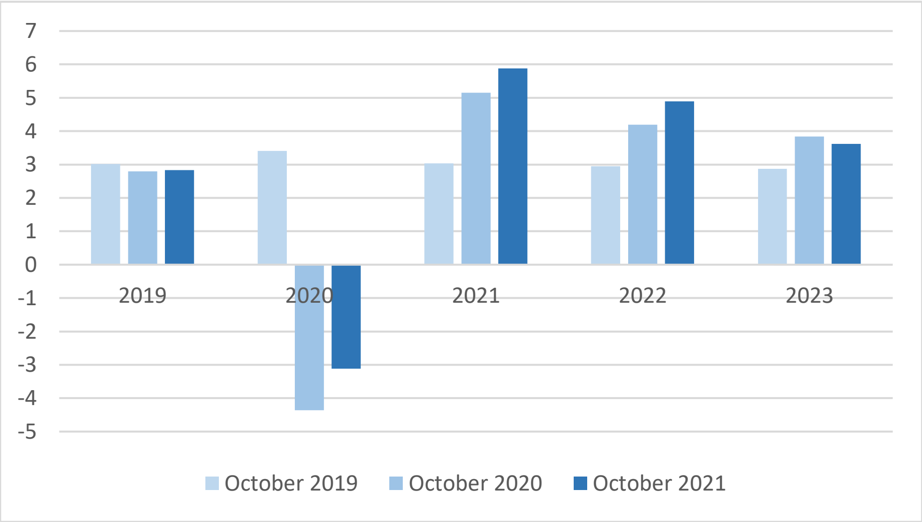
Figure 1.1

Global growth

Top panel: global GDP percentage real growth - October estimates/forecasts.

Bottom panel (overleaf): index (2016 = 100) of real-terms GDP - October 2021 estimates/forecasts: dashed lines are October 2019 estimates/forecasts

Source: International Monetary Fund (IMF) World Economic Outlook October 2021, October 2020, October 2019.



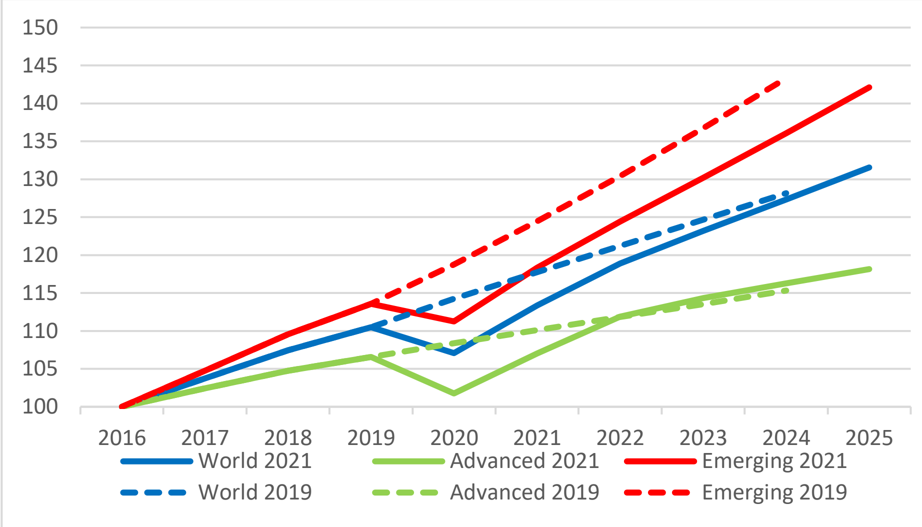


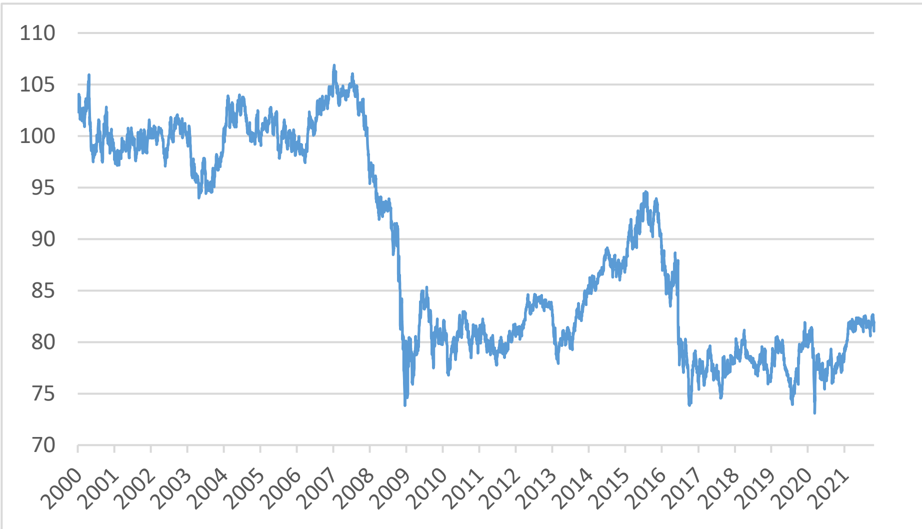
Figure 1.2 below shows the trade-weighted value of sterling in comparison to the currencies of its trading partners. After a slight appreciation at the beginning of 2021, the index was relatively consistent for much of this year, though it fell 1% on 4 November following the decision to hold UK interest rates at record lows. The scale of sharp depreciations coinciding with the global financial crisis of 2008 and the original Brexit referendum result in 2016 were not seen at the end of the Brexit transition period, meaning no added pressure on imported inflation from the exchange rate. Equity markets have recovered since the falls in early 2020, and price to earnings ratios have fallen.

Figure 1.2

Sterling's trade-weighted index

The "Effective exchange rate index" shows movements in sterling's foreign exchange value against its trading partners. (Jan 2005 = 100)

Source: The Bank of England (BoE) 2021.



Another important source of inflation volatility is the price of energy. Crude oil prices are a significant determinant of headline inflation in the Jersey economy and have been rising from their lowest value in recent years which was recorded in April 2020.

Figure 1.3

Crude oil prices

Indexed price of crude oil acquired by UK refineries, index (2010 = 100)

Source: Department for Business, Energy and Industrial Strategy (BEIS) 2021.

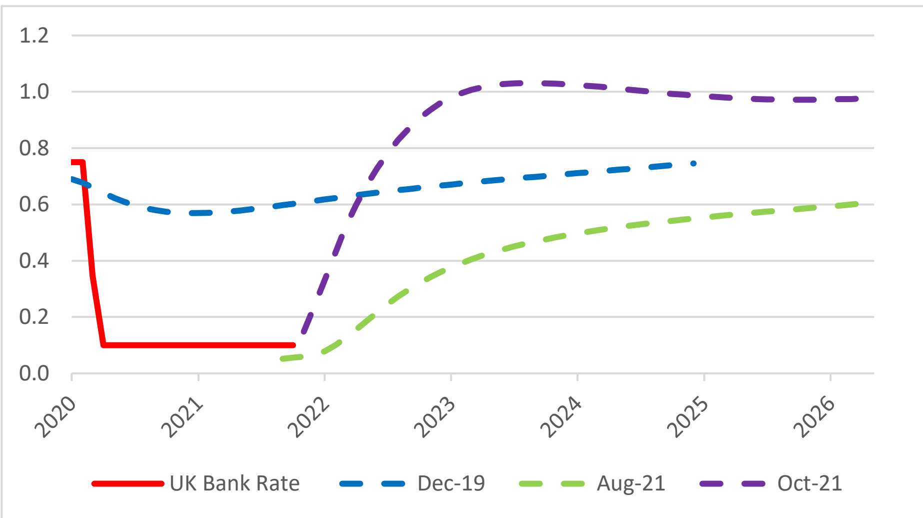
Earlier moves towards higher policy interest rates were reversed in response to Covid-19. In the United States, the Federal Funds Rate fell from a target rate of 1.50-1.75 at the beginning of March 2020 to 0-0.25% by 16 March 2020. Similarly, the Bank of England cut the Bank Rate to an all-time low of 0.1%, whilst the European Central Bank has kept its base rate negative since 2014. The Monetary Policy Committee (MPC) voted to maintain the Bank Rate at 0.1% in their November sitting due to the dampened growth projections laid out in the November Monetary Policy Report combined with supply chain disruptions, recruitment difficulties. The MPC expects that it will be necessary to increase the Bank Rate over the coming months to return inflation to the target 2% if economic data are in line with the central projections of the November report. Markets have responded to this announcement with a fall in expected rate rises, though rates are still expected to reach 0.9% by the end of 2022. The expectation for increases in interest rates offers the potential of improved profitability for Jersey banks.

Figure 1.4

Future UK Bank Rate expectations

Average monthly expectations for the future UK bank rate, Dec 2019, Aug 2021. Oct 2021 and actual value for the UK bank rate.

Source: Bank of England (BoE) 2019, 2021



1.2 Jersey economic developments

Gross Value Added (GVA) is the headline measure of economic activity in Jersey. The most recent GVA data available, for 2020, capture the initial impact of Covid-19. The economy shrank by 8.7% in 2020 real terms, similar to other advanced economies such as the UK and France, which fell 9.8%, and 8.0% respectively. This followed GVA growth of 2.1% in 2019, which exceeded the Panel's forecast. The record fall in GVA recorded in 2020 is partly a result of the public health restrictions limiting economic activity. Restrictions of varying severity remained throughout the final three quarters of 2020. Around half of the economic contraction was driven by reduced profits in the financial services sector.

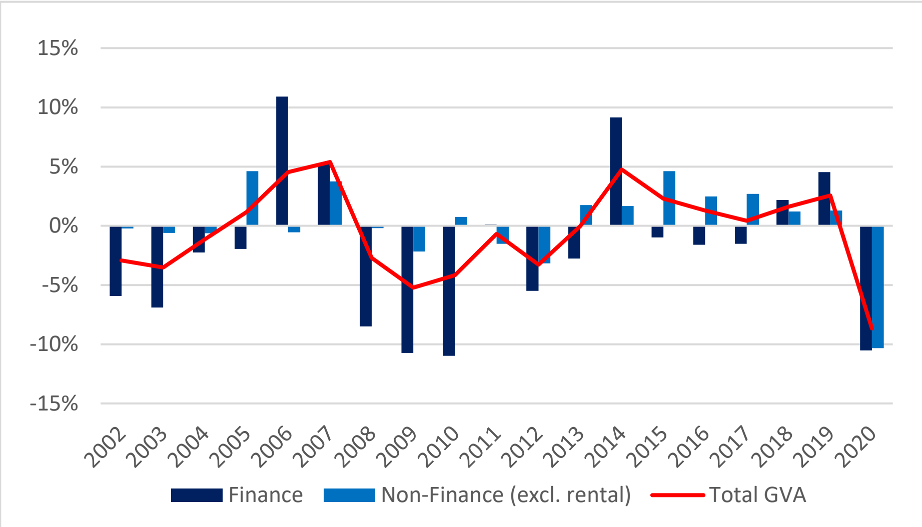
The decline varied by sector. There was a 45% contraction for hotels, restaurants and bars. Financial services declined by 11%, whilst wholesale and retail (-6%), construction (-15%), agriculture (-23%) and other business (-9%) also saw contraction. The only sectors which grew in 2020, were public administration (+9%), electricity, gas and water (+5%), manufacturing (+3%). The income of private households grew by 1%.

Figure 1.5

Jersey GVA

Annual GVA percentage change in real terms

Source: Statistics Jersey



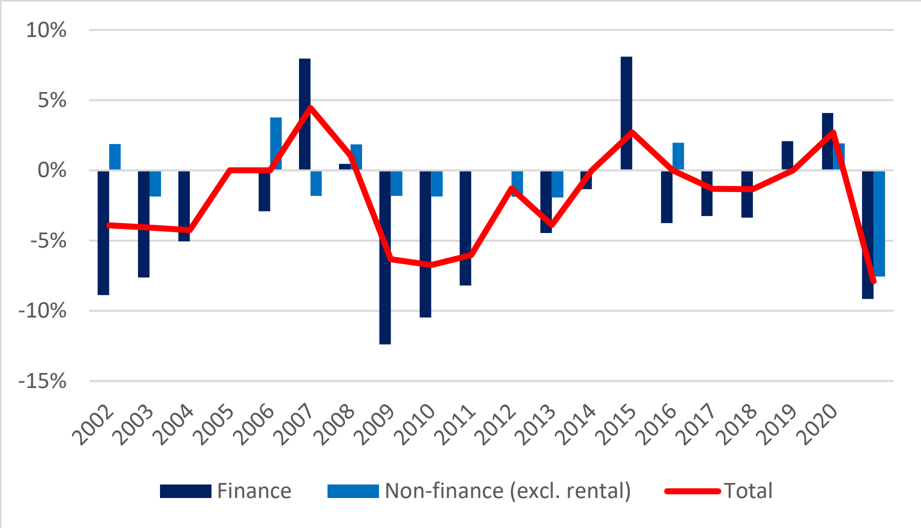
Falling productivity (measured as value-added per worker) is an important trend. The period of 2007-2010 in particular saw rapid decreases in productivity, driven by the global financial crisis and by the impact of lower interest rates on banking profits. Since then, productivity has not recovered, instead it stagnated at around £75,000 per FTE in 2020 prices until 2018. Productivity growth occurred across most sectors in 2019, particularly in financial services, but this was reversed in 2020 with a 7.9% fall in overall productivity.

Figure 1.6

Productivity growth

Annual percentage change in GVA per FTE in real terms

Source: Statistics Jersey



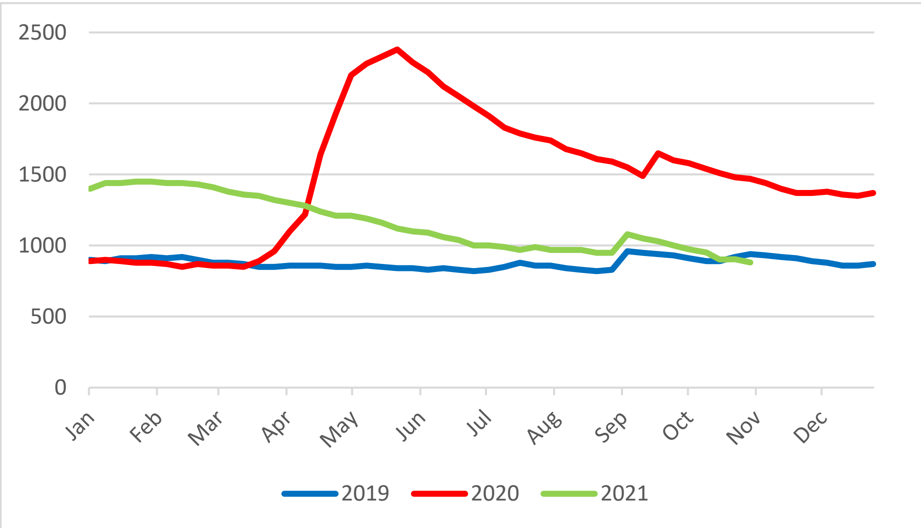
Though official data on output for 2021 are not yet available, other high frequency data series help to indicate the strength of the economic recovery. The available economic data point to a faster than expected recovery. To the assess the recovery trends, the Panel has considered data from Customer and Local Services (CLS) who provide a weekly total of those registered as Actively Seeking Work (ASW). These data act as a proxy for the number of unemployed workers in the island. The number of those actively seeking work has fallen consistently from the peak of 2,380 reached in May 2020, to 880 in October 2021. This is slightly below the levels seen during the same period in 2019, indicating a return to pre-Covid unemployment levels.

Figure 1.7

Actively Seeking Work

Weekly numbers of those registered as "Actively Seeking Work". (Note: The September jump is a seasonal feature of the data and occurs on the first week of school with a number of parents returning to the labour market)

Source: Statistics Jersey / Customer and Local Services



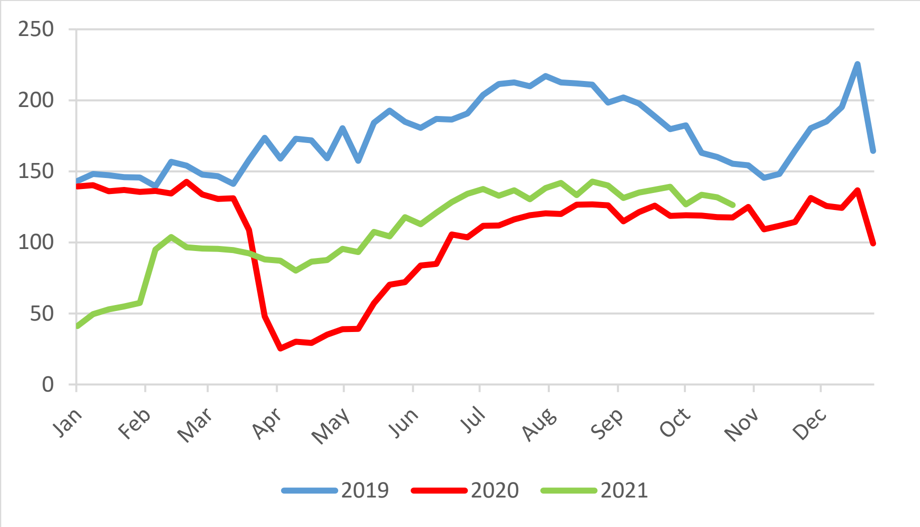
Other high-frequency data are also available that give an indication of physical mobility and, indirectly, the return to normal consumption and production patterns in economic activity. Footfall data for St. Helier paints a more subdued picture of the economic recovery as footfall on the high street is yet to return to the numbers seen in 2019. This is most likely due to a fall in visitor numbers due to travel restrictions and an increased number of people continuing to work from home.

