STATES OF JERSEY

RESOURCES STATEMENT TO THE DRAFT STRATEGIC PLAN 2015 – 2018 (P.27/2015) – INCLUDING IFG REPORT ON INCOME FORECASTS (MARCH 2015)

Presented to the States on 23rd April 2015
by the Council of Ministers

STATES GREFFE

Resources Statement to Draft Strategic Plan (P27/2015) - Update on States Finances 2015-2019

Chief Minister's Foreword

Strategic Plan

The Council of Ministers believes that the future of Jersey depends on a government that prioritises and delivers effectively and efficiently. The Council of Minister's draft Strategic Plan prioritises the key issues where it believes progress has to be made in the next four years to deliver a better future for all.

The four priority areas are: Health, Education, Economic Growth and St. Helier. In Health we want to continue the transformation of our health and social services system so all Islanders can be cared for and in Education, we need to raise standards.

Boosting Economic Growth to create new jobs and businesses is designed to increase States income to pay for services. St. Helier is a priority, ensuring that our town will become a place where people aspire to live, enjoy working and want to visit.

The Funding Challenge

The first Medium Term Financial Plan (MTFP) increased the funding for Health significantly and provided economic stimulus and new investment for back to work initiatives. These initiatives were funded without increasing taxes. The next MTFP will require further increased spending for Health and to fund the other strategic priorities. If we are determined to maintain low taxes and balanced budgets then extensive reprioritisation of existing spend and increased effort to boost economic growth will be required.

Jersey distinguishes itself from many other jurisdictions by having prepared and provided for the future and therefore avoided meeting funding challenges by debt. This is what we have always done and it is the right thing to do.

The challenge for this Council is to maintain these principles whilst factoring in the challenges and impact of the recent recession. The solution is to reprioritise: to save in some areas to enable us to spend more on health, education, economic growth and our essential infrastructure.

We are now publishing updated income forecasts and initial details on resources for the Strategic Plan before the debate later this month. The forecasts show that if we are continue current spending, fund the priority areas of Health and Education, maintain the funding in the first Medium Term Financial Plan (MTFP) for the economy and jobs, and allocate funding for capital spending, we would need to find at least an extra £125 million by 2019.

The Economics

Financial decisions should be taken on the basis of sound economics. Maintaining public finances on a sound and sustainable footing in the medium-term is critical to maintaining the stability in which economic growth can flourish. This requires that we follow Fiscal Policy Panel (FPP) advice to ensure that we address any structural deficit by 2018/19 but at the same time that the range and timing of any measures minimises the risk to economic recovery. Although there are now clear signs that local economic conditions continue to improve the economic outlook is still uncertain and we must retain flexibility so that we can continue to support the economy and keep recovery on course. We do need to aim to balance revenue and current expenditure over the economic cycle as indicated by the FPP but we also need to continue to invest, particularly in our infrastructure to support productivity improvements and competitiveness.

Sound economic and fiscal policies are best developed within open and transparent frameworks. R102/2014 'Updating the Fiscal Framework' presented to the States alongside the 2015 Budget included a number of recommendations to improve the framework in which we make fiscal decisions. Drawing on this report, FPP advice and other recent fiscal developments a new fiscal framework will be finalised and presented in June alongside the MTFP. This will ensure that future fiscal decisions continue to support our economic objectives and lay the foundations for productivity led economic growth.

Whilst Jersey has weathered the economic crisis comparatively well there can be no room for complacency. Other jurisdictions have shown that a focus and prioritised approach to economic growth can boost productivity and tax revenues. The digital revolution will have an impact on all service based economies including Jersey, and the effect of this have to be prepared for. Current forecasts are rightly and prudently based on a continuation of the current economic growth but an updated and even more ambitious economic growth strategy could, if successful, play an important role in funding the challenges in this report.

Public Sector

The reform programme has laid the foundations for this reprioritisation, by setting up systems for e-government, implementing a business improvement (Lean) methodology throughout the States to help streamline processes, progressing Workforce Modernisation to ensure our workforce is flexible in the future, restructuring some departments and planning office rationalisation.

We plan a variety of measures to meet the funding challenge working across the organisation to identify restructuring opportunities, rather than departmentally, ceasing to provide some services and redesigning the way others are provided, merging departments if appropriate, reducing duplication and removing unnecessary regulations.

Our reform programme was established to keep spending under control and to develop a flexible public sector that is ready for the challenges ahead. These measures will take that programme to the next stage, and help ensure the available funds go where they are most needed.

As around half of the public sector's spending is on staff, Ministers recognise that reducing headcount is one way of contributing to the overall savings. The need for compulsory redundancies will be minimised by leaving posts vacant when staff leave or retire, and by offering voluntary redundancy when services are redesigned. This work will be done in partnership with trade unions and through active engagement with staff.

Next steps

Our income forecasts will be revised again in May to ensure we use the most up to date information, and Ministers will continue to develop the balanced spending proposals before final figures and plans are published in the Medium Term Financial Plan at the end of June.

Resources Statement - Update on States Finances 2015-2019

1. Background

The Council of Ministers has committed to provide an update on the financial position ahead of the lodging of the draft MTFP 2016-2019 and to inform the debate of the draft Strategic Plan on 28th April 2015.

The draft Strategic Plan includes reference to provisional income forecasts prepared in November 2014 to inform the new Council of Ministers development of the strategic priorities and available resources. Those forecasts indicated a potential shortfall of £50 million in 2019 if current spending levels continued and included provisions for pay, inflation, up-rating of benefits, a real terms 2% annual increase in the health budget and an allocation of £35 million per year for capital projects to be funded from General Revenues.

The £50 million shortfall was before any savings but also before departments' requests for additional revenue expenditure growth, in particular the further investment needed in H&SS and to meet the funding required in Education.

Ministers have initiated a spending review, with the support of external advisers, to identify savings and efficiencies to contribute to funding the projected shortfall by 2019, consistent with the FPP advice to balance budgets by 2018/2019. Ministers have also asked for the impact of additional savings, efficiencies and user pays measures to be prepared, which would enable a redistribution of resources to be considered for growth and other funding priorities which have been identified.

The Council has been presented with revised income forecasts, including an interim report from the Income Forecasting Group (IFG), as part of a new formal forecasting process. The revised income forecasts use information from the provisional outturn for 2014 and remodelling based on the economic assumptions endorsed by the FPP in it's Pre-MTFP Report (January 2015).

This report provides an interim summary of the financial position arising from the interim income forecasts from IFG and the latest expenditure forecasts, growth requests and funding pressures from the initial outcomes of the spending review, ahead of lodging the draft MTFP 2016-2019. The Income Forecasting Group (IFG) have recommended a further review of the income forecasts, to ensure that the most up to date economic assumptions are used to inform the draft MTFP, and this will be presented to Ministers in May.

The work on the spending review will continue and Ministers will develop the high level expenditure proposals ahead of lodging the draft MTFP at the end of June 2015.

Consideration is also being given to providing greater flexibility in the presentation of the MTFP proposals, reflecting comments and recommendations from the Fiscal Policy Panel, Corporate Services Scrutiny Panel and most recently the Comptroller and Auditor General. Proposals for minor changes to the Public Finances (Jersey) Law 2005 to facilitate this approach have initially been shared with Scrutiny and will be lodged this month for consideration by the States ahead of the draft MTFP lodging.

2. Revised Income Forecasts 2015-2019

The States income forecasts have been revised from the previously published forecasts from the Budget 2015 to inform the development of the proposals for the next MTFP 2016-2019.

The revised forecasts for all States income derived from taxation and duty have for the first time been reviewed and agreed by the newly constituted Income Forecasting Group (IFG).

The format and remit of this group includes the forecasts for all States income derived from taxation and duties. The Treasury and Resources Minister approved the Terms of Reference of this Group.

The IFG has been established to improve and formalise the process by which the Minister for Treasury and Resources and the Council of Ministers are provided with robust forecasts of States income from taxation and duty.

The IFG has produced its first formal report which has been presented to the Council of Ministers. This detailed report is included as **Appendix B** for information

Forecasts of other States income have also been revised by the Treasury in respect of dividends, returns, island rate and miscellaneous income. These are similarly based on provisional outturn for 2014 and economic assumptions but with input from investment advisers and the business plans of States strategic investments as appropriate.

The forecasts of States income are presented as a forecast range and it is important that the Council recognises that there is much uncertainty in the economic outlook. This uncertainty has been commented on by the IFG in its current report and also by the FPP in the Pre- MTFP report in January 2015.

The uncertainty in the forecasts reflects general uncertainty in the outlook but certain additional factors which are documented in the IFG report relating to; changing interest rate forecasts, uncertainty of income tax from shareholder income and the potential impacts of the UK banking reforms.

For this reason it is important that the Council include appropriate flexibility in the proposals for the MTFP 2016-2019 and also recognise the comments of the IFG that the risks are on the downside of the central scenario. The IFG is also proposing to present a further update to the Council in May, to ensure the most up to date forecasts are provided to inform the development of the final proposals for the next MTFP.

Movement in forecasts since MTFP 2013-2015

In early 2012, when the original MTFP economic assumptions and forecasts were prepared, while the euro crisis had begun to unfold, the extent and depth of the consequences were not fully apparent. This meant that forecasts at this time did not fully anticipate the fallout from the euro crisis. As a consequence there have been significant reductions to the States income forecast with the biggest impact on the forecasts of income tax revenues.

The previous forecasts of States income in the Budget 2015 identified a reduction compared to MTFP forecasts (March 2012) of £35 million in 2014 and £50 million in 2015.

The 2015 Budget proposed contingent measures to manage the deficits in 2014 and 2015 and the indications were that these reductions in income forecasts were not temporary and would need to be addressed with sustainable measures over the period of the next MTFP 2016-2019. The FPP has advised that any structural deficit should be addressed by 2018/2019 as the economy returns to capacity.

Draft MTFP forecasts 2016-2019

The latest update is based on the unaudited 2014 outturn and economic assumptions from the FPP Pre-MTFP Report in January and show a further reduction in States income forecasts.

The reduction since the forecasts in the 2015 Budget is primarily due to:

- A reduction in the 2014 outturn for income tax relative to the Budget 2015 forecast for 2014;
- Differences in economic forecast variables, namely;
    - slightly lower assumptions for average earnings and financial services profits growth from 2016 to 2018;
    - an assumption that only the low long-term trend rate of economic growth of 0% in real terms, will occur from 2018;
    - Inflation, employment growth, average earnings and interest rate expectations are all now generally lower than expected in the Budget 2015, particularly in the latter years of the forecast period.
- Information from financial services companies suggests lower growth in profits than was forecast for the Budget 2015; and
- For other income the change in interest rate profile and investment returns together with lower fund balances have reduced investment income forecasts.

Overall range of forecasts

The economic assumptions endorsed in the FPP Pre-MTFP report (January 2015) provide a range of assumptions higher, lower and central. These assumptions are used for the modelling of the different types of States income along with some other factors to provide an illustrative range of income forecasts.

The range in the forecasts by 2019 is £135 million between the higher and lower scenarios which represents broadly +/- 9% around the central scenario. The central scenario is broadly the mid-point of the range but, as concluded by the IFG, the risks are on the downside of the central scenario and the proposals for the next MTFP should consider and include appropriate flexibility within this range. Figure 1 shows the forecast range for the draft States income forecasts and indicates the movement since the Budget 2015 forecasts.

Figure 1 – draft MTFP forecast range for States Income for 2013-2019

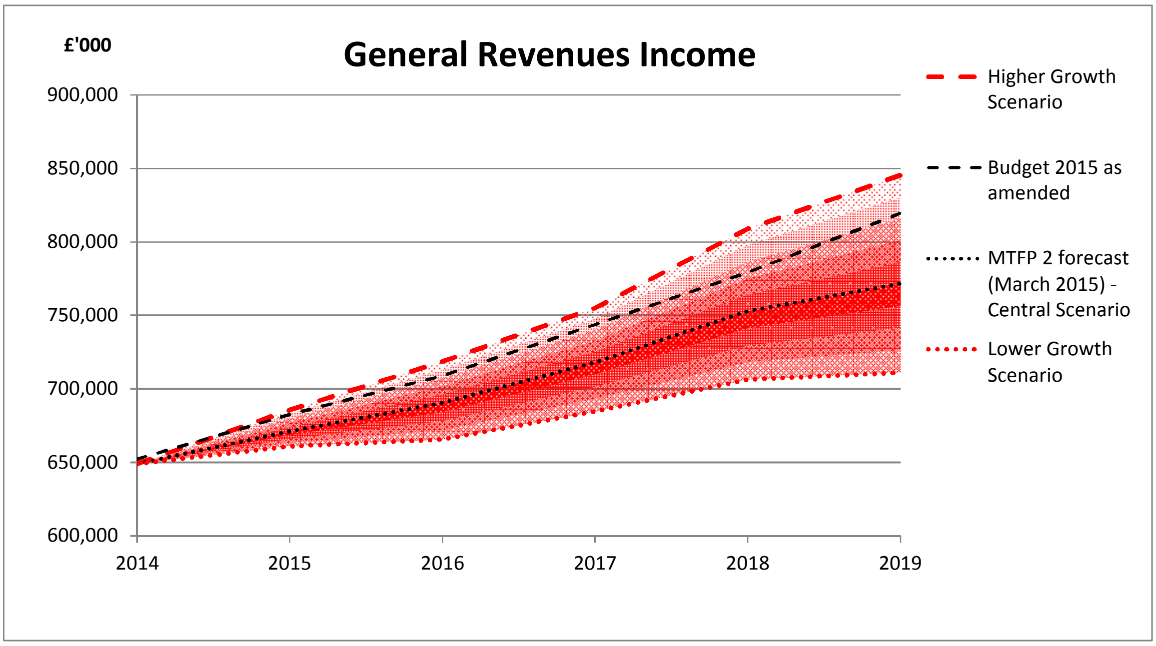


Figure 2 draft MTFP forecasts for States income 2015-2019

Central Forecast from Range	Draft MTFP2 forecasts 2015 £'000	2016 £'000	2017 £'000	2018 £'000	2019 £'000
States General Revenues Income					
- Income Tax	443,000	463,000	488,000	513,000	534,000
- GST	81,740	83,334	84,968	85,779	86,609
- Impôt Duties	55,219	55,098	55,169	55,368	55,602
- Stamp Duty	25,524	26,357	28,802	30,946	31,800
Income from Taxation and Duty	605,483	627,789	656,939	685,093	708,011
- Other Income	65,642	62,805	61,190	67,844	63,731
Higher Scenario Income Forecast	685,584	718,562	755,022	808,869	845,300
Total States Income - Central Scenario	**671,125**	**690,594**	**718,130**	**752,937**	**771,741**
Lower Scenario Income Forecast	660,880	665,607	684,712	706,267	711,011
Budget 2015 (May 2014) Forecast	682,531	708,909	743,799	779,290	819,502
Variation to Budget 2015 Forecast	(11,406)	(18,315)	(25,670)	(26,353)	(47,761)

Economic Assumptions 2015-2019

IFG has considered the economic assumptions endorsed by the Fiscal Policy Panel (FFP) in the Pre-MTFP report (January 2015) and these assumptions are the basis for the draft income forecast modelling for the MTFP 2016-2019.

Changes in assumptions since 2015 Budget

The main features of the latest economic assumptions when compared to the Budget 2015 forecast are:

- Real economic growth is expected to be slightly stronger in 2014 and 2015 but slightly weaker in 2016 and 2017. For 2018 and beyond, the FPP advised that the States should plan on the basis of a trend rate of real growth of 0%.
- Inflation (as measured by RPI and RPIY, for example) is expected to be lower until 2017, recognising the recent sharp falls in oil prices and lower market expectations for interest rate increases.
- Financial services profits are expected to grow more slowly following information gained through a series of interviews with financial services companies in November and December 2014. This is a key assumption for the company income tax forecast.
- Relative to the Budget 2015 forecasts, employment is expected to grow more quickly in 2014 and 2015, and then more slowly in 2016 and 2017.
- Average earnings growth is expected to be weaker in 2015 and 2016.
- Interest rates are now expected to increase later and more slowly, according to financial markets expectations.

The economic assumptions factor in the latest local and international developments.

Figure 3- Economic Assumptions for 2014-2019: Central Scenario (March 2015)

					Return to trend	
	2014	**2015**	**2016**	**2017**	**2018**	**2019**
Real GVA	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	3.2	3.5	3.7	4.4	3.0	3.0
Company profits(a)	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.6	1.2	1.5	2.0	2.5
House prices	1.0	3.0	4.0	5.0	3.0	3.0

Key:

OUTTURNS

Planning for a further update

The target date for lodging the draft MTFP 2016-2019 is the end of June and the current economic assumptions were produced in January 2015.

IFG has concluded that it would be helpful, particularly in relation to the latest UK interest rate profiles and to be able to include any further information on future profitability in the finance and banking sector, that a further revision be considered in April. The forecasts will therefore be remodelled and presented to Council in May, ahead of the draft MTFP lodging in June.

The current forecasts should therefore be considered as subject to potential revision in May 2015. However, the potential for further variations are not considered to be relatively significant, although on the downside, and the draft forecasts are appropriate for the development of the draft MTFP 2016-2019 at this stage.

3. Draft Expenditure forecasts for the MTFP 2016-2019

The Council of Ministers have had to make difficult choices in presenting the draft Strategic Plan and has focussed on key areas where progress must be made in the next four years.

The four priority areas are to improve Health and Wellbeing, Economic Growth, Education and St. Helier. These strategic priorities will need to be provided with appropriate funding within the resources available to maintain balanced budgets and to address any structural deficit with sustainable measures by 2019.

The current financial position is likely to mean that this funding will be a combination of re-prioritising existing base budgets and identifying additional savings, efficiencies or fees and charges, beyond that required to address the shortfall in income, which can be re-invested in these priority areas.

The Council of Ministers initiated a spending review early in 2015, supported by external advisers, which would identify savings and efficiencies both across the States and within individual department programmes.

At the same time departments have been required to review the funding proposals for 2016-2019, which were prepared as part of the “Long Term Revenue Planning Review” (R136/2014), in light of the further reductions in States income forecasts.

A review is also being carried out of the proposals from the Long Term Capital Plan for the projects proposed for the Capital Programme 2016-2019.

Base Expenditure forecasts

The planned base revenue expenditure assumptions for 2016-2019 include provision for pay and inflation increases and the uprating of social security benefits and the States grant to the Social Security Fund.

There are also a number of commitments from MTFP1 and a requirement to replace the £6 million per annum funding for primary health care, which was previously funded by a contribution from the Health Insurance Fund. A provision is also included for the move to the new PECRS scheme over the course of the next MTFP.

Capital Expenditure Forecasts

The initial review of the capital programme from the LTCP in 2014 identified over £200 million of capital projects for the period 2016-2019. This compared to an average of nearer £35 million per year over the 25 years of the LTCP.

The current review of the capital programme is targeting an initial total allocation of £140 million to be provided from General Revenues Income for the 4 year period of the MTFP, broadly based on the long-term average capital requirement of £35 million per year at current prices. This target is a significant increase on the capital funding provided from General Revenues for routine capital projects in recent years, where significant alternative funding has been applied from receipts, special dividends or redemption of strategic investments, or the use of surplus balances on Special Funds.

The FPP has advised that funding of important investment, particularly if it supports productivity improvements and competitiveness, should be looked at separately. This principle would support the funding of major projects such as the New Hospital, Liquid Waste Strategy, Les Quennevais School, the Office Rationalisation Strategy and Fort Regent from specific and alternative sources of funding, in addition to the routine capital funding from General Revenues.

The draft MTFP will also give consideration to the appropriate provision for depreciation, instead of an annual capital allocation, as part of the assessment of the structural position of States finances recommended by the FPP. The provisional forecast of annual depreciation is £45 million per annum for the period of the MTFP 2016-2019.

Investing in the Strategic Priorities

<u>Funding the increasing cost of healthcare</u>

The Health and Social Services Department (HSSD) has worked hard to review and refine requirements in all its areas since the initial submissions to the LTRPR.

The significant funding from the first MTFP 2013-2015 is also being maintained including the £11 million recurring funding for the first phase of White Paper Growth.

HSSD revenue expenditure funding requests for 2016-2019 are made up of three main components, in addition to the annual provisions for pay and prices:

- the continued policy of provide 2% annual increase in Health budget
- the agreed pay parity provision for nurses
- the continuation of the investment in P82/2012 – A New Way Forward

These requests total £47 million p.a. of additional expenditure by 2019.

A request for an additional £5 million p.a. expenditure for Health property maintenance has also been made, reflecting the cost of maintaining existing assets while the new hospital project is ongoing. This will need to be funded from within the £35 million p.a. capital allocation. This is in addition to growth of £2 million p.a. sought to address backlog maintenance across the Health estate.

All areas of proposed investment in Health and Social Care are inter-dependent. It is essential that the 2% investment in service standards and healthcare inflation is maintained in order to provide a stable base from which to drive forward transformational change. Cost drivers such as changes to drug treatments and other therapies will continue.

The provision of modern, safe and appropriate health and social care services is predicated on the delivery of the whole programme – as is the size of the new Hospital. Key aspects of this programme of change have already been implemented in accordance with the States decision to support P82/2012. It is important that this change continues and accelerates if health and social care services are going to be adequate to meet the needs of the ageing demographic into the future.

In addition, HSSD has re-assessed and re-prioritised the requirements for additional funding in Children's Services, which has arisen in the last year following the Scrutiny review of CAMHS and the resulting service review.

The Council of Ministers has initiated work to allow it to consider options to provide a sustainable funding mechanism for the increasing cost of Healthcare, as agreed in P82/2012, and are developing options to enable the consideration of an in-principle commitment to additional funding in the draft MTFP. The ongoing additional revenue expenditure proposed for health can only be afforded if a funding mechanism for healthcare is agreed.

It is self-evident that to meet the costs arising from the ageing population and to address the investment in health services, additional funding must be provided. This is in accordance with a States decision in 2012, to develop a sustainable and affordable mechanism for healthcare.

Funding strategic priorities in Education

Education is another one of the four main strategic priorities of the Council of Ministers. Additional funding is being prioritised to address raising standards, support and improve the ICT investment in schools and to address the demographic pressures from early years through to post 16 education.

The crucial work on improving standards will include additional funding in three main areas:

- Targeted funding to address the risk of low performance across all groups of pupils vulnerable to lower attainment. If young people in Jersey are to meet and exceed outcomes of their peers in neighbouring jurisdictions a local equivalent to the UK's 'Pupil Premium' is required. Growth funding aims to bring the level of entitlement for those disadvantaged pupils in our schools in line with those with disadvantage in the UK, resulting in higher standards achieved.
- Raising standards is not possible without robust data systems. An enhanced data insight team would provide the essential analytical tools to match those available to all education services in the UK. The addition of two data analyst is required.
- The expansion of the School Achievement and Standards Team to include two additional Professional Partners. This is the most effective and economical means of expediting the changes necessary to raise standards.

The additional funding currently proposed for education amounts to £9 million p.a. by 2019.

Funding for other priorities and pressures in other departments

The MTFP 2013-2015 provided significant funding to support the strategic priorities of economic growth and getting people into work. This important injection of funding was allocated across a range of projects in different departments and amounted to £14 million per annum by 2015. As part of the spending review this investment is being maintained from 2016 where it continues to provide effective investment in the ongoing priorities, or it will be reprioritised towards other measures to grow the economy..

The requests from departments, which were originally submitted as part of the Long Term Revenue Planning Review (R136/2014), have also been reviewed and assessed against current priorities.

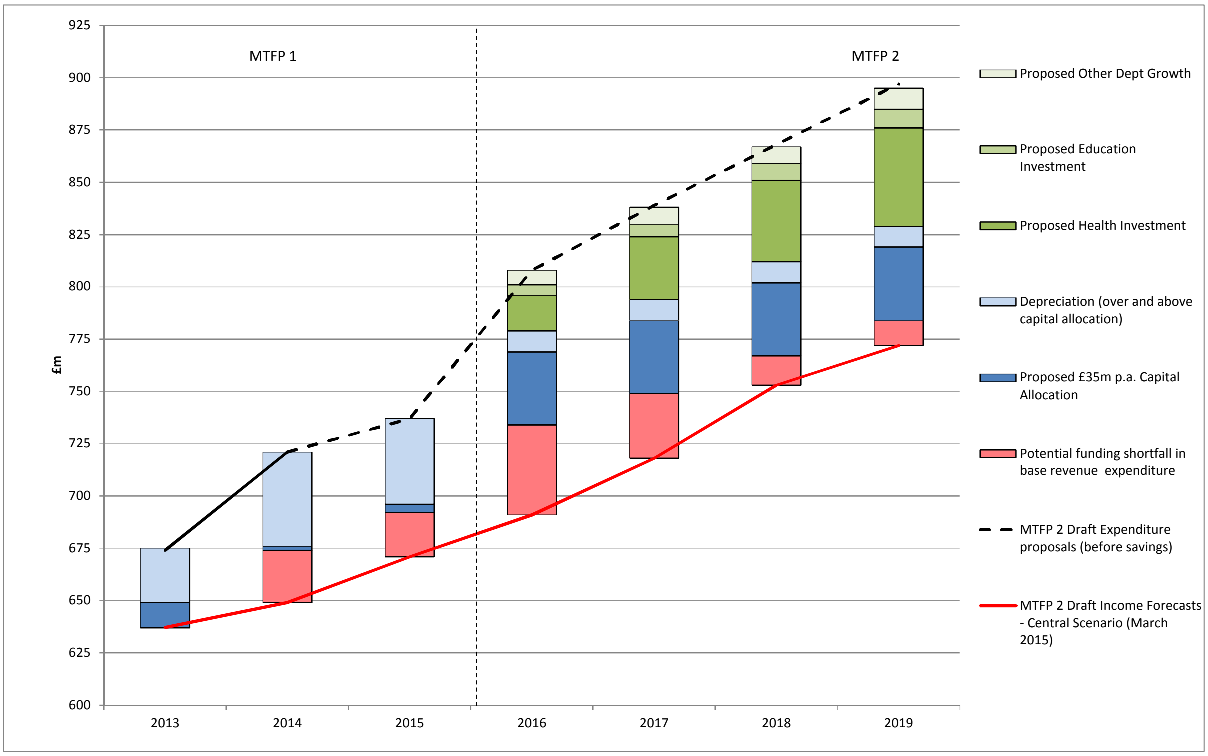
A number of requests arise from pressures and commitments from the period of the first MTFP, for example the expectation of income from handling and disposal of Guernsey waste has not materialised, and there is an ongoing resource required to facilitate the Freedom of Information legislation.