Figure 1.8

St. Helier Footfall

Weekly footfall totals for St. Helier (thousands)

Source: Government of Jersey



1.2.1 Financial services sector

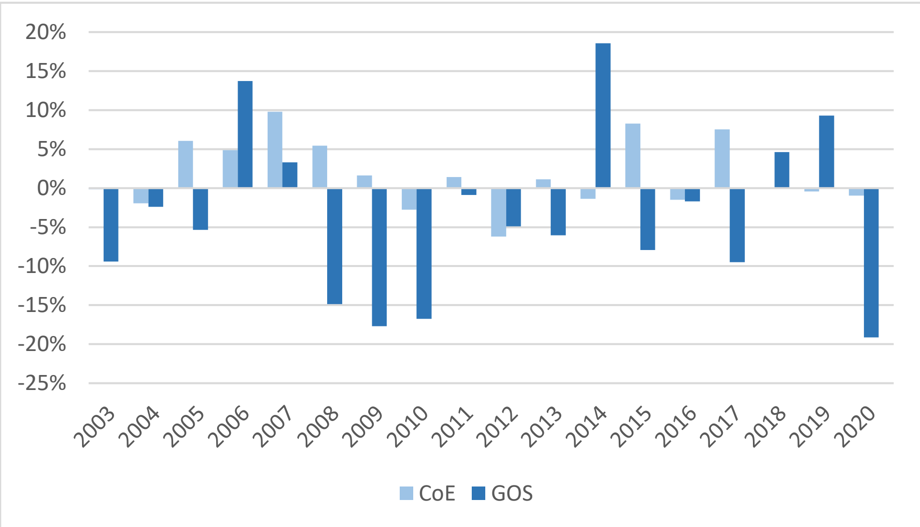
The financial services sector saw an 11% fall in real terms GVA in 2020. Financial services profits, particularly in the banking sector, are a significant driver of GVA in the local economy. Financial services profits fell by 19.1% in 2020, largely driven by the Bank of England's Bank Rate falling to a record low 0.1%. Employee compensation also fell 1.0% in real terms.

Figure 1.9

Financial services profit and employment costs

Annual real-terms percentage change in gross operating surplus (dark bars) and compensation of employees (pale bars)

Source: Statistics Jersey



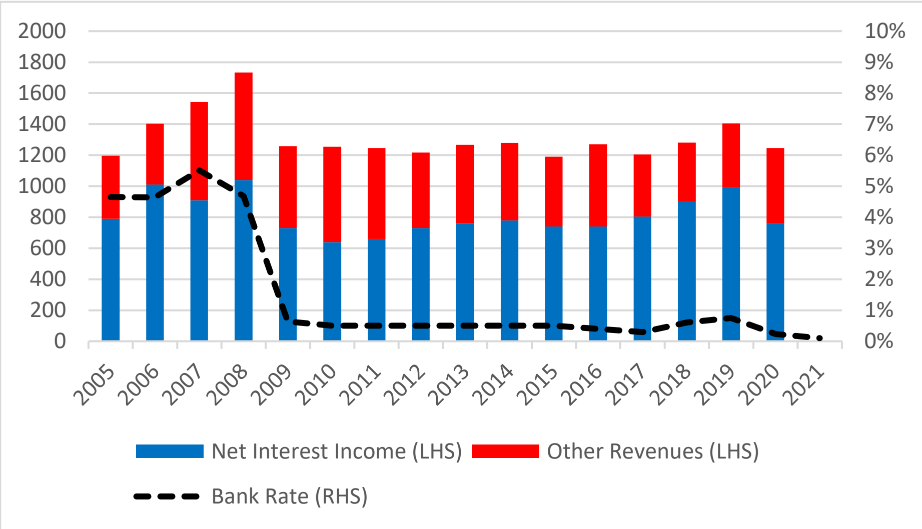
Unprecedented low interest rates throughout 2020 and 2021 have resulted in a fall in net interest income, which makes up a substantial portion of financial services revenue. **Figure 1.10** below shows the recent annual history of financial services revenues. Net interest income fell (by 24%) in nominal terms in 2020 along with the Bank Rate, reversing the trend of rising net interest income seen between 2016 and 2019.

Figure 1.10

Banking revenues

Source of revenue (£m, current prices - left hand scale) and annual average for Bank of England Official Bank Rate (percentage - right hand scale, 2021 until end Oct)

Source: Statistics Jersey, Bank of England



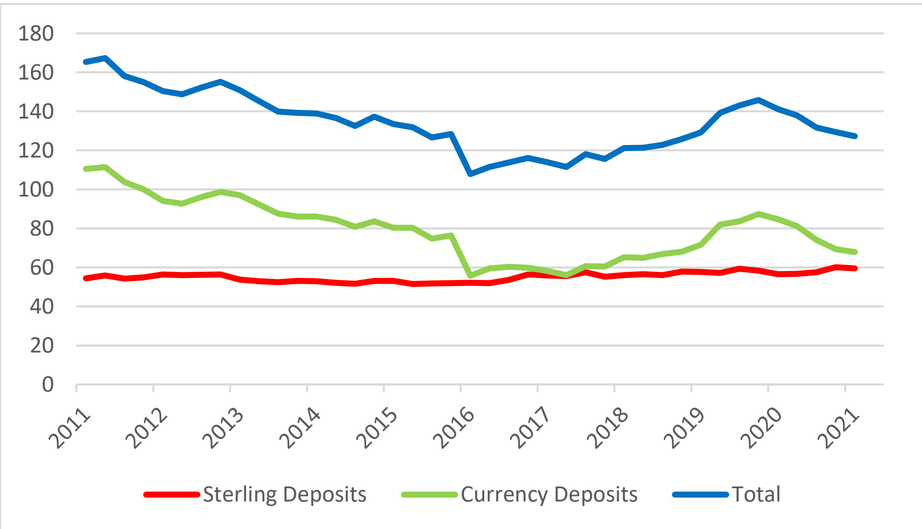
Sterling deposits have not moved from their level of long-term stability since last year's report. Deposits of foreign currencies ("currency deposits") are falling in contrast to their recent upward trend, having decreased by 13% (June-21) from their six-year peak in March 2020. A significant portion of Jersey's deposits are held in US dollars, so interest rate increases in the US would be positive for the banking sector, though this is less key to sectoral profitability than changes in UK Bank Rate.

Figure 1.11

Banking deposits

Total bank deposit values (£bn current prices) in sterling and foreign currencies ("Currency Deposits")

Source: Jersey Financial Services Commission



Whilst sterling deposits have been relatively stable throughout the pandemic, the value of funds administered in Jersey has continued its growth trend dating back to 2015. This promising growth means that the total value of funds administered has risen 93% since June 2015 to total £436bn in the most recent data. Growth of 15.4%, 9.4% and 8.0% over the past three years suggest continued resilience in this sector, although a considerable share of this growth is due to higher asset prices.

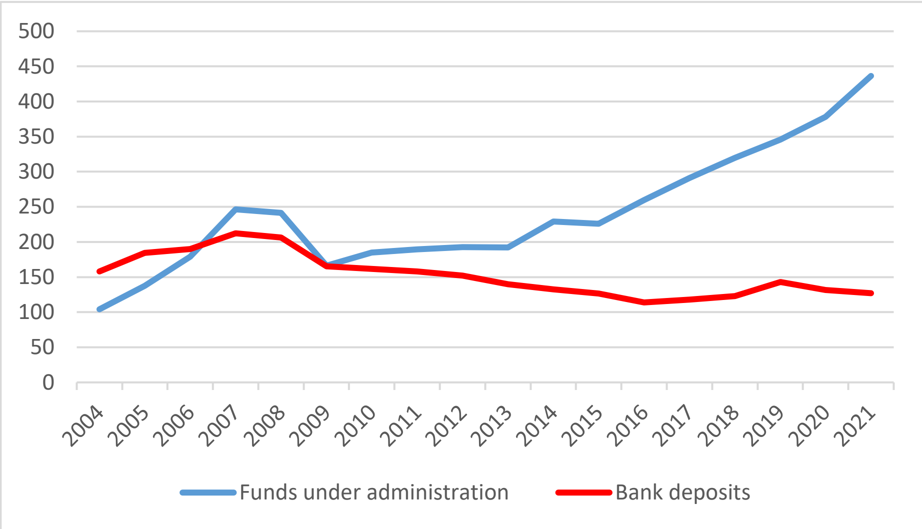
When the Panel met with representatives from the funds industry, they reported increased levels of activity. Sector representatives identified that Jersey was likely to be able to retain market share in a growing market.

Figure 1.12

Deposits and funds

£bn, total banking deposits held in Jersey (red line) and net asset value of regulated funds under administration (blue line); 2004-2020 is year-end, 2021 is June.

Source: Jersey Finance



The **Business Tendency Survey (BTS)** from September 2021 suggests continuing positive sentiment, although growth appears to have dampened from the particularly positive June results. The headline business activity indicator became positive in June across both finance and non-finance sectors for the first time since 2019, decisively so in the finance sector.

Figure 1.13 presents a summary indicator drawn from Principal Component Analysis (PCA) which identifies a common determinant in cyclical indicators produced from weighted responses to the BTS. Overall responses to the BTS are optimistic, with the summary indicator reaching a level similar to that of early 2018. September 2020 marks the start of a sharp sustained increase in business sentiment, following a very sharp fall earlier in 2020. The non-finance sector experienced a more pronounced initial fall in industry sentiment but has since risen to a level above that of the finance sector in the latest BTS for September 2021.

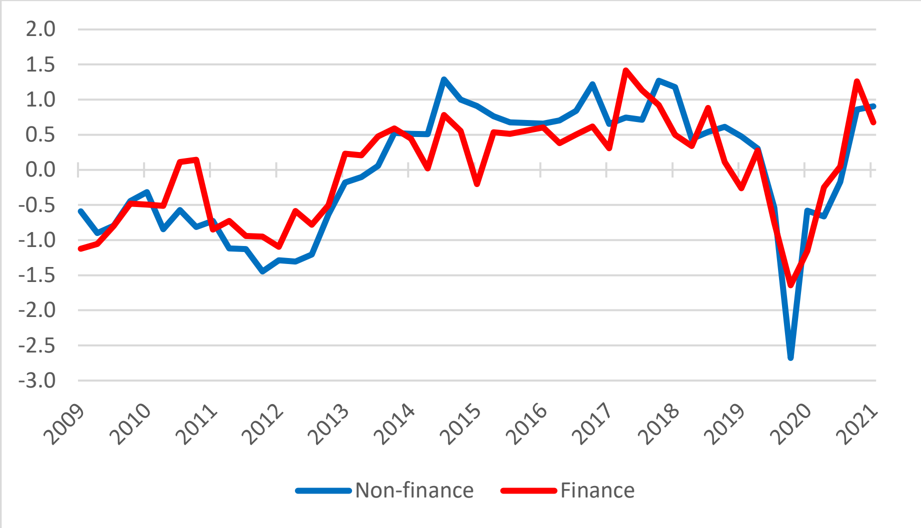
Figure 1.13

BTS summary indicator

Summary indicator incorporating responses from finance and non-finance sectors to the BTS

Note: Results for future employment in September in the financial services are an average of the past three quarters, due to a technical error in survey administration

Source: Statistics Jersey, Panel calculations



Expectations for the financial services sector are more optimistic than those in the previous annual report. The weighted proportion of firms expecting an increase in profits was 63 percentage points greater than those expecting a fall in profits during 2021.

Figure 1.14

Finance employment and profit expectations

Percentage net balance of respondents (weighted by employment) expecting an increase in employment (pale bars) and profits (dark bars). Results from June are in-year expectations and results from December are expectations for the following year

Source: Statistics Jersey

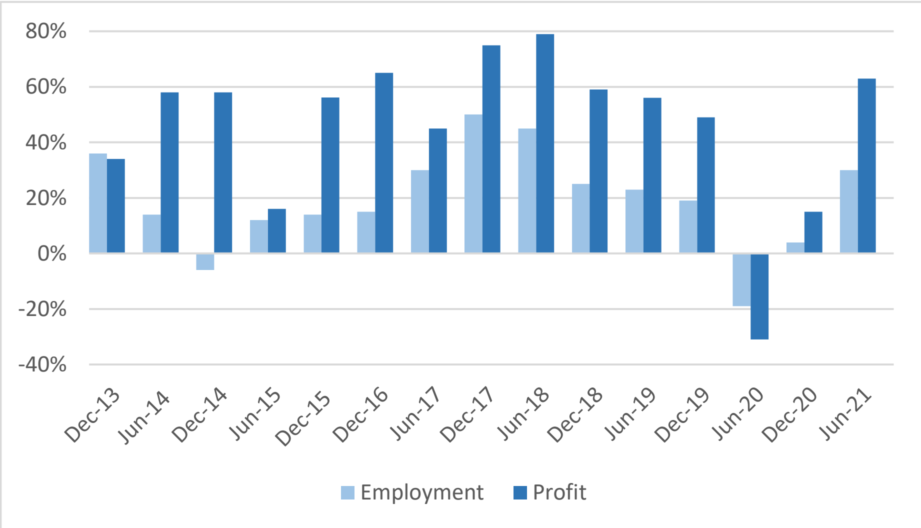


Figure 1.15 compares the business activity indicator from the BTS with the financial services sector GVA growth. GVA fell significantly in 2020, mirrored by the fall in the business activity indicator. In early 2021, the business activity indicator showed marked improvement which signals that there should be an improvement in GVA for 2021, in line with the economic recovery forecast by the Panel.

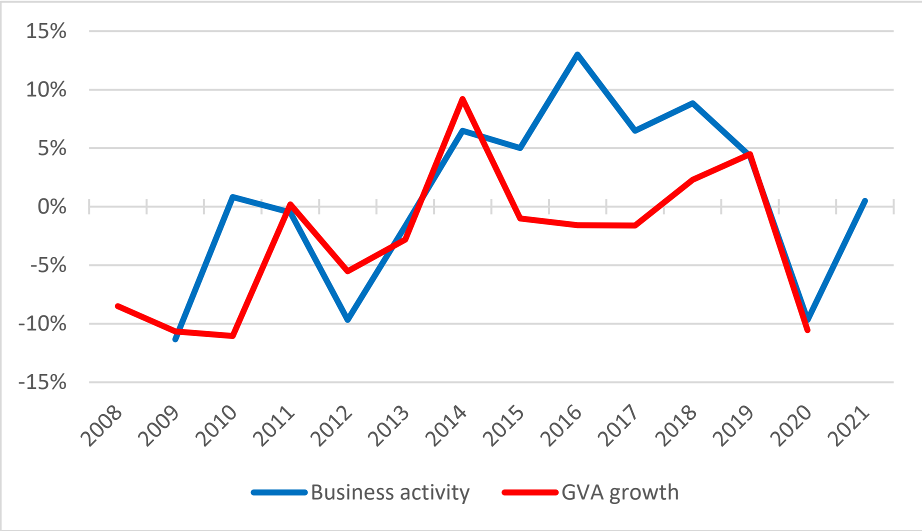
Figure 1.15

Finance GVA growth vs BTS results

Annual real GVA growth of financial services sector and financial services responses to business activity question averaged over each year with mean and variance aligned to those of data for growth in real GVA.

Note: 2021 is the average of responses to "business activity" in March, June and September plus "future business activity" from the September survey.

Source: Statistics Jersey, Panel calculations



During the Panel's recent factfinding meetings, representatives from banks reported a significant fall in profitability; this was principally driven by low interest rates with non-performing loans a lesser drag. Banks reiterated their expectation of continued investment in Jersey. Even small increases in interest rates will improve net interest income due to the large value of deposits held by local banks.

While the financial sector has largely adapted well to the challenges of the pandemic, longer-term risks remain. It is important that Jersey maintains market access following Brexit, and the extent to which the UK may start to compete with Jersey in some areas of business remains uncertain. Both the sector and Jersey's government are monitoring the development of a global consensus on corporate tax reform; however, the OECD Inclusive Framework is anticipated to have a limited impact in Jersey.

Recruitment is difficult, particularly in compliance, analytical roles and other key professions. Cost of living pressures mean that recruiting from off-island can be a challenge, particularly due to the cost of housing. Competition for talent is leading to some wage pressures.

1.2.2 Rest of the economy

The non-finance sector contracted for the first time in eight years in 2020. Real output fell by 10% in comparison to 2019. Hotels, restaurants and bars fell by 45%, the largest decline of any sector. Transport, storage and communication were also heavily impacted by the pandemic restrictions and saw a 22% contraction in 2020. Retail and wholesale saw a contraction of 6%, relatively modest in comparison to that of other sectors. Public administration saw the largest increase in GVA (9%), driven primarily by increased employment as a result of measures taken in response to the pandemic, including testing and tracing.

The June 2021 BTS showed a significant improvement across all categories, with future business activity indicators becoming positive in March 2021 for all non-finance sectors for the first time since the start of the pandemic. Previous consecutive BTS results have shown improvements across most indicators and sectors. September 2021 BTS responses highlighted continuing positive sentiment with most indicators remaining positive, although growth is slowing. Forward looking indicators fell in the hospitality sector, most likely due to expectations of the upcoming winter season.

Figure 1.16

Non-finance business tendency

Percentage net balance of respondents reporting an increase (weighted by employment). Average of quarterly results

Note: 2021 covers just March, June and September

Source: Statistics Jersey

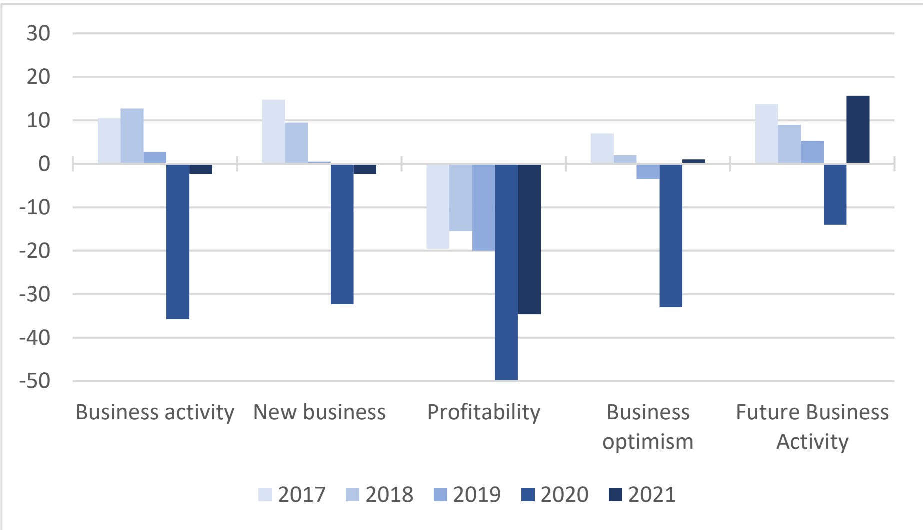


Figure 1.17 compares the business activity indicator from the BTS with the growth of the non-finance sector GVA (excluding the rental income of private households). A similar trend to that of the finance sector is seen in the non-finance sector. The business activity indicator showed a drastic improvement in early 2021, rebounding quickly to indicate the potential for a strong GVA recovery in 2021.