A schedule of all the current revenue expenditure requests, including those from Health and Social Services and Education, is included at **Appendix A.**

The level of requests currently stands at £47 million p.a for Health and Social Services, £9 million for Education and £10 million p.a for other departments by 2019.

Work will continue on the prioritisation, phasing and costing of measures currently proposed ahead of lodging the draft MTFP.

Figure 4 – Projected Funding Shortfall before Savings or Funding Measures



Summary of expenditure proposals

The proposals for additional funding for departments from 2016 will continue to be reviewed, examined and prioritised and will be considered with the savings and funding measures that will be required to afford them. The level of shortfall in funding for 2016-2019 will depend on the Council of Ministers' final proposals for revenue and capital expenditure.

With the current central scenario for income forecasts and the current level of the base provisions, proposed capital allocations, increased funding for health, education and other priorities the shortfall in funding would be in the region of £115 million in 2019.

After allowing for the £10 million p.a. difference between the proposed capital allocation of £35 million p.a. and the provisional forecast for depreciation of £45 million p.a., the projected funding shortfall would be £125 million by 2019.

This shortfall is before any savings or funding measures for the period 2015 to 2019.

4. Addressing the Shortfall in Funding 2015-2019

The Council of Ministers is working towards the recommendation of the FPP that the States should aim to balance its tax revenues and current expenditure, including an appropriate allowance for depreciation over the economic cycle, and that the economy is expected to be close to full capacity by 2018/2019.

The Council of Ministers is adopting a three-part approach:

- Firstly, to secure the economic recovery forecast by the FPP and lay the foundations for raising productivity and the underlying rate of economic growth over future economic cycles, thereby increasing States revenues;
- Secondly, to focus on;
    - a programme of savings, efficiencies and expenditure constraint; and
    - consideration of the level of provision of benefits and changes in fees and charges for services where appropriate;
- Only when these measures are agreed will consideration be given to taxes and contribution changes.

The investment in health services envisaged could only be approved with the agreement to additional funding being introduced, in accordance with previous decisions to ensure sustainable funding of Healthcare.

Ministers have a set an initial target to deliver £130 million of savings and other measures by 2019. This target recognises the advice from the IFG that:

- a further income forecast is appropriate;
- the forecasts are the central scenario within a range; and
- the risks are on the downside of the central scenario for planning purposes.

This target also allows for the inclusion of depreciation in determining total expenditure levels, as proposed by the FPP.

The target of £130 million includes the £12 million of savings already taken from cash limits in 2015.

Ministers will also develop contingency plans for inclusion in the MTFP, which will define the further options available in the event that the income is in the lower range of forecasts.

<u>Economic Growth</u>

The latest economic assumptions endorsed by the FPP show that the economy is expected to return to real growth in 2014 and that growth will continue in the 2015-17 period. However, significant risks remain, not least relating to the outlook for the international economy. The Council of Ministers will therefore continue to focus on delivering fiscal support to the economy in the early years as advised by the FPP to ensure that growth returns on a sustained basis.

In addition, the draft Strategic Plan sets out how existing policies on growth and productivity will be reviewed, refreshed and enhanced to help achieve the growth forecast in coming years but also quite critically achieve sustained productivity-led economic growth over future economic cycles. In particular:

- an increased focus on new, high potential growth sectors;
- increased innovation, enterprise and inward investment across all sectors;
- promoting competition within a new competition framework;
- an updated skills strategy;
- identifying barriers to work for key groups to improve participation; and
- ensuring Jersey has sustainable public finances and low inflation.

Recognising the importance of investing in our economy and jobs, funding allocated through the current MTFP of £14 million by 2015, for getting people into work, back to work and employment initiatives, is being maintained, although as with all areas of expenditure may be subject to savings targets.

Spending review

The spending review is developing various savings programmes and themes across departments in order to deliver service redesign, savings and efficiencies between 2016 and 2019. The current target is for £60 million of staff related savings and £35 million of savings on non-staff expenditure, changes to benefits and user pays charges.

Staff savings

Payroll spending accounts for around half of the budget and continued pay restraint will be required to minimise pay bill growth. A reduction in staffing costs will be managed through taking advantage of natural attrition supported through strict vacancy management; stronger performance management and the redesign of services that look across the organisation as well as within departments.

We will continue our partnership working with trade unions and active engagement with staff to ensure the delivery of service redesign initiatives and work force modernisation, together creating a smaller more agile organisation with a more modern, flexible and affordable workforce, better able to deliver the right services to the citizens of Jersey.

Natural turnover and voluntary redundancy will be used to minimise the number of compulsory redundancies.

Other Savings

The level of savings required could have a significant impact on services if changes were made solely in individual departments so senior managers are working across the organisation and operating collaboratively with the support of our external advisers.

This work could be viewed as an organisation wide reprioritisation exercise. Prioritising investment in health and education and supporting economic growth and finding savings from a variety of sources including base budgets.

Our reform programme was established to keep spending under control and develop an agile, flexible public sector that is fit for the challenges ahead. The measures will not reduce total spending – they will limit increases in spending required to deliver a public sector that can care for an ageing population and maintain investment in our essential infrastructure.

Changes to Benefits

The great majority of Social Security's budgets are used to provide benefits to individuals. Changes in benefit expenditure are being considered using the following major themes:

- *Promote financial independence* – use changes in benefit to promote activities that will support the financial independence of claimants, and protect benefits which are supporting the financial independence of claimants;
- *Improve targeting of benefits* – change benefits in areas where public money is not specifically targeted to vulnerable groups; and
- *Minimise individual impact* – spread changes over larger groups of claimants, rather than a few individuals.

User Pays

Proposals are also being considered in relation to a small number of fees and charges for certain services where the current recovery could appropriately be increased. Separately, measures are also being developed to establish an appropriate source of funding for liquid and solid waste disposal.

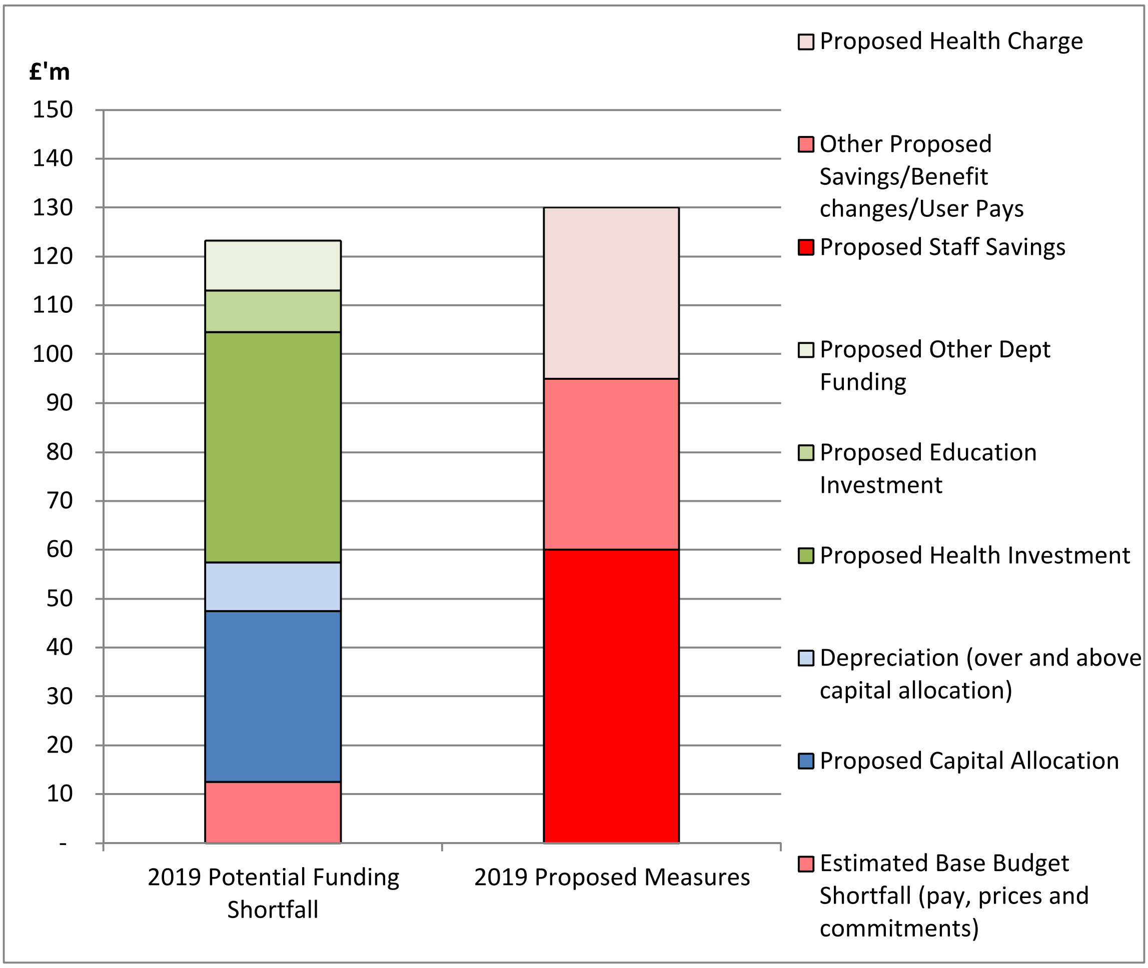
Sustainable funding for Healthcare

Work is being carried out to consider various options to provide a sustainable funding mechanism for the increasing cost of Healthcare, as agreed in P82/2012, and these proposals will be further developed ahead of the draft MTFP. The ongoing additional revenue expenditure proposed for health will only be affordable if a funding mechanism for healthcare is agreed.

Contingency Plans

The Council of Ministers will also be developing contingency plans as part of the draft MTFP in the event that income forecasts are in the lower range over the period of the MTFP and to ensure there is flexibility within the overall proposals.

Figure 5 – Proposals for a Balanced Budget by 2019



<u>Short-term funding measures</u>

The outcomes of the spending review will deliver a projected profile of recurring savings and other funding measures from 2016 to 2019. However, many of these will take some time to agree and implement as will proposals for funding healthcare and there will remain a considerable shortfall in the early years of the MTFP. These shortfalls will need to be addressed by short-term measures.

The Council will consider a number of short to medium-term options and these will need to include the deferral of some of the additional funding and possible re-phasing of capital projects in the early years.

These measures alone are unlikely to be sufficient to meet the funding gap and Ministers will need to consider other options including drawing on reserves or other balances in the short-term, which would be consistent with the advice from the FPP to minimise the risk of any impact on the economic recovery.

Any measures proposed either as short-term or sustainable solutions for the Consolidated Fund, will need to be considered alongside proposals being developed by Social Security to address the ageing population and in particular providing sustainable funding for the provision for State pensions.

5. Presentation of the MTFP 2016-2019

The Council of Ministers are proposing changes to the presentation of the MTFP and the annual Budgets for the period 2016-2019. The Treasury Minister will be presenting proposals to debate the associated changes to the Public Finances (Jersey) Law 2005 in advance of the scheduled lodging date of the draft MTFP.

Lessons learned from MTFP 1

The principle of longer term planning to provide greater control over spending remains important. The main lesson learned has been to ensure that there is sufficient flexibility in the medium term planning process to enable additional funding to be allocated when appropriate but equally to retain flexibility to address a reduction in available funding when income forecasts reduce.

The significant reduction of income forecasts and available funding seen from 2012-2015 has not been a familiar trend in Jersey, except where the reduction in income was planned over a period of time as part of the move to the 0/10 corporate tax strategy.

The current MTFP 2013-2015 allocated the majority of the available spending limits and growth funding up front, rather than holding back growth and capital, as provided for in the Finance Law, to be allocated in the annual budgets during the course of the MTFP.

With hindsight MTFP 1 did not provide sufficient flexibility for the changing economic circumstances that occurred and in particular the reductions in income forecasts that occurred as the global economic outlook changed. Economic forecasts at the time assumed a return to growth whereas the severity of the euro crisis meant that in reality there was a further decline in the economy in both 2011 and 2012, and associated reductions in income forecasts from 2012 to 2015.

The draft proposals for the presentation of MTFP 2 for 2016 - 2019 seek to address the lessons learned, to provide a robust, transparent and formalised forecasting process and also to address the recommendations and comments of the Fiscal Policy Panel (FPP) and the Corporate Services Scrutiny Panel (CSSP) in the reports over the last three years. These can be summarised as follows:

- provide for sufficient flexibility to allow for variations in income and economic forecasts;
- provide for appropriate levels and use of contingency over the period of the MTFP;
- provide flexibility within the allocation of the capital programme to be able to reflect changes in the local construction capacity;
- consider a rolling approval process over the period of the MTFP;
- consider rolling financial forecasts which maintain a forward forecast for 3-5 years;

- maintain central growth provisions to be allocated on an annual basis during the MTFP period;
- consider changes to the capital allocation process; and
- maintain the ability to recalibrate expenditure allocations over the period of the MTFP, particularly as the term increases to 4 years.

Where possible the proposals will also take account of recommendations from the recent report of the Comptroller and Auditor General (C&AG) R38/2015 – 'Review of Financial Management' (April 2015).

Draft Proposals for MTFP 2 for 2016-2019

The Council of Ministers are proposing changes to the presentation of the MTFP and the annual Budgets for the period 2016-2019. The draft proposals for MTFP 2016-2019 are summarised in Figure 4 and would propose:

- total States income targets for all years 2016-2019;
- total maximum expenditure allocation limits for all years 2016-2019;
- total net capital expenditure allocation limits for all years 2016-2019; and
- department spending limits, central contingencies, savings and other measures for 2016 only.

This would result in the 2016 Budget proposing:

- tax and funding proposals for 2016; and
- capital allocations (net of funding from other sources) for individual projects for 2016.

This report also recommends that future years' Budget propose:
- tax and funding proposals for the respective year
- department spending limits, central contingencies, savings and other measures for at least the respective year within the total spending limits set in the MTFP; and
- net capital allocations for individual projects for the respective year

It would be the Council of Ministers' intention to bring forward the proposals for 2017, 2018 and 2019 department spending limits in 2016 for debate as part of the 2017 Budget, to provide a degree of certainty to departments for future years at the earliest opportunity.

The proposals do not alter the provisions for relevant transfers to and from States funds or the provisions in relation to borrowing.

Changes to the Finance Law
The changes required to the current Finance Law have been initially shared with Scrutiny and will be lodged for debate ahead of the scheduled date for lodging the

draft MTFP at the end of June 2015. These changes are not significant as the original Law and framework intended to provide flexibility over the MTFP period.

For certain changes in approach, such as updated income forecasts and total expenditure plans to always cover the following 4 years on a rolling basis, no changes to legislation are required and these will be covered in the Fiscal Framework.

<u>Updating the Fiscal Framework</u>

R102/2014 'Updating the Fiscal Framework' was presented to the States alongside the 2015 Budget and included a number of recommendations. The Fiscal Framework has been progressed alongside the development of the MTFP to act on these recommendations and will also address a number of the other comments and recommendations from the FPP and CSSP when it is scheduled to be presented in June alongside the MTFP.

Figure 6 – Summary of Proposals for the Presentation of MTFP 2

	2015	2016	2017	2018	2019
May				MAY ELECTION	
June	Lodge MTFP 2 2016-2019			for 4 years to May 2022	Lodge MTFP 3 2020-2023
		Lodge Budget 2017	Lodge Budget 2018		
July	MTFP2 to propose: Total Income targets Total Spending limits Total Capital Limits for 2016-2019. Dept cash limits 2016 Indicative dept cash limits 2017 - 2019 and capital projects 2016-2019	Budget 2017 intention to propose: Tax and Funding 2017 Dept Cash Limits 2017, 2018 and 2019 Capital projects 2017 Rolling forecast of Income and Expenditure extended to 2020	Budget 2018 proposes: Tax and Funding 2018 Capital projects 2018 Rolling forecast of Income and Expenditure extended to 2021	Develop New Strategic Plan in 100 days and prepare Budget 2019 for Tax and Funding Proposals only. Rolling forecast of Income and Expenditure extended to 2022	MTFP3 to propose for 2020-2023: Total Income targets Total Spending limits Total Capital Limits Dept cash limits Growth allocations Indicative capital projects 2020-2023
September	Debate MTFP 2 2016-2019			Lodge Budget 2019	Debate MTFP 3 2020-2023
October	Lodge Budget 2016	Debate Budget 2017	Debate Budget 2018	Lodge Strategic Plan 2019	Lodge Budget 2020
	Budget 2016 to propose: Tax and Funding Capital Projects for 2016			Budget 2019 to propose: Tax and Funding and Capital Projects for 2019	Budget 2020 to propose: Tax and Funding and Capital Projects for 2020
November				Debate Budget 2019	
December	Debate Budget 2016			Debate Strategic Plan 2019	Debate Budget 2020

Dept	Proposals	Category	2016	2017	2018	2019	2019
			£'000	£'000	£'000	£'000	FTE
HSS	2% Investment in Service Standards and Healthcare Inflation	Press	4,175	8,790	13,754	19,007	66.0
HSS	Nurses Pay Parity Provision	Com	2,097	4,299	6,543	6,707	-
HSS	P82/2012 - Health Transformation (White Paper)	Dem	7,941	13,830	17,439	21,009	119.0
HSS	**Total Requests for Health**		**14,213**	**26,919**	**37,736**	**46,723**	**185.0**
ESC	Primary Schools Demographics	Dem	745	1,053	1,434	1,744	20.6
ESC	Secondary Schools Demographics	Dem	1,313	1,575	1,755	2,100	35.0
ESC	Nursery Demographics	Dem	376	295	274	303	-
ESC	Revenue consequences of capital scheme - Investment in IT strategy	Com	750	769	788	808	-
ESC	Revenue consequences of capital schemes - Operational costs of new classrooms	Com	100	125	485	525	-
ESC	Raising standards funding - (UK Pupil Premium)	New	1,537	1,801	2,077	2,365	8.0
ESC	Improving the collection and analysis of data	New	120	122	125	127	1.0
ESC	Strengthening the Achievements and Standards Team	New	288	294	300	306	2.0
ESC	Investment in early years provision for vulnerable children	New	278	284	289	295	7.0
ESC	**Total Requests for Education**		**5,507**	**6,318**	**7,527**	**8,573**	**73.6**
CMD	Financial Services / McKinsey Implementation	Com	523	533	544	555	3.0
CMD	FOI - Central Unit/Office of the Information Commissioner	Com	160	160	160	160	2.0
CMD	Joint Safeguarding	Com	125	128	131	133	-
CMD	Information services - increased for support and licences	New	355	486	490	547	-
HA	Revenue consequences of capital scheme - new Police Station & Prison	Com	95	377	385	423	-
LOD	Law Officers - Revised Pay and Rewards Structure	Com	209	216	226	237	-
LtG	Lt. Governor's Office - Cadet and Military Support Officer	Com	42	43	44	45	-
SSD	Child Personal Care Benefit level 2 & 3 (underwritten by Contingencies)	Com	477	487	496	506	-
TTS	Energy From Waste - Shortfall in Income (JEC/waste volumes)	Press	1,121	1,169	1,218	1,267	-
TTS	Energy From Waste - No Guernsey Waste Income	Press	1,530	1,561	1,591	1,624	-
TTS	Tipping Fees Shortfall	Press	-	-	340	346	-
TTS	Bus Contract - Main Contract and School Bus Service	New	278	288	300	311	-
TTS	Revenue consequences of capital schemes - new Sewerage treatment Works	New	0	0	0	1,700	-
T&R	Additional Property Maintenance for Health Estate	New	2,000	2,000	2,000	2,000	-
T&R	Funding for periodic asset valuation	New	-	250	-250	-	-
T&R	Strengthening the Shareholder Relationship Resources	New	200	200	200	200	-
Other	**Total Requests for Other Departments**		**7,115**	**7,898**	**7,875**	**10,054**	**5.0**
	TOTAL		26,835	41,135	53,138	65,350	263.6

Categories:

Pressures - Addressing pressures created by a shortfall in projected income or maintaining standards (HSS)

Demographics - Addressing demographic pressures

Committed - Committed expenditure during MTFP1 now required in MTFP2

New - New departmental requirements (growth of base budget)

Notes: The Health and Social Services and Education, Sport and Culture Ministers have agreed to carry out a final review with officers to consider if further reductions and/or improvements in the profile of the proposed requests can be achieved.

Appendix B

IFG Initial Report on Draft Forecasts of States Income from Taxation for the preparation of MTFP 2016-2019 (March 2015)

Executive Summary

1. Purpose

To provide draft forecasts of States income from taxation and duty for the Council of Ministers to inform the preparation of the next MTFP 2016-2019.

2. Background

The forecasts for all States income derived from taxation and duty have for the first time been reviewed and agreed by the new Income Forecasting Group (IFG) (see Section 3 of the main report.)

The IFG forecasts represent a large proportion of States income but exclude other States income for Island Rate, dividends and returns from States Investments and other fees which are produced and reported separately.

3. Summary of Draft Forecasts of States Income from Taxation and Duty

The IFG is presenting the current forecast range in line with the agreed timetable and to inform the development of the MTFP at this stage.

However, the Group are of the opinion that a further review of the forecasts should be carried out to ensure that the most up to date economic assumptions can be included. The Group is proposing a further update to be presented to CoM in May, to inform and be included in the final proposals for the draft MTFP 2016-2019 ahead of lodging at the end of June.

There is much uncertainty in the economic outlook, as commented by the Fiscal Policy Panel in its Pre-MTFP Report in January. For this reason it is important that, while a central scenario has been produced by the IFG using best estimates of the variables on which the income forecast is based, appropriate flexibility is built into the proposals for the MTFP 2016 – 2019.

The IFG would emphasise to Ministers that within the range identified there are thought to be more risks of a downside within the forecast range than an upside due to –

- The financial markets now expect interests rates to increase later and more slowly than in the FPP assumptions in January 2015;
- The uncertainty in the forecast period with respect to income tax from shareholder income;
- The impact on the banks, who are a major contributor to corporate and individual taxable income of the UK banking reform programme
- The impact on business decisions of the uncertainty of the outcome for Jersey of any referendum on the UK's future relationship with the EU
- High level of uncertainty in general terms.

These downside influences should be offset by the benefits obtained from the recovery of the economy supported by the jobs and growth policy but at this time it is felt to be more appropriate to set plans on the assumption that there is a greater risk that the income will be below the central scenario.

The impact of the latest interest rate profile on financial services companies (particularly banks) profits, and in turn the income tax forecast, will be included in time for the update in May.

Movement in forecasts since MTFP 2013-2015

In early 2012, when the original MTFP economic assumptions and forecasts were prepared, while the euro crisis had begun to unfold, the extent and depth of the consequences were not fully apparent. This meant that forecasts at this time did not fully anticipate the fallout from the euro crisis. As a consequence there have been significant reductions to the States income forecast with the biggest impact on the forecasts of income tax revenues.

The forecasts of States income in the Budget 2015 identified a further reduction compared to MTFP forecasts of £35 million in 2014 and £50 million in 2015.

The 2015 Budget proposed contingent measures to manage the deficits in 2014 and 2015 and the indications were that these reductions in income forecasts were not temporary and would need to be addressed with sustainable measures over the period of the next MTFP 2016-2019.

Draft MTFP forecasts 2016-2019

The latest update is based on the provisional 2014 outturn and economic assumptions from the FPP Pre-MTFP Report in January show a further reduction in States income forecasts. The reduction is primarily due to:

- A reduction in the 2014 outturn for income tax relative to the Budget 2015 forecast
- A smaller reduction in income forecasts from 2016 to 2018 reflecting slightly lower assumptions for average earnings and financial services profits growth and a further reduction in income from 2018 is expected due to a low trend rate of economic growth.
- Information from financial services companies suggests lower growth in profits than was forecast for the Budget 2015.
- Inflation, employment growth, average earnings and interest rate expectations are all now generally lower than expected in the Budget 2015, particularly in the latter years of the forecast period.

Figure 1 Draft MTFP forecasts for 2016-2019 for States income from taxation and duty

	Draft MTFP 2 forecasts				
States Income from Taxation and Duty	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
- Income Tax	443,000	463,000	488,000	513,000	534,000
- GST	81,740	83,334	84,968	85,779	86,609
- Impôt Duties	55,219	55,098	55,169	55,368	55,602
- Stamp Duty	25,524	26,357	28,802	30,946	31,800
Higher Scenario	*619,462*	*654,366*	*691,363*	*737,421*	*777,271*
Central Scenario	605,483	627,789	656,939	685,093	708,011
Lower Scenario	*595,549*	*605,343*	*626,856*	*642,424*	*651,937*
		4%	5%	4%	3%
Budget 2015 (May 2014) Forecast as amended	615,137	640,476	668,592	700,456	737,682
Variation	(9,654)	(12,687)	(11,653)	(15,363)	(29,671)
November 2014 Provisional Forecast	607,395	634,332	662,805	695,867	726,583
Variation	(1,912)	(6,543)	(5,866)	(10,774)	(18,573)

A further update will be prepared and presented to CoM in May. This will include a further update of economic assumptions endorsed by the FPP and any further information that is available at that time.

4. Recommendation

a) In light of the uncertainties in the outlook, the IFG would recommend that the Council of Ministers builds sufficient flexibility into the plans for the draft MTFP 2016-2019 to recognize that the central forecast is within a range of the draft income forecasts presented.
b) The IFG would recommend that the Council of Ministers agree to receive a further update of the draft forecasts in May, with updated economic assumptions, to inform the final proposals prior to lodging the draft MTFP 2016-2019.

Main Report

1. Purpose

To provide draft forecasts of States income from taxation for the Council of Ministers to inform the preparation of the next MTFP 2016-2019.

2. Background

The States income forecasts have been revised from the previous published forecasts from the Budget 2015. A further set of planning forecasts were produced in November 2014 and have been used internally to enable initial work developing the new Strategic Plan and MTFP with the Council of Ministers.

The draft MTFP2 forecasts are based on the provisional 2014 outturn and the modelling uses the latest economic assumptions from the Fiscal Policy Panel (FPP) Pre-MTFP Report in January 2015.

The forecasts for all States income derived from taxation and duty have for the first time been reviewed and agreed by the new Income Forecasting Group (IFG) see Section 3.

3. Income Forecasting Group (IFG)

The forecasts of States income are a critical component of the States medium and long term financial planning. They are also required as part of an annual Budget and MTFP, alongside forecasts of States expenditure, to assess the projected balance on the Consolidated Fund. This is a requirement of the Treasury and Resources Minister as part of the Public Finances (Jersey) Law.

The largest single component of States income is income tax revenue. For several years an Income Tax Forecasting Group (ITFG) has been responsible for advising the Treasurer in respect of the forecast for income tax revenues.

The format and remit of this group has been reviewed and the Treasury and Resources Minister has approved the Terms of Reference of a new Income Forecasting Group (IFG).

The new group has been established to improve and formalise the process by which the Minister for Treasury and Resources and the Council of Ministers are provided with robust forecasts of States income from taxation and duty. The Terms of Reference are attached as Appendix A. This will become a part of the updated Fiscal Framework to be prepared alongside the next MTFP.

The Group will report at least twice a year, no later than March and no later than September to inform the annual Budget. In an MTFP year, such as 2015, a further update will be prepared between the March update and the lodging of the MTFP.

4. Summary of Draft Forecasts of States Income from Taxation and Duty

The forecasts have been prepared by officers and reviewed by the IFG. The IFG are of the opinion that a further review of the forecasts should be carried out ahead of lodging the draft MTFP 2016-2019 to ensure that the most up to date economic assumptions can be included.

There is much uncertainty in the economic outlook, as commented by the Fiscal Policy Panel in its Pre-MTFP Report in January. For this reason it is important that, while a central scenario has been produced by the IFG using best estimates of the variables on which the income forecast is based, appropriate flexibility is built into the proposals for the MTFP 2016 – 2019.

The IFG would emphasise to Ministers that within the range identified there are thought to be more risks of a downside within the forecast range than an upside due to –

- The financial markets now expect interests rates to increase later and more slowly than in the FPP assumptions in January 2015;
- The uncertainty in the forecast period with respect to income tax from shareholder income;
- The impact on the banks, who are a major contributor to corporate and individual taxable income of the UK banking reform programme
- The impact on business decisions of the uncertainty of the outcome for Jersey of any referendum on the UK's future relationship with the EU
- High level of uncertainty in general terms.

These downside influences should be offset by the benefits obtained from the recovery of the economy supported by the jobs and growth policy but at this time it is felt to be more appropriate to set plans on the assumption that there is a greater risk that the income will be below the central scenario.

The impact of the latest interest rate profile on financial services companies (particularly banks) profits, and in turn the income tax forecast, will be included in time for the update in May.

<u>Movement in forecasts since the MTFP</u>
The March 2012 forecast that was used in the MTFP was based on analysis conducted largely in February 2012 and in particular drew on the most up to date forecasts by the FPP for the Jersey economy, by the OBR for the UK economy and by the IMF and other forecasters for the global economy.

In early 2012 while the euro crisis had begun to unfold, the extent and depth of the consequences were not fully apparent. This meant that forecasts at this time did not fully anticipate the fallout from the euro crisis. The biggest impact has been on the forecasts of income tax revenues.

By the time of the modelling for the March 2013 forecast the extent of the euro crisis and its impact on the global economy was much more apparent and it was clear that the Jersey economy was not performing as well as expected. GVA growth was below expectations and quite crucially for income tax forecasts earnings and employment trends also significantly weaker than expected. This also led to reductions in future economic assumptions for these variables as expectations of recovery were pushed back. This delay in economic recovery meant that personal income tax growth was revised down by about £25m in 2014 and £30m in 2015 and was the sole reason for the downgrading of forecasts at that time (and partially offset by expectations of higher corporate tax from in year forecasting).

When the forecasts were updated in March 2014 leading to the Budget 2015 forecasts the economic assumptions were revised in the light of the latest economic developments locally and internationally and based on the most recent FPP forecasts. The revisions to the forecast due to economic assumptions were not significant and included slightly weaker growth in earnings and employment in 2013, 2014 and 2015. In addition, overall economic growth was revised up slightly in 2015-17 as interest rates were expected to rise sooner (in line with market expectations) and that this could have led to stronger growth in financial services profits.

Other factors also contributed to the further weakening of the 2015 Budget forecasts, particularly in income tax:

- a reduction in 2013 outturns causing a revision of the 2013 tax base by £5 million,
- In year company tax information for 2014 resulting in an adjustment of £5 million,
- the combined impact of 2014 Budget measures, including the reduction in the marginal rate from 27% to 26%, amounted to £5 million.

The overall reduction in the 2015 Budget forecasts relative to the original MTFP forecasts amounted to £35 million in 2014 and £50 million in 2015.

The 2015 Budget proposed contingent measures to manage the deficits in 2014 and 2015 and the indications were that these reductions in income forecasts were not temporary and would need to be addressed on a sustainable basis over the period of the next MTFP 2016-2019.

Draft MTFP forecasts 2016-2019

The latest update is based on the provisional 2014 outturn and economic assumptions from the FPP Pre-MTFP Report in January show a further reduction in States income forecasts. The reduction is primarily due to:

- A reduction in the 2014 outturn for income tax relative to the Budget 2015 forecast
- A smaller reduction in income forecasts from 2016 to 2018 reflecting slightly lower assumptions for average earnings and financial services profits growth and a further reduction in income from 2018 is expected due to a low trend rate of economic growth.
- Information from financial services companies suggests lower growth in profits than was forecast for the Budget 2015.
- Inflation, employment growth, average earnings and interest rate expectations are all now generally lower than expected in the Budget 2015, particularly in the latter years of the forecast period

A summary of the draft forecasts for the MTFP 2016-2019 are shown in Figure 2, together with a comparison with the Budget 2015 forecast and previous forecasts in Figure 3.

Figure 2 Draft MTFP forecasts for 2016-2019 for States income from taxation and duty

States Income from Taxation and Duty	Draft MTFP 2 forecasts 2015 £'000	2016 £'000	2017 £'000	2018 £'000	2019 £'000
- Income Tax	443,000	463,000	488,000	513,000	534,000
- GST	81,740	83,334	84,968	85,779	86,609
- Impôt Duties	55,219	55,098	55,169	55,368	55,602
- Stamp Duty	25,524	26,357	28,802	30,946	31,800
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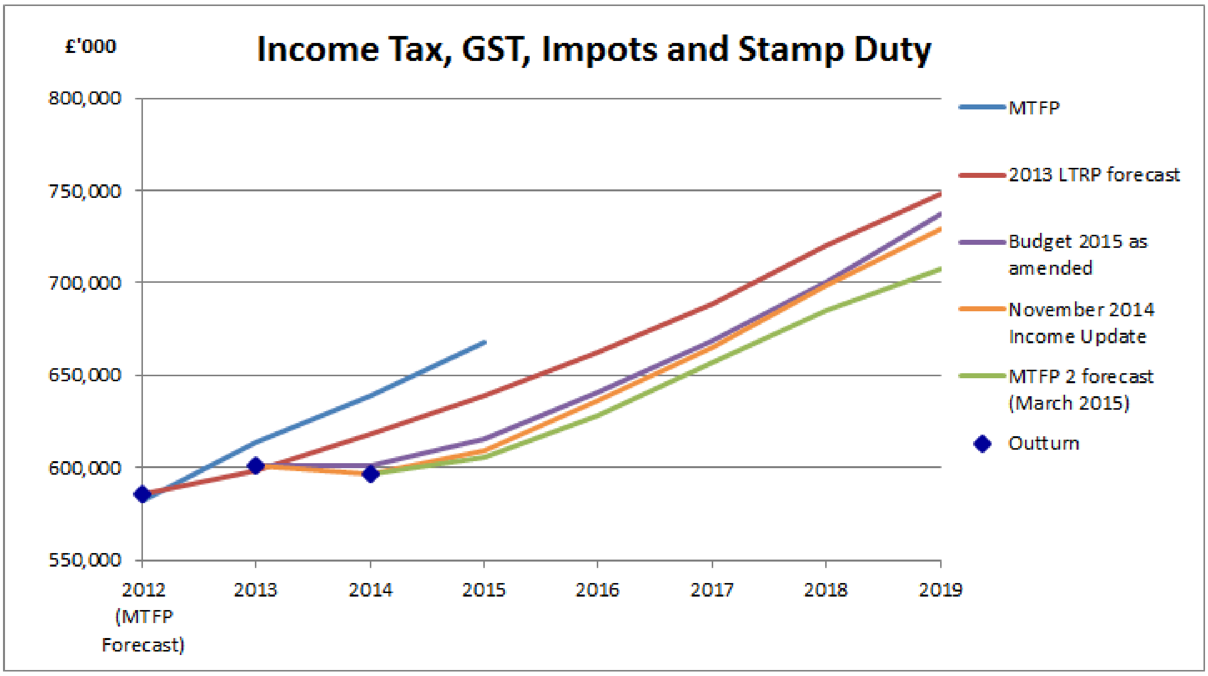
Central Scenario	605,483	627,789	656,939	685,093	708,011
Lower Scenario	*595,549*	*605,343*	*626,856*	*642,424*	*651,937*
		4%	5%	4%	3%
Budget 2015 (May 2014) Forecast as amended	615,137	640,476	668,592	700,456	737,682
Variation	(9,654)	(12,687)	(11,653)	(15,363)	(29,671)
November 2014 Provisional Forecast	607,395	634,332	662,805	695,867	726,583
Variation	(1,912)	(6,543)	(5,866)	(10,774)	(18,573)

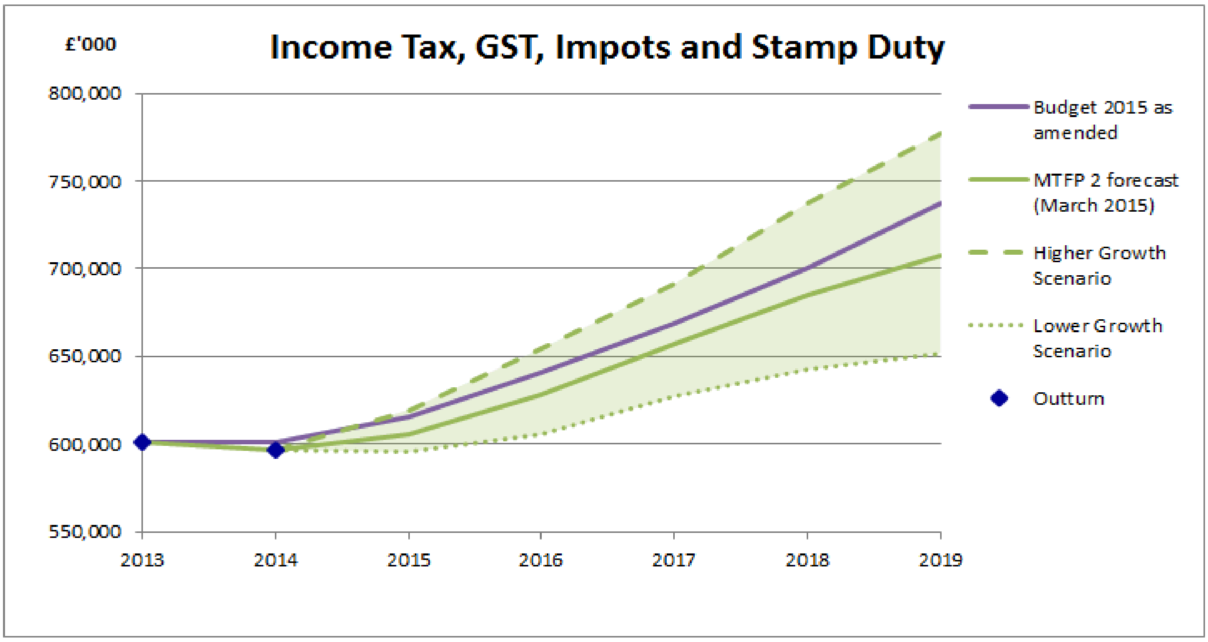
Figure 3 - Movement in Forecasts of States income from taxation and duty for 2013-2019



<u>Overall range of forecasts</u>

The economic assumptions from the FPP Pre-MTFP report provide a range of assumptions higher, lower and central. These assumptions are used within the modelling of the different types of States income along with some other factors to provide an illustrative range within which the central forecast sits. The forecast range will provide an indication of the likely risk in the income forecasts and can be used to establish a degree of flexibility within the forward plans.

Figure 4 – Range of Income Forecasts from Taxation and Duty



The Graph illustrates the movement from the 2015 Budget forecast (as amended) to the draft MTFP2 Forecasts (March 2015).

5. Economic Assumptions 2014-2019

R102/2014 'Updating the Fiscal Framework' recommended the involvement of the FPP in the preparation of economic assumptions to be used for financial forecasting. In the Panel's first Pre-MTFP Report, economic assumptions have been produced for 2014-2019 and endorsed by the Panel for use in the preparation of the financial forecasts.

IFG has considered the economic assumptions provided by the Fiscal Policy Panel (FFP) in the Pre-MTFP report and endorsed that these assumptions be used as the basis for the draft income forecast modelling for the MTFP 2016-2019.

The economic assumptions factor in the latest local and international developments. A detailed report has been prepared for IFG (see Appendix B) and is summarised here.

<u>Changes in assumptions since 2015 Budget</u>
The main features of the latest economic assumptions when compared to the Budget 2015 are:

- Real economic growth is expected to be slightly stronger in 2014 and 2015 but slightly weaker in 2016 and 2017. For 2018 and beyond the FPP advised that the States should plan on the basis of a trend rate of real growth of 0%.
- Inflation (as measured by RPI and RPIY, for example) is expected to be lower until 2017, recognising the recent sharp falls in oil prices and lower market expectations for interest rate increases.
- Financial services profits are expected to grow more slowly following information obtained through a series of interviews with financial services companies in

November and December 2014. This is a key assumption for the company income tax forecast.

- Employment is expected to grow more quickly in 2014 and 2015 rather than in 2016 and 2017.
- Average earnings growth is expected to be weaker in 2015 and 2016.
- Interest rates are now expected to increase later and more slowly, according to financial markets expectations.

Figure 5 draft Economic Assumptions for MTFP 2014-2019

Central scenario

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	3.2	3.5	3.7	4.4	3.0	3.0
Company profits(a)	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.6	1.2	1.5	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

Key:

OUTTURNS

Consideration of a further update

The target date for lodging the draft MTFP 2016-2019 is the end of June and the current economic assumptions were produced in January 2015. The IFG has considered whether a further update may be appropriate ahead of the draft MTFP lodging at the end of June.

IFG is recommending that a further update is needed, particularly in relation to the latest UK interest rate profiles. An update of the economic assumptions will be produced and endorsed by the FPP in April. These assumptions along with any in-year information will be used to remodel the forecasts and present a report to CoM in May, which will inform the final proposals prior to lodging the draft MTFP 2016-2019.

The current forecasts should therefore be considered as draft and subject to potential revision in April/May 2015. However, the potential for further variations are not considered to be significant and the draft forecasts are appropriate for the development of the draft MTFP 2016-2019 at this stage.

Range in Economic Assumptions

The economic assumptions from the FPP Pre-MTFP report have been expanded to provide an upper and lower range of assumptions. The range of assumptions will inform the MTFP planning in terms of the levels of risk in States income and the scale of flexibility that may need to be considered and provided for over the four year period.

The economic assumptions and the range in the assumptions are discussed further in Appendix B.

6. Draft Income Tax Forecasts 2015-2019 from IFG

The Taxes Office have provided data on the personal and company income for the year of assessment 2013 (YOA 2013) together with the values of exemptions and allowances.

The model is tested by running the actual tax data through it and checking the results against the 2014 outturn. Any amendments to the model can be made to improve the forecasting model going forward.

There are also several new sources of information since the Budget 2015 forecast:

- the Taxes Office has new information on personal and company tax assessments for YOA 2013.
- the Statistics Unit has published data on economic variables, such as for economic growth, employment and average earnings.
- the Fiscal Policy Panel (FPP) has published their pre-MTFP report[1] which contains a new economic growth forecast for Jersey and the underlying economic assumptions.
- the latest market expectations for interest rates, for example, those published in the Bank of England's Inflation Report.
- 2014 ITIS data providing information on employment income trends.
- information from tax agents, interviews with major financial institutions and initial assessments for companies relative to tax payable in 2015.

The latest economic assumptions are summarised in Section 5 and described in detail at Appendix B.

Figure 6 - Draft MTFP forecasts for Income Tax

	Actual		Forecast				
Budget year	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Personal	357	356	360	376	397	419	437
Companies	98	83	86	89	93	97	100
Bad debts	-3	-2	-3	-2	-2	-3	-3
	452	**437**	**443**	**463**	**488**	**513**	**534**
Annual growth		-15	6	20	24	26	21
Annual growth, %		-3%	1%	4%	5%	5%	4%

IFG have considered the variations from the Budget 2015 and raised a number of issues which have been addressed between IFG meetings with further information provided.

The differences between the draft MTFP2 forecasts and those at Budget 2015 are illustrated in Figure 7.

[1] Fiscal Policy Panel Pre-MTFP Report 2015, http://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Fiscal%20Policy%20Panel%202015%20annual%20report%2020150130%20JE.pdf

Figure 7 – Variations in Income Tax to Budget 2015

Budget year	Actual 2013 £m	Forecast 2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
<u>Personal tax</u>							
Budget 2015 forecast	**357**	**364**	**373**	**386**	**404**		
2014 outturn		-8	-8	-8	-8		
2015 Budget measures				2	2		
2015 in-year estimate of employment income			-4	-4	-4		
Updated economic assumptions			0	0	3		
Current provisional central forecast	**357**	**356**	**360**	**376**	**397**	**419**	**437**
<u>Company tax</u>							
Budget 2015 forecast	**98***	**84**	**85**	**91**	**97**		
2014 outturn		-1	-1	-1	-1		
2015 in-year estimate of top 100 taxpayers			2	2	2		
Updated economic assumptions			0	-3	-5		
Current provisional central forecast	**98***	**83**	**86**	**89**	**93**	**97**	**100**

Actual ; Forecast * This includes a one-off £10m tax receipt in 2013.

The income tax forecasts have reduced since the original MTFP (March 2012), these reductions have predominantly been in personal income tax and arise due to weaker than expected growth. The main reasons have been;

- lower than expected growth in average earnings and employment 2012-2014.
- the impact of changes to the taxation of shareholder income.
- the 2014 Budget measures, in particular the cut in the marginal rate to 26%.

The Group requested additional information to confirm some of the assumptions in the model, particularly related to employment income and shareholder income. This information was provided to the second meeting of the Group and as a result of this additional information the Group agreed minor changes to the draft forecasts for 2015-2019.

The Group also considered the suggested range around the forecasts which had been calculated using the range in relevant economic assumptions. However, the Group felt that a more significant variation was required in the early years 2015 and 2016 and this is reflected in Figure 8.

Figure 8 – Range of income tax forecasts

Budget year	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Upper		455	485	515	555	590
Central	**437**	**443**	**463**	**488**	**513**	**534**
Lower		435	445	465	475	485
Range as a % of central, +/-		2%	4%	5%	7%	9%

The detailed income tax forecasting note from IFG is attached as Appendix C.

7. Draft GST and ISE Forecasts 2015-2019 from IFG

There are three components of the GST forecast:

- GST on purchases of goods and services on Island,
- GST on imports, and
- International Service Entity Fees (ISE) fees paid by businesses exempt from GST.

GST on purchases on Island

Good & Services Tax (GST) was introduced in 2008 and is collected by the Taxes Office. GST is collected from duty paid on purchases of goods and services on the Island. Initially introduced at 3% the GST rate was increased to 5% in 2011.

In year GST forecasts are usually modelled using the previous increases in actual GST income as a base to project forward. MTFP1 GST forecasts were based on the economic assumptions at the time (March 2012) which were for economic growth and inflation. During the last 3 years the actual GST income has been lower than forecast in MTFP1.

The Group asked for information on the trends in GST over the period since 2008 and the average increase has been 0.5% over the period. However, in 2014 the increase has been stronger at 2%, probably reflecting the improving economic conditions.

The Group asked if similar trends could be identified by sector to provide more detail on individual trends about which forward assumptions could be made. Detailed trends for the various sector where subsequently provided but there were no obvious correlations identified that would help improve the forward forecast.

The proposal is that for 2015 to 2017, while economic growth is forecast to continue, to use the recent 2% trend. For 2018 and 2019 the longer term average of 0.8% is used.

GST on imports

Import GST has increased gradually in recent years. Over the last 3 years it has increased by an average 6% per annum reflecting an increase in on-line sales. The MTFP2 forecast has been developed based on this trend growth. The Group has no reason to believe this trend will not continue.

ISE Fees

ISE Fees are a relatively stable income stream for the States and have consistently been around £9 million per annum.

The 2014 outturn was £9.04 million in line with the November 2014 provisional forecast and the Budget 2015. The MTFP2 forecast assumes £9 million of ISE fees per annum.

All GST forecasts

In the 2015 Budget the emerging trend in 2014 was used to forecast forward over the MTFP2 period. At the time economic growth was assumed to continue through to 2019, rather than the trend % real growth now assumed from 2018.

The main difference in the forecasts since the 2015 Budget arises out of the different economic assumptions beyond 2017.

Figure 9 – Summary GST draft forecasts 2015-2019

		Draft MTFP2 Forecasts				
Budget Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
GST	67,904	69,262	70,647	72,060	72,637	73,218
Import GST	3,281	3,478	3,687	3,908	4,142	4,391
ISE Fees	9,042	9,000	9,000	9,000	9,000	9,000
Total GST	**80,227**	**81,740**	**83,334**	**84,968**	**85,779**	**86,609**
Annual Growth %		*1.9%*	*2.0%*	*2.0%*	*1.0%*	*1.0%*
Budget 2015 Forecast	79,107	80,650	82,584	84,571	86,460	89,171
Variation	1,120	1,090	750	397	- 681	- 2,562

Forecast Range

Following proposals from the Economics Unit to the IFG the recommendation is that:

- a lower range 1% below the central assumption and a higher range 1% above the central assumptions is used for MTFP2 for forecasting net GST.
- a wider 2% range above and below the central forecast is proposed for import GST reflecting the higher trend growth assumption for this income stream.
- ISE fees are relatively stable between years, and a 0.5% range above and below the central forecast is proposed.

The overall effect of the range of forecasts is shown in Figure 10.

Figure 10 – GST draft forecast range

		Draft MTFP2 Forecasts				
Budget Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Higher	80,227	82,530	84,911	87,379	88,897	90,460
Central	**80,227**	**81,740**	**83,334**	**84,968**	**85,779**	**86,609**
Lower	80,227	80,995	81,818	82,652	82,800	82,953
Range £'000	-	1,535	3,093	4,727	6,097	7,507
Range %	0%	2%	4%	6%	7%	9%

8. Draft Impôts Duty Forecasts 2015-2019 from IFG

Impôts duties are levied on a range of commodities imported to the Island. The duties on the various commodities, principally alcohol, tobacco and fuel are reviewed at the annual Budget. The duty increases for alcohol and tobacco are influenced by the strategies for particular Health improvement and reduction in consumption policies rather than a policy to raise additional revenues.

The policies in that regard can be considered fairly successful based on the importation trends. These show that for most alcohol and tobacco commodities the long-term trend is for reduced importation. There is evidence to suggest an increase in duty free consumption but this is actively policed by customs.

The basis of the impôts duty forecasts is to take the latest 2014 outturn and to apply the last 10 year average importation figures and then to forecast the future duty rates.

10 year importation trend
Customs maintain records going back a number of years and on statistical advice use a 10 year average of importation trends to forecast future levels.

The average 10 year trends by commodity are:

Spirits	98%
Wines	101%
Cider	103%
Beer	98%
Tobacco	94%
Fuel	100%

Increases in Impôts duty rates

The Group discussed the appropriate uprating of impôts duty rates and requested information from customs on the impact of above and below RPI increases in duty on the following year's importation. The information showed that there was no real correlation and the Customs Director confirmed that this had been looked at previously with a similar outcome.

The Group therefore concluded that it was appropriate to assume that recent policies in annual Budgets would continue, particularly as updates to both the Tobacco and Alcohol and Licensing Strategies were not due ahead of the next MTFP. Analysis of recent budgets showed that broadly RPI increases for tobacco and alcohol were common and that increases to fuel and other commodities were less likely.

The forecasts use the current 2015 Budget rates and assume RPI increases in future years for alcohol and tobacco only.

From 2014 a new bonded warehouse scheme has been introduced by customs to deter profiteering around budget announcements for the following year. This reduced tobacco taken to duty in 2014 but correspondence with the tobacco wholesalers suggests that this will be a one-off effect and future forecasts should not be affected.

Figure 11 - Draft MTFP forecasts for impôts duties

		Draft MTFP2 Forecasts				
Budget Year	2014	2015	2016	2017	2018	2019
	£'000	£'000	£'000	£'000	£'000	£'000
Impôts on Spirits	4,801	4,871	4,893	4,938	4,999	5,061
Impôts on Wine	7,615	7,914	8,193	8,523	8,892	9,279
Impôts on Cider	988	1,091	1,152	1,223	1,301	1,384
Impôts on Beer	5,285	5,150	5,172	5,221	5,287	5,352
Impôts on Tobacco	13,788	13,847	13,342	12,918	12,543	12,180
Impôts on Fuel	20,708	21,410	21,410	21,410	21,410	21,410
Impôts on Other Goods	161	175	175	175	175	175
Vehicle Emissions Duty	760	761	761	761	761	761
Total Impôts Duties	**54,106**	**55,219**	**55,098**	**55,169**	**55,368**	**55,602**
Year on Year Change		*2.1%*	*-0.2%*	*0.1%*	*0.4%*	*0.4%*
Budget 2015 Forecast	55,613	55,649	55,587	55,558	55,566	55,602
Variation £'000	- 1,507	- 430	- 489	- 389	- 198	-

<u>Forecast range</u>

An approach to providing a range around the impots duty forecast was accepted by the Group and this uses the variation around the RPI assumptions compounded by a +/-1% variation on future importation assumptions. The impact on the central forecasts is shown in Figure 12.

Figure 12 – Impôts draft forecast range

		Draft MTFP2 Forecasts				
Budget Year	2014	2015	2016	2017	2018	2019
	£'000	£'000	£'000	£'000	£'000	£'000
Higher	54,106	54,666	55,531	52,613	51,828	51,188
Central	**54,106**	**55,219**	**55,098**	**55,169**	**55,368**	**55,602**
Lower	54,106	55,771	56,695	57,838	59,142	60,516
Range £'000	-	1,105	1,164	5,225	7,314	9,328
Range %	0%	2%	2%	9%	13%	17%

9. Draft Stamp Duty Forecasts 2015-2019 from IFG

Stamp duty is charged on property, equity and share transfer transactions according to the value of the transaction. It is also collected on Wills, Probate and Obligations. The Stamp duty forecasts are separated into general stamp duty, stamp duty on probate and stamp duty on share transfer property transactions.