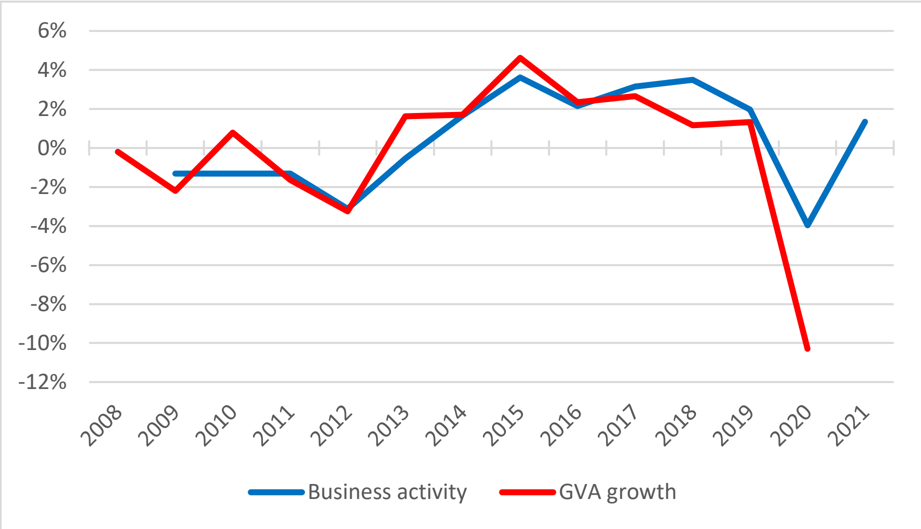
Figure 1.17

Non-Finance GVA Growth vs BTS results

Annual real GVA growth excluding financial services and rental and non-finance responses to business activity question averaged over each year with mean and variance aligned to those of data for growth in real GVA.

Note: 2021 is the average of responses to "business activity" in March, June and September plus "future business activity" from the September survey.

Source: Statistics Jersey, Panel calculations



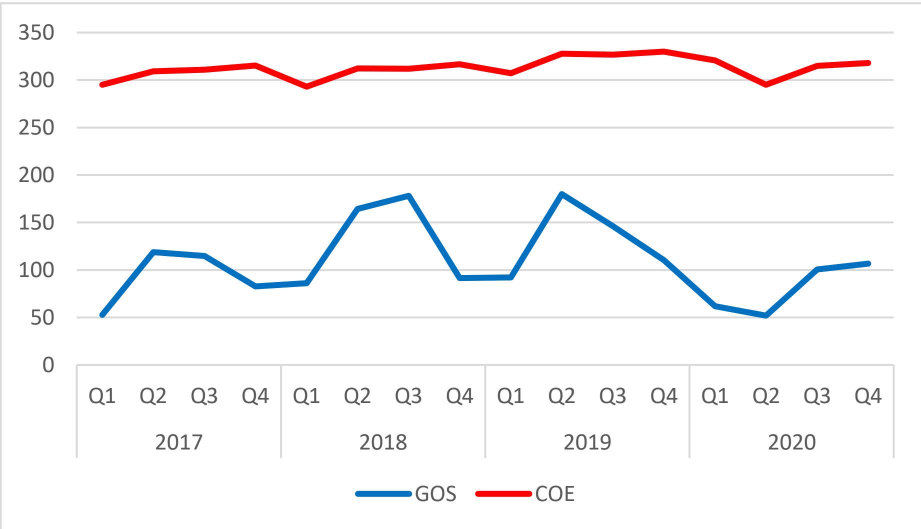
Statistics Jersey has recently begun publishing quarterly data for the non-finance sector which includes the gross operating surplus and compensation of employees for each sector. **Figure 1.18** shows that profits fell much more sharply than aggregate wages in the sector, indicating the success of government intervention to support employment. Compensation of employees has since recovered to pre-pandemic levels, whilst profits have only partially recovered by the end of 2020. Profits tend to be highly seasonal, and the profits in quarter 2 of 2021 will be a key indicator for the pace of the recovery this year.

Figure 1.18

Non-finance profit and employment costs

Quarterly gross operating surplus and compensation of employees for the non-finance sector (£m)

Source: Statistics Jersey



1.2.3 Sectoral performance of non-finance economy

Wholesale and retail saw a 6% contraction, registering a fall in GVA for the third consecutive year in 2021. The sector has been facing challenges before the pandemic as consumers have switched from high street stores to online retailers, with this trend being accelerated by the pandemic. From March 2020, food retail saw an unprecedented increase in demand and the rise of food home delivery services. Meanwhile, other retail and wholesale businesses were subject to restrictions including mandatory closure and are more likely to be affected by reduced consumer confidence. While there are a number of vacant units following the collapse of UK chains such as the Arcadia Group, vacancy rates are lower than comparable retail spaces in the UK for example. New investment continues, and there may be potential for a more efficient use of space.

The industry has seen a gradual recovery as restrictions eased with the net balance of firms reporting an increase in business activity outweighing those reporting a decrease by 17 percentage points in June 2021. Responses to the September BTS have been slightly negative across the indicators for the retail and wholesale sector, particularly in input costs and profitability. Significant improvement in the future employment indicator suggests strong recruitment in the retail sector ahead of the festive period.

The **hotels, restaurants and bars sector** contracted by 45% in 2020, the most severe contraction across all sectors. Public health restrictions affected the hospitality industry along with other personal services more than other sectors that were able to adjust to working from home swiftly. Recovery in the hospitality sector has also been slower than that of both retail and construction. The industry is facing staff shortages and recruitment difficulties and is struggling to recruit back the levels of staffing that were lost during the pandemic.

BTS responses for the hospitality sector saw a steep rise in the business activity indicator as it turned positive for the first time since 2019, with the net balance of firms reporting an increase outweighing those who reported a decrease by 40 percentage points. However, optimism has waned with future indicators turning negative ahead of the winter season. Historically hospitality BTS sentiment tends to be more negative than those of other sectors, but recent responses will reflect the challenges of the restrictions on social mobility. The Co-Funded Payroll Scheme still supported around 200 jobs in hospitality during September, though this is significantly less than the 3,600 hospitality jobs supported in April 2020, as the scheme approaches the end of Phase 6.

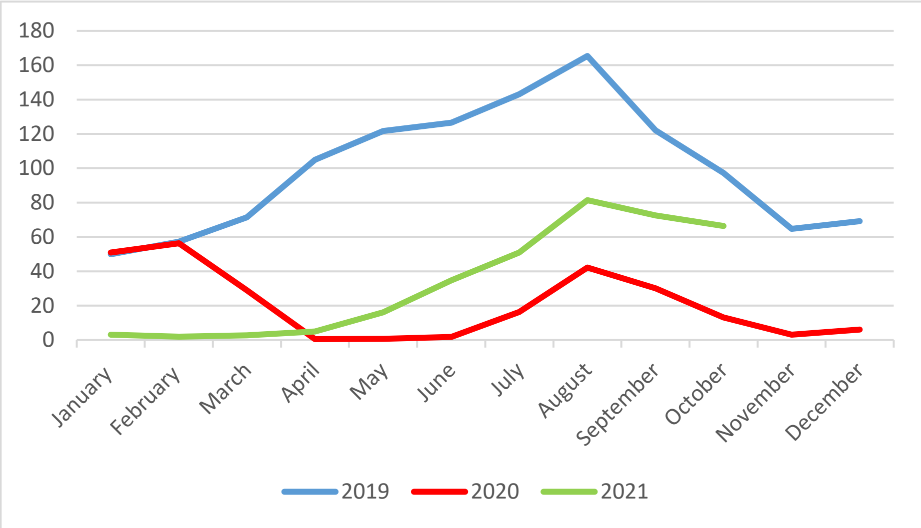
The hospitality sector has suffered through the second consecutive disrupted summer season. Air and sea departures have remained substantially below pre-pandemic levels as travel restrictions interrupted the usual summer travel season. Departures in the peak month of August were 51% lower than in August 2019. Whilst departure numbers are lower during autumn and winter months, October levels were only 31.7% lower than two years prior. As local restrictions eased, increased local demand made up some of the shortfall from visitors, but the visitor-focussed businesses such as hotels still faced reduced demand. The extent to which visitor numbers will return to pre-pandemic levels is uncertain, with stakeholders reporting that the accommodation sector will lose up to 10% of bed-stock due to the closure or planned closure of a number of hotels.

Figure 1.19

Port departure numbers

Number of departures from Jersey air and sea terminals (thousands)

Source: Ports of Jersey



The **construction** sector saw a 15% fall in GVA in 2020 but after an initial sharp fall it rebounded strongly in the final quarter of 2020, recording its largest gross operating surplus in four years.

The BTS in June 2021 gave the first overall positive result for business activity in the sector. Future indicators were also overwhelmingly positive in comparison to results from the previous five quarters, although this sentiment has been reversed in the September BTS as construction reported a marked fall in many indicators. Input costs are rising, with the net balance of firms reporting an increase in input costs outweighing those who reported a decrease by 75 percentage points. Shortage of materials and commodity prices will continue to put pressure on costs.

While there are some capacity constraints, representatives of construction have indicated that in many cases this is due to a backlog of projects that were delayed due to the pandemic – though this is mitigated somewhat by sites having only been shut down for 6-8 weeks during the initial lockdown. Looking ahead to the next three years of the Bridging Island Plan, affordable housing and meeting the housing demand will be an important source of work for the sector. The local construction industry should benefit from a strong pipeline of new construction projects but delays, for example in planning, mean that it is difficult for the sector to have certainty over timing of future work. The £150 million Fiscal Stimulus package has allocated £30 million towards capital projects that can be implemented quickly, with a significant proportion of these focussed in the construction sector. These capital projects were initially due to be completed by the end of 2021, but it is understood that a number may be extended into 2022.

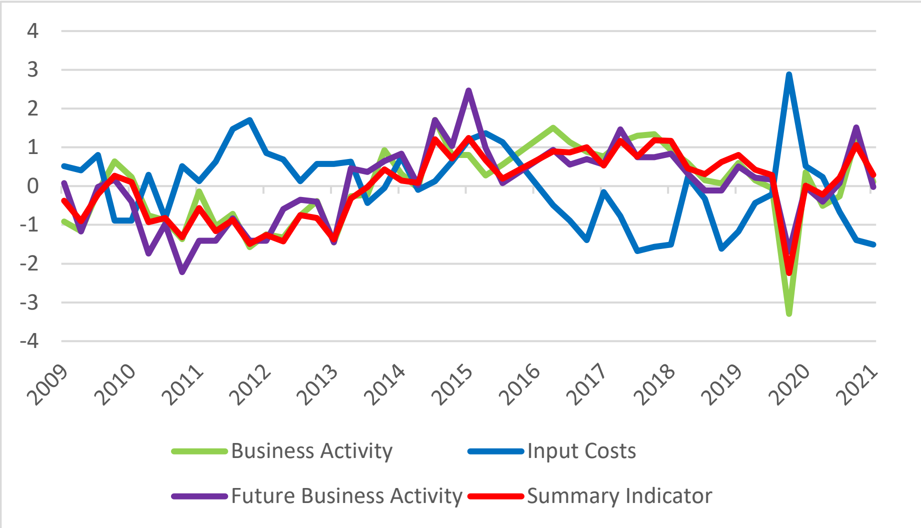
A summary indicator created using the same method as **Figure 1.13** for responses to the BTS from the construction sector, is presented in **Figure 1.20** alongside series for input costs, business activity and future business activity. Input costs fell sharply at the beginning of 2020 but have been rising since. The weighted balance of firms reporting an increase in input costs outweighs those reporting a decrease by 75 percentage points.

Figure 1.20

BTS results for the construction sector

Summary indicator for the construction sector and mean and variance adjusted series for the business activity, future business activity and input costs.

Source: Statistics Jersey, Panel calculations



1.3 Labour Market

Labour Market data for 2020 and 2021 highlight the unequal effects of the pandemic across sectors. The pace of recovery also differs considerably, with hospitality continuing to be impacted by social mobility restrictions through the summer of 2021. Vacancies and ASW data show a potential mismatch in the skills available and those most required by industries. Average weekly wages in the hospitality sector grew by almost 16% in the 12 months to June 2021, though this partly reflects a recovery from the sharp fall in June 2020 with the growth over two years being largely in line with inflation. During the Panel's factfinding, there were reports of strong competition for staff, with in some examples staff being offered up to double their existing salary to move between employers. Analysis by the Economics Unit looking at vacancies advertised on gov.je in both 2019 and 2021 suggest that advertised hourly wage rates for hospitality roles grew by an average of 11% across around thirty employers who advertised the same job title in both years, with one employer having increased the advertised rate for a role by over 60% between 2019 and 2021.

While hospitality is reporting particularly acute challenges with finding staff, other sectors in both finance and non-finance are also finding it increasingly difficult to fill roles. **Figure 1.21** shows that on the basis of available data, the labour force shrank over the course of 2020, rebounding to pre-pandemic levels in June 2021. Total employment stood at 62,430 in June 2021, only 40 below June 2019. However, over the period 2009 to 2019, Jersey experienced strong net inward migration averaging 900 per year. The number of 'registered' workers (i.e. those who have been in Jersey less than five years) has fallen by approximately 1,000 since June 2019, which suggests that inward migration was dampened by the pandemic. Some of these registered workers will have completed their five years and some may have left the island, so it is difficult to establish the exact number of new migrants each year.

This analysis suggests the labour force may have recovered to pre-pandemic levels by June 2021, as the sum of ASW and employment reached 63,420 compared to 63,300 in June 2019. While it is not possible to draw definitive conclusions about what this may mean for population growth[1], it does suggest that the working age population in 2021 may be relatively unchanged when compared to 2019. But this contrasts with recent years where net inward migration resulted in strong growth in the labour force. Future capacity in the labour market will depend on the extent to which pre-pandemic migration patterns are restored.

Section **2.2.6** sets out the significant capital programme planned by government and its subsidiaries over the coming years, in particular the hospital. As the Assembly considers future population policy, consideration will need to be given to the resources needed to deliver this significant increase in construction. A more holistic approach is required to identifying resource requirements, including not just availability of funding but also internal resource capacity to manage projects, and capacity in the supply chain to deliver.

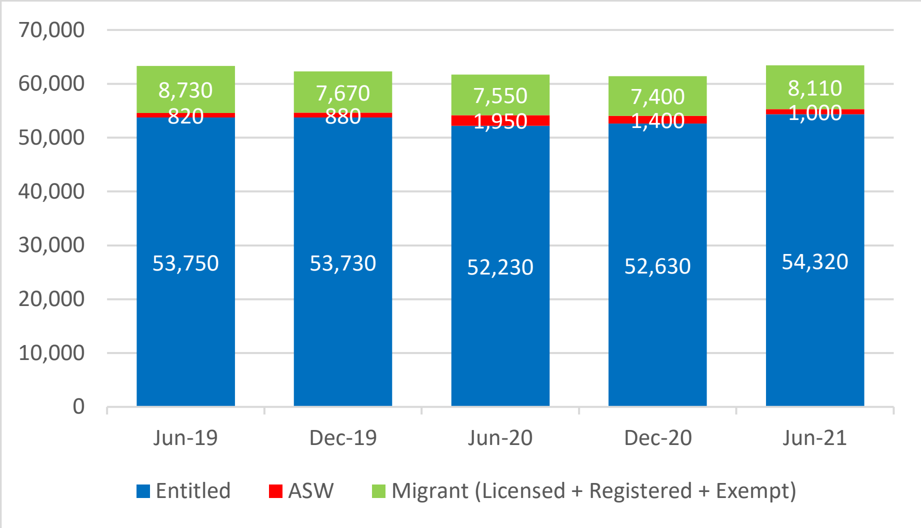
[1] The analysis does not consider the number of people holding more than one job, the number of people registered as ASW but working part-time, or the number of economically inactive or unemployed but not registered as ASW. The publication of the Census results next year will provide a snapshot of the population from March 2021.

Figure 1.21

Labour force composition

Total numbers of workers registered as entitled, actively seeking work and migrant (includes those in the licensed, registered and exempt categories).
Note: ASW includes some underemployed individuals, whereas some unemployed individuals will not register with CLS. This calculation is therefore only ever an approximation of changes in the size of the labour force.

Source: Statistics Jersey



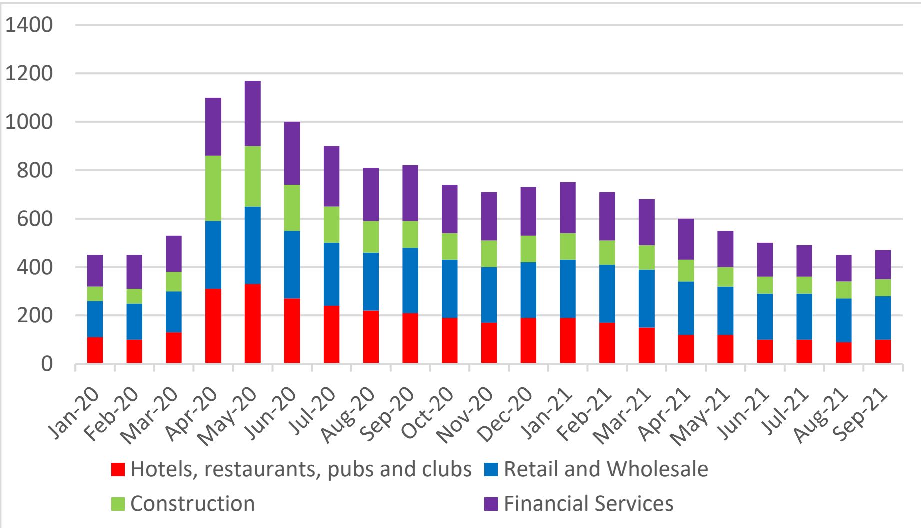
The ASW data provided by CLS contain information about the sector of previous employment for over 90% of those registered, providing some indication about the relative recovery of each sector. Over the course of late 2020 and 2021 ASW numbers previously employed in the hospitality sector have been falling to their pre-pandemic levels. This is mirrored by the finance and construction sectors, whilst the retail and professional and domestic services sectors continue to see elevated ASW numbers. ASW previously employed in all other sectors (not shown on the chart) have also fallen back close to pre-pandemic levels.