General Stamp Duty

The main component is duty on property and in addition the forecasts allow for a relative fixed forecast of stamp duty on Obligations and Wills.

The duty on property transactions has been particularly volatile over the last five years, falling from over £14 million in 2009 to £10.7 million in 2013, a fall of 25% and then increasing to over £17 million in 2014, an increase of 64%.

The last MTFP was based on the actual in 2011 of £13.3 million and an assumption for an economic recovery from 2012 and 2013. The conditions in the property market for 2012 and 2013 have meant that stamp duty income has been well below the MTFP forecast in those years.

The current draft forecast for the next MTFP 2016-2019 has been based on a considerable analysis of the past years data. This has identified some key trends which informed the assumptions by the Group for the forward forecast, in particular to identify an approach which separates the forecasts for higher value properties over £2 million.

2014 Outturn – establishing a base for the MTFP forecasts 2015-2019

The reasons for the significant increase in 2014 were examined and have been identified as:

- a general increase in activity and increase in the average value of transactions
- an unusually large number of high value properties transacted in 2014 which were linked to the relocation of high net worth individuals to Jersey.
- the effect of the 2015 Budget announcing an increase in Stamp Duty rates for properties above £1m. This is thought to have led to an acceleration of high value property transactions leading up to the end of 2014 where purchasers looked to transact before rates increased. (A similar pattern of activity was seen in the first half of 2011 when Stamp Duty rates were also raised for properties over the value of £1m on 1st July 2011.)

The Group asked for information to be sought on potential high net worth activity and forecasts of high net worth residency applications in future years. As a result of this work with the High Net Worth Residency team, the Group has been able to identify that the activity in over £2 million property transactions in 2014 was unusual and based on latest information is unlikely to recur at a similar level in future years. However, there is sufficient evidence to suggest an increase in the assumption for the average number of high value residential transaction in future years. Information was also provided which suggests a significant receipt in the first quarter of 2015 for which a one-off adjustment has been included but not affecting future years.

The Group agreed to reduce the 2014 outturn figure to be used as the basis of the forward forecast. A further adjustment was then agreed for the improved assumptions for high value properties.

The 2015 Budget measures were discussed with the conclusion that the net effect of these measures should be broadly neutral. The Group was not aware of any further changes in rates or policy that would affect the forward forecasts.

Economic Assumptions

The general stamp duty forecasts are modelled using economic assumptions for the forecast movement in house prices and the forecast level of housing market turnover. These are derived from the forecasts provided in the FPP report.

These assumptions, like the economic assumptions generally, are slightly more buoyant in the short term and less so from 2017 onwards compared to those used in the 2015 Budget forecasts. The market turnover assumptions forecast a return to pre downturn levels at about the point the economy is forecast to return to capacity in 2018/2019.

Stamp Duty on Share Transfer – Land Transaction Tax (LTT)

The majority of share transfer property transactions are for flats and apartments, and therefore likely to be lower value properties (on average) than non-share transfer property transactions. Therefore they are less likely to be subject to the anomalies seen on general property transactions.

The draft MTFP forecasts are based on an adjusted 2014 outturn and the same economic assumptions have been applied as for general stamp duty.

Probate duty

Probate duty is extremely difficult to forecast. It is the result of duty payable from individuals who die and are domiciled in Jersey, or where the individual is not so domiciled but have Jersey moveable property. Between 2009 and 2014 however, transactions have remained steady at around 2,000. Anomalies in income were seen in 2009 and 2012 due to one-off large transactions, but changes in the 2013 Budget have capped probate duty to £100,000 per estate as a competition measure to attract greater investment in the Island, so these anomalies will not be seen in future.

There are no economic assumptions applied to this forecast and a flat £2.5 million forecast is assumed based on the long term trend.

Draft MTFP Forecasts for 2015-2019

The resulting draft MTFP forecasts in Figure 14 show an improvement in the early years and a slight deterioration by 2018 and 2019 compared to the 2015 Budget forecasts

Figure 13 - Draft MTFP forecasts for Stamp Duty

		Draft MTFP2 Forecasts				
Budget Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Stamp Duty	21,988	21,668	22,376	24,669	26,680	27,480
Probate	2,735	2,500	2,500	2,500	2,500	2,500
Stamp Duty on Share Transfer (LTT)	1,254	1,356	1,481	1,633	1,766	1,819
Total Stamp Duty	**25,977**	**25,524**	**26,357**	**28,802**	**30,946**	**31,799**
Year on Year Change		*-1.7%*	*3.3%*	*9.3%*	*7.4%*	*2.8%*
Budget 2015 Forecast	22,730	23,838	25,605	27,763	31,730	33,209
Variation £'000	3,247	1,686	752	1,039	- 784	- 1,410

The 2014 and 2015 stamp duty is adjusted to reflect the high volume of >£2 million property transactions, as a result this skews the forecast profile of growth in stamp duty in the years to 2016. In 2017 to 2019 the annual growth in stamp duty, excluding probate duty, reflects the economic assumptions for the increase in market turnover and house prices for these years.

Forecast range

An approach to providing a range around the Stamp Duty forecast was accepted by the Group and this uses the variation around the economic assumptions on house prices. The impact on the central forecasts is shown in Figure 14.

Figure 14 – Stamp Duty draft forecast range

		Draft MTFP2 Forecasts				
Budget Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Higher	25,977	26,161	27,760	31,146	34,382	36,295
Central	**25,977**	**25,524**	**26,357**	**28,802**	**30,946**	**31,799**
Lower	25,977	24,888	24,994	26,591	27,796	27,796
Range £'000	-	**1,273**	**2,766**	**4,555**	**6,586**	**8,499**
Range %	0%	5%	10%	16%	21%	27%

10. Recommendation

a) In light of the uncertainties in the outlook, the IFG would recommend that the Council of Ministers builds sufficient flexibility into the plans for the draft MTFP 2016-2019 to recognize that the central forecast is within a range of the draft income forecasts presented.

b) The IFG would recommend that the Council of Ministers agree to receive a further update of the draft forecasts in May, with updated economic assumptions, to inform the final proposals prior to lodging the draft MTFP 2016-2019.

Appendix A

Terms of Reference for an Income Forecasting Group

Purpose

The group is established as an advisory function on the forecasts of all States income from taxation and social security contributions which will be informed by economic assumptions produced by the Fiscal Policy Panel.

Objectives

To produce an absolute minimum of two forecasts each year

- A full review of states tax, social security contributions and duty revenue forecasts will take place following the provisional outturn and no later than March of each year.
- A further forecast to inform the Budget debate, no later than September, including any revised economic assumptions and experience form the current year actual revenues.
- In an MTFP year, a further update will be considered between the full review in March and the actual lodging of the MTFP.

To produce reports on the forecasts of states income from taxation and social security contributions, including:

- Forecasts for income tax revenues
- Forecasts for goods and services tax and ISE Fees
- Forecasts for impots duties
- Forecasts for stamp duties
- Forecasts for social security contributions
- Economic assumptions used; and
- Factors and risks that should be considered

The forecasts will cover a period of at least four years and include a range within which a central forecast can be applied

Reporting

The reports will be presented to the Treasury and Resources Minister in advance of the Council of Ministers consideration.

Once a report is approved by the Treasury and Resources Minister it will be published alongside the Medium Term Financial Plan and the Budget.

Other reports can be prepared on the request of the Treasury and Resources Minister.

Administration

All meetings will be minuted with agreed actions.

Quarterly review meetings will also be held.

Quorum – at least six of the nine members be present for the meetings to be considered quorate.

Any variations to the group membership once established to be agreed by the Treasury and Resources Minister or Chief Minister.

It will be the responsibility of the Chief Executive and Treasurer of the States to ensure that the group has sufficient resources to fulfil its responsibilities.

Group Membership

The members of the group are:

- Interim Treasurer of the States of Jersey (Chair)
- Comptroller of Taxes
- Director of Financial Services
- Chief Officer, Economic Development
- Chief Officer, Social Security
- Adviser, International Affairs
- Deputy Director of Tax Policy
- States Economic Adviser
- An external person appointed by the Treasury and Resources Minister

The meetings of the group will be attended by the following officers in a supporting role

- Head of financial planning (secretary)
- Finance director, Income Tax
- Economist

The group will invite other officers and external advisers to attend as appropriate which will be documented.

The group will operate independent of any political influence.

Appendix B

States of Jersey
Economics Unit
March 2015

Income Forecasting Group - Detailed analysis supporting the economic assumptions for the new income tax forecast, March 2015

Introduction

This note supports the IFG's income tax forecast paper by describing the underlying economic assumptions that have been used and their longer term trends.

The Fiscal Policy Panel (FPP) published their Pre-MTFP report on 30 January 2015. The report included their latest assessment of the economic position, an economic growth forecast and, for the first time, an assessment of Jersey's longer term economic growth rate. This is supported by an analysis of the past trends in economic growth and what these are likely to be in the future. All this analysis supports the FPP's economic growth forecast and central economic assumptions.

The income tax forecast is based on the FPP's central economic assumptions. This note summarises the key points in the analysis from the FPP's Pre-MTFP report and also covers any new economic data and developments that will need to be considered when these economic assumptions are finalised in April.

The paper is set out as follows:

Section 1 describes the FPP's economic growth forecast and how it has changed since last year. Section 2 outlines the new data since the FPP's economic growth forecast. Section 3 discusses the long term trends in the economic variables and what they mean for the future. There is also an appendix, for information, which contains the UK's Office for Budget Responsibility (OBR) economic assumptions which determine their fiscal forecasts for the UK.

1. FPP economic growth forecast

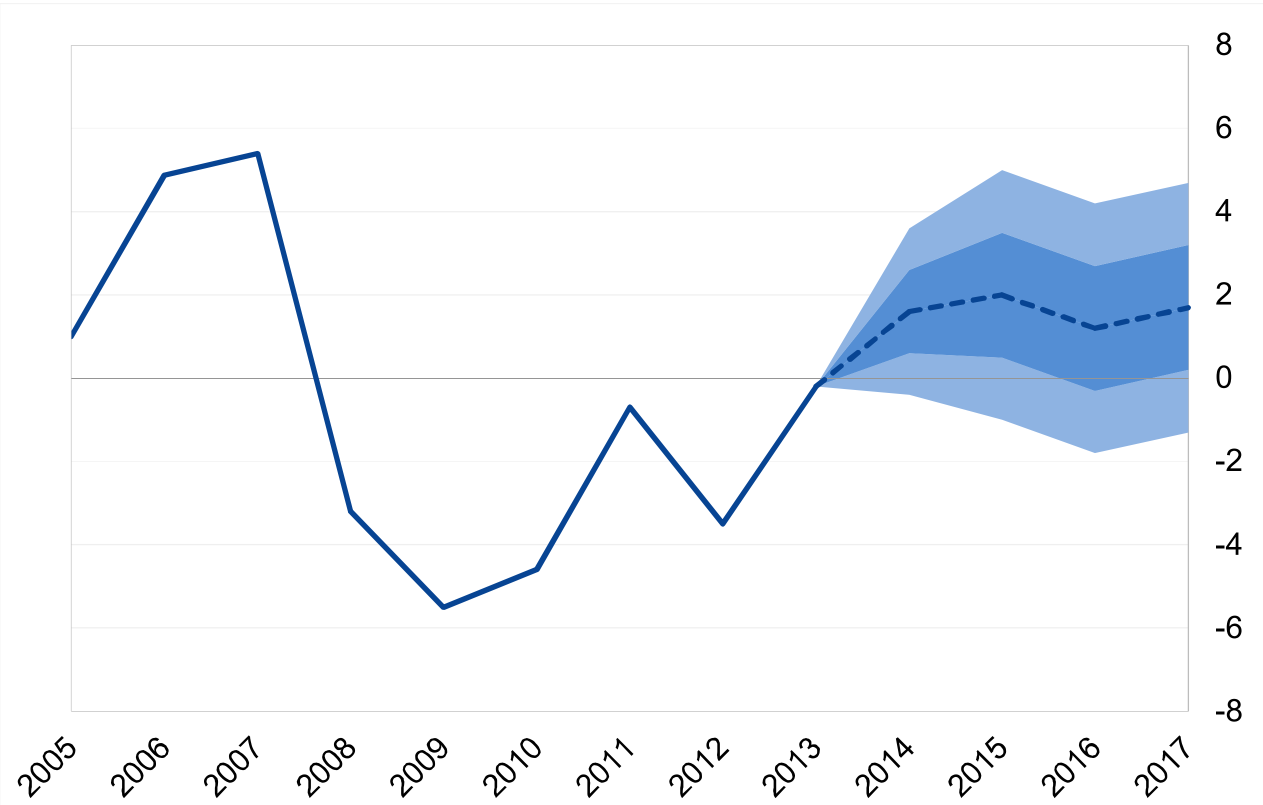
Central assessment of economic position

The FPP's central assessment of the current economic position is that Jersey's output is about 5% below its potential level and that spare capacity will be used up by about 2018 as Jersey's economy recovers. This assessment is subject to great uncertainty relating mainly to: the speed and durability of the global economy, the competitiveness of Jersey financial services and the ability of businesses to employ people locally and internationally.

Economic growth forecast: 2014-2017

The FPP's economic growth forecast up to 2017 is based on recent developments, including data on Jersey's economy, survey findings, market interest rate expectations and information from interviews with financial services businesses (Figure 1). It is also based on the States' expected fiscal stance not changing significantly.

Figure 1: Economic growth forecast
% change in real GVA on year before



Source: Jersey Statistics Unit and FPP judgement.

The central forecast is for between 1% and 2% real growth each year between 2014 and 2017, with a central range of 1% either side in 2014 and 1.5% either side from 2015-2017. The dark blue area around the central growth forecast represents a more likely range around future growth rates.

The light blue area represents a less likely, but still possible, range of growth rates that could occur.

Economic growth forecast: From 2018 onwards

The FPP suggests that there is not enough evidence to assume a trend rate of growth that is positive in Jersey and that future fiscal trends should be tested against a trend rate of 0% a year. Future productivity performance will have a profound impact on the long term rate of growth. However, these estimates are uncertain because of the nature of the economy and the period for which data are available (Figure 2).

Figure 2: Calculation of trend GVA growth
Summary of projections for trend in each component of GVA

	Low Scenario	Central Scenario	High Scenario
GVA/FTE	-2.0	0	+0.7
Hours worked	-0.5	0	+0.1
Employment rate	-0.2	+0.2	+0.3
Working age	-0.4	0	+0.2
Total	**-3.1**	**+0.2**	**+1.3**

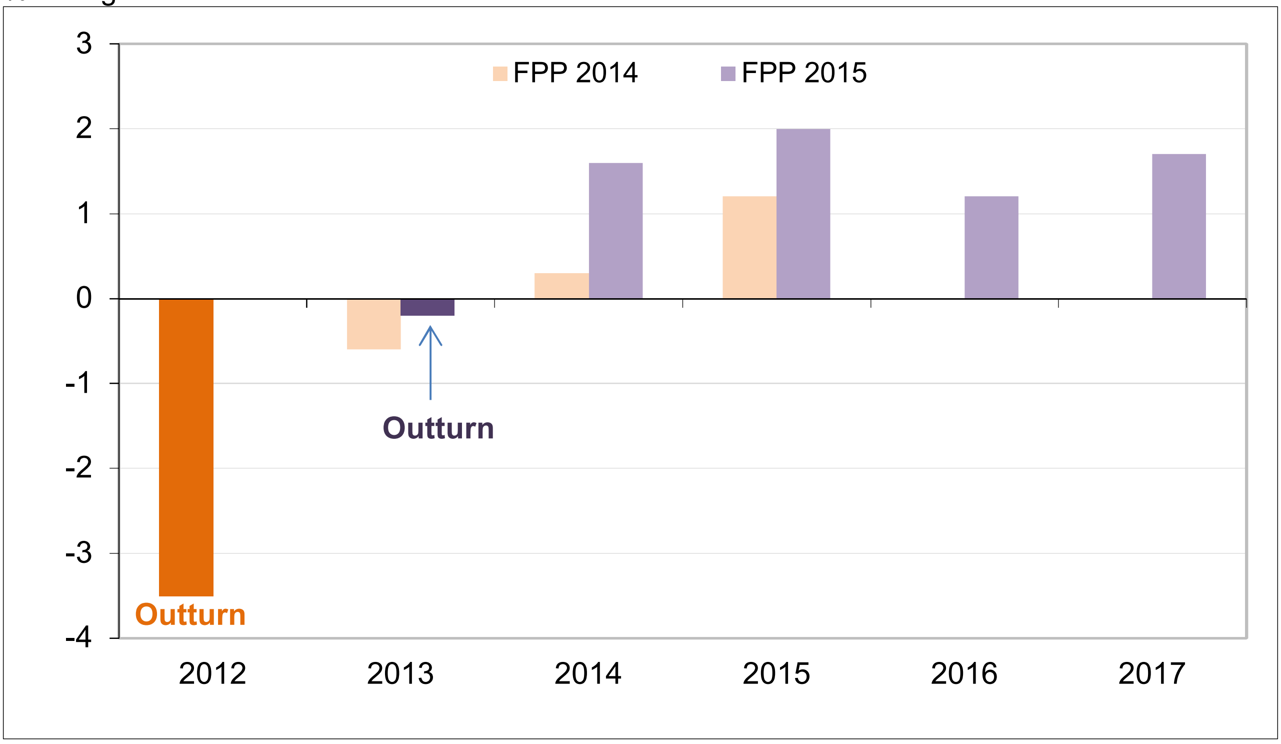
Source: FPP Pre-MTFP report January 2015

Comparison with previous economic growth forecasts

The FPP latest forecast is more positive than their previous forecast (July 2014 annual report), because more recent local developments have been slightly better than expected (Figure 3). For example:

- Total employment in June 2014 had increased by 620 and stood at its highest level on record.
- Average earnings in nominal terms increased by 2.6% in the year to June 2014, slightly higher than the 2.2% increase in 2013. It was also the second successive year in which average earnings increased faster than inflation.
- Unemployment, as measured by the internationally comparable ILO rate, fell to 4.6% in June 2014 – a significant fall from 5.7% in June 2013. The numbers actively seeking work have also been on a downward trend.
- Survey data suggest an improvement in sentiment in both the finance and non-finance sectors in 2014.

Figure 3: FPP forecast 2015 v FPP forecast 2014
% change in real GVA



Sources: FPP Annual Report 2014, FPP Pre-MTFP report 2015

2. Additional data on the local economy

So far in 2015 there has been new data on business sentiments and expectations (Business Tendency Survey Q4 2014 – published before the FPP reported), the housing market (House Price Index Q4 – 2014) and retail sales (Retail Sales Index – Q4 2014).

Overall, the new developments shown in this data are positive and support the other improvements in economic indicators that have been seen during 2014.

Recent trends in interest rate expectations (particularly important for future trends in the banking sector) are covered in more detail on page 19.

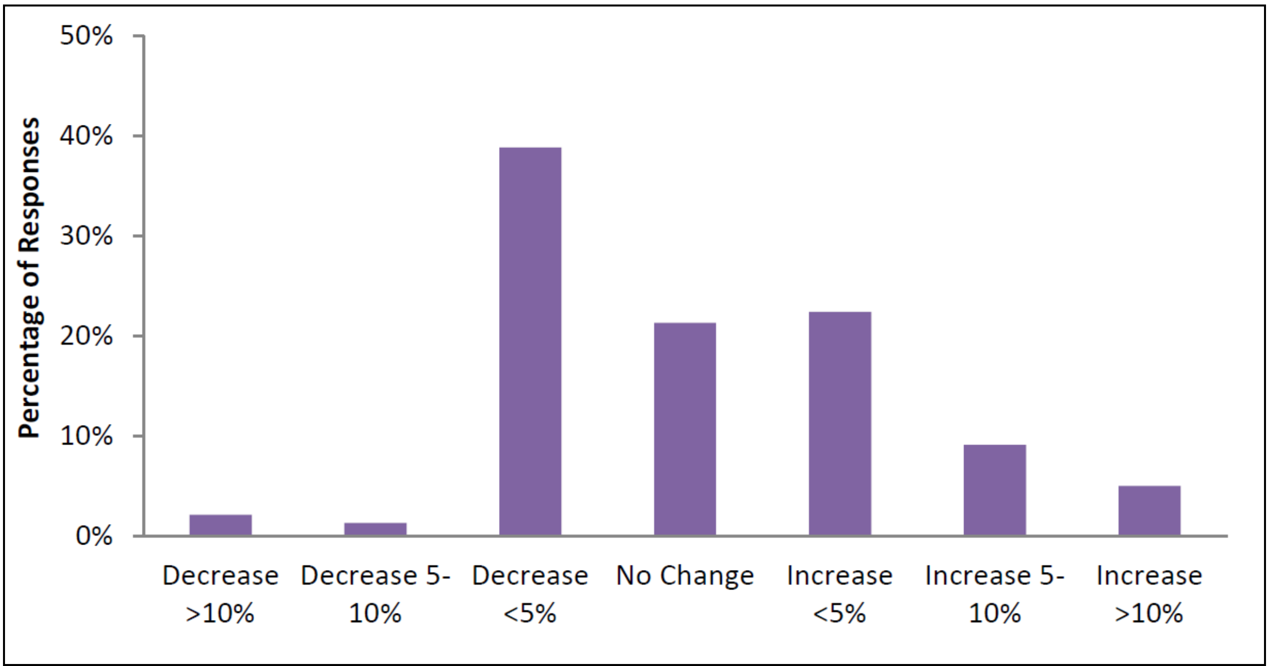
Business sentiments and expectations

The latest Business Tendency Survey showed:

- The headline all-sector Business Activity Indicator declined slightly (down from 12pp to 5pp) in the latest quarter, returning to the broadly neutral levels seen in late 2013 and early 2014.
- For the finance sector, the indicators were generally slightly positive (business activity +10pp, new business +27pp, profitability +5pp, employment +4pp, future business activity +17pp and future employment +8pp). Four of the indicators declined compared with the previous quarter, five were broadly unchanged and one improved.
- For the non-finance sectors, the indicators were generally neutral or negative (business activity +3pp, new business +2pp, profitability -23pp, employment -1pp, future business activity +13pp and future employment +4pp). All ten indicators were broadly unchanged compared with the previous quarter.

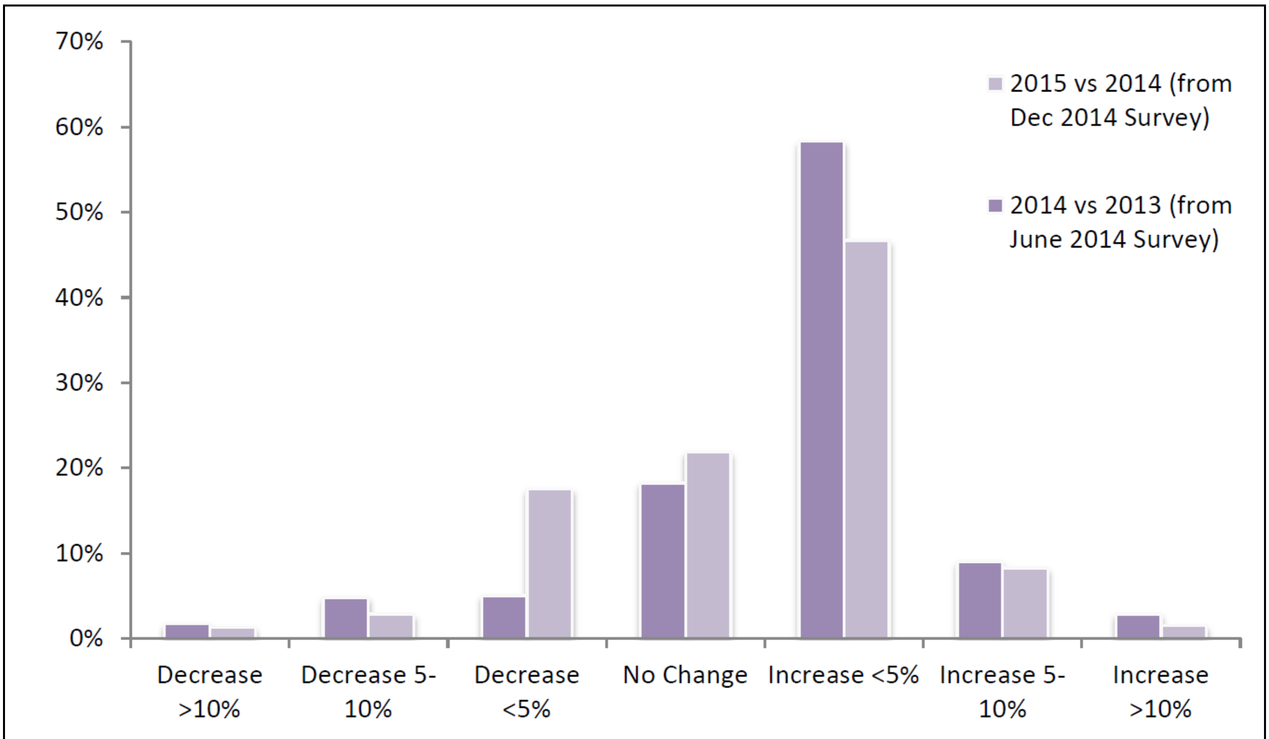
Figures 4 and 5 show the finance sector's employment and profit expectations for 2015.

Figure 4: Finance sector's employment expectations, 2015
% of responses



Source: Jersey Statistics Unit, BTS December 2014, Figure A2a, page 12.

Figure 5: Finance sector's profit expectations for 2015 (compared with 2014, expressed in December 2014) and for 2014 (compared with 2013, expressed in June 2014)
% of responses



Source: Jersey Statistics Unit, BTS December 2014, Figure A4a, page 14.

36% of finance sector businesses expected to increase employment in 2015, 21% of companies anticipated no change, whilst the remaining 42% of businesses expected employment to decrease during 2015 – most of which thought the decrease would be by less than 5%. Weighting the replies by expected size of change implies that employment is still expected to increase on average by about 1%.

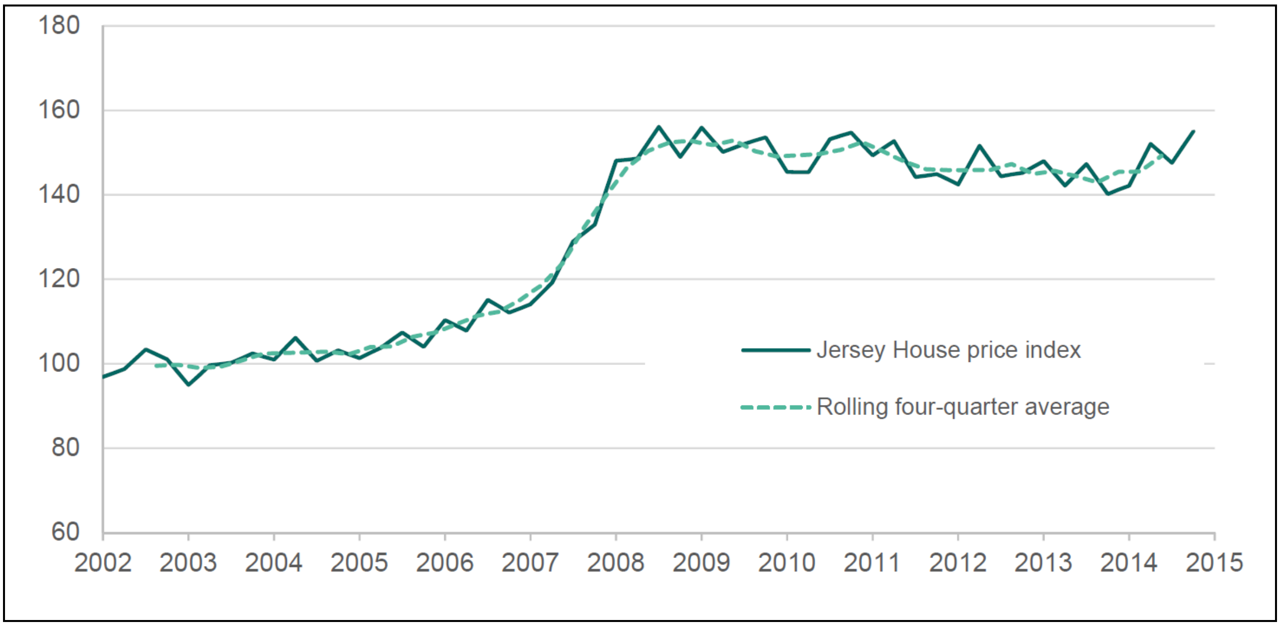
Profit expectations for 2015 (expressed in December 2014) were less positive than those for 2014 (expressed in June 2014); the weighted net balances were positive in each case, +35 pp for 2015 and +59 pp for 2014.

Care is required in interpreting the survey results. The survey is qualitative and has only been in existence since 2009 which makes it harder to understand what changes in its indicators mean about conditions in the local economy.

House prices

There are two developments of interest from the latest Jersey House Price Index. Firstly, average house prices were 3% higher in 2014 compared to 2013, representing the first annual increase in property prices since 2009 (Figure 6). Secondly, the number of properties sold in 2014 was 15% higher than in the previous year.

Figure 6: Jersey House Price Index
(2002 = 100; including share transfer properties; non□seasonally adjusted)



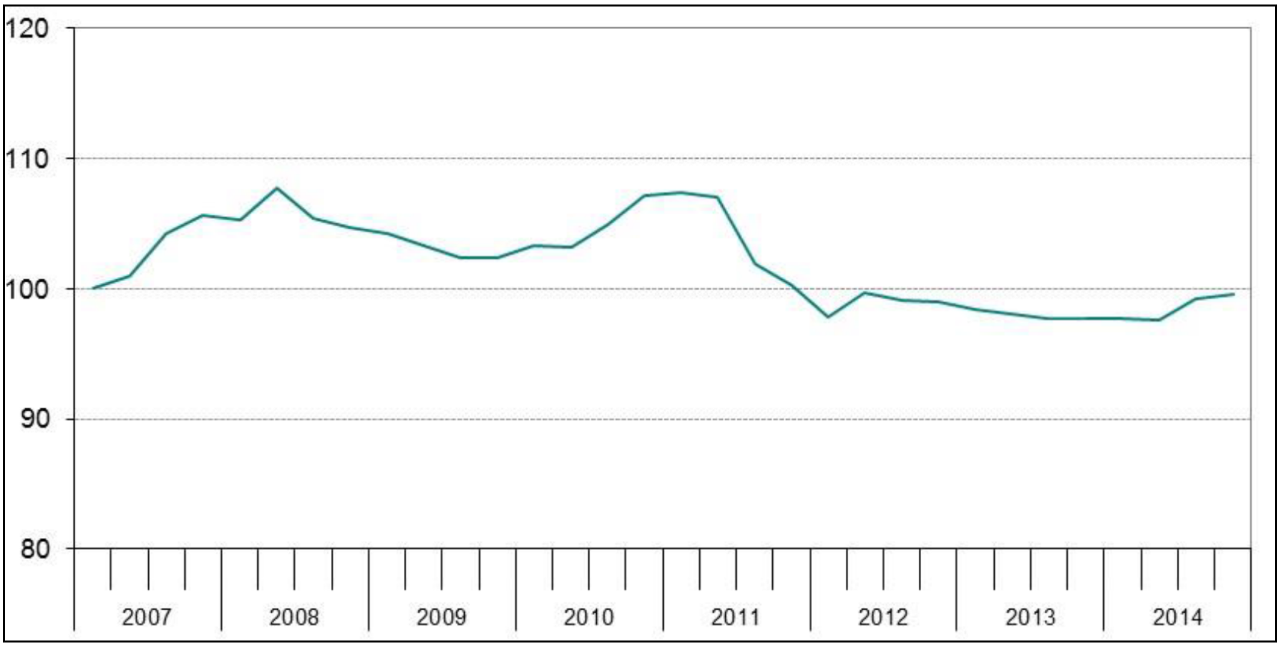
Source: Jersey Statistics Unit, Jersey House Price Index Q4 2014

These developments may be indicative of more confidence and perhaps a stronger economy in 2014. This would be consistent with the positive developments seen in a number of the other economic indicators.

Retail sales

The total volume of retail sales increased by 2% on an annual basis in Q4 2014, reversing the -1% a year decline between 2012 and 2014. The increase in 2014 is mostly due to the volume of retail sales in the (predominantly) food sector being 3% higher than the year before (Figure 7).

Figure 7: Retail sales – total volume
(Q1 2007=100) Seasonally adjusted



Source: Jersey Statistics Unit, Jersey Retail Sales Q4 2014

3. Long-term trends

Section 2 of the FPP's Pre-MTFP report describes and analyses the long-term trends in all the key economic variables and explains the assumptions that should be used when the economy is expected to return to its trend growth rate from 2018 onwards.

This section summarises they key points and provides some further analysis of the trends where possible.

GVA

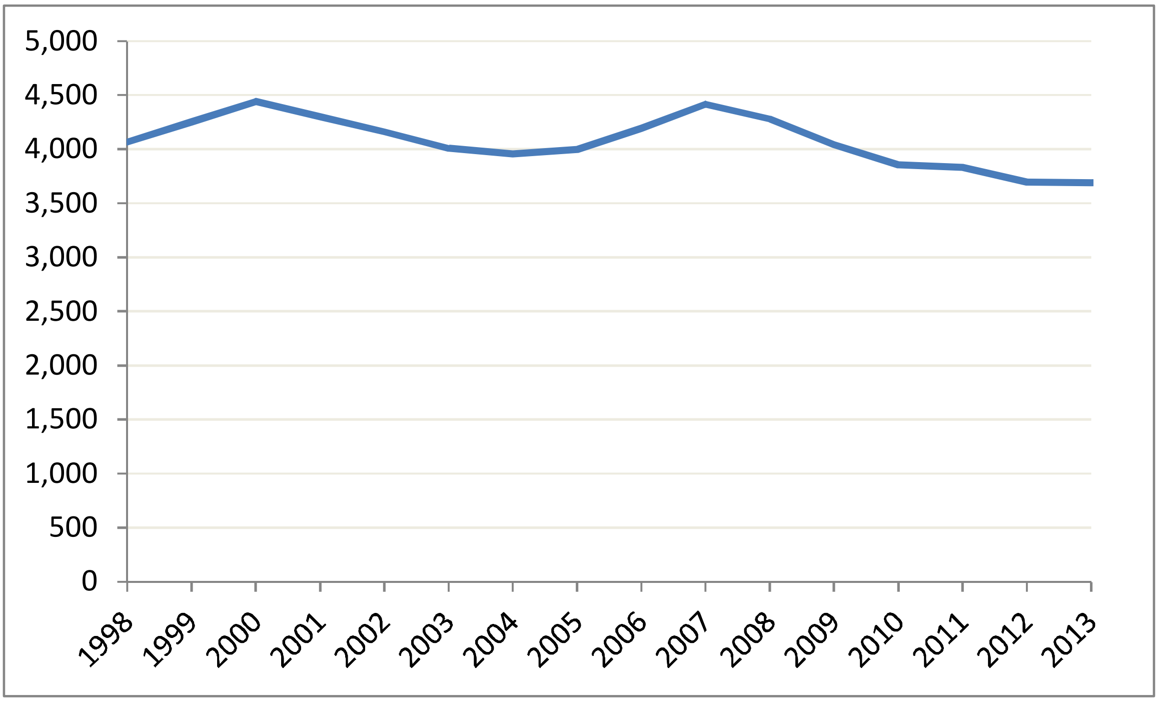
Over the period 1998 to 2013, measured GVA fell by 9% in real terms – equivalent to an average annual fall of 0.6%. However, this period covers more than one economic cycle, and looking over a single cycle may give a more accurate estimate of trend growth for that cycle.

The most recent full cycle is from the peak in 2000 to the peak in 2007, a period over which measured GVA declined by 1%, equivalent to an average annual fall of 0.1%.

If the FPP forecasts prove to be correct (i.e. the economy grows in 2014) then 2004-2013 would also represent a complete economic cycle. Over this period measured GVA declined by 7%, equivalent to an average annual fall of 0.8%.

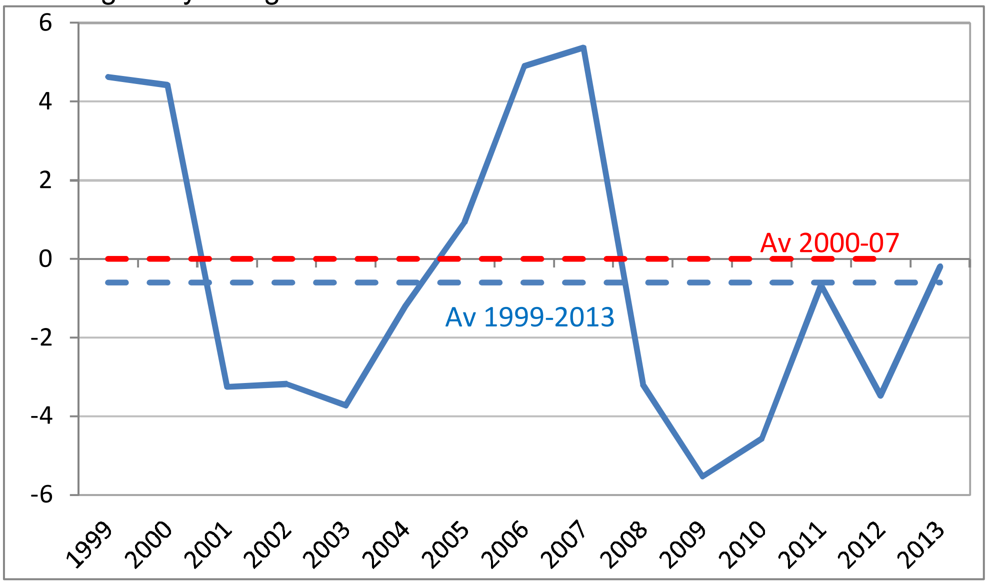
The significant fall in GVA over the 2004-2013 period is due to trends in the financial services sector (and in particular the banking sector) as the GVA of the non-finance sectors (excluding the rental income of private households) grew by 3% over the same period.

Figure 8: Economic performance (as measured by GVA)
2013 prices, £m



Source: States of Jersey Statistics Unit

Figure 9: Economic performance (as measured by GVA)
% change on year ago

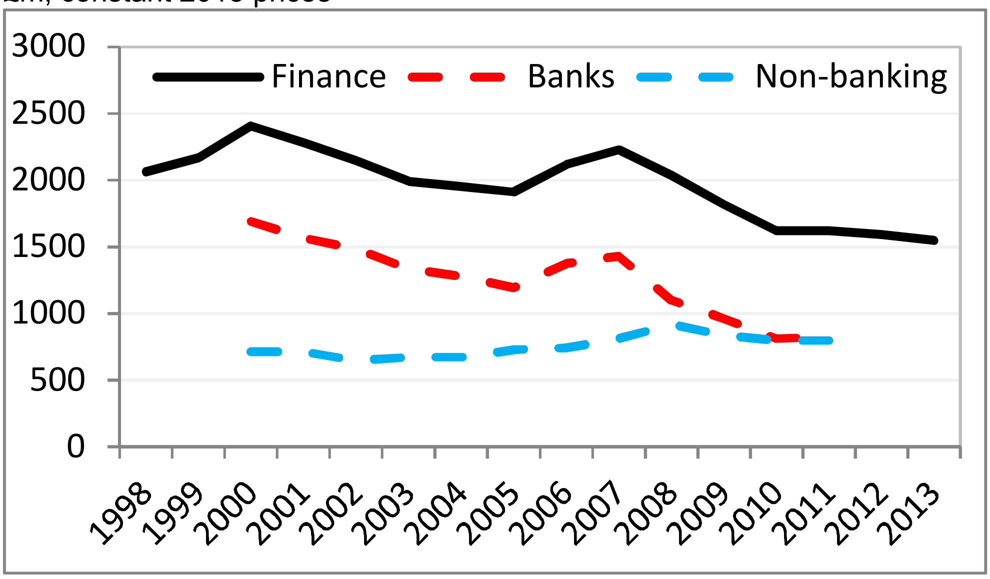


Source: States of Jersey Statistics Unit

Figure 10 shows that the trend in banking sector GVA has driven the overall trend in finance sector GVA in recent years. The fall in banking sector profits, and in particular revenues, explain the recent falls in banking sector GVA. An important component of the banking sector's revenue is the net interest income they receive which fell sharply as UK interest rates were cut.

The 2008 to 2012 period, however, is influenced by the global "great recession". This appears to represent a one-off "step down" in GVA, rather than a standard cycle. Caution is therefore required in drawing any conclusions about trends over this period. GVA over this period will also have been negatively influenced by the low interest rate environment, given the importance of financial services profits to total GVA.

Figure 10: Finance and banking GVA
£m, constant 2013 prices



Source: States of Jersey Statistics Unit

Trend GVA/FTE

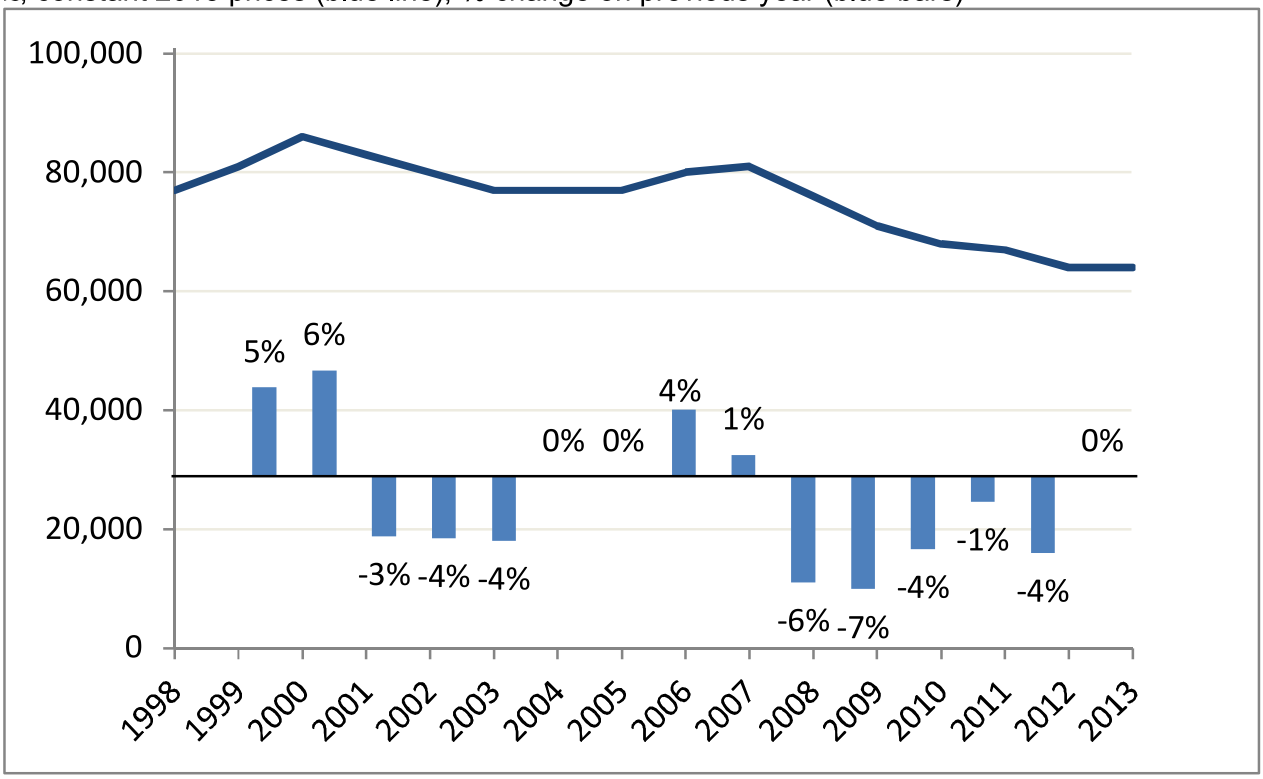
GVA per full-time equivalent employee (FTE) is a measure of labour productivity. Figure 11 shows GVA per FTE for Jersey since 1998. GVA per FTE tends to follow the economic cycle, recording high growth rates when GVA growth is high and vice versa. This is because employment tends to be less volatile than GVA.

Over the economic cycle 2000-2007, GVA per FTE fell by an average of almost 1% per year, driven by a fall in finance sector GVA/FTE. While non-finance productivity grew by an average of 0.7% per year over the period, finance sector productivity fell by an average of 2.4%.

Over the possible economic cycle 2004-2013, GVA/FTE fell by an average of 2% per year – again driven by a fall in finance sector productivity (averaging 3.6% per year) with non-finance productivity relatively flat over the period.

Looking forward, any increase in productivity would represent a considerable improvement on previous performance.

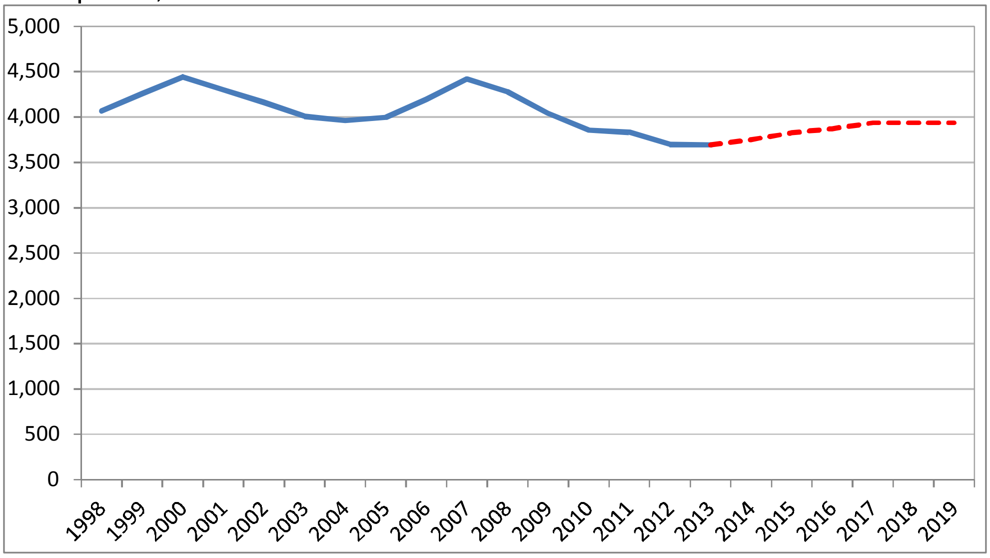
Figure 11: GVA per FTE
£, constant 2013 prices (blue line), % change on previous year (blue bars)



Source: States of Jersey Statistics Unit

The chart below shows what is expected to happen to the level of real GVA as the Jersey economy returns to trend growth from 2018 onwards.

Figure 12: GVA levels including FPP forecast and forward looking assumptions
2013 prices, £m

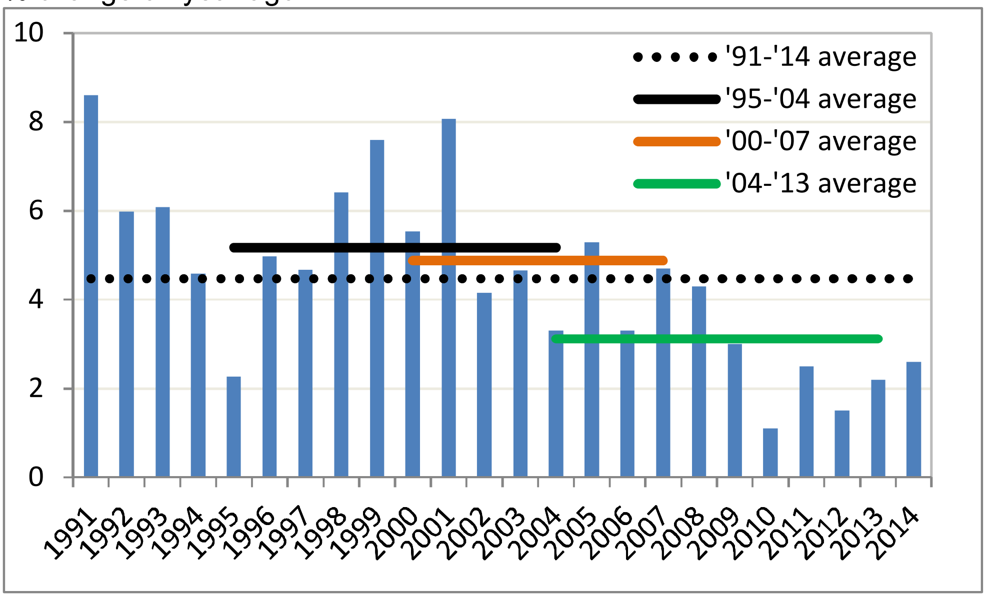


Source: States of Jersey Statistics Unit/Economics Unit calculations

Average earnings

The long-term trend in average earnings growth has been lower in the last ten years (2004-2013: 3.1%) than in the previous ten years (1994-2003: 5.3%). Therefore, the long-term trend appears to be downward (Figure 13). However, the trends in recent years have clearly been affected by the economic downturn. It is difficult at this stage to judge whether recent trends are purely cyclical, structural or a combination of the two.

Figure 13: Average earnings growth
% change on year ago



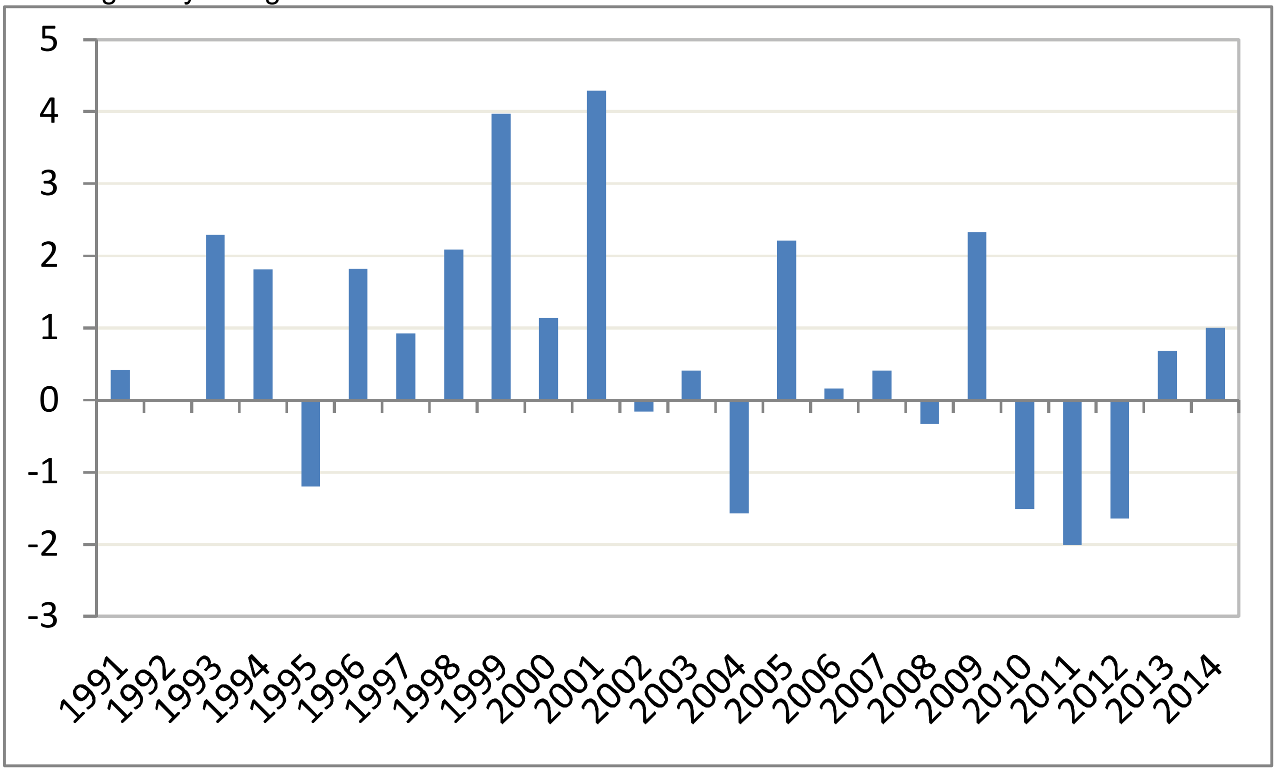
Source: States of Jersey Statistics Unit

In understanding trends in average earnings it is also important to consider trends in inflation as often the wage bargaining process uses them as a reference point. Figure 14 shows the long-term trend in average earnings relative to RPI. In the long-term (1991-2014), average earnings growth has averaged 0.7% above RPI and this is similar to the 0.9% above RPI achieved over the recent economic cycle (2000 to 2007). However, over the last 10 years, real average earnings growth has been much lower at 0.1% above RPI.