Figure 1.22

Actively Seeking Work by industry of last employment

Number of those registered as Actively Seeking Work on the last calendar day of each month, for construction, financial services, wholesale and retail and hotels, restaurants and bars sectors.

Source: Customer and Local Services



The most recent figures for claims made under the Co-Funded Payroll Scheme (CFPS) show around 650 jobs supported by the scheme in September 2021 compared to the 16,240 supported in April 2020. There was a spike in jobs supported by CFPS during Phase 3+ as a result of the Winter Strategy Circuit Breaker which commenced in the first week of December

2020 leading to a 23-percentage point rise in the proportion of hospitality jobs that were supported, and a 7-percentage point increase in the proportion of jobs in wholesale and retail. Phase 4 saw hospitality claims fall back to earlier claim rates, while other sectors saw continued falls in demand for the scheme suggesting a return to relatively normal turnover levels.

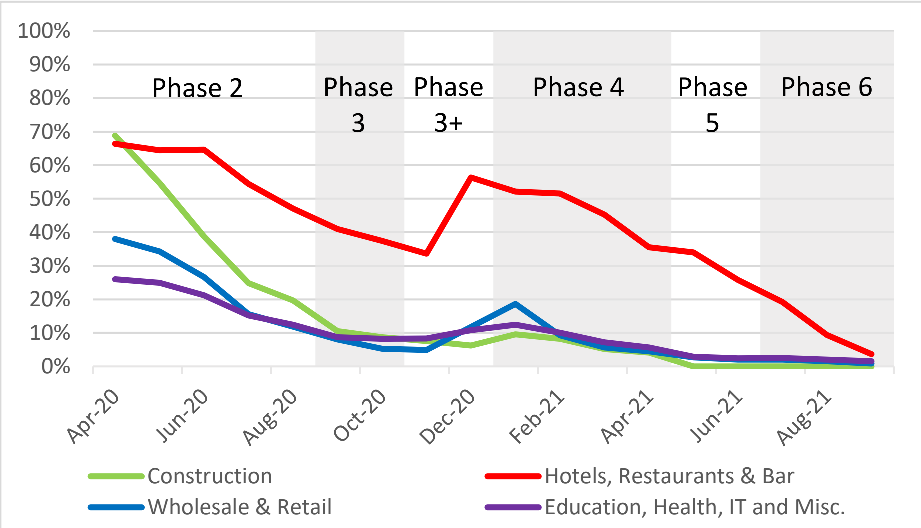
Since Phase 5, eligibility has been restricted to a smaller number of sectors so the reduction in claims is partly driven by this. The scheme concluded at the end of October, although alternative support to businesses has been extended into 2022. This may allow labour supply pressures to ease by reducing the incentive to retain unproductive labour.

Figure 1.23

Co-Funded Payroll Scheme by sector

Jobs supported by the CFPS as a proportion of December 2019 total job count.

Source: Customer and Local Services, Statistics Jersey



Monthly online job vacancy data are a useful indicator of the health of the labour market and how demand for labour has shifted. GeekTalent compiles data of online job postings by industry each month. In recent months the total number of job postings across all sectors has risen above those in equivalent months in 2019, however the composition of these job postings by sector has been changing. Hospitality has seen dramatic increases in job vacancies whilst numbers of those registered as ASW in the hospitality sector has been fallen to pre-pandemic levels, suggesting a growing issue of unmet demand for labour in the sector.

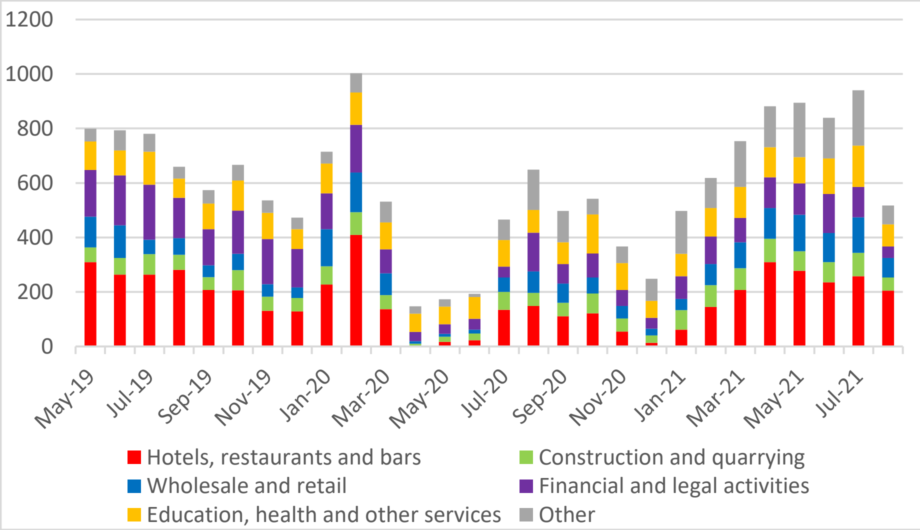
The increase of vacancies in the public sector and social work are included in the education, health and other services category. The public sector expanded in 2020 due to requirements for the government to supply additional services during the pandemic, such as the test and trace service. Social work vacancies also contributed to this increase as Jersey identified a need for increased capacity in this sector. The increased vacancies in these sectors are therefore not necessarily an indication to the strength of the economic recovery as they are structural changes.

Figure 1.24

Online job vacancies by sector

Jersey job postings on the internet by industry sector.

Source: Geek Talent



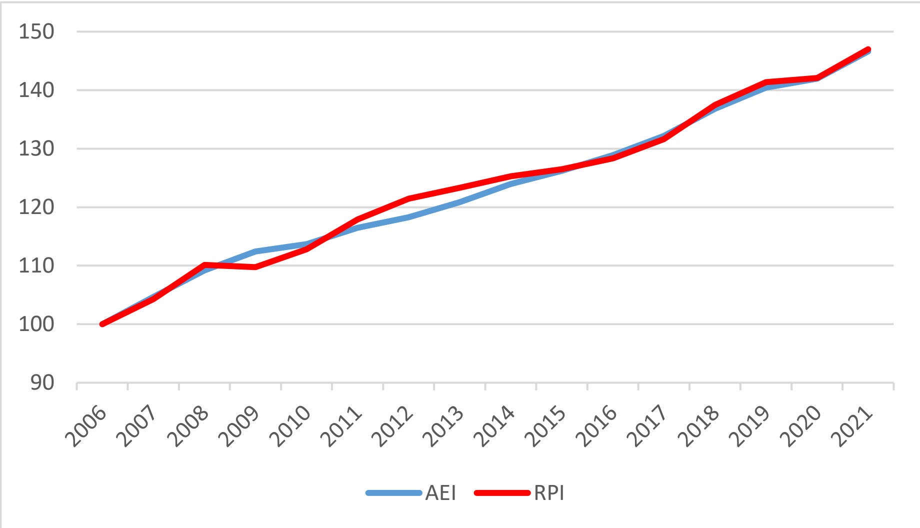
Average weekly earnings were 3.3% higher in June 2021 than at the same time in 2020. However, a 3.5% rise in the Retail Price Index over the same period means that this is a small drop in real-terms earnings. In contrast, 2020 saw a growth of real-terms earnings of approximately 0.5%. Hospitality saw the largest increase, but this follows a significant fall in average earnings in 2020. Over two years wages in the sector have failed to keep pace with inflation. Since 2006, real wages have not seen sustained growth.

Figure 1.25

Average earnings and inflation

Index (2006 = 100) of average earnings (blue line) and retail price index (red line)

Source: Statistics Jersey



1.4 Inflation

The Retail Price Index (RPI) increased by 2.9% in the year to September 2021, as the rate of inflation slowed from a 3.5% increase in the year to June. This follows a period of very low inflation and is partly driven by the easing of lockdown restrictions, which allowed consumers to return to more normal spending habits as the hospitality sector reopened. Rising energy costs are an ongoing concern as electricity prices will increase by 4% in January, gas prices have already seen a 13% increase and heating oil prices in Jersey have increased by more than 30% since the start of the year.

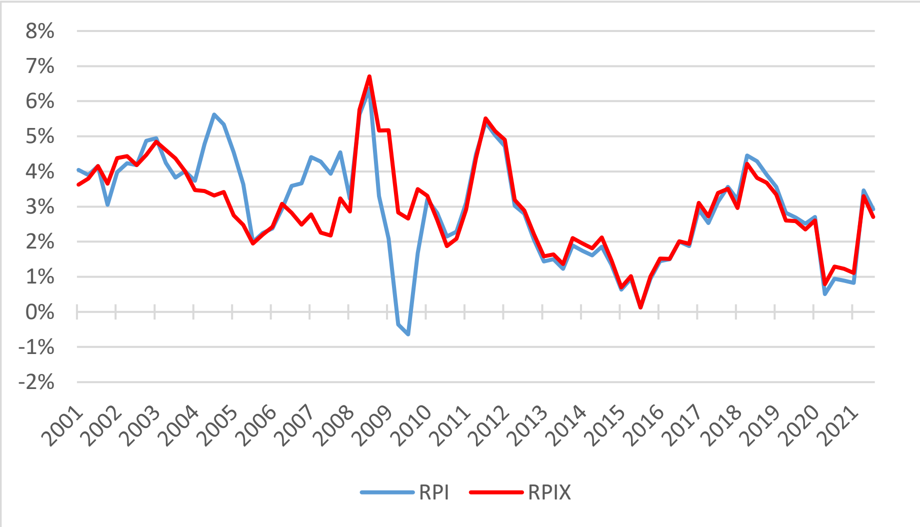
Jersey's RPI rose in line with UK inflation which jumped to 3.1% in September 2021, above the Bank of England target of 2% and following a period of below 1% inflation. The UK Bank Rate remains at a record low of 0.1% as it has done throughout the pandemic, despite the sharp rise in inflation. As inflationary pressures begin to mount, there are expectations for a tightening of monetary policy by the Bank of England later in the year or early in 2022.

Figure 1.26

Inflation in Jersey

Annual percentage change in retail prices index and retail prices index excluding mortgage interest payments

Source: Statistics Jersey



Across all sectors, businesses have reported an increase in input costs (a common theme since the BTS began in 2009), likely due to supply chain constraints resulting from the end of the Brexit transition period and Covid-19 related disruption. Supply chain constraints are likely to be eased as some of these temporary factors recede but there is a risk that some of the issues persist. The price rises seen in some groups of goods and services are mostly correctional changes due to falls in prices in March 2020 (particularly in fares and travel). Wage pressures are likely to affect some sectors in the coming months due to staff shortages and recruitment difficulties, with the potential to add further inflationary pressures.

1.5 The housing market

Expectations at the beginning of the Covid-19 pandemic were for a fall in house prices in most economies as occurred in the last global recession of 2008. These expectations were confounded as prices only paused before continuing to rise above previous growth paths. The UK experienced a growth in house prices of 13.2% in the year to June 2021, while the US house price index provided by the Federal Housing Finance Agency grew 16.5% in the same period.

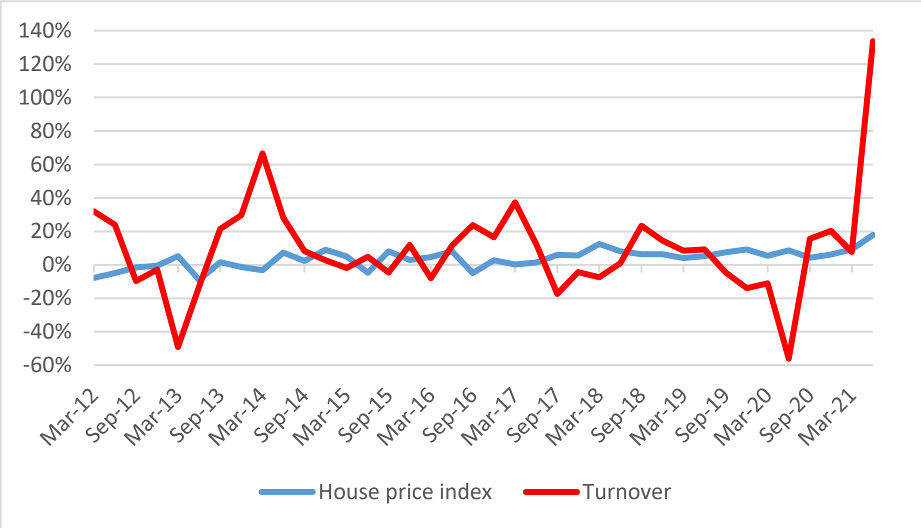
Jersey's housing market has followed a similar trend as house prices rose by 17.9% in the year to June 2021 (accompanied by a 133.7% increase in turnover over the same period – due to the easing of restrictions that limited the operation of the housing market during the initial lockdown). The Panel's forecast (**Figure 1.30**) assumes robust house price growth in the early years of the forecast, reflecting the buoyancy of the property market and low interest rates. The latest increase in house prices represents the greatest jump in the last decade.

Figure 1.27

Housing market

Annual change in House Price Index and transaction numbers

Source: Statistics Jersey



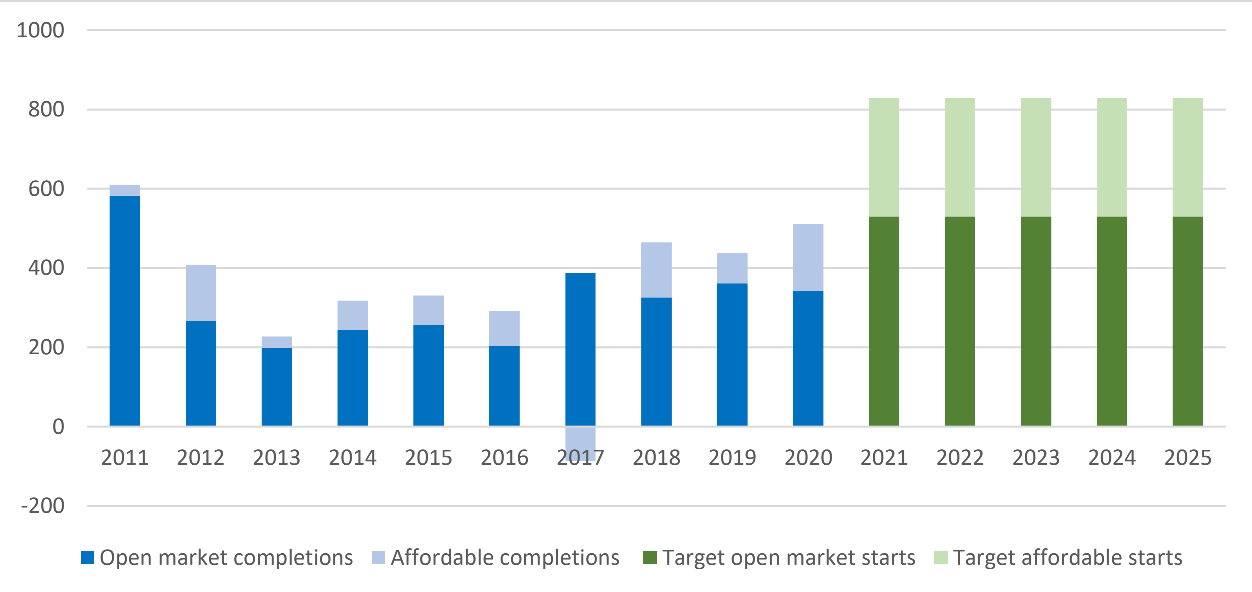
Box 1: Housing and Construction

Housing supply and affordability has been a growing issue in Jersey, with house prices notably jumping close to 18% in the year to June 2021. The 2022-2025 Government Plan reiterates the current government's commitment to providing suitable and affordable housing for the island's growing population.

The average 4-bedroom family home has increased 160% in value over the past 15 years, reaching a record high of £1.28 million. 2-bedroom flats saw a 103% increase, also reaching a record high of just under £500,000 - whilst the average earnings index only rose by 47% in the same period. The increased availability of credit, alongside growth in population, creates additional demand, and if these factors do not change and supply does not increase, this will result in further price pressure on properties.

The Bridging Island Plan makes a provision for the supply of 4,150 new homes by the end of 2025, with 1,500 of these to be affordable housing.

Figure 1.28 Construction completions and future targets Note: Construction targets laid out in the Bridging Island Plan for the years 2021-2025 are assumed to be evenly distributed over the period.
Source: Government of Jersey



The Panel welcomes the planned substantial increase in housing construction over the forthcoming Bridging Island Plan. If delivered, this would help to relieve some of the pressure on the housing market and ease the constraints on the Island's population and economy. As with the capital programme covered in section **2**, these ambitious building targets may be challenged by capacity constraints in the construction sector.

1.6 The output gap

The output gap represents the difference between the current level of output in the economy and the potential level it could sustain without putting upward or downward pressure on inflation. The output gap depends on the levels of labour, capital and productivity and is commonly used to measure spare capacity or overheating in the economy.

Whilst the output gap is not directly observable, it can be estimated using Principal Component Analysis (PCA). PCA identifies a common determinant among a number of cyclical indicators including earnings data, vacancies data, employment and ASW rates, and BTS indicators. The Panel uses this common determinant as an indicator of the degree of spare capacity in the economy and therefore the output gap.