In the income tax forecast it has been assumed that real earnings continue to grow by between 0.5% and 1% in 2016 and 2017. From 2018, when the Jersey economy is expected to return to its long term trend rate of growth, it has been assumed that average earnings grows at a similar rate to RPI – i.e. no real earnings growth.

The assumptions for 2015, 2016 and 2017 are consistent with the past trends in real average earnings growth and the assumptions for 2018 and 2019 are consistent with the central expectation of no real growth in the economy.

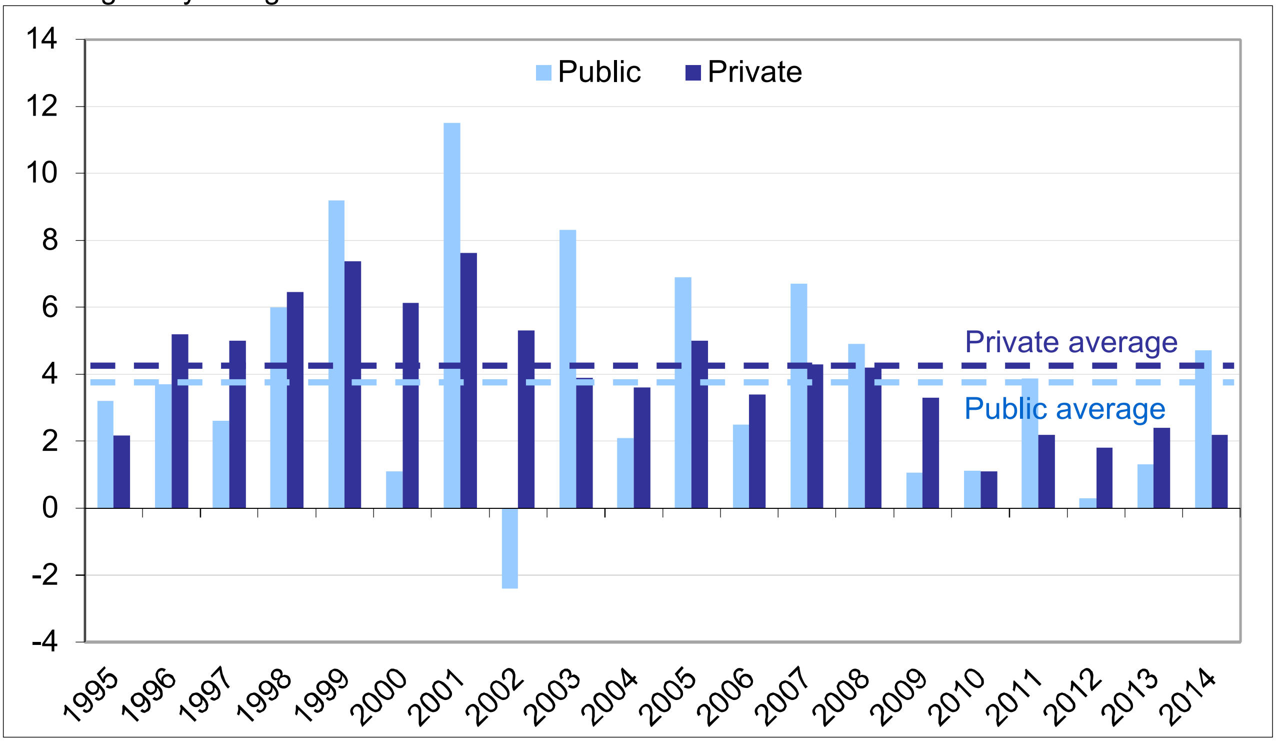
Figure 14: Differential between average earnings and RPI
% change on year ago



Source: States of Jersey Statistics Unit

The chart below shows that public sector and private sector earnings growth have on average been quite similar since the mid 1990's. (Care is required in looking at public sectors earnings data as it can be distorted by the fact that in some years there is no pay award due to continued negotiations and it carries forward into the next year meaning that in others there may be two awards.)

Figure 15: Public and private sector earnings growth
% change on year ago



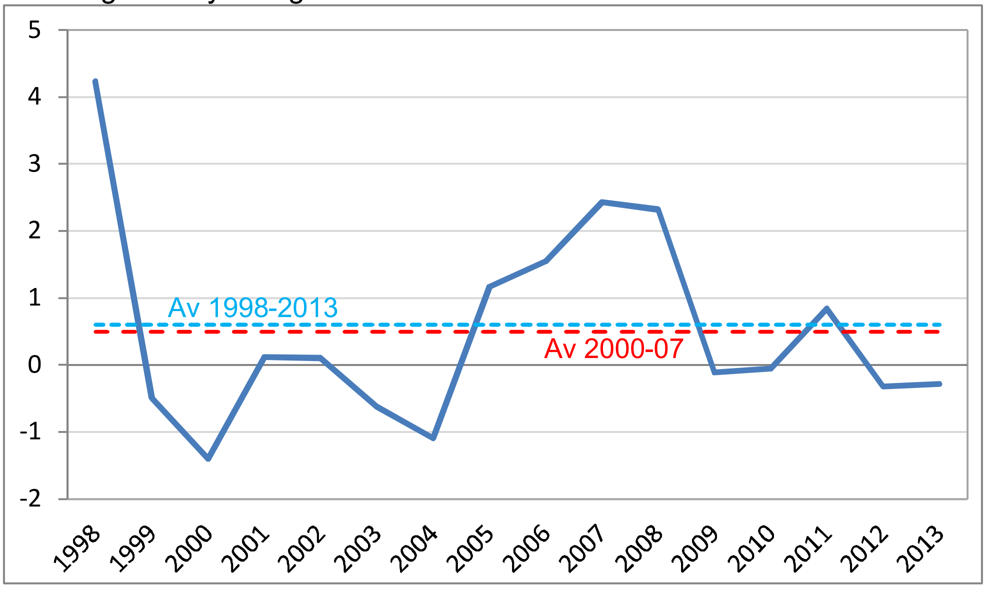
Source: States of Jersey Statistics Unit

Employment

Employment growth has averaged around 0.5% a year over the long-term and over the recent economic cycle 2000-2007 (Figure 16). This has been influenced by external economic conditions, and productivity, demographic and migration trends. Looking forward, it is difficult to see how any of these are going to be more supportive of employment growth given the weak global economy, concern about levels of inward migration and the ageing population (i.e. a risk that the working age population becomes smaller).

As the economy uses up spare capacity over the next few years, employment is initially expected to grow by 1% in 2015 before returning to the long-term average growth rate of 0.5% in 2016/17. From 2018 onwards, employment is expected to remain stable, given the trends outlined above (Figure 17) and the FPP's advice to use flat trend real GVA growth.

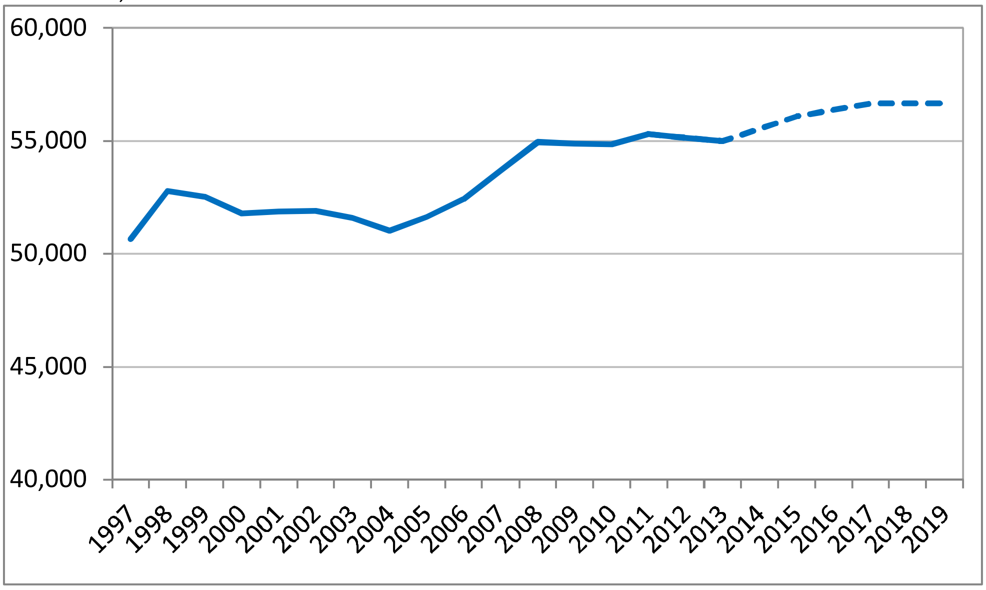
Figure 16: Trends in employment
% change on a year ago



Source: States of Jersey Statistics Unit

Figure 17 shows that under these assumptions, employment continues to grow until 2017, before stabilising from 2018 onwards.

Figure 17: Trends in level of employment
numbers, headcount basis



Sources: Jersey Statistics Unit / FPP assumptions

Company profits

Figure 18 shows that company profits have fallen slightly, by about 0.3% a year between 2001 and 2013 in nominal terms, although over the recent economic cycle (2000-2007) there has been 2.9% growth a year on average.

This is quite a short run of data and over a period when the data has been impacted by trends in financial services profitability which has suffered as a result of the global financial crisis and the low interest rate environment. At the same time there have been ongoing changes in global financial services regulation which will also have impacted on the profitability of the financial services sector, although it is difficult to separate out the scale of this impact which is likely to be ongoing, from the other factors mentioned above. In addition, pressure remains on offshore centres across the world.

Figure 18 also shows that trends in company profits excluding finance and rental income have been higher with nominal growth at about 2% on average or 4% over the 2000-2007 period.

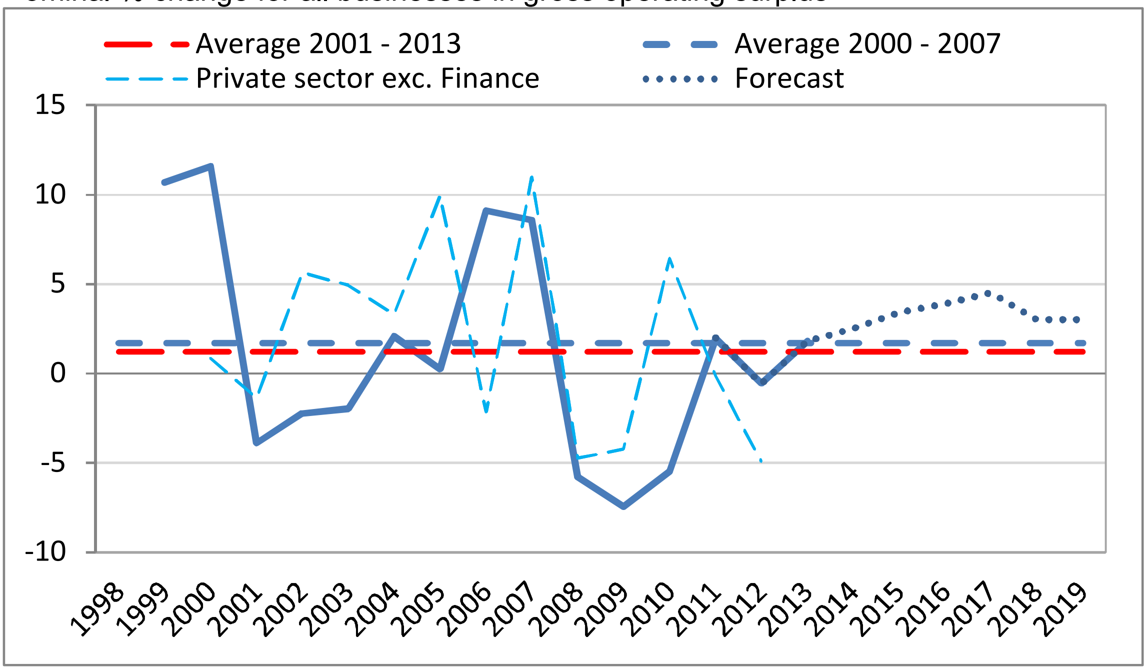
Given all these uncertainties, 2.5% to 4.5% a year nominal growth (i.e.weak real growth) in company profits has been assumed until 2017, with a trend growth rate of company profits after this of about 3% a year (flat in real terms).

This assumption factors in a gradual improvement in financial services profitability (Figure 19) based on interviews with finance sector representatives carried out towards the end of 2014, the most recent Survey of Financial Institutions and the Business Tendency Survey Q4 finance sector expectations for 2015.

There is a lot of uncertainty surrounding the assumptions for company and particularly financial services profit growth. Parts of the banking sector are undergoing changes to meet new regulatory requirements, and it is unclear how quickly and by how much interest rates will increase in the future. Future increases in interest rates should improve the profitability of the banking sector.

Figure 18: Company profits

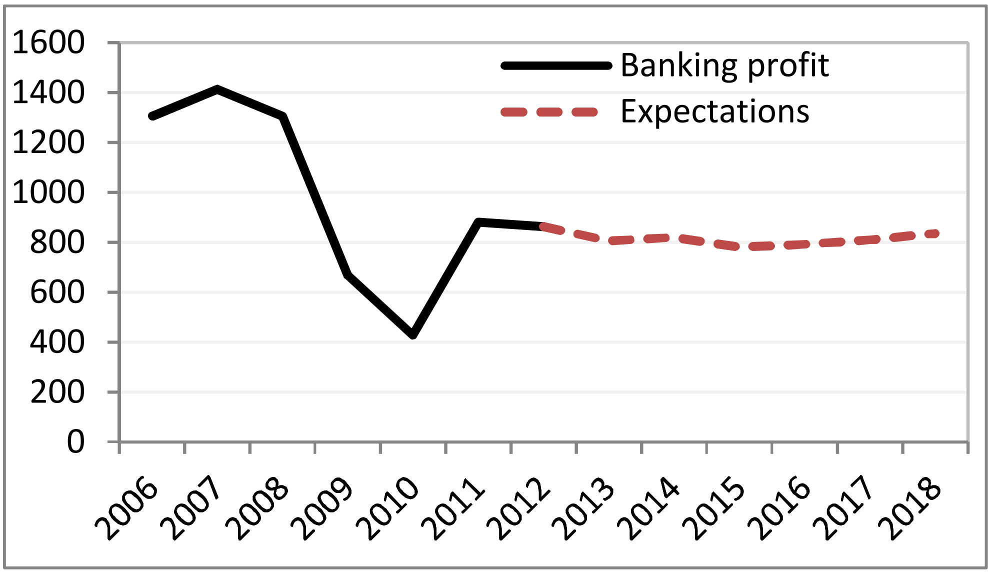
ominal % change for all businesses in gross operating surplus



Source: States of Jersey Statistics Unit / FPP assumptions

Figure 19: Banking sector taxable profit and future expectations

et profit, £m (constant 2013 prices)



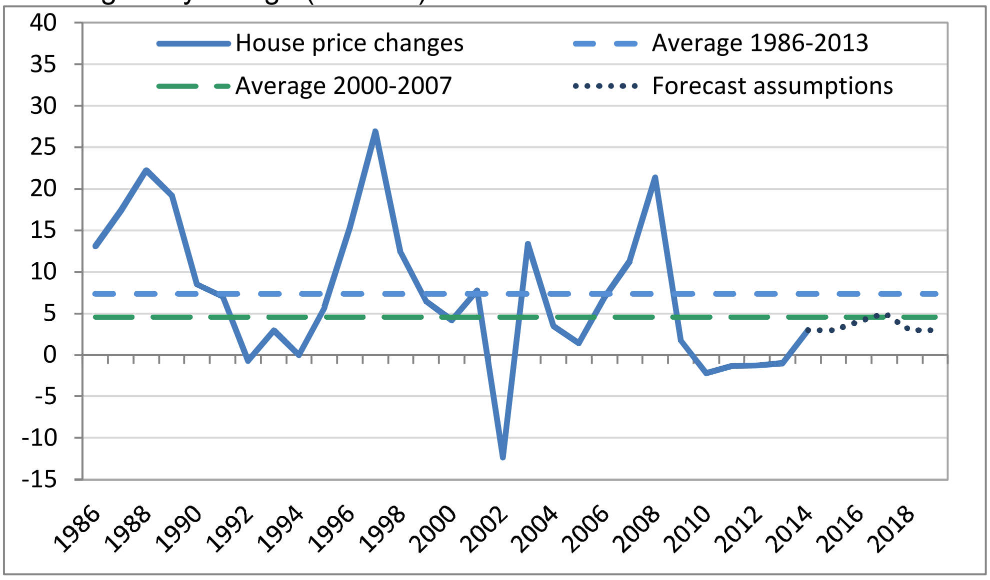
Sources: Jersey Statistics Unit / FPP assumptions. (FPP pre-MTFP report Figure 2.13)

House prices

The long-term average increase in house prices is 7.3% a year (1985-2014) although over the last economic cycle (2000-2007) they have averaged 4.6% growth each year (Figure 20). Over the last few years, changes in house price have been lower than expected with prices falling 1% in 2012 and 2013. However, in 2014, house prices increased slightly more than expected (3% growth compared to 1% growth).

Taking this into account, house prices are now assumed to increase gradually until 2017 and then grow at a longer term trend rate of 3% a year afterwards - similar to the longer term assumption for average earnings growth. This is equivalent to 0% real growth each year, after taking into account the assumptions for future inflation.

Figure 20: Trends in house prices
% change on year ago (nominal)



Source: Jersey Statistics Unit / Economics Unit calculations

Interest rates

Interest rates have been at historically low levels since 2009 (Figure 21) and in recent years there has been increased commitment from central banks across the world to keep interest rates low for an extended period.

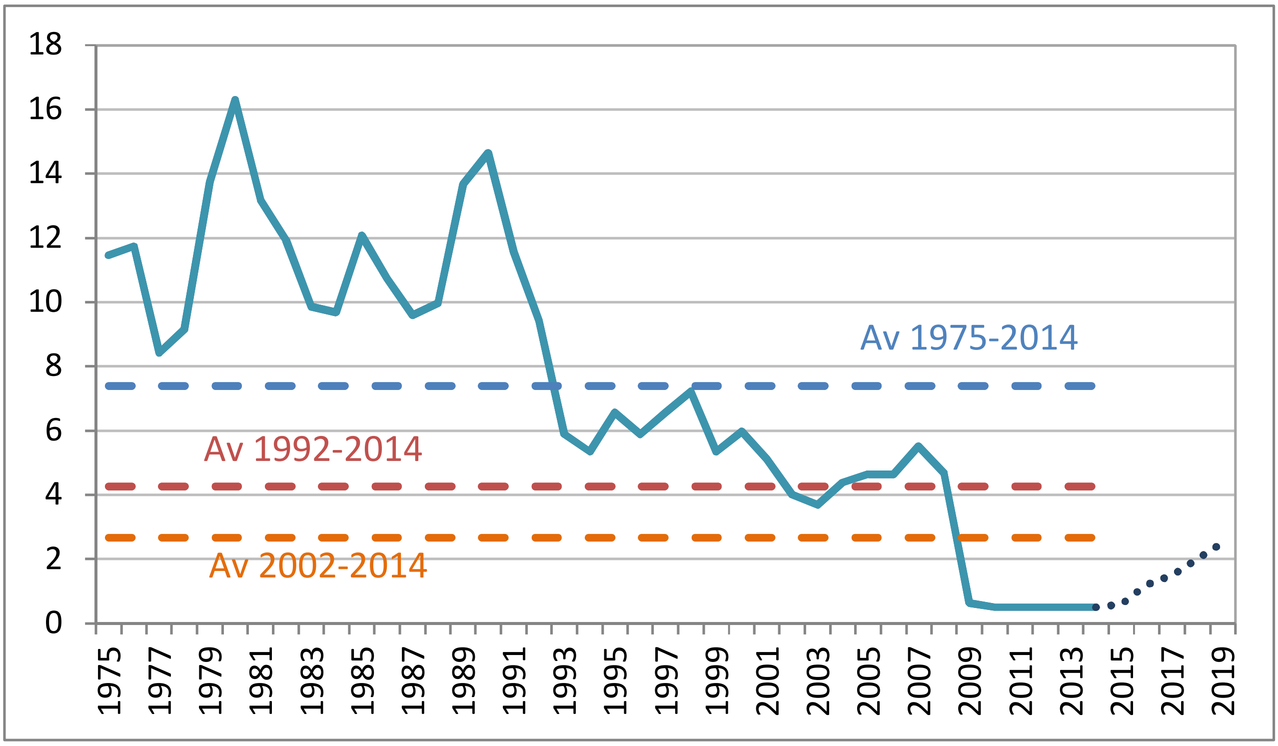
The Bank of England has indicated that when interest rates increase, they will do so slowly and perhaps to 2% or 3%, which is still very low by past standards.

There are uncertainties between market commentators about when the UK's interest rates will start to go up. It will depend on how quickly the UK economy recovers and the UK inflation outlook. Figure 22 shows market interest rate expectations published alongside the last three Bank of England Inflation reports. Market expectations have fallen sharply over the last nine months as there appears to be more scope for the UK economy (and productivity) to recover over the next few years without increasing inflationary pressure to an unacceptable level. Part of this is due to the lower than expected inflation caused by the falls in oil prices over the last year.

The FPP's assumptions for interest rates are based on the market expectations published in ovember 2014 and the income tax forecast assumptions are based on these.

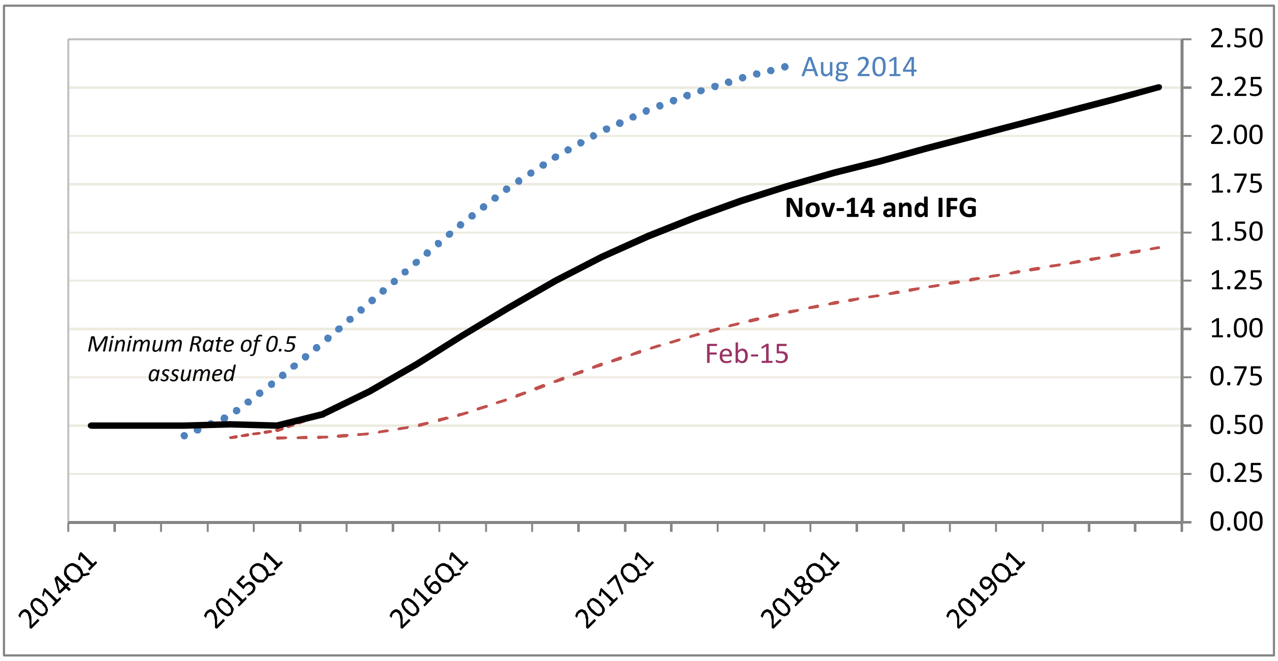
However, since then, market expectations have slipped back again, for an initial rate rise in 2017 and increasing slowly to about 1.5% by the end of 2019 (Figure 22). This suggests there is a risk that financial services profits may not grow as strongly as expected at the time of the finance sector interviews.

Figure 21: Interest rates
% bank base rates



Source: Bank of England (and forecast assumptions 2015+)

Figure 22: Market interest rate expectations
% bank base rates



Source: Bank of England Inflation reports

Appendix: UK OBR's fiscal forecast – key assumptions

The Office for Budget Responsibility (OBR) was established in 2010 to provide independent and authoritative analysis of the UK's public finances. In their December 2014 Economic and Fiscal outlook, they set out their fiscal forecasts to 2019-20.

These assumptions are specific to the UK's economy as are the FPP's assumptions specific to Jersey's economy. Therefore, differences between the two sets of assumptions should be expected.

The economic assumptions that underpin their forecasts are included below for information.

OBR's economic assumptions for their fiscal forecast, December 2014

	Percentage change on a year earlier					
	2014	**2015**	**2016**	**2017**	**2018**	**2019**
Real GDP	3.0	2.4	2.2	2.4	2.3	2.3
Nominal GDP	5.0	4.0	3.6	4.1	4.2	4.3
Employment	2.3	1.6	0.6	0.3	0.3	0.3
Average earnings	1.8	2.0	3.1	3.9	3.9	3.8
CPI	1.5	1.2	1.7	2.0	2.0	2.0
RPI	2.4	2.2	2.9	3.4	3.6	3.6
House prices	10.2	7.4	5.9	5.8	5.1	3.8

Appendix C

States of Jersey
Economics Unit
March 2015

Income tax forecast note for Income Forecasting Group

1. Introduction

This note describes the provisional results of the income tax forecasting model for the Income Forecasting Group (IFG). The note is set out as follows:

- Section 2 covers how the forecast is carried out.
- Section 3 updates on the latest tax data (Year of Assessment 2013).
- Section 4 goes through the other new information and updates the assumptions used in the tax model.
- Section 5 shows the income tax forecast and forecast range suggested by the model.
- Section 6 provides a sensitivity analysis for the key economic assumptions.