The interpretation of this type of analysis is particularly difficult at the current time, with significant swings in both demand and supply caused by the global pandemic and the unprecedented levels of disruption. For the UK, the Office of Budget Responsibility (OBR) recommends that less weight be placed on output gap estimates than usual. Public health restrictions have simultaneously restricted both supply and demand for a period (to varying degrees in different sectors), This makes it difficult to estimate an accurate level of potential output and consequently the output gap.

Figure 1.29 shows the results of the PCA output gap estimate. This demonstrates that the onset of the pandemic resulted in a significant degree of spare capacity as unemployment increased, job vacancies fell, and business sentiment became strongly negative. In the first half of 2021, the analysis suggests that this has reversed, and the spare capacity has been used up such that the output gap has fully closed. However, this analysis is uncertain and may be partly driven by supply constraints that prove to be temporary. The level of spare capacity may be particularly volatile as both supply and demand recover. This is related to the potential for a significant short-term rise in inflation, driven by global supply constraints rather than by demand.

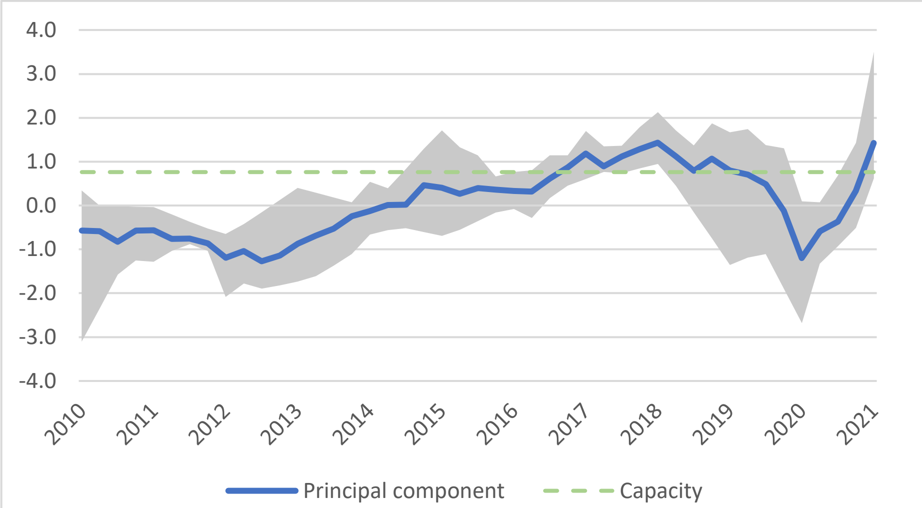
The Panel's view is that Jersey should plan on the basis of the output gap closing in 2024. Future capacity (and also demand to a lesser extent) will depend on migration and the extent to which future migration is permitted by the outcome of the population debate in December.

Figure 1.29

Output Gap estimate based on PCA

Blue line is Principal Component, grey swathe is the minimum and maximum of scaled series used in PCA.

Sources: Statistics Jersey, Government of Jersey, Panel calculations



1.7 Economic growth forecast

The Panel's most recent forecast is from August 2021 and is for the economy to see above trend-growth throughout the forecast period, as the economy recovers from the significant contraction in 2020. **Figure 1.30** shows the Panel's August forecast, which has not been updated for this report.

Figure 1.30

Central economic assumptions

Percentage 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: Panel judgement

August 2021 assumptions

% change unless otherwise specified	2020	2021	2022	2023	2024	Trend 2025+
Real GVA	-9.3	2.2	2.8	3.3	1.6	0.6
RPI	1.3	3.0	3.6	2.6	2.5	2.6
RPIY	1.2	3.0	3.5	2.5	2.4	2.5
Nominal GVA	-8.0	4.8	6.2	5.7	4.0	3.1
Gross operating surplus (including rental)	-17.7	6.1	10.2	9.2	5.2	3.2
Financial services profits	*-27.5*	*4.0*	*14.4*	*16.9*	*7.5*	*3.4*
Compensation of employees (CoE)	0.5	3.8	3.2	3.0	3.0	3.1
Financial services CoE	*1.5*	*3.5*	*3.5*	*3.5*	*2.8*	*3.4*
Non-finance CoE	*0.0*	*3.9*	*3.0*	*2.7*	*3.0*	*2.9*
Employment	-2.4	1.1	1.0	0.8	0.9	0.4
Average earnings	1.1	2.6	2.2	2.1	2.1	2.7
Interest rates (%)	0.2	0.1	0.2	0.5	0.5	0.6*
House prices	6.1	5.0	4.0	3.0	2.0	2.7
Housing transactions	-3.8	5.0	3.5	3.0	2.5	1.5

* Bank Rate forecast for 2025 only

Outturn GVA for 2020 was largely in line with the Panel’s forecast – with a fall of 8.7%, very close to the Panel’s forecast for a 9.3% contraction. The Panel’s judgement of the pace of recovery has not changed significantly since August. However, there have been some important developments since August:

1. Market expectations for interest rates have increased markedly, as shown in **Figure 1.4**. If rates were to increase more quickly than the August forecast, this would result in a faster recovery in banking profits and a faster recovery in GVA.
2. The latest inflation data for September 2021 mean that annual average inflation for 2021 may be slightly lower than forecast by the Panel in August. However, the inflation outlook for 2022 is likely to be for a more rapid increase in prices next year. The Panel’s August forecast implied that real earnings would be squeezed in the medium-term, though a tight labour market for some roles may result in wages and prices rising in some sectors.
3. Average earnings grew by 3.3% in the year to June 2021. However, this is largely due to base effects as June 2020 was a period of significant disruption to the economy. Average earnings over the whole year are likely to have grown more slowly.

The Panel will continue to monitor the latest economic data and update the forecast in due course

Figure 1.31 shows an illustrative quarterly path of GVA that is consistent with the Panel’s annual forecast. This implies that the economy is still significantly smaller by 2024 than it would have been had it followed the path of the October 2019 (pre-pandemic) forecast. Partly this is due to the assumption made in August that interest rates would not recover to their 2019 level by 2024, based on market expectations at the time. However, the forecast also implies some structural ‘scarring’ – equivalent to around 1-2% of GVA. This degree of scarring is smaller than implied by the Panel’s previous forecasts - those that were published in 2020 and early 2021.

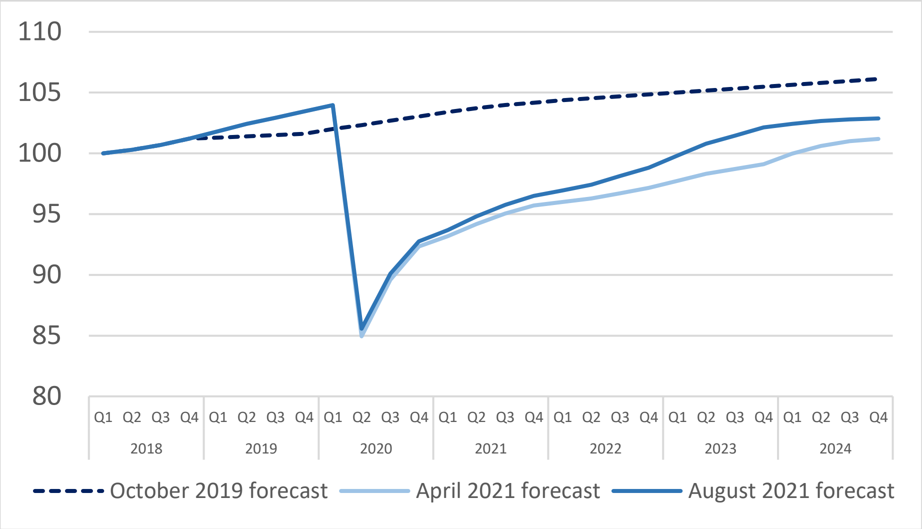
While the likelihood and size of any structural impact remains highly uncertain, the Panel believe this is a prudent assumption based on the impact of the economic crisis brought about by Covid-19. It is reasonable to assume that the sharp contraction in activity may have reduced investment, and disrupted firm-labour linkages. In Jersey there is a risk that it will result in a permanently smaller visitor economy, due to less demand for business travel and the reduction in bed-stock - though some of this may have happened even without the pandemic. The retail sector may also be smaller in the medium term, due to the pandemic’s effect of accelerating the shift to online retail.

Figure 1.31

Economic output forecast

Illustrative shape of quarterly, indexed FPP forecasts of economic output

Sources: Panel judgment



Section 2 - **The Fiscal Outlook**

2.1 Introduction

This section considers the proposed Government Plan for 2022-25 ('the Government Plan'), which was lodged on 21 September 2021 and will be debated by the States Assembly on 14 December 2021. It is the second time that the Government Plan has been prepared since the Covid-19 pandemic started. Whilst there has been success in vaccine deployment and uptake in Jersey, leading to greater confidence in economic growth than last year, it remains a highly uncertain time for global and local economies and the outlook for public finances also remains uncertain. However, there is now greater clarity around the impacts on revenue, expenditure and borrowing which have taken place over the past year. The extent to which Covid-19 cases will rise in the future and whether any further restrictions will be imposed to counter these is less certain, and this creates a downside risk for revenues and the potential for the economy to need further support or stimulus. Equally, revenues may improve more than expected if Bank Rate increases boost financial sector profits.

Proposed Government Plan 2022-25

The proposed Government Plan sets out:

- An operating deficit of £85m in 2022 before returning to surplus from 2023 onwards, as a result of improved revenue forecasts
- No new revenue-raising with changes to income tax thresholds offsetting duty increases. The commitment to set out £10m revenue raising from 2024 has been retained.
- £40m windfall from sale of part of JT Global in 2021, all of which earmarked for spending
- The borrowing requirement for Covid-19 in 2022 revised down from £457m to £259m then to decrease in future years of the Government Plan
- Refinancing existing pension liabilities, saving £700m (adjusted for inflation) over the long term
- Capital expenditure of £1.1bn over four years including £724m for Our Hospital

Public Finances Law

The Public Finances Law 2019 (the 'PFL') requires the FPP to prepare an annual report on the state of the economy and on government finances as set out in the Government Plan. The report is required to comment on:

a. the strength of the economy in Jersey;
b. the outlook for the economy in Jersey;
c. the outlook for world economies and financial markets;
d. the economic cycle in Jersey;
e. the medium-term and long-term sustainability of the States' finances in light of the States' financial assets and liabilities; and
f. the advisability of transfers to or from the Strategic Reserve Fund and Stabilisation Fund

Fiscal framework

Previous Government Plans set out a number of guidelines that form part of Jersey's new fiscal framework and these guidelines continue to underpin this year's Government Plan. They are:

- seek to increase the Strategic Reserve and public sector net worth, while following the advice of the Fiscal Policy Panel on borrowing and net financial assets.
- run a primary structural current balance or surplus in the long term until the Strategic Reserve is judged large enough to meet its mandate.
- borrow only to finance investment (or refinance liabilities), except under times of economic duress, and monitor the impact on net financial assets.

The Panel will assess the extent to which the Government Plan follows the fiscal framework guidelines. The Panel is pleased that last year's recommendations were generally met.

The remainder of this section is set out as follows:

- Income and expenditure, including current surplus/deficit, rebalancing, revenue forecast and capital (section **2.2**)
- The adjusted fiscal position, i.e. the aggregate impact of government activity on the economy (section **2.3**)
- Flexibility (section **2.4**)
- Net asset position, including the forecast for reserves (section **2.5**)
- Borrowing (section **2.6**)
- Initial debt strategy (section **2.7**)
- The Panel's previous recommendations (section **2.8**)
- Future fiscal considerations in the Government Plan (section **2.9**)
- Long-term challenges (section **2.10**)

2.2 Income and expenditure

The headline metric in the Government Plan is the 'operating balance', which includes current spending and income and excludes capital spending. This metric includes depreciation as the expense of the capital stock 'used up' to deliver public services. The Panel supports depreciation being included in the operating balance as it removes incentives to cut capital spending in order to achieve a balanced budget.

The measure differs from the 'primary structural balance', which is used in the fiscal framework. The primary structural balance differs from the operating balance in two ways:

1. It includes an adjustment for the economic cycle (i.e. it is a structural balance, that aims to remove any cyclical component in expenditure and revenue). This relies on the judgement of the Panel, as set out in section 1.
2. It excludes investment returns and borrowing costs whereas the operating balance includes both borrowing costs (for the revolving credit facility, refinancing pension liabilities, Our Hospital and the housing bond) and some investment returns (on the Consolidated Fund and Currency and Coinage Fund).

While the structural budget balance is more of a question of judgement, it is possible to produce the primary budget balance using figures in the Government Plan. **Figure 2.1** sets out recent outturns and a forecast to 2025 for the primary balance / primary budget position, by excluding investment returns and borrowing costs.

Figure 2.1

Income and expenditure forecasts

£m (current prices). 2021 includes an extraordinary £40m dividend from JT Global

Source: Panel calculations based on data from Treasury and Exchequer

The primary budget was in deficit during 2020 of £88m after previous years of surplus. This was an appropriate response to the economic conditions triggered by the pandemic and the deficit is in line with the FPP's advice to support the economy. The primary budget is forecast to continue to be in deficit in 2021 and 2022 despite a one-off exceptional dividend from JT in 2021. From 2023 onward the primary budget is in surplus, but this is driven by the temporary suspension of the States Grant in 2023.

Figure 2.2

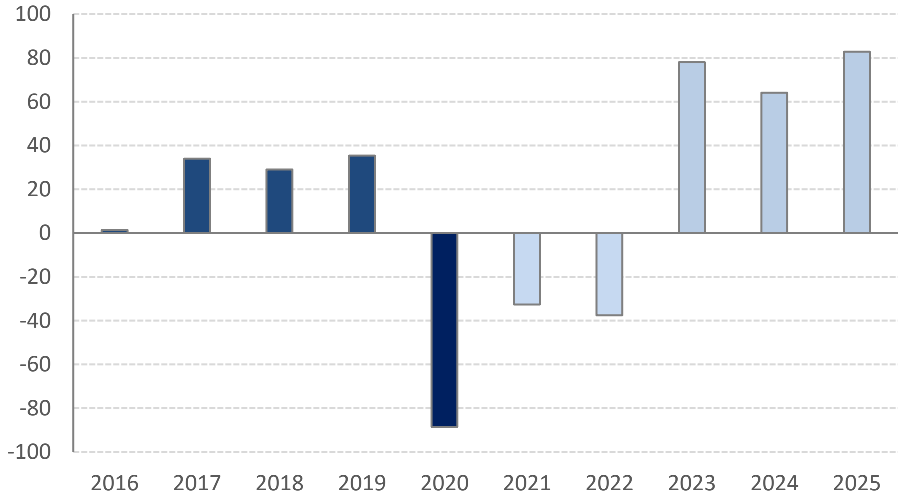
Primary surplus/deficit

Primary budget surplus - £m (current prices)

Outturn (dark blue bars) and forecast (light blue bars)

2021 includes an extraordinary £40m dividend from JT Global

Source: Panel calculations based on data from Treasury and Exchequer



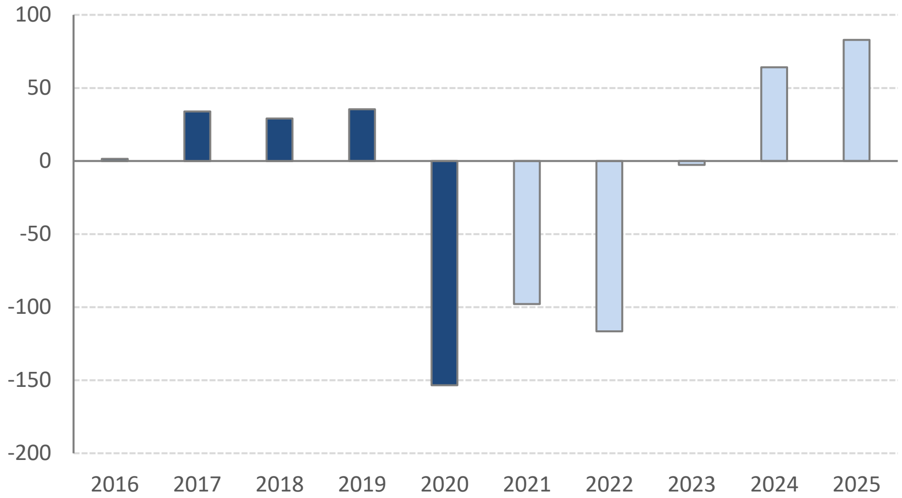
The 'States Grant' is an annual transfer to the Social Security Fund from the Consolidated Fund to support old age pensions and some working age benefits. The Social Security Fund receives this annual grant, in addition to the contributions received from employers, employees and the self-employed. The aggregate value of this transfer is calculated using a formula set out in law, though the States Assembly has suspended this for 2020 and 2021 and the Government Plan proposes the States Grant is not paid in 2022 and 2023. Last year, it was intended that from 2024 onward, the States Grant would be fixed at £65m per year, however, this year's Government Plan reverts back to using the formula, leading to an estimated £83m in 2024 and £85m in 2025. Without the suspension of this grant, the budget deficits would be larger in 2022 and the budget would switch from a surplus to a small deficit in 2023. But even reverting to the formula, the budget is still in surplus in 2024 onwards, in line with FPP advice to balance the budget by 2024.

Figure 2.3

Primary surplus/deficit if States Grant was not withdrawn

Primary budget surplus - £m (current prices)
Outturn (dark blue bars) and forecast (light blue bars)
2021 includes an extraordinary £40m dividend from JT Global

Source: Panel calculations based on data from Treasury and Exchequer



Although economic growth forecasts have improved since the last Government Plan, it remains appropriate for the Government to run a budget deficit in the next year and bring the budget back into balance by 2024, while retaining flexibility for further economic support if necessary. Any surpluses generated from stronger revenue should be used to support the balance sheet. This is in line with Fiscal Policy Panel advice provided to the Treasury Minister in August.

The Government Plan also sets out a forecast of the 'Government of Jersey Group' surplus, which includes the income and expenditure of all funds. This shows that, including investment returns and borrowing costs, the balance of income and expenditure improves rapidly from a small surplus of £14m in 2022 to £221m in 2025. However, this compares to a surplus of £415m in 2019. This is a significant improvement from last year's Government Plan, which forecast a £93m deficit in 2022 and smaller surpluses in 2023 and 2024.

The level of investment returns in individual years, and over the long term, is highly uncertain and while the assumptions used in the Government Plan appear prudent there is a risk that investments could perform significantly differently from past performance.

Figure 2.4

Government of Jersey Group forecast

£m

Source:
2019-21 from Treasury and Exchequer;
2022-25 from Government Plan: Table 52;

	2019	2020	2021	2022	2023	2024	2025
Operating surplus	18	-113	-43	-85	30	17	36
Trading operations surplus	2	3	3	3	4	4	5
Special Funds surplus	10	-97	-99	-72	-80	-3	-3
Group operational surplus	**31**	**-208**	**-139**	**-154**	**-46**	**19**	**38**
Investment returns	384	240	152	168	169	173	183
Group surplus	**415**	**32**	**13**	**14**	**124**	**191**	**221**

2.2.1 Expenditure related to Covid-19

As with the previous two years, a large driver of the deficit in 2022 is due to one-off/temporary spending pressures related to mitigating and dealing with the impact of the Covid-19 global pandemic. This includes both costs associated with reducing the spread of the virus, treating cases of the virus and supporting the economy.

Figure 2.5

Covid-19 expenditure

£m

Source:
2020-21 from Treasury and Exchequer;
2022-25 from Government Plan: Table 8.

	2020	2021	2022	2023	2024	2025
Nightingale field hospital	10	5	0	0	0	0
Cofunded Payroll Scheme	98	33	0	0	0	0
Borrowing costs	2	3	7	9	8	8
Income support costs	6	1	1	0	0	0
Economic recovery	12	0	10	10	0	0
Education costs	4	1	0	0	0	0
Test and tracing programme	16	30	21	0	0	0
Vaccine	0	6	7	0	0	0
Fiscal stimulus	0	50	0	0	0	0
Other	43	26	42	7	3	2
Total Covid costs	**190**	**155**	**87**	**26**	**11**	**9**
Covid-19 costs as a proportion of GVA	**4%**	**3%**	**2%**	**0%**	**0%**	**0%**

2.2.2 Rebalancing

The Government Plan maintains a target of £120m 'rebalancing', relative to 2019, to be reached by 2024. The Plan states that a wide range of fiscal measures will be required and therefore rebalancing incorporates efficiencies. The categories of rebalancing that the Government Plan states are:

- A reduction in spend, delivering better quality services for less
- A reduction in current spend through Zero Based Budgeting and service reviews
- More efficient collection of existing income and better debt management

- Increasing the Government's revenue through further recovery of existing costs, moving towards full cost recovery of services where appropriate
- The extension and increase of existing charges or the introduction of new charges as revenue-raising measures

The 2019 Government Plan targeted £100m efficiencies across 2020-23 and a further £20m was subsequently added last year to be realised in 2024. The Panel notes no further rebalancing objectives have been stated for 2025 above and beyond existing plans. Of the £40m efficiencies targeted for 2020 and £60m for 2021 (including the £40m recurring from 2020), £40m was achieved in 2020 albeit some being delivered through £15m one-off efficiencies.

As some of these efficiencies were one-off, this increases the new amount of rebalancing needed in 2021 so the target changed from £20m recurring to £35m. Of the new target, £30m are due to be delivered on a recurring basis with £5m of one-off which again will be added to 2022. The Government Plan sets out a target of £22m of rebalancing measures for 2022, with detail set out in the Plan.

The largest measures for 2022 are £5.3m of spend reduction from the non-staff inflation budget for the Council of Ministers, £4.3m from enhanced tax compliance and £3.8m from non-staff cost reductions in the Health and Social Services department. It appears many of these efficiencies are due to technology investment leading to increased productivity of staff and efficiencies resulting from Covid-19 which are locked-in.

There is less detail provided on rebalancing beyond 2022, but there are several opportunities identified particularly around driving productivity through use of technology services, rationalising the government property estate, increasing focus on prevention and enhanced commercial services.

The FPP recommends that efficiencies should be sought regardless of the stage of the economic cycle and the government should continue to search for efficiencies in future years. A deterioration in economic conditions should not result in any divergence from the efficiencies programme.

Whilst rebalancing targets have been maintained in the Government Plan, the net departmental expenditure has still increased in future years. For example, in 2024, net revenue expenditure has increased by £57m between this and last year's government plan (excluding new hospital borrowing costs). This includes new investment in strategic priorities, which has increased despite no increase in rebalancing. It is not clear therefore how this applies the principle that 'Savings generated over the Government Plan period are the primary source of funding for new investment'. If improvements in fiscal forecasts are used to commit to new, recurring expenditure this will make long-term fiscal sustainability harder to achieve. The Panel recommends that increased spending should be given the same rigour as rebalancing ensuring strong value for money and the major drivers of any increased expenditure should be communicated clearly in next year's Plan.

The Panel understands that the current approach to Government Plans is to outline detailed rebalancing proposals for the next year with general ambitions for future years. Rebalancing and efficiencies can be difficult to pre-empt, especially in uncertain economic times. However, the target remains ambitious and efficiency gains can often be challenging to achieve in practice without planning. Current forecasts suggest that there will be delays in finding £5m of efficiencies in 2021, which were previously committed to in last year's Government Plan. **The Panel recommends that detailed, realistic and time-bound targets for all years should be built into the four-year Government Plan.** This planning of medium-term rebalancing may help identify opportunities to 'invest-to-save' and allow for departments to plan how they will achieve efficiencies.

2.2.3 Revenue forecast

This Government Plan is based on a revenue forecast that is around £71m higher for 2022 than the forecast from the previous Government Plan. There are also further increases in the forecast for beyond 2022. The revenue forecast is conditioned on the FPP economic forecast from August and therefore follows the upward revisions to the FPP forecast, however, the latest forecast for 2023 remains lower than the pre-pandemic forecast.

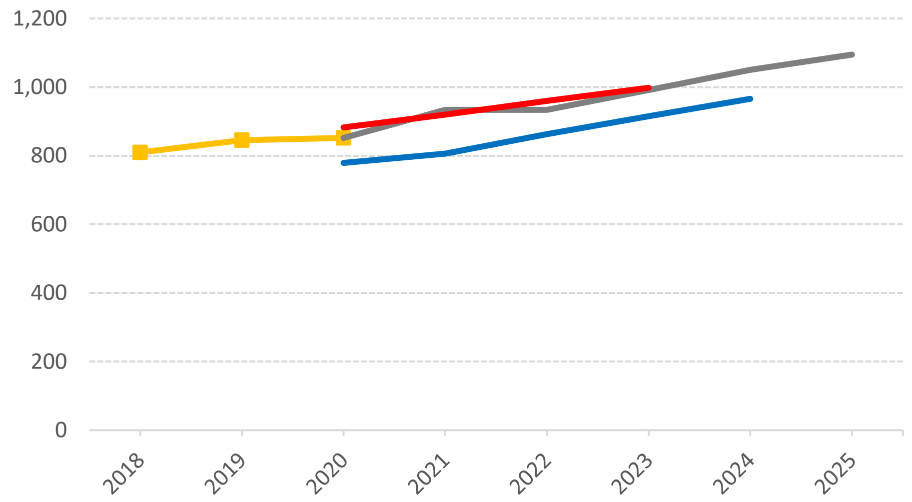
There is an £84m difference for 2024 between this and last year's government plan resulting from the upward revision since the last autumn forecast. Of this the majority relates to an increase in the forecast for income tax (personal and corporate) of £59m, with the GST forecast increased by £9m, stamp duty by £11m, impôts by £2m and other income by £3m.

Figure 2.6

General revenue income forecast

£m
Red line is Government Plan 2020-23
Blue line is Government Plan 2021-24
Grey line is Government Plan 2022-25
Yellow line is outturn

Source: Government Plan Table 23; Government Plan 2021-24 Table 19



2.2.4 Revenue measures

There are only small revenue-raising measures in 2022, which are forecast to raise £0.5m. It is limited to duty increases, which is in line with the Panel's advice to avoid implementing significant new revenue streams too quickly.

No other significant changes have been made to 2022 revenue, with part of fuel duty and Vehicle Emissions Duty rises going towards the Climate Emergency Fund corresponding to £0.8m.

Figure 2.7

Government Plan revenue forecast and measures in 2022-25

£m, total revenue

Source: Government Plan: Table 22

	2022	2023	2024	2025
Income Tax	638.0	687.0	729.0	768.0
GST	103.6	105.8	107.8	110.0
Impôt duties	71.0	72.8	73.2	73.6
Stamp duty	41.7	42.3	43.7	45.0
Other income	66.1	67.7	69.5	70.9
Central scenario - IFG	**920.5**	**975.6**	**1,023.2**	**1,067.6**
Domestic Compliance	12.9	14.0	15.5	15.5
Budget measures	0.5	0.5	0.5	0.5
GST de minimis reduction	0	1.1	1.1	1.1
Future additional tax measures	0	0	10.0	10.0
General Tax Revenue	**933.9**	**991.2**	**1,050.3**	**1,094.7**

The Government Plan set an initial target last year of approximately £10m of further new revenue from several sources, with measures to be brought forward in Government Plan 2022 for implementation by 2024 including:

- Broadening the corporate income tax base
- Taxation of medicinal cannabis growing and processing
- Reviews of commercial and residential stamp duty

• Changes to GST de minimis for imported goods

Some of these have been progressed such as:

- The Revenue Policy Development Board has decided rules on the taxation of medicinal cannabis industry including a 20% rate although regulations and revenue forecasting is yet to be completed.
- The Treasury Minister proposes to make a change to GST Law to take effect from 2023 making it mandatory for certain overseas retailers to register for GST and then subsequently reducing the GST de minimis level.
- The stamp duty review is due to be completed next year with legislation introduced on its completion. The review will cover the scope and the differential between residential and commercial property rates.

There has been no further detail on the broadening the base for corporate tax. It remains unclear whether the £10m will be achievable by changing existing tax rules or whether indeed it will be much larger. Detailed revenue raising measures, which are costed, should be set out in next year's Government Plan. The future Government Plans should at the same time retain flexibility to look at other revenue raising streams to those suggested above or possibly alter the amount raised to ensure taxation rates are based on clear rationale and understanding of implications rather than specifically focussed on an aim to achieve £10m.

The economy is recovering, but is still weakened and the outlook remains unclear. Whilst inflation is forecast to be higher over the next year, revenue raising steps, including higher taxes, impose a burden and would not be appropriate at present. Yet raising revenue over the longer-term is important and the Government should clarify how it will do so in its next Government Plan.

The revenue measures outlined in the Government Plan include £13m of additional revenue from 'domestic compliance' in 2022, rising to £16m in 2025.

2.2.5 Hypothecation

Hypothecation is where the government commits to spend a revenue stream, usually taxes, on a specific objective or policy issue and not for any other means. The Panel has previously recommended that hypothecation should only be introduced where revenue and spending are likely to be justifiably related. The risk presented by hypothecation is exacerbated by the impact of Covid-19 on the public finances.

The 2022-25 Government Plan continues to hypothecate an element of the increase in excise duties towards the Climate Emergency Fund. The Government Plan also signals further revenue streams; a road user charge, commercial solid waste charges, car parking charges and a travel duty with the intention to hypothecate this into the Climate Emergency Fund.

The challenge in delivering Net Zero by 2030 will require system wide consideration of policies across the whole Government Plan and will need to be broader than the Climate Emergency Fund and hypothecation.

Expert analysis produced for the States Assembly in 2019 suggests achieving net zero by 2030 would cost between £60m and £360m in the heating and road transport sectors, which account for the majority of Jersey emissions. The Panel welcomes the discussion of a wider range of policies referenced in its recent 'Carbon Neutral Preferred Strategy', which goes beyond small, hypothecated taxes. This states that costed policies and programmes will be presented in the Carbon Neutral Roadmap later this year.

Achieving net zero will require a careful use of both taxes and expenditure to create the right economic incentives. It is important that the existence of a Climate Emergency Fund does not create a presumption that revenue received in the Fund should be equal to climate related spending.

As with recent past Government Plans, this year's Plan proposes to create new funds, e.g. the Technology Fund and the Health and Social Recovery Fund. Creation of funds can be problematic as they reduce transparency of public finances and the flexibility the government has to spend money in the way in which it will best deliver value for money for Jersey. Taking the Technology Fund as an example which is proposed to receive a transfer of £20m, it may be that the government are able to identify £15m very beneficial projects and £5m low value projects. It would be optimal for the government to only spend the £15m and use the remaining £5m to support the balance sheet and potentially generate returns. The inverse of this example is true in that there may be £25m worthwhile projects but the government is overly constrained. **The proliferation of separate funds is undesirable e.g. the new Technology Fund. Thorough consideration should be given towards the consolidation of funds and no further funds should be proposed without strong rationale.**

2.2.6 Capital

The Government Plan sets out a plan for £1.1bn of capital spending over the four-year period, including £10m from 'trading funds'[2]. The Our Hospital project represents 64% of this spending, leaving £398m of other investment.

Outside of Our Hospital, spending is largest in 2022 at £127m and decreases gradually to £86m in 2025. Our Hospital gradually increases with £85m planned in 2022 growing to a peak in 2024 to £287m. This is in addition to £13m of funding that was required to be brought forward to 2021, which was temporarily funded from other existing capital allocations.

The main areas of capital spend relate to Our Hospital (£724m), major projects (£190m), school and educational developments (£62m), estates (£42m), IT (£38m) and replacement assets (£34m). The largest individual areas of spending / projects include:

- Our Hospital (£85m in 2022)
- Integrated technology solution (£19.7m in 2022)
- Infrastructure Rolling Vote and Regeneration Including St. Helier (£13.3m in 2022)
- Sewerage Treatment Works (£10.7m in 2022)

The majority of these have been designated as 'major projects' and therefore will span multiple years.

Figure 2.8

Capital spending

£m

Source: Government Plan: Table 15 and Table 16

Capital programme area	2020	2021	2022	2023	2024	2025	Total 2022-2025
Central Planning Reserves	12	4	1	0	0	0	2
Major Projects	0	0	73	52	41	25	190
Replacement Assets	10	11	8	7	8	11	34
Disc Law, safeguarding, Reg of Care	3	4	2	2	2	2	6
Schools extensions/improvements	2	7	11	13	13	26	62
Infrastructure incl Rolling Vote	25	14	2	2	2	1	7
Information Technology	26	40	15	13	6	4	38
Estates including new Schools	15	48	12	11	7	12	42
Reserve for Risk and Inflation	1	2	2	2	2	2	8
Trading Funds	2	1	2	2	3	3	10
Total exc. Hospital	**95**	**131**	**127**	**103**	**82**	**86**	**398**
Our Hospital	11	49	85	182	287	170	724
Total with Hospital	**106**	**180**	**212**	**285**	**370**	**255**	**1,122**

Capital spending for 2022 is estimated to be £212m. This represents a large increase from 2021, where capital spend was budgeted as £127m, although when Our Hospital is stripped out of 2022 spending, this represents a similar level of spending to 2021 also at £127m.

The latest forecast for 2021 is that £180m will be spent, significantly in excess of the 2021 allocation of £127m. This excess is predominately due to £55m

[2] The Car Parking Trading Fund and the Fleet Management Trading Fund

capital allocations from previous years being spent in 2021, largely on the Our Hospital project.

A large part of the government capital programme appears to relate to IT and therefore may have a limited impact on the local construction sector. However, subsidiary companies (i.e. public corporations such as Andium Homes, the States of Jersey Development Company and the Ports of Jersey) are projected to spend £772m of capital over four years – making a total of £1.9bn over four years for this wider 'Government Group'.

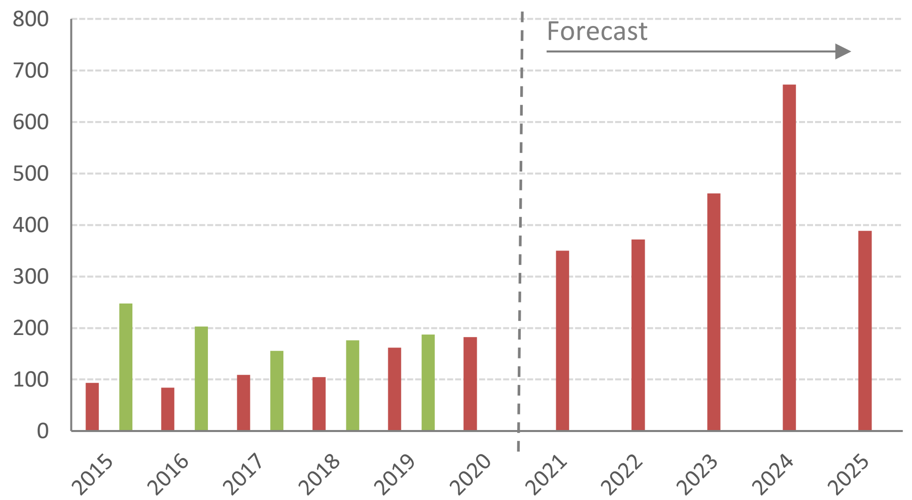
It appears that the difference between the capital that government is forecasting and that it ends up spending has reduced over the past five years as can be seen in **Figure 2.9**. In 2016, the government forecast that it would spend £248m and only spent £84m, creating a difference of £164m. In the most recent data relating to 2020, this difference was only £5m representing a much greater amount of allocated capital being spent. Whilst there remains an underspend across all recent years, this suggests the government is becoming better at delivering on forecast capital expenditure. This is relevant to the adjusted fiscal section in section **2.3** as large variations in spending including capital affect the expected fiscal position.