There are also some appendices with reference information for the Income Forecasting Group.

- Appendix 1 describes the current economic assumptions and the economic assumptions used in the 2015 Budget forecast.
- Appendix 2 describes optimistic and pessimistic economic scenarios.
- Appendix 3 discusses additional forecasting information that was used for Treasury's longer term planning in May 2014 and November 2014.

2. How the forecast is carried out

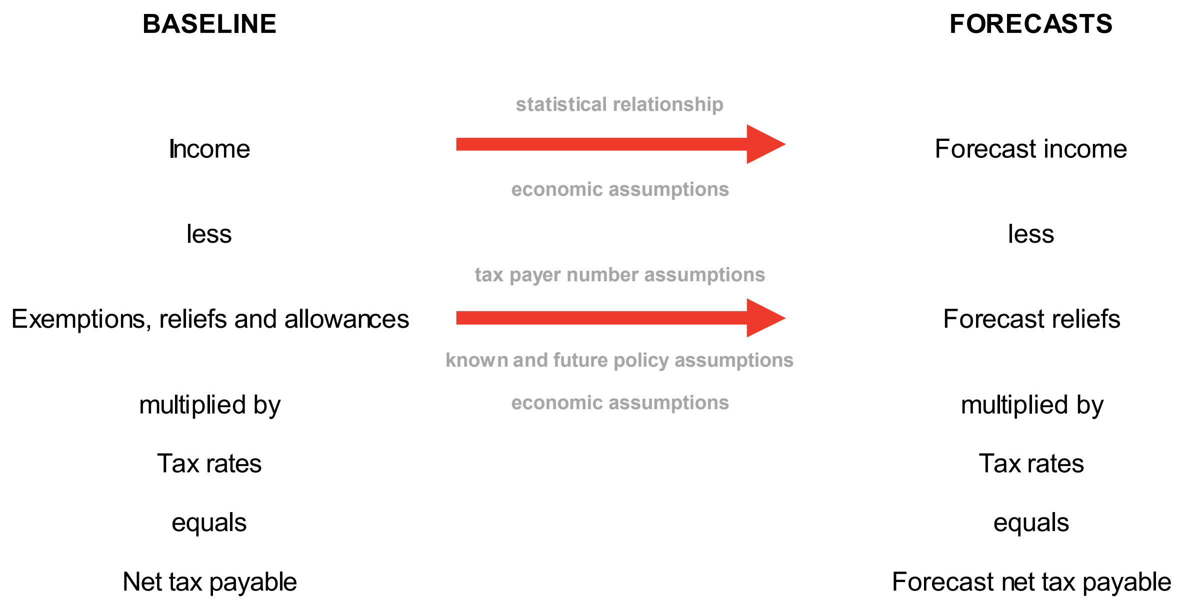
The Taxes Office provides data on personal income and company income, and the value of personal exemptions, reliefs and allowances for all years up to the last complete year of assessment (YOA) which was 2013.

An overview of the tax model is shown in Figure 1. There are two main parts to it – forecasting taxable income and forecasting the value of exemption thresholds, reliefs and allowances.

Taxable income is estimated over the forecast period by taking the data provided by the Taxes Office and using statistical relationships between income and various economic variables, in combination with assumptions about the economic variables going forward. The economic variables include economic activity (Gross Value Added (GVA)), company profits, employment, average earnings and interest rates, for example.

The value of exemptions, reliefs and allowances are estimated over the forecast period by taking the baseline data and using assumptions about future tax payer numbers, inflation, interest rates and Budget policy.

Figure 1: Model overview



Forecast net tax payable is adjusted for the expectation of the size of bad debts in the future to arrive at a final forecast for income tax revenue.

In order to reflect the fact that there is significant uncertainty in the forecast, a central forecast is produced with a range, with the emphasis on the range rather than the point estimates. The model can provide a range based on a set of optimistic and pessimistic economic assumptions. In recent forecasts, the IFG has set the range at +/- 5% of the central forecast for the forecast period.

The forecast is considered by the IFG and they use their judgement to decide what the final income tax forecast will be.

3. Updates on the latest tax data

The latest complete year of tax data (covering incomes in 2013 - Year of Assessment (YOA) 2013) shows that total income tax revenue was £437m for Budget year 2014[1].

The last central forecast (in the 2015 Budget) for income tax revenue in 2014 was £444m, and so actual income tax receipts were £7m lower than forecast (Figure 2).

The £437m income tax revenue for Budget year 2014 was £15m lower than the income tax revenue received in Budget year 2013.

[1] The income tax due on incomes and profits received in 2013 is recognised as States income tax revenue in 2014.

Figure 2: Actual 2014 income tax revenue compared to 2015 Budget forecast

	Actual £m	2015 Budget Forecast £m	Difference £m
Personal	356	364	-8
Companies	83	84	-1
Bad debts	-2	-3	1
	437	444	-7

Note: The forecast and difference columns do not sum due to rounding.

Income tax revenue growth was lower than expected mainly because personal incomes did not grow as quickly as expected. Weaker income growth (in particular in employment income and shareholder income) were the main contributors to the £8m shortfall. A higher yield than expected helped to partially offset the weaker income growth.

Variances in other forms of taxable income were individually worth less than £1m in income tax and acted to offset each other.

The Budget 2015 forecast was carried out between February and May 2014. During this time, the economic model was using actual 2013 economic data, and not economic assumptions, to forecast income tax revenue for 2014. Therefore any differences between forecasts and actual outturns were due to:

- the model's estimated relationships between economic variables and the tax base and yield (and therefore tax revenue)
- some of the other underlying assumptions made for forecasting purposes such as trends in shareholder income.

In this case, the relationship that tries to predict employment income growth overestimated it on the basis of the economic performance and variables in 2013. There is no economic relationship which tries to predict shareholder income – the other key difference between actual and forecast.

Figure 3 shows the differences between forecast and actual personal income tax and company income tax receipts outlined in Figure 2.

Figure 3: Breakdown of the difference between the 2015 Budget forecast and 2014 outturn

	£m	£m
Personal:		
Forecast		**364**
Income - lower than forecast:		-11
Employment income	*-6*	
Shareholder income	*-5*	
Yield - higher than forecast		3
Actual outturn		**356**
Company:		
Forecast		**84**
Other		-1
Actual outturn		**83**

The forecast for Budget 2015 did not include an adjustment for the impact of the final withdrawal of the deemed dividend rules, or any behaviour changes resulting from the taxation of shareholder income applying in YOA2013. This could have contributed to the fall in shareholder income seen. Employment income and shareholder income is considered in more detail later (page 16 onwards).

4. Assumptions for the new forecast

There are several new sources of information since the 2015 Budget forecast was carried out:

1. The Taxes Office has new information on personal and company tax assessments for YOA 2013 which relates to income tax revenue in Budget year 2014.
2. The Taxes Office has earned income data from the Income Tax Instalment System (ITIS) and company profit estimates from agents for YOA2014.
3. The Statistics Unit has published data on economic variables, such as for economic growth, employment and average earnings.
4. The Fiscal Policy Panel (FPP) has published their Pre-MTFP report[2] which contains a new economic growth forecast for Jersey and the underlying economic assumptions.
5. The latest market expectations for interest rates, for example, those published in the Bank of England's Inflation Report.

[2] Fiscal Policy Panel Pre-MTFP Report 2015, http://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Fiscal%20Policy%20Panel%202015%20annual%20report%2020150130%20JE.pdf

Tax base assumptions

The provisional income tax forecast has been updated to include the latest information from tax assessments. **The main assumption is that all the changes seen in personal and company assessments last year remain in the tax base in future.** This means that:

- For the personal tax base, the forecast starts from the amount of taxable income and exemptions, reliefs and allowances seen in the most recent complete year of assessment (2013).
- For the company tax base, the forecast starts from the amount of profits seen in the 2013 year of assessment. The effective tax rate, or yield, on company profits is assumed to remain the same over the forecast period.

The starting tax base is £437m. There are currently no accounting adjustments or one-off receipts for 2014 that should be adjusted for in the income tax outturn figures.

News so far this year

The Taxes Office has received some provisional estimates for the top 100 company taxpayers from their tax agents, which give an indication as to the amount of company income tax they will pay in 2015.

The Taxes Office has also examined the amount of employment income recorded during 2014 through ITIS. This informs how much income tax revenue will be received in Budget year 2015.

Company income tax provisional assessments

The Taxes Office has received agents' estimates for the majority of the top 100 company income taxpayers for 2014 YOA.

The agents' estimates for the top 20 are significantly different to the bottom 80, so each group has been estimated separately.

It has been assumed that:

- The tax receipts for the top 20 will grow by 8% - the indication from the estimates received so far.
- The tax receipts for the next 80 will fall by 5% - the indication from the estimates received so far.
- The tax receipts for companies outside of the top 100 will grow by 2.5% in 2014, the current company profit assumption for all companies overall (as provided in the FPP report).

Figure 4: Company income tax estimate

Central	YOA 2013 £m	YOA 2014 £m	Change on year %	Number
Top 20 - estimates	45.1	48.6	7.8	17
Top 20 - not known	4.4	4.8	7.8	3
21-100 - estimates	12.8	12.1	-5.3	60
21-100 - not known	4.2	4.0	-5.3	20
Rest	16.2	16.6	2.5	
	82.7	86.1	4.1	

Note: Assumed increases are in red.

This suggests an estimate for company income tax of £86m in 2015 and this has been used in the provisional forecast. Relative to the Budget 2015 forecast, this is £2m higher.

However, there is some uncertainty involved extrapolating the estimated assessments across all company taxpayers. This could affect the estimate by up to £1m or £2m in either direction and it is possible the estimate could be out by more than this. There is also still the uncertainty inherent in using estimated assessments, rather than final assessments.

Employment income for 2014

The Taxes Office has looked at the ITIS returns to find out the amount of employment income earned during 2014. This shows that employment income increased by 2.9% compared to 2013 and this has been used in the model.

Relative to the Budget 2015 forecast which assumed a higher rate of employment income growth, the impact of this is to reduce the provisional personal income tax forecast by £4m a year from 2015. This estimate of employment income is robust and will not change significantly.

Unfortunately, only ITIS data for January 2015 was available at the time the forecast was prepared. Therefore there isn't enough information on earned incomes in 2015 yet to be able to compare with the model's forecast for earned incomes and come to any conclusions. This will be reviewed at the time of the April update to see if there is any useful indication of trends in 2015.

Economic assumptions

The Fiscal Policy Panel's economic assumptions have been used in the tax model. These assumptions factor in the local and international developments since the last forecast was carried out (Figure 5).

These assumptions are described in the FPP's pre-MTFP report. A summary of these, and some further analysis, is included in the accompanying paper to this note, "Income Forecasting Group -

Detailed analysis supporting the economic assumptions for the new income tax forecast, March 2015".

In this forecast (compared to the assumptions in the Budget 2015 forecast):

- Real economic growth is expected to be slightly stronger in 2014 and 2015 but slightly weaker in 2016 and 2017. For 2018 and beyond the FPP advised that the States should plan on the basis of a trend rate of real growth of 0%.
- Inflation (as measured by RPI and RPIY, for example) is expected to be lower until 2017, recognising the recent sharp falls in oil prices and lower market expectations for interest rate increases.
- Financial services profits are expected to grow more slowly following information gained through a series of interviews with financial services companies in November and December 2014. This is a key assumption for the company income tax forecast.
- Employment is expected to grow more quickly in 2014 and 2015 rather than in 2016 and 2017.
- Average earnings growth is expected to be weaker in 2015 and 2016.
- Interest rates are now expected to increase later and more slowly, according to financial markets expectations.

The changes since the last forecast are covered in Appendix 1 (page 24).

Figure 5: Economic assumptions used (% change, unless otherwise stated)

Central scenario

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	3.2	3.5	3.7	4.4	3.0	3.0
Company profits(a)	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.6	1.2	1.5	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

Key:

OUTTURNS

Exemptions, allowances and reliefs assumptions

The assumptions about the future value of the exemption thresholds, allowances and reliefs (EARs) have been made bearing in mind the expected number of tax payers, past Budget decisions, a future Budget policy stance[3] and other economic variables, such as the rate of inflation (Figure 6).

Figure 6: Assumptions for exemptions, reliefs and allowances

Budget year Year of assessment (YOA)	2015 2014	2016 2015	2017 2016	2018 2017	2019 2018
	%	%	%	%	%
Exemption limits	1.5	1.7	2.5	3.0	3.3
Allowances and reliefs	0	0	0	0	0
Number of tax payers	1.0	1.0	0.5	0.5	0.0

Notes: Exemption limits, allowances and reliefs for YOA 2014 and 2015 have already been set in past Budgets. Other more specific measures affecting exemption limits, allowances and reliefs agreed in past Budgets have been included in the forecast but not detailed in the table above.

The main change in these assumptions since the Budget 2015 forecast is slower growth in the exemption limits (determined by lower RPI assumptions) and slower growth in the number of taxpayers (based on the assumption for future employment growth).

The effective tax rate, or yield, for personal tax payers is determined by these assumptions over the forecast period. The yield changes over time as personal incomes grow and the amount of EARs claimed by taxpayers change.

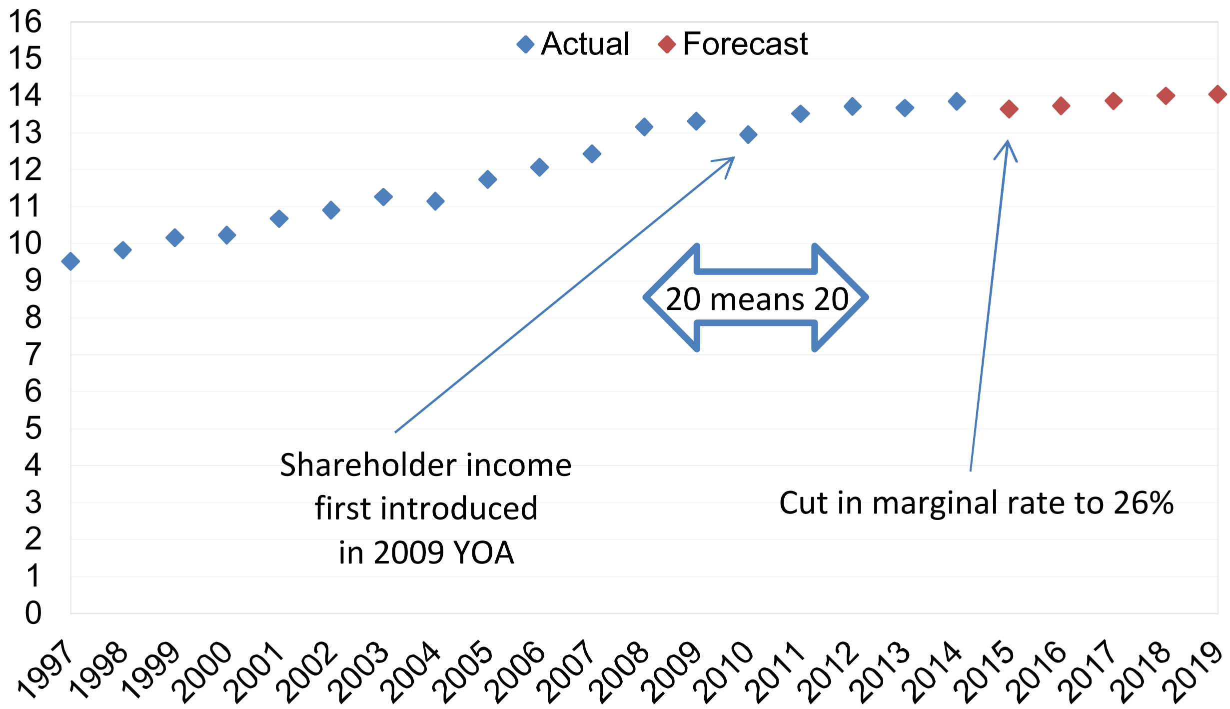
In this forecast, the yield increases from 13.6% in 2015 to 14.0% in 2019 because personal incomes are expected to grow more quickly (3.9% a year on average) than the value of EARs claimed (by 2.7% a year on average).

The yield in 2015 (13.6%) is expected to be slightly lower than the yield in 2014 (13.8%) because of the cut in the marginal income tax rate from 27% to 26% passed in the 2014 Budget (Figure 7).

Some uncertainty remains regarding the impact of higher interest rates on mortgage interest tax relief and the impact this will have on the yield.

[3] The baseline future Budget policy stance is assumed to be slight growth in exemption thresholds and no growth in allowances and reliefs. This is consistent with Budget policy in recent years.

Figure 7: Personal income tax yield
Total personal income tax as a % of total personal income, Budget year



5. Income tax forecast and the forecast range

Provisional central forecast

The provisional central forecast for income tax revenue is shown in Figure 8. There is a lot of uncertainty involved in forecasting income tax revenue and so the central forecast should not be used by itself, but as part of a range which is described later in this section (see Figure 16).

Figure 8: Provisional central income tax forecast

	Actual		Forecast				
Budget year	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Personal	357	356	360	376	397	419	437
Companies	98	83	86	89	93	97	100
Bad debts	-3	-2	-3	-2	-2	-3	-3
	452	**437**	**443**	**463**	**488**	**513**	**534**
Annual growth		-15	6	20	24	26	21
Annual growth, %		-3%	1%	4%	5%	5%	4%

Comparison with 2015 Budget forecast

This forecast includes new information since the last forecast was carried out (Figure 9):

- New data on 2014 outturns has resulted in a £8m decrease in the starting personal tax base and a £1m decrease in the starting company tax base.
- New in-year data on employment income from ITIS records.
- New in-year data on agents' estimates of company tax for the top 100 taxpayers.
- New data and revised assumptions for the economic variables has resulted in higher growth expectations for personal tax (+£3m in 2017) but lower growth expectations for company tax (-£5m by 2017).
- The 2015 Budget measures overall are expected to increase personal tax revenue relative to the last forecast by about £2m a year from 2016.

Appendix 3 (page 26) discusses an extension to the 2015 Budget forecast out to 2019 which was provided to the Treasury in advance of the draft 2015 Budget to help with the development of the Long Term Revenue Plan.

Figure 9: Differences between the provisional central forecast and 2015 Budget forecast

Budget year	Actual 2013 £m	Forecast 2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Personal tax							
Budget 2015 forecast	**357**	**364**	**373**	**386**	**404**		
2014 outturn		-8	-8	-8	-8		
2015 Budget measures				2	2		
2015 in-year estimate of employment income			-4	-4	-4		
Updated economic assumptions			0	0	3		
Current provisional central forecast	**357**	**356**	**360**	**376**	**397**	**419**	**437**
Company tax							
Budget 2015 forecast	**98***	**84**	**85**	**91**	**97**		
2014 outturn		-1	-1	-1	-1		
2015 in-year estimate of top 100 taxpayers			2	2	2		
Updated economic assumptions			0	-3	-5		
Current provisional central forecast	**98***	**83**	**86**	**89**	**93**	**97**	**100**

Actual ; Forecast

* This includes a one-off £10m tax receipt in 2013.

As a consequence, overall revenues are expected to be lower than forecast in the 2015 Budget by about £12m a year from 2015 (Figure 10). The figures in this table tie in with those in Figure 9.

Figure 10: Summary of the differences between the provisional central forecast and the 2015 Budget forecast

Budget year	Actual 2014 £m	Forecast 2015 £m	2016 £m	2017 £m
Personal	-8	-13	-10	-7
Companies	-1	1	-2	-4
Bad debts	1	0	0	0
	-7	**-12**	**-12**	**-11**

The effects of the updated economic assumptions on the provisional forecast are as follows:

Figure 11: Impact of the changes in economic assumptions on the provisional forecast

Budget year	Forecast 2015 £m	2016 £m	2017 £m
Personal tax			
Compensation of employees	1	1	1
Lower RPI	0	1	2
Other	-1	-2	0
	0	**0**	**3**
Company tax			
Financial services profits and interest rates	**0**	**-3**	**-5**

Analysis of forecast growth in personal income tax

The growth in the provisional central income tax forecast is mainly expected from growth in personal income tax, rather than company income tax (Figure 12). The totals in this table relate to the annual growth summarised in Figure 8.

Figure 12: Central forecast growth in personal and company income tax

Budget year	2015 £m	2016 £m	Forecast 2017 £m	2018 £m	2019 £m
Personal	4	16	21	22	18
Company	3	3	4	5	3
Bad debts	-1	1	0	-1	0
Change on previous year	6	20	24	26	21

There are two reasons this growth in personal income tax is being forecast. Firstly, personal incomes are expected to grow over the forecast period. Secondly, the yield – the average amount of income tax paid per £1 of personal income – is expected to gradually increase as personal incomes grow faster than the amount of exemptions, reliefs and allowances claimed by taxpayers (Figure 13). This is known as 'fiscal drag'. Note that the fall in yield in Budget year 2015 is due to the cut in the marginal rate of income tax from 27% to 26%.

Figure 13: Central forecast growth in personal income tax – income and yield

Budget year			Forecast		
	2015	2016	2017	2018	2019
	£m	£m	£m	£m	£m
Change in incomes	10	14	17	18	17
Change in yield	-6	2	4	4	1
Change on previous year	4	16	21	22	18

The forecast growth in personal incomes is explained in more detail in Figure 14 in terms of their impacts on personal income tax revenue (assuming an average yield on this income). Most of the increase is due to forecasting an increase in employment income and to a lesser extent, increases in pension income and investment income.

Employment income is expected to increase as average earnings and employment are expected to increase over the forecast period. Pension income is expected to increase based on the long term trend seen over the last 18 years (this is not obvious in the table because the impact on income tax revenue is relatively small and rounded to the nearest £1m). Investment income (from bank interest, dividends and rental) is expected to increase as interest rates gradually increase and growth picks up generally in the global economy. Shareholder income is expected to grow in line with inflation (although there are particular risks to this income discussed later).

The forecast for employment income in 2015 is more certain because it is based on employment income information from ITIS returns in 2014, whereas the forecast increases from 2016 onwards are based on the model's relationship which is mainly based on the assumptions for earnings and employment growth. This relationship is considered further on page 17.

Figure 14: Central forecast growth in personal incomes – detail

Budget year			Forecast		
	2015	2016	2017	2018	2019
	£m	£m	£m	£m	£m
Employment income	7	10	12	14	11
Pension and other	2	2	2	2	2
Investment income	1	1	2	2	2
Shareholder income	0	0	1	1	1
Growth in personal incomes	10	14	17	18	17

Provisional forecast range

The size of the forecast range is a matter of judgement. It should be large enough so that actual income tax revenue is likely to be within the forecast range but small enough to be useful for planning purposes.

The income tax forecasting model can provide an indicative forecast range using different sets of economic assumptions.

The income tax forecast range shown in Figure 15 is based on the FPP's real economic growth forecast and the central range around it, which is 1% either side in 2014 and 1.5% either side from 2015 to 2017. The upper and lower range has been rounded to the nearest £5m.

Figure 15: Provisional forecast range based on central economic growth assumptions

Budget year	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Upper		450	480	515	555	590
Central	**437**	**443**	**463**	**488**	**513**	**534**
Lower		440	450	465	475	485
Range as a % of central, +/-		1%	3%	5%	7%	9%

However, this range is particularly narrow in 2015 and 2016. The IFG has agreed that a wider range is more appropriate – 2% either side in 2015 and 4% either side in 2016, leading on to the range of 5%, 7% and 9% either side suggested by the model (Figure 16).

Figure 16: Provisional forecast range - adjusted

Budget year	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
Upper		455	485	515	555	590
Central	**437**	**443**	**463**	**488**	**513**	**534**
Lower		435	445	465	475	485
Range as a % of central, +/-		2%	4%	5%	7%	9%

Comparison with MTFP 2013-2015

Figure 17 illustrates the difference in the forecast of income tax revenue between the MTFP 2013-2015 (whose forecasts were agreed in 2012) and the current provisional forecast. The MTFP adopted a 10% range (5% either side) in each year. The £437m income tax revenue received in 2014 was below the MTFP forecast range (£450m - £495m) and the provisional forecast of between £435m and £455m for 2015 is also below the MTFP forecast range (£475m - £525m).

Income tax revenue has been, and is expected to be lower than forecast in the MTFP mainly due to weaker growth in personal tax revenue. The reasons for this weaker growth are:

- Lower than expected growth in average earnings and employment 2012-2014.
- The impact of changes to the taxation of shareholder income.
- The 2014 Budget measures, in particular the cut in the marginal rate to 26%.

Figure 17: Provisional forecast compared to previous MTFP 2013-2015 forecast

£m. Black line represents outturns. Blue lines represent the current provisional forecast range. Red lines illustrate the range of the forecast that informed the MTFP in 2012.