Figure 2.9

Capital spending - outturn and forecast

£m (current prices) including trading operations and subsidiary companies
Red bar is outturn and GP 2022-25 forecast
Green bar is most recent forecast before outturn from previous GPs and Budgets

Source: Treasury and Exchequer



In the 2019 Annual Report, the Panel set out a recommendation to undertake further work to set out how the capital programme can be delivered without exacerbating capacity constraints in the local construction industry. Given the economic outlook has been worse across the past year and a half, there may have been some spare capacity in the construction sector and this has been less urgent. However, with the economy recovering, this spare capacity looks to being used up and this will become more acute with work projected to start on Our Hospital next year. This could mean the government finds it harder to deliver on future capital plans and projects being delayed. The Government should give further consideration to constraints and how to source the labour required for the whole programme. This includes consideration not only of the financial resources required but also the resources within government to manage projects, and resources within the supply chain to deliver.

2.3 The adjusted fiscal position

The Panel's reports also set out an indication of how supportive the overall fiscal position is to the economy, i.e. how much demand government is putting 'into the economy' as current and capital expenditure; and how much government is 'taking out' of the economy in taxes and contributions.

Overall, as outlined in the previous sections, government is continuing to provide significant support to the economy through the overall fiscal balance:

1. The significant government group capital programme including spending through Our Hospital and further capital spending from the subsidiary companies – in particular Andium Homes and the States of Jersey Development Company. As stated in section 2.2.6, the latest estimate for capital expenditure in 2021 is £60m higher than previously forecast.
2. A current deficit in the first year, reducing as the economy recovers.

This overall support to the economy is appropriate during a period when a degree of spare capacity is expected to persist and there remains uncertainty as to the extent of economic recovery and resilience of Jersey business. **Whilst the economic assumptions have improved since the last Government Plan, the uncertainty means it would be prudent to continue with planned support across the next year to mitigate downside risk. Temporary economic support should be unwound gradually as the economy recovers. Expenditure relating to long term capital projects should not be delayed or held up by changes in Covid-related spending.**

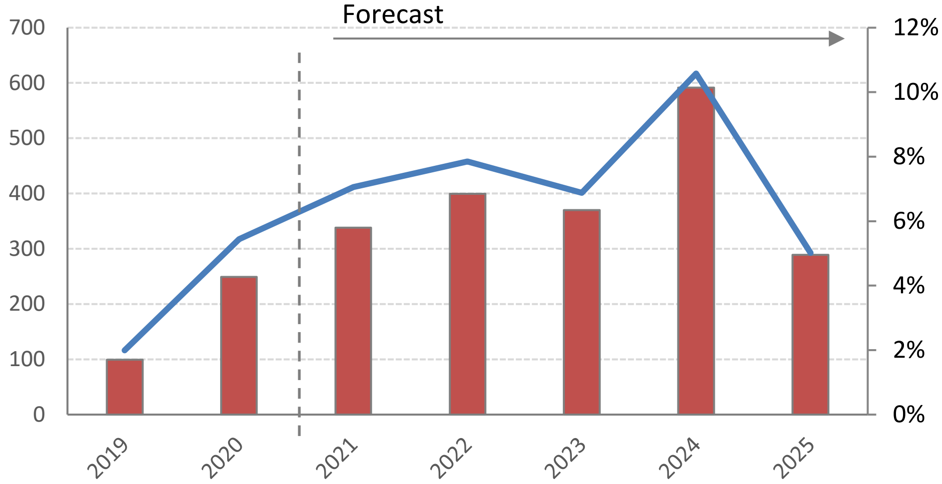
Figure 2.10

Adjusted fiscal position

Red bars represent total government net spending into the economy including expenditure and Group capital subtracting receipts

Blue line is spending as % of GVA

Source: Treasury and Exchequer; Panel calculations



2.4 Flexibility

Whilst economic assumptions have improved since the Government Plan, these assumptions are subject to greater uncertainty than previous periods. The winter period inevitably creates greater health risks and it is possible that there will be an increase in Covid-19 cases, which could impact on finances through enforced or voluntary changes to behaviour. Government should in the first instance allow the automatic stabilisers to work. However, these are comparatively smaller than other countries due to Jersey's relatively low marginal tax rates and because Jersey's personal tax base is less cyclical than other jurisdictions (see Box 1 of the Panel's 2018 Annual Report).

If the economic outlook deteriorates and negative impacts on public finance do transpire, the government may need to provide further fiscal stimulus to mitigate the impacts of a further recession. On the other hand, if the economy continues with its recovery and surpasses current forecasts then it would be sensible to avoid introducing new stimulus measures and any extra revenue should be used to strengthen the balance sheet. It is more difficult for the Jersey government to manage potential overheating given it cannot control monetary policy. Therefore, the government should also consider how to reduce any inflationary pressure from government spending; this could be through tax rises or reducing expenditure. These demand-dampening policies are likely to be more difficult to achieve operationally and politically and the trade-offs will have to be considered carefully. It is likely a combination of expenditure reductions and tax rises would be needed, however, the Panel considers areas this may be easier are where multiple policy objectives could potentially be achieved concurrently e.g. i) bringing rebalancing forward and/or

ii) proposing new taxes that satisfy other objectives such as taxing carbon-generating activities.

The Panel believes that the upside risks currently outweigh the downside risks given recent change in market expectations for a sooner than previously expected rise in interest rates. The Panel have analysed the recent impact of the decrease in interest rates on GVA, and the estimated impact on government revenues. Based on this analysis, it is approximated that each 1/4pp increase in interest rates could result in an increase in annual revenues of around £10m.

Given these risks, the Panel recommends that flexibility is retained with regards to fiscal stimulus in this Government Plan period.

As indicated in section 1, a further significant increase in inflation over the next 6-9 months appears highly likely at this stage, but this is not primarily driven by the impact of government support on demand. Therefore, **any spike in inflation should not be seen as a reason for significant fiscal consolidation**, e.g. increased taxes, in order to reduce demand in the economy. Indeed, the impact on households may be negative, reducing demand. Government should make contingency plans for how it might meet the cost impact of higher inflation on its own activities but should not seek to use fiscal policy to counteract inflation that is driven by global factors or by supply constraints.

Conversely, it would be futile to attempt to compensate fully households and businesses for the increase in costs. For example, reductions in consumption taxes will only increase demand and lead to further inflationary pressure.

Government should continue to follow the actions set out in the report of the Inflation Strategy Group[3], supporting the role of competition in the economy and seeking efficiencies where possible to avoid increasing the cost of user-pays charges.

2.5 Net asset position

In 2019, the Government Plan set out the current fiscal framework with several guidelines that should continue to underpin this year's Government Plan. One of these guidelines states that government should seek to increase public sector net worth, i.e. the overall net asset position including both physical assets and net financial assets. This is a key objective for achieving fiscal sustainability in the long term. Further, the Public Finances Law requires the Panel to comment on the sustainability of public finances in light of the States' financial assets and liabilities. The revisions to the economic assumptions will ease some of the pressures of public finances but the economy is still

[3] Report of the Inflation Strategy Group - https://statesassembly.gov.je/assemblyreports/2020/r.16-2020.pdf

expected to remain smaller in the long run than was forecast in the pre-Covid-19 period.

Figure 2.11 sets out how the net asset position will change over the 2022-25 Government Plan period. The forecast includes balance sheet forecasts for the subsidiary companies (Andium Homes, Ports of Jersey and States of Jersey Development Company).

Figure 2.11

Net asset position

£ billion (current prices)

Source: Treasury and Exchequer

	2019	2020	2021	2022	2023	2024	2025
Physical assets	3.9	4.0	4.1	4.2	4.5	4.8	5.0
Financial assets	3.7	3.7	3.8	3.6	3.5	3.4	3.4
Total	7.6	7.6	7.8	7.9	8.0	8.2	8.4
as % of GVA	**152%**	**167%**	**164%**	**154%**	**148%**	**146%**	**145%**

As a proportion of the economy, i.e. gross value added, the net asset position is forecast to remain relatively stable throughout the Government Plan period with steady growth of the net assets. Financial assets decline from 2021 and physical assets increase, which is largely driven by the building of the hospital. Net assets as a percentage of GVA is temporarily high in 2020 and 2021 as net assets remained stable during the pandemic primarily due to strong investment returns whilst GVA was lower. This temporary high percentage falls as GVA increases at a faster pace than net assets, as part of the economic recovery.

Financial assets are held in funds including the Strategic Reserve, Consolidated Fund, Stabilisation Fund and a number of 'Social Security Funds'. Due to the forecast receipt of the £756m bond to pay for Our Hospital in 2022 into the Strategic Reserve Fund, the aggregate value of these funds is temporarily increased when compared to the pre-pandemic position with the Strategic Reserve increasing from an estimated £1bn in 2021 to £1.7bn in 2022. The aggregate value of these funds is due to fall across the Government Plan period predominately due to the drawdowns on the Strategic Reserve Fund with it falling from £1.7bn in 2022 to an estimated £1.1bn in 2025. When Our Hospital temporary payments are stripped out, it can be seen that the 2025 aggregate reserves are still below the 2019 level as a proportion of GVA.

Figure 2.12

Reserves

Size of selected funds, balance at end of year (£m)

Source:
2019 and 2020 from Treasury and Exchequer;
2021-24 from Government Plan: Table 40

	2019	2020	2021	2022	2023	2024	2025
Consolidated Fund	161	-	-	-	-	-	-
Strategic Reserve	906	968	1,008	1,033	1,061	1,090	1,121
Stabilisation Fund	50	1	1	1	1	1	1
Social Security Reserve Fund	1,983	2,093	2,105	2,142	2,172	2,292	2,420
Social Security Fund	92	76	85	88	86	79	78
Health Insurance Fund	108	108	92	77	62	51	48
Long Term Care Fund	26	37	44	51	58	65	71
Total	**3,327**	**3,283**	**3,335**	**3,391**	**3,441**	**3,579**	**3,739**
Total as % of GVA	67%	72%	70%	67%	64%	64%	65%

The Consolidated Fund can be seen as the government's day-to-day fund for revenues and expenditure, including capital expenditure. Over the Government Plan period the size of this fund is forecast to be zero at year end. The Consolidated Fund is prevented from running negative balances through a combination of borrowing and reducing transfers to other funds.

The following sections consider three of the funds in more detail.

2.5.1 Stabilisation Fund

The Stabilisation Fund was created in 2006 to help smooth the economic cycle, receiving transfers in when the economy is performing well, or precisely when it is 'above trend', and to use these resources to support spending when economic conditions are worse, or when the economy is 'below trend'.

Last year, given the economic conditions and protracted period below trend, the Government transferred nearly all of the balance of the Stabilisation Fund to the Consolidated Fund. There remains £0.6m in the fund.

In the 'Advice for the Government Plan' report, the Panel advised that **when the balance on the Stabilisation Fund is not sufficient, it is appropriate to consider alternative methods of funding counter-cyclical fiscal policy, including borrowing.**

The ability to draw on the £50m of past surpluses last year was valuable and demonstrates the importance of the Stabilisation Fund in supporting counter-cyclical policy in Jersey.

The Panel recommended in its August 2021 letter to the Treasury Minister that any surpluses that occur should be prioritised to rebuilding the Stabilisation Fund. This is in line with the Panel's advice that the government should plan on the basis of the economy returning to its trend level of output in 2024. The Government Plan 2022-25 does not have any transfers to the Stabilisation Fund; however, surpluses are instead used to support the balance sheet in other ways e.g. restoring the States Grant to the Social Security Fund. **If the economy performs better than expected, surpluses generated from better budgetary outturns should be transferred to the Stabilisation Fund.**

It is important to build the Stabilisation Fund in future years, whilst retaining flexibility to support the economy in the short term if needed and therefore it remains sensible to have short-term financing options available such as the Revolving Credit Facility. The utility of the Facility was seen during the pandemic, where it allowed the government to provide the necessary economic stimulus and to support the pandemic-related spend without needing to use reserves.

2.5.2 Strategic Reserve

The Strategic Reserve has a mandate of protecting the economy from structural threats, for example a severe and permanent contraction in the financial services sector.

The Government Plan proposes using investment returns and capital appreciation to finance long-term borrowing including the repayment of Our Hospital debt at £756m, pension debt at £480m and repayment of Covid-19 fiscal stimulus debt at £259m. No principal repayment is expected to be due on debt until 2041. Whilst these repayments have the impact of dampening the future growth forecast of the Strategic Reserve, it is still forecast to rise across the next 40 years due to expected future returns on investments offsetting repayment costs. This would also be the case if the future rate of return were 4.1% (nominal) as opposed to the central estimate of 4.6%, however, it is important to note that these returns are uncertain and could be even lower than the low-profile path.

Last year, the States Assembly agreed to move all personal taxpayers from prior year basis to a current year basis for income tax purposes. This meant that last year, taxpayers paid for their 2020 current liability rather than their accrued 2019 liability which has been frozen and will be paid in the future. This will have the impact of meaning a new revenue for receipts relating to the 2019 tax liability. The Government Plan 2022-25 states that it intends to transfer these amounts into the Strategic Reserve for eventual repayment of Covid-19 debt. This is prudent given these are one-off payments, and under accounting rules were previously recognised as an asset and so should not be used for day-to-day spending to avoid a weakening of the balance sheet. Likewise, the Government Plan predicts that the value of these receipts will exceed the Covid-19 borrowing and this revenue should be considered in future plans, with the Government Plan stating that it will be "available for transfer to the Strategic Reserve or to be available for future infrastructure investment". This is in line with the fiscal guidelines.

The Panel previously recommended that the Government should set out a plan to increase the Reserve. Based on analysis of the fiscal impact of crises in other small economies, the Panel suggested that a Strategic Reserve of over 30% of GDP would have been prudent in those cases. This was considered a minimum bound and up to 60% could be required. The Government Plan forecasts would see the Reserve remain broadly stable at 21%-22% of GVA over 2022-2025

The Strategic Reserve has been projected forward to the next 40 years to analyse how it changes with debt and interest payments. This is done using simplistic annual growth rates rather than more detailed modelling which will be outlined in the investment strategy next year. In the long term, the Reserve will increase over the next 20 years before reaching 28% of GVA and then fluctuating between 20% and 30% for the following twenty years as repayments draw down upon the balance whilst returns increase the balance. This can be seen in **Figure 2.13**. Bond proceeds and payments related to Our Hospital have been excluded from the Strategic Reserve balance given this represents temporary changes, not related to growth of the Reserve and will not affect the long-term position. Given current projections do not forecast the Reserve reaching 30% for the next 40 years, the Panel's lower bound recommendation, it would be prudent to build the Strategic Reserve through payments from the Consolidated Fund in earlier years. The timing of any possible future requirement for the Strategic Reserve to be used to mitigate any structural economic decline is highly uncertain, however there is a risk that the balance would be insufficient if required in the medium term. This may have further implications for the repayment of debt, which is increasingly relevant given borrowing plans laid out in this Government Plan. Consideration should therefore be given to implementing a plan of contributions to the Strategic Reserve towards the end of next year's Government Plan period. **Given economic uncertainty and further years of the economy being below capacity, it is not advisable to make any transfers to the Reserve over the current Government Plan period, in light of the pressure already on the Consolidated Fund and Stabilisation Fund.**

To maintain the Strategic Reserve has required the Government to significantly increase borrowing instead to pay for the costs of the pandemic. Borrowing is covered in more detail in section **2.6.** The Panel considers that borrowing rather than drawing on the Strategic Reserve provides more flexibility and retains the option to use the Reserve in the event of a future shock – when borrowing could be more difficult than it currently is.

In the face of uncertainty, prudent uses of Jerseys funds will be important. In the event of temporary economic distress, fiscal deficits should be financed by borrowing rather than drawing down the Strategic Reserve.

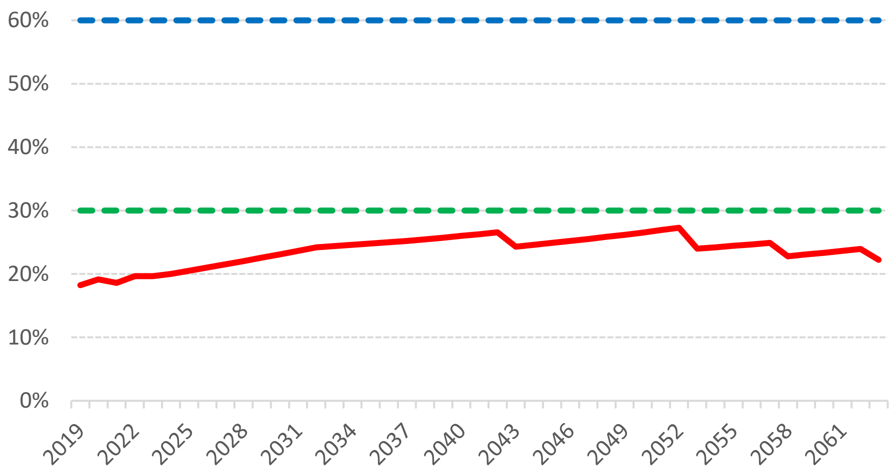
The expectation is still for Jersey's economy, including its financial sector, to return to health following the pandemic. Whilst there is the potential for a structural impact from the pandemic, it is expected that permanent scarring will be relatively small, and the majority of the economic impacts will be recovered with time including interest rate rises. The Strategic Reserve should be retained to manage long-term structural threats.

Figure 2.13

Strategic Reserve as % of GVA with Our Hospital bond issuance stripped out

Red line is SR as a percentage of GVA
Green line is 30%
Blue line is 60%

Source:
2026-2063 from Treasury and Exchequer;
2022-25 from Government Plan: Table 41



2.5.3 Social Security Fund / Social Security Reserve

The Social Security and Social Security Reserve Funds have been built up over the last 20 years with the intention of smoothing the impact of meeting pensions needs of future demographic challenges. They had a combined value of over £2bn at the end of 2020 and therefore represent the majority of Jersey's financial assets. The reserve has been built up predominately through returns on investment and surpluses in the Social Security Fund – due to contributions being collected at a rate higher than the 'break-even' rate.

The initial aspiration was to achieve a balance in the reserve worth five times the annual expenditure, which had been exceeded with the latest actuarial review, published in 2019[4], estimating that the fund balance represented 7.6 times annual expenditure in 2017. The actuarial review projected the fund would remain above five times the expenditure, throughout the projection period covering the next 60 years with a assumption of net migration of 700. In the last Government plan, fiscal changes brought in due to the pandemic, such as the cancellation of the States Grant, and weaker investment returns meant the projections for the reserve fell significantly. The situation has improved

[4] Report by the UK Government Actuary on the financial condition of the Social Security Fund as at 31 December 2017

since and the Fund is now projected to have reserves worth around 4x its annual expenditure in 60 years' time although less urgency is given in the government plan to building this back to higher multiples. **The economic objectives for Funds should be clear. This includes considering whether the objective for the Social Security Fund should be 5x annual expenditure in the long run.**

The 2022-25 Government Plan amends the Grant from the Consolidated Fund to the Social Security Fund in 2024. Last year's Government Plan proposed fixing the allocation at £65m rather than reverting to the existing formula. This year's Plan proposes to reverse this decision and funding has been reinstated to its full amount leading to an estimated £83m grant in 2024 and £85m in 2025.

The combined Social Security Fund and Reserve Fund remains in a relatively strong position after these changes and therefore remains between 42-44% of GVA in the Government Plan period.

Despite the decision to return to the formula for the Grant, the outlook beyond 2024 is forecast for a small decline – both as a proportion of GVA and in nominal terms. Contributions are forecast to be £222m in 2025, with benefit spend of £308m so a States Grant of £85m would leave an annual deficit of around £2m. The Social Security Fund will be subject to a full actuarial review in 2022 which will assess the sustainability of the fund.

The Government Plan previously committed to a review of funding arrangements for the Social Security Fund. Whilst this appears to not have been completed, the States Grant to the Social Security Fund has been restored from 2024 onwards. The reversion to the formula for the States Grant does provide a short-term buffer and reduces the pressure on the urgency of changes potentially needed. The Panel will review the appropriate level of transfers when the actuarial review is complete.

Figure 2.14

Social Security Fund income and expenditure

£m; excludes capital expenditure and transfers to/from Social Security Reserve

Source: Adapted from Government Plan: Table 44

	2022	2023	2024	2025
Contribution income	205	210	215	222
States Grant	0	0	83	85
Benefit expenditure	-284	-298	-305	-308
Surplus	**-78**	**-89**	**-7**	**-2**

2.6 Borrowing

For many years, Jersey has undertaken little to no external borrowing. In the recent past, the only borrowing that the government has engaged in was issuing a £250m bond to finance a ring-fenced fund to lend to affordable housing providers. Since 2014, there has been consideration of borrowing to fund the new general hospital, a large capital project spanning multiple years. Also, the Covid-19 pandemic has put pressures on public finances where the government has made a decision to finance this pressure through borrowing. In addition, the government is seeking to take advantage of an economic opportunity to reduce future payments on liabilities by refinancing pension debt.

The States Assembly has approved the financing of £756m for the Our Hospital project. This is expected to be funded through issuance of a bond due for repayment in 2057 for half of the total and the remaining balance due in 2062. The Government Plan proposes that this is paid through debt issuance and interest assumed at £19m annually until first payment, and the bond repayments are financed through gains on the Strategic Reserve. In the FPP August letter to the Treasury Minister, the Panel referred to previous advice where they had said '*a similar strategy was sensible but, as with any potential alternative strategies, this approach is not without risk'.*

Given financial pressures of reduced receipts and increased expenditure arising during the Covid-19 pandemic, a revolving credit facility for up to £500m was set up in May 2020 with a consortium of local banks. Given previous economic assumptions, it was proposed that £336m of the Facility would be utilised in addition to £50m of borrowing for the Fiscal Stimulus Fund. Due to improvements in the economic assumptions, this has been revised downwards by £127m, retaining the £50m borrowing for the Fiscal Stimulus Fund, meaning only £259m will now be utilised from the Revolving Credit Facility.

Finally, the government proposes re-financing existing pension liabilities where the government would issue borrowing valued at £480m to then be repaid in 2052. Currently the government has a finance charge on the existing liability to the teachers and public employees schemes and the Government Plan estimates refinancing these liabilities will save £700m after adjusting for inflation. Given this is refinancing, this has the effect of not altering the balance sheet in the short term but does increase external borrowing and therefore may increase risk.

Due to these funding choices, the total borrowing in 2022 is forecast to surpass £1.7bn, 34% of GVA, and is projected to remain at that amount for the

Government Plan period. This represents a £1.5bn growth in borrowing from the position in 2019 where borrowing made up 5% of GVA. This compares to 103% in 2021 for the U.K and 115% for France. While Jersey has a stronger balance sheet, low trend growth prospects mean that a low borrowing position is appropriate.

This does mean that the Strategic Reserve will grow more slowly than it would if the debt were repaid through general revenues, or if the debt were to be refinanced upon maturity. However, repaying through the Consolidated Fund would require additional revenue raising or expenditure cuts, which would come with a certain cost – rather than the risk from funding them through investment returns. These alternatives should be considered when assessing options for the Strategic Reserve. **Current forecasts suggest the Strategic Reserve will remain below the desirable range of 30-60% of GVA for the next 40 years. A long-term plan is needed to increase the size of the Reserve and the Government should set this out.**

The Fiscal Framework sets a guideline that government should *'borrow only to finance investment (or refinance liabilities), except under times of economic duress, and monitor the impact on net financial assets'*. On this basis therefore the Panel's view is that **the plan to borrow to refinance existing liabilities, provide support during economic duress and finance investment through the Our Hospital project is appropriate.**

The economic recession leads to an increased debt-to-GDP ratio, and the proposed borrowing will exacerbate this. However, **the Panel considers this should not mean capital investment is withdrawn.** Capital investment should not be influenced by natural short-term fluctuations in the economic situation as it may help improve long term growth rates, for example through increased health outcomes and reduced absenteeism, and increases in wellbeing that are more difficult to quantify. Likewise, falls in net financial assets should be offset in large part by increases in physical assets and therefore impacts on public sector net worth may be relatively neutral. The specific choices in capital investment sits outside the Panel's remit.

The Government Plan does not intend to draw down the Strategic Reserve in the short term to pay for the one-off costs associated with the pandemic. The reasons for this are outlined in section **2.5.2** and relate to the need to maintain the option to use the Reserve for a severe structural impact such as the loss of a key industry.

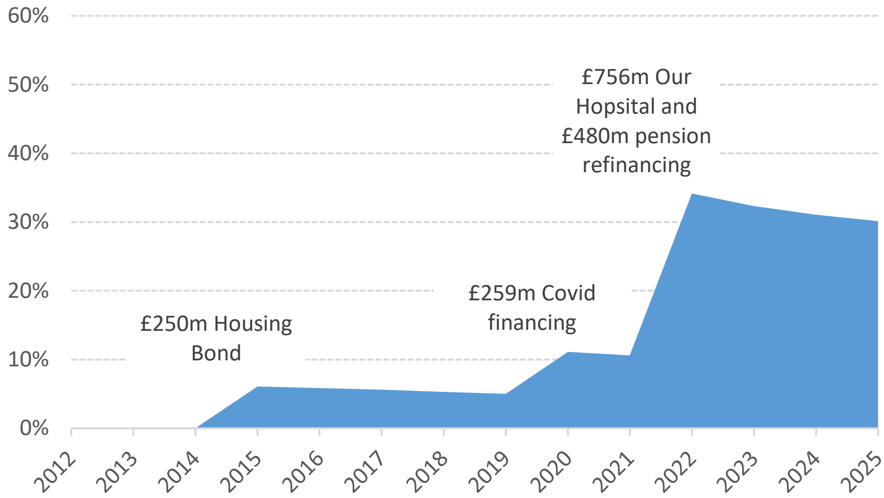
Borrowing for investment purposes can be a risk as it introduces leverage into the system, mechanically magnifying gains and losses. For this reason, the FPP would not support large scale borrowing for investment purposes, though note that this is not part of the current plans as borrowing is only held in the reserve temporarily before being drawn down.

Figure 2.15

Debt as proportion of GDP

Borrowing highlighted in the chart

Source: Government Plan Table 6; Annual Reports and Statistics Jersey



2.7 Initial debt strategy

In August 2021, the Government set out a debt framework along with the debt strategy. The debt strategy set out in the Government Plan has been analysed in the previous section. The debt strategy also details four aims which it lists under key reporting metrics. It is important that the fiscal framework broader aims are considered in respect of these debt aims which are analysed below. Two of the aims are related to debt and asset to GDP ratios such:

- Aim 1: *"Jersey will aim to achieve a medium-term debt-to-GDP ratio in a range of between 30% and 40%. Independent advice indicates that maintaining this range (or lower) reduces the potential for negative adjustments to the credit rating."*
- Aim 2: *"Jersey will aim to achieve a liquid asset to GDP buffer in excess of 100%. This is intended to provide sufficient scope to meet liabilities as they fall due and allow sufficient headroom to manage the GoJ asset portfolio in the event of a prolonged downturn."*

A debt-to-GDP ratio between 30-40% in itself is not problematic particularly when compared to current ratios of close partners such as the UK and France although it should be noted these are potentially seen as more robust to investors. Whilst this aim relates to debt-to-GDP, it should be considered with context to the fiscal framework to only borrow for economic duress or capital spending. This also means that there may be instances, e.g. in economic duress, in which it would be preferable to increase debt-to-GDP ratio beyond 40% rather than drawing upon reserves. Further, in order to sustain this ratio in the long term, it would likely need to be well below 30-40% during more favourable economic periods. Ideally, the Stabilisation Fund would be built up in time for future downturns such that it could reduce any borrowing requirement. There also should be read across from the debt-to-GDP ratio to the Strategic Reserve investment strategy, such that the risk profile is updated to reflect the debt position.

A liquid asset to GDP in excess of 100% is sensible when considering protection from future economic downturns and maintaining borrowing costs low when they are required.

In this sense, these two objectives alone are sensible. However, whilst sensible, they form only part of the picture and the assets to liabilities ratio is as important particularly when monitoring the impact of debt on net assets as in the fiscal framework.

- Aim 3: *"Jersey will aim to maintain a coverage ratio of at least 1.0 for financing costs that are met from reserves, meaning that investment returns are greater than financing costs. For financing costs met from general revenues we will aim to ensure that those costs are less than 5% of total revenues."*

In order to increase public sector net worth, it is key that where financing costs are met from reserves, that returns are greater than financing costs. This aim, whilst admirable, may be difficult to achieve in economic downturns where returns are likely to be low, which is not within the government's direct control. It is worth considering whether a condition should be added that this applies across the business cycle such that the coverage ratio may be lower in downturns but would be more than compensated by economic growth periods. Consideration should be given to having short-term liquidity to cover periods where the coverage ratio is lower, to prevent the need to sell assets at depressed prices.

- Aim 4*: "Jersey will aim to maintain an investment grade rating (BBB- and above) under all market conditions, this will support the ability of GoJ to issue debt or to access short-term facilities if warranted by the prevailing environment."*

This aim is reasonable and whilst less immediately relevant to the fiscal framework, is an important aim in terms of achieving the other aims particularly with regards to being able to access low-cost financing such that public sector net worth can be increased. Whilst debt is forecast to increase over the next five years and the investment grade rating is not directly within government's control, retaining a strong investment grade rating will be important.

Overall, the Debt Framework aims are sensible and should be built upon in future iterations. The government should modify the coverage ratio and debt-to-GDP to apply across the business cycle such that not achieving the aims during economic downturn won't be unduly scrutinised. The Strategic Reserve risk profile should give due consideration to the forecast debt position.

2.8 Panel's previous recommendations

The Panel made several recommendations in October 2020's Annual Report and has given further advice in letters to the Treasury Minister in March 2021 and August 2021. Overall, the Panel is pleased that past recommendations have generally been followed. The extent to which the individual recommendations have been followed is considered below:

The recommendation that deficits in the Consolidated Fund and Security Fund should be unwound yet not delay capital expenditure is followed, with the States Grant returning to formula from 2024 and surpluses in the Consolidated Fund forecast from 2023.

The recommendation for the Government Plan to include a clear estimate of the size of the structural deficit and breakdown the measures intended to close is no longer necessary given revisions to forecast suggest there may not be a structural deficit in future years.

The Panel also recommended that establishment of an Infrastructure Fund should be compared with other options. This appears to have been followed with a conclusion that there are no immediate plans to progress with the Fund.

The Panel recommended any funding under the Economic Recovery and Fiscal Stimulus Fund should be assessed against ability to have a permanent positive impact. This has been a consideration of the Fiscal Stimulus Oversight Group and in deciding upon projects. The need for further restrictions on economic activity means that some of the funding from the Economic Recovery allocation have tended to be more short-term in nature but it is accepted that supporting otherwise viable firms through a temporary period of restrictions can be positive for productivity in the long-term.

Several of the Panel's recommendations have been addressed earlier in the report:

- The recommendation around revenue-raising measures has been covered in section **2.2.4** and this will increase in priority next year, on the basis of the current economic assumptions.
- Construction capacity constraints may resurface as new projects are started. This is covered in section **2.2.6**.

- The Panel recommended surpluses should be transferred to the Stabilisation Fund which is covered in section **2.5.1**. This has been given lower priority in the Government Plan 2022-25.
- In October 2020, the Panel recommended no further transfers to the Strategic Reserve over the Government Plan which is covered in section **2.5.2** and remains appropriate in this period.
- The Panel recommended not using the Strategic Reserve for Covid-19 spending pressures which is covered in section **2.6** and remains appropriate with revised Covid-19 spending.
- The recommendation around the review of Social Security Fund is covered in section **2.5.3.**

2.9 Future fiscal considerations in Government Plan

The Government Plan 2022-2025 sets out several fiscal considerations for 2022. It is one of the Panel's key principles that fiscal policy needs to be focussed on the medium term and it is prudent to consider these issues. The Jersey Teachers Superannuation Fund will not be analysed until finance implications of any changes are clear and introduction of independent taxation will not be analysed due to sitting outside of the Panels remit. For the other issues, the Panel analyses the proposed approach below

2.9.1 Infrastructure Fund

The Infrastructure Fund has been delayed with no immediate plans to proceed. As mentioned in section **2.8**, this is consistent with the Panel's recommendation that the Fund should be considered against other alternatives. It remains sensible that if this Fund is progressed, it should be compared to further borrowing or use of reserves.

2.9.2 Technology Fund

The Government received an extraordinary dividend of £40m relating to the sale of part of JT. The proposed approach is that half will be used for a fund to assist with technology projects and the other half to fund investment in IT infrastructure for government. The latter relates to investment and therefore may help to create efficiencies. The Panel is of the view that the fund, which could be considered day-to-day spending, would preferably have been financed from the Consolidated Fund if it was deemed a worthwhile project. In the Panel's letter to the Treasury Minister in August 2021, the Panel recommended *"any windfalls or asset sales that occur should not be used for day-to-day spending. Using the proceeds of asset sales to fund such spending would have a negative effect on public sector net worth".*

2.9.3 Review of Social Security sustainability

The Government Plan commits to a review of Social Security with a full review of all health costs undertaken during 2022 and presented in 2023. Given the previous review of Social Security has been postponed/cancelled, this should be prioritised.

The States Grant transfer to the Social Security has been restored to its full value from 2024 onwards, which is in line with the Panel's recommendation from last year to reduce previous fiscal support as the economy recovers.

2.9.4 Financial wellbeing in old age, including workplace pensions

The Government previously committed to work and engagement on financial wellbeing in old age, which was stopped in 2020. The Council of Ministers are keen that this is implemented in 2025, with consideration given to a workplace pension scheme funded initially from the Social Security Fund.

2.9.5 Sustainability of health funding

The Government have committed to a review in 2022 into the funding options for increased health care costs.

2.9.6 Zero based budgeting

In 2020 and 2021, the Government has committed to the implementation of zero-based budgeting where Budget Managers start from a clean sheet and all activities conducted are justified on their contribution to outcomes. This has seen significant delays which may lead to difficulties in achieving rebalancing targets. Given there are no current targets for 2025 and less detail on rebalancing measures beyond 2022, this work will be important in delivering change. The Government Plan 2022-25 notes that there have been meaningful insight and lessons although no specifics have been given to the outcomes of the project itself. The Government Plan sets out an aim to roll out Zero-Based Budgeting across all departments by mid-2022. The outputs from this including any new identified efficiencies should be detailed in next year's plan.

2.9.7 Coastal Management Strategy/Shoreline Management

The Coastal Management Strategy currently uses funding from the Infrastructure Rolling Vote, a fund intended for maintenance. The Government Plan commits to consider long-term funding requirements in 2022 and make recommendations. This is prudent especially given the context of longer-term pressures potentially presenting themselves from climate change.

2.10 Long-term considerations

In addition to the above, there may be new challenges brought out by the pandemic resulting in emigration or reduced immigration of highly skilled workers due to:

- **Increased remote working** meaning workers do not need to live on Island to work for Jersey based businesses and potentially fewer workers now off-Island relocating
- **Increased house prices in Jersey** may lead to individuals and families homeowners relocating off-Island where they can potentially upsize or cash in by buying a similar sized house elsewhere at a lower price

Whilst being cognisant of the downside risks, there are also upside risks. There are upside risks which, if left unchecked, could lead to become issues in their own right:

- **Interest rates rises** will likely deliver greater profits for the finance industry and will likely contribute to a growing economy, however, this could mean pressures on households with variable mortgages and the interest rates that the government needs to pay on borrowing. Whilst initial borrowing may predate Bank of England rate rises based on current forecasts, recent pressures appear to bring those forecasts earlier. This is relevant given the extent of borrowing the government is planning.
- **The economy may 'overheat'** if the low unemployment and high vacancies lead to sustained wage inflation. This could lead to investment uncertainty, value of savings being eroded and a reduction in the competitiveness of exports through increased wages, without increased productivity. The difficulties of reducing fiscal support to counterbalance this is outlined in section **2.4** and Jersey cannot directly alter monetary policy.

The Panel set out several long-term challenges in its *Advice for the Government Plan* report in March 2019. In addition to the above medium-term challenges, some of which encroach into longer term issues, the below longer-term challenges will need to be confronted:

- Risks to the financial services sector
- Productivity growth
- Climate change

These issues are complex and require a thorough examination. The Panel will produce a special report next year looking at medium-term issues to inform the next government.