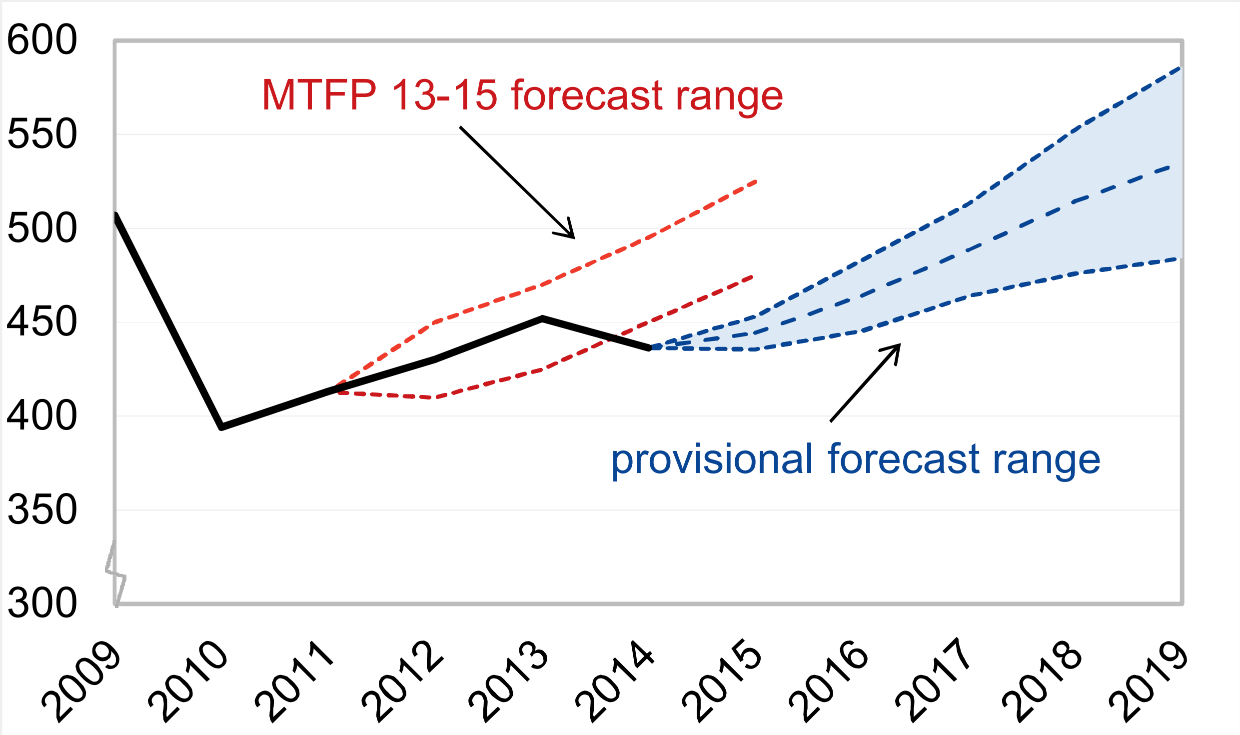
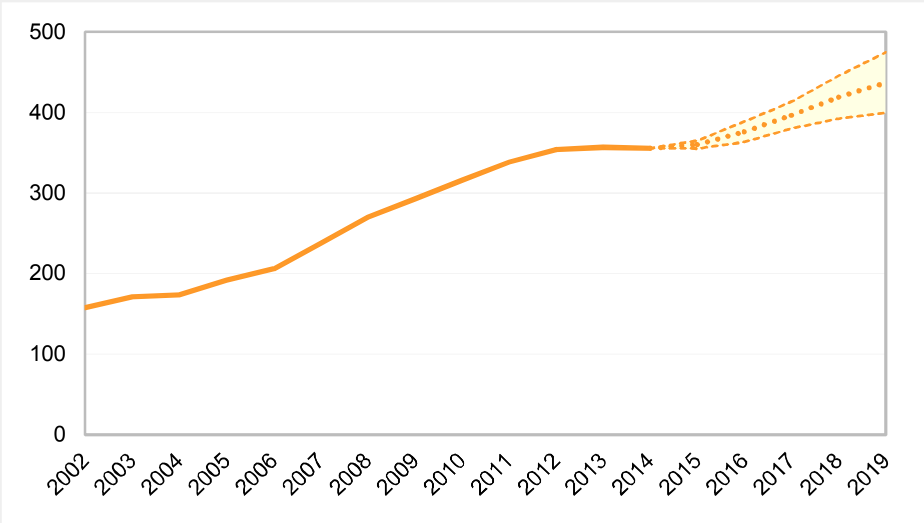
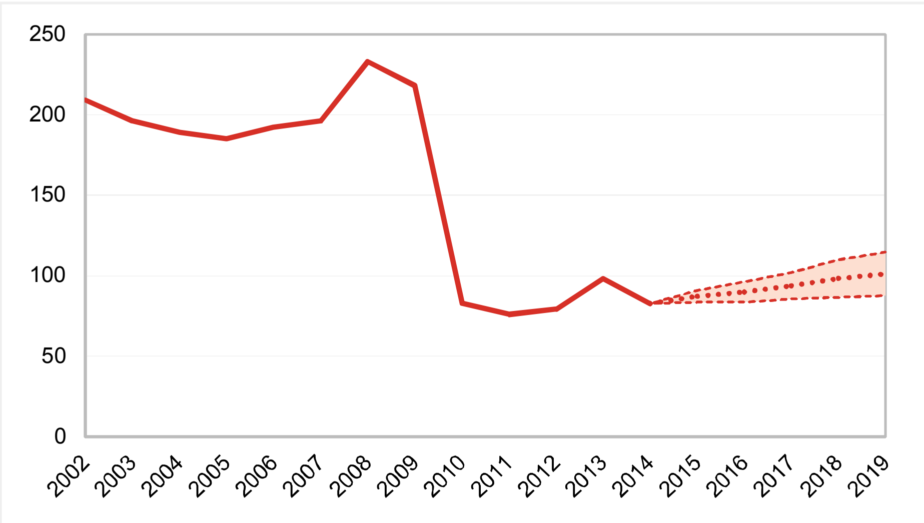


Figure 18: Forecasts by taxpayer type

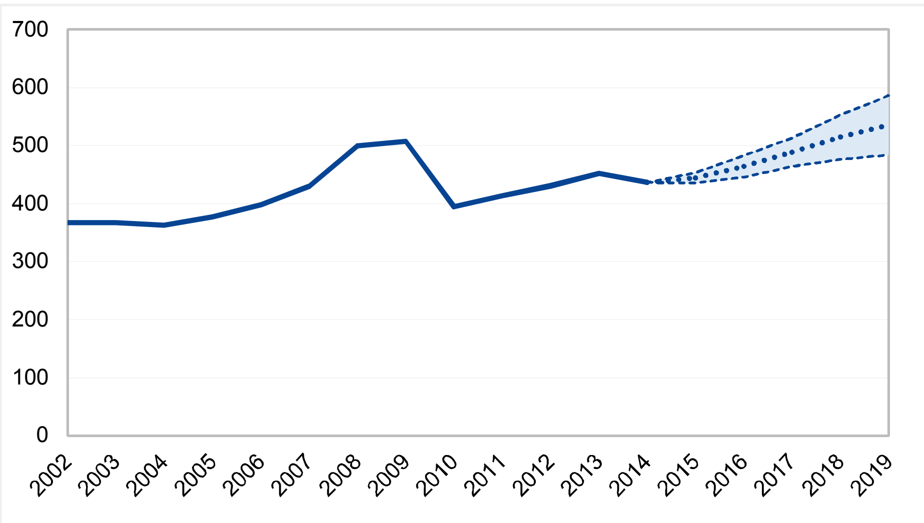
Personal, £m



Company, £m



Total income tax, £m



Recent developments

Recent developments in employment income, shareholder income, and financial services company profits are considered in this section.

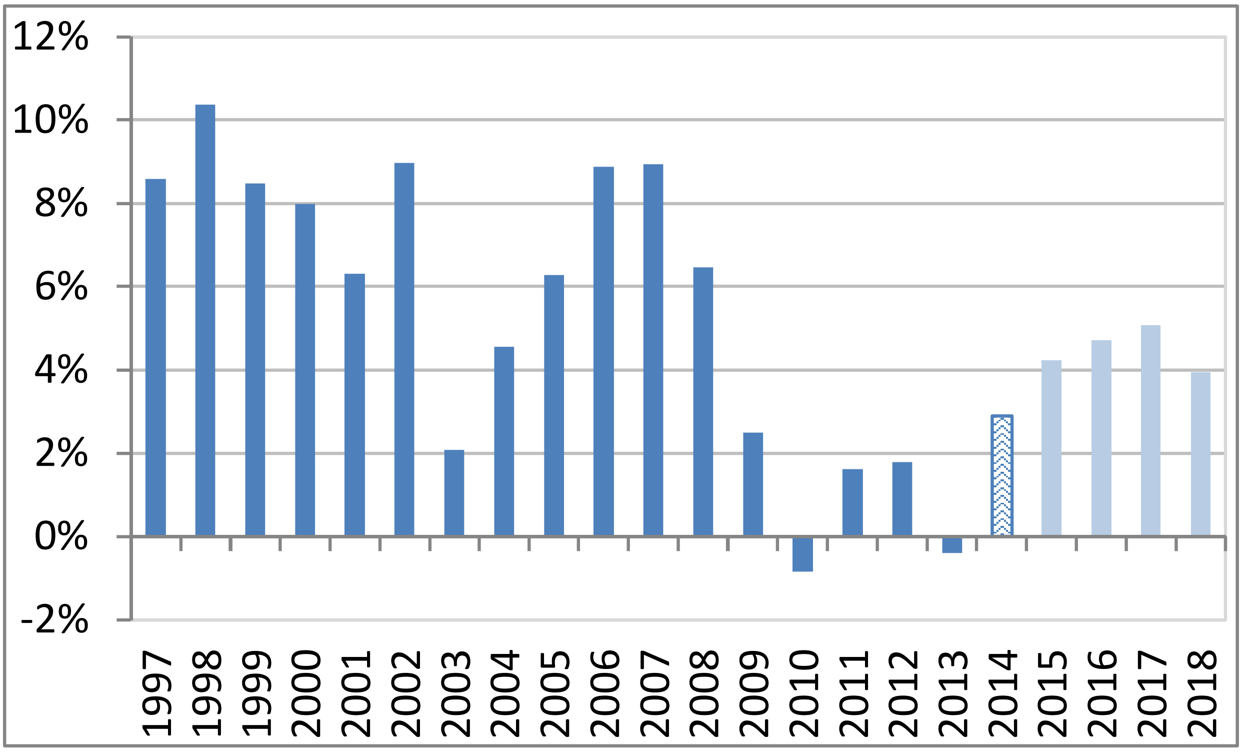
Employment income

Employment income makes up 65% of total personal income recorded on tax returns and is affected by changes in employment and average earnings. Employment income is forecast to grow as Jersey's economy recovers, and employment and earnings growth return to previous trends.

The chart below shows that growth in employment income has been relatively weak since 2008 and there is uncertainty as to how quickly and by how much this will grow in future.

The light blue bars show the model's forecast for employment income growth of about 4% each year (in nominal terms) (or about 2% a year in real terms) from 2015, using the central scenario assumptions.

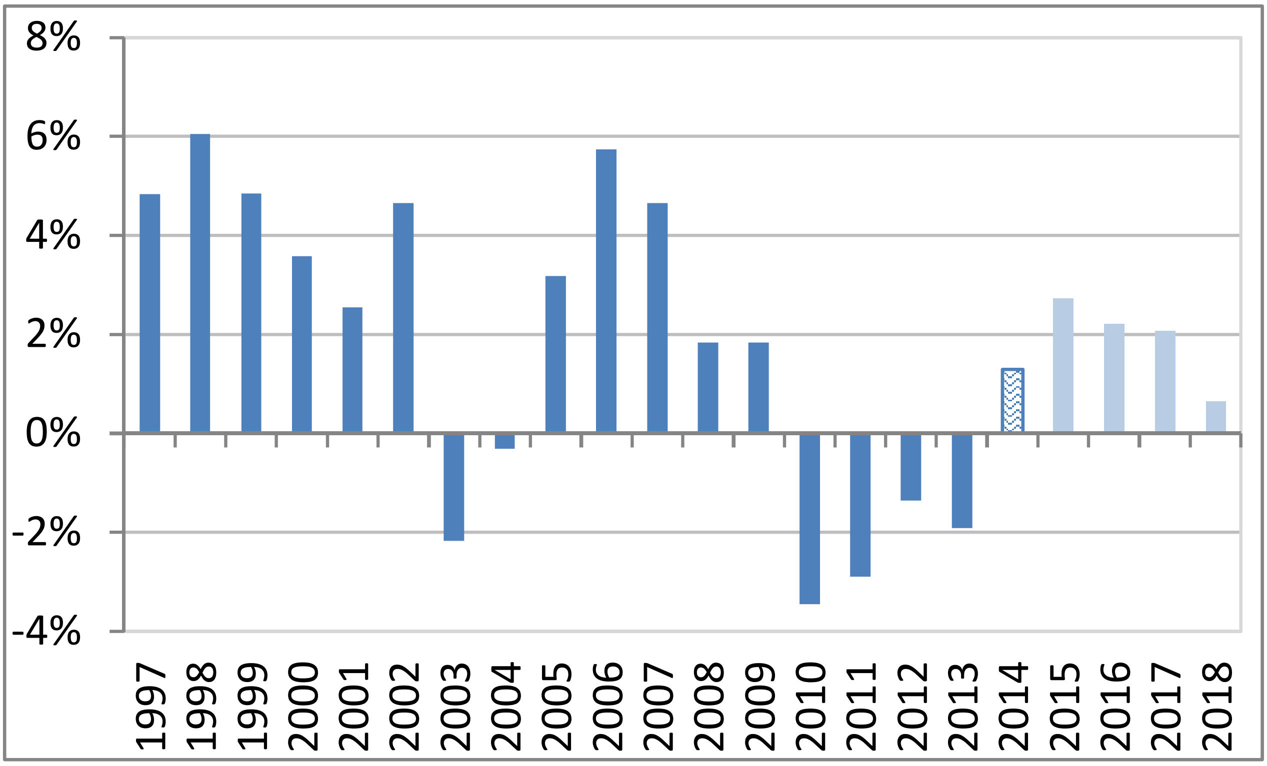
Figure 19: Employment income
annual % change (nominal) calendar year (impacts on income tax revenue the following year)



Note: 1997-2013 are actuals, 2014 is based on ITIS returns and 2015-2018 is the model forecast. Employment income in 2014 impacts on personal income tax revenue in 2015.

Employment growth is assumed to return to the previous trend of slight growth and this therefore assumes that there is no further shift from full-time to part-time employment or further declines in employment in the finance sector. Likewise, it does not assume that future employment growth includes a shift back to full-time employment or a greater share of employment in sectors such as finance where tax per person employed is higher than the average.

Figure 20: Employment income
annual % change (real). Deflated using RPI



Note: 1997-2013 are actuals, 2014 is based on ITIS returns and 2015-2018 is the model forecast. Employment income in 2014 impacts on personal income tax revenue in 2015.

<u>The model's relationship for employment income growth</u>

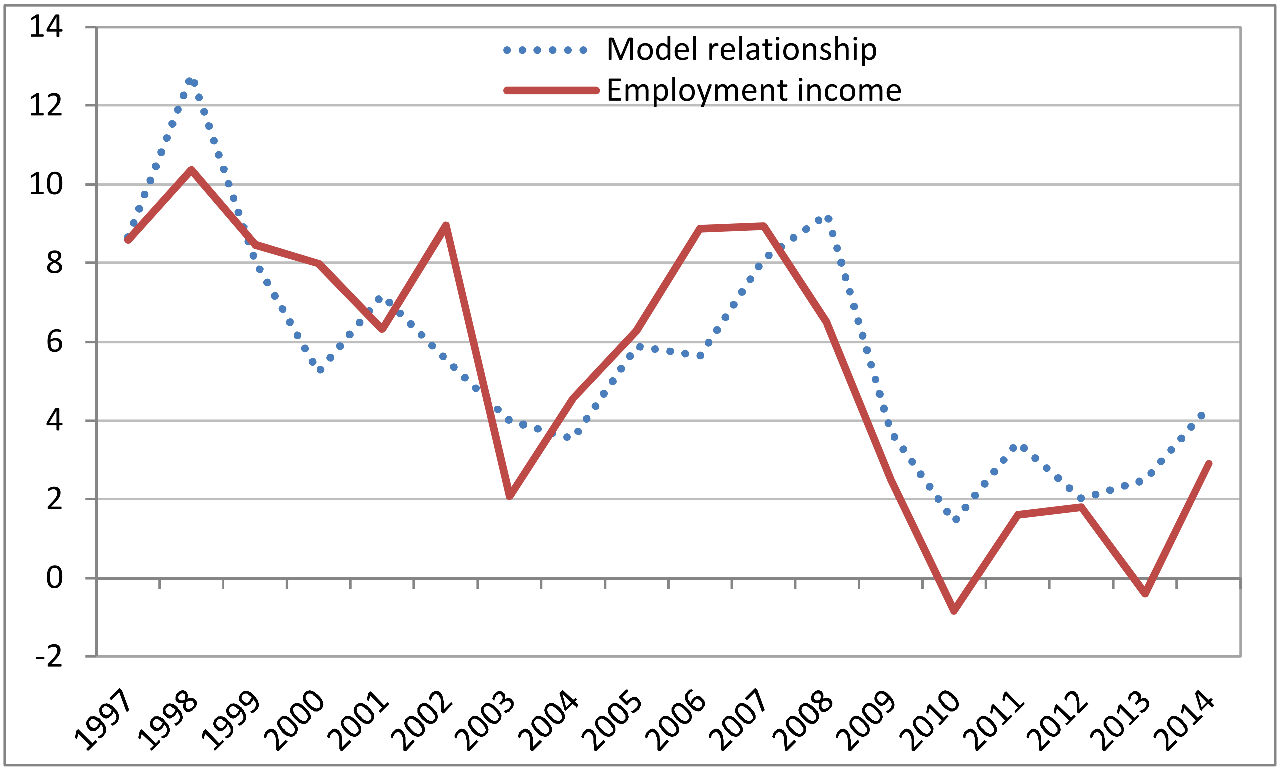
The model's estimated relationship for employment income growth is based on past changes in average earnings, employment and to a lesser degree house prices, and how they best fit with past changes in employment income growth.

Where there is no economic data, the model uses economic assumptions which at times are subject to significant uncertainty and may turn out to be too high or too low. This is another source of forecast error which could work in the same (or opposite) direction as the differences that result using the model's estimated relationships.

Figure 21 shows past changes in employment income and the model's relationship for employment income growth using actual data. The relationship is based on 18 years of income tax and economic data.

The estimated relationships are indicating that employment income has grown more strongly in 2014 than in the last few years. The latest ITIS data confirms what the model is indicating, although as would be expected not the precise % change.

Figure 21: The model's fitted relationship for employment income growth compared to actual employment income growth
Annual % increase



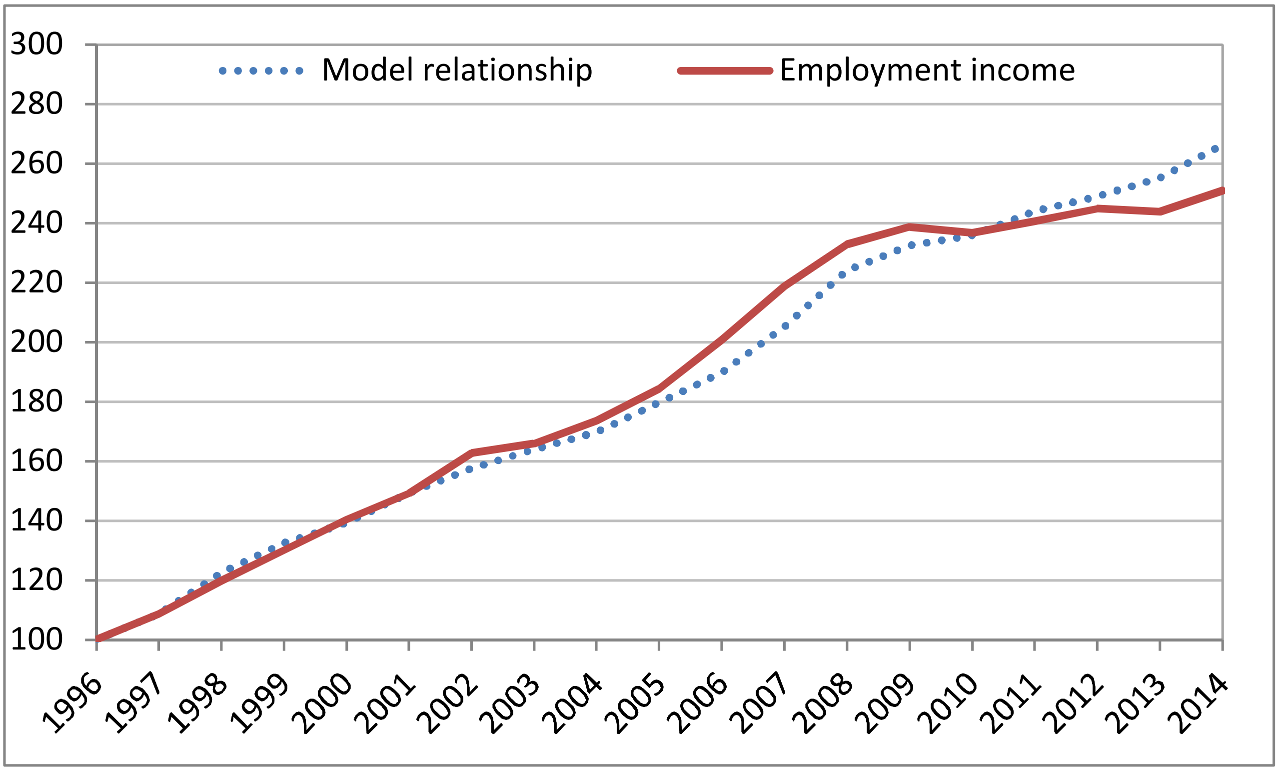
The model has overestimated actual employment income growth in 11 of those years and underestimated in the other 7 years. For the last 7 years – since the impact of the global financial crisis in 2008 – the model's relationship has overestimated employment income growth by an average of 1.8%. However, over the 18 year period the model has overestimated employment income growth by 0.3% on average.

Overall, with the hindsight of real economic data, the model will tend to overestimate employment income growth when Jersey's economy is performing poorly and employment income is growing weakly, and underestimate employment income growth in the upward phase of the economic cycle.

The FPP expects that Jersey's economy returned to growth in 2014 and that the economy will continue to grow more quickly (in nominal terms) in 2015, 2016 and 2017.

Although there is a risk that the model continues to overestimate actual employment income growth as it has done since 2008, there is also the risk that the model starts to underestimate employment income growth as it has done before when Jersey's economy performs more strongly (Figure 22).

Figure 22: The model's fitted relationship for employment income growth compared to actual employment income growth – cumulative growth
Index (1996=100)



As a guide, every 1% of employment income growth might raise about £2m in personal income tax. If the forecast overestimates or underestimates employment income growth by 1% each year in 2015, 2016 and 2017, then the forecast difference would grow by about £2m a year from Budget year 2016 to a total of £6m a year by Budget year 2018.

UK context

The UK's Office for Budget Responsibility published its 'Economic and Fiscal Outlook' in December 2014 which sets out their latest fiscal forecast for the UK's public finances, and the economic and market assumptions that underpin the forecast.

The OBR's income tax forecast is driven by assumptions for growth in the total wages and salaries in the UK economy, in nominal terms, which is made up of assumptions for employment growth and average earnings growth. The provisional forecast for personal income tax in this note is also driven by a similar assumption (changes in employment growth and average earnings growth drive employment income changes).

Figure 23 shows the OBR's assumptions for UK employment and average earnings growth compared to the assumptions for Jersey employment and average earnings growth. Between 2014 and 2017 the assumptions for both economies are fairly similar. In 2018 and 2019, the OBR's assumptions are about 1% higher altogether than the FPP's assumptions.

Figure 23: UK and Jersey forecast assumptions for average earnings and employment growth

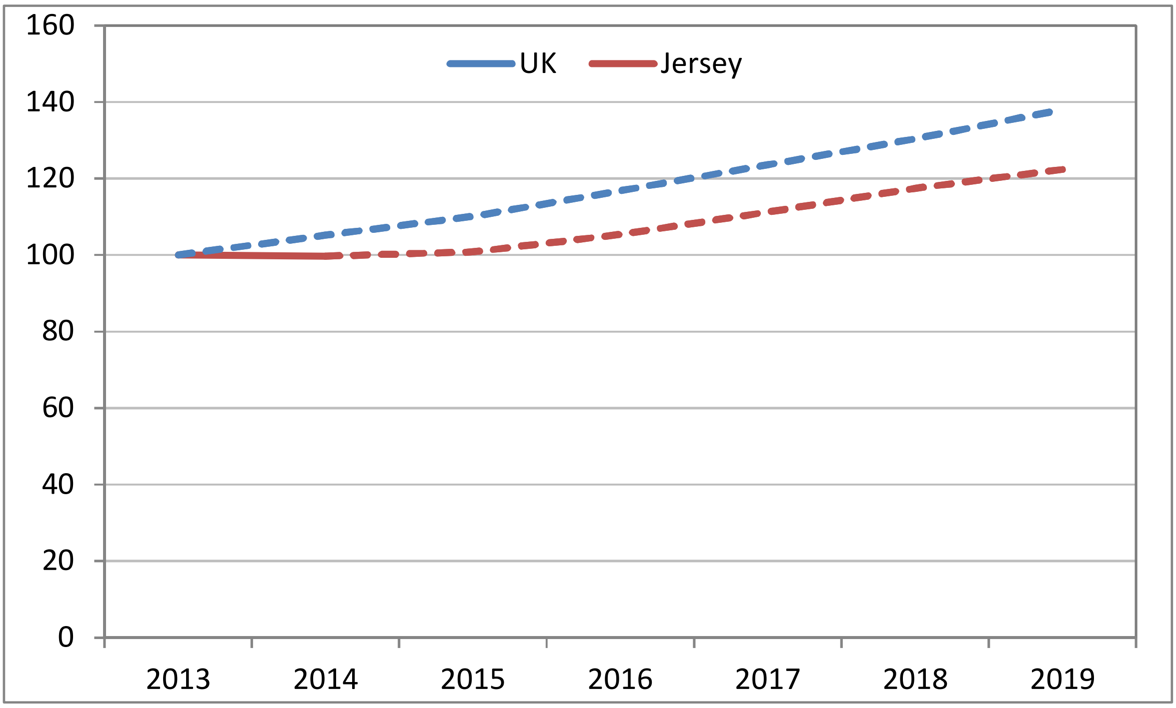
	2014	2015	2016	2017	2018	2019
			%			
UK						
Employment growth	2.3	1.6	0.6	0.3	0.3	0.3
Average earnings growth	1.8	2.0	3.1	3.9	3.9	3.8
Jersey						
Employment growth	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings growth	2.6	2.5	3.0	4.0	3.0	3.0

Source: OBR Economic and Fiscal Outlook December 2014

On the basis of these economic assumptions, the OBR is expecting the UK's personal income tax revenue to grow from £155bn to £214bn between April 2013 and April 2020 (38% growth) (Figure 24, growth between 2013 and 2019). This is comparable with the provisional central forecast for Jersey's personal income tax revenue growing from £357m to £437m (22% growth) over a similar period.

The cut in the marginal rate of income tax from 27% to 26% also helps to explain why personal income tax revenue is expected to pick up more slowly than in the UK.

Figure 24: UK and Jersey personal income tax forecasts
Index 2013=100



Note: UK personal income tax years run from year beginning 6 April. For the UK line, 2013 = 6 April 2013 to 5 April 2014.

Source: OBR Economic and Fiscal Outlook December 2014.

Shareholder income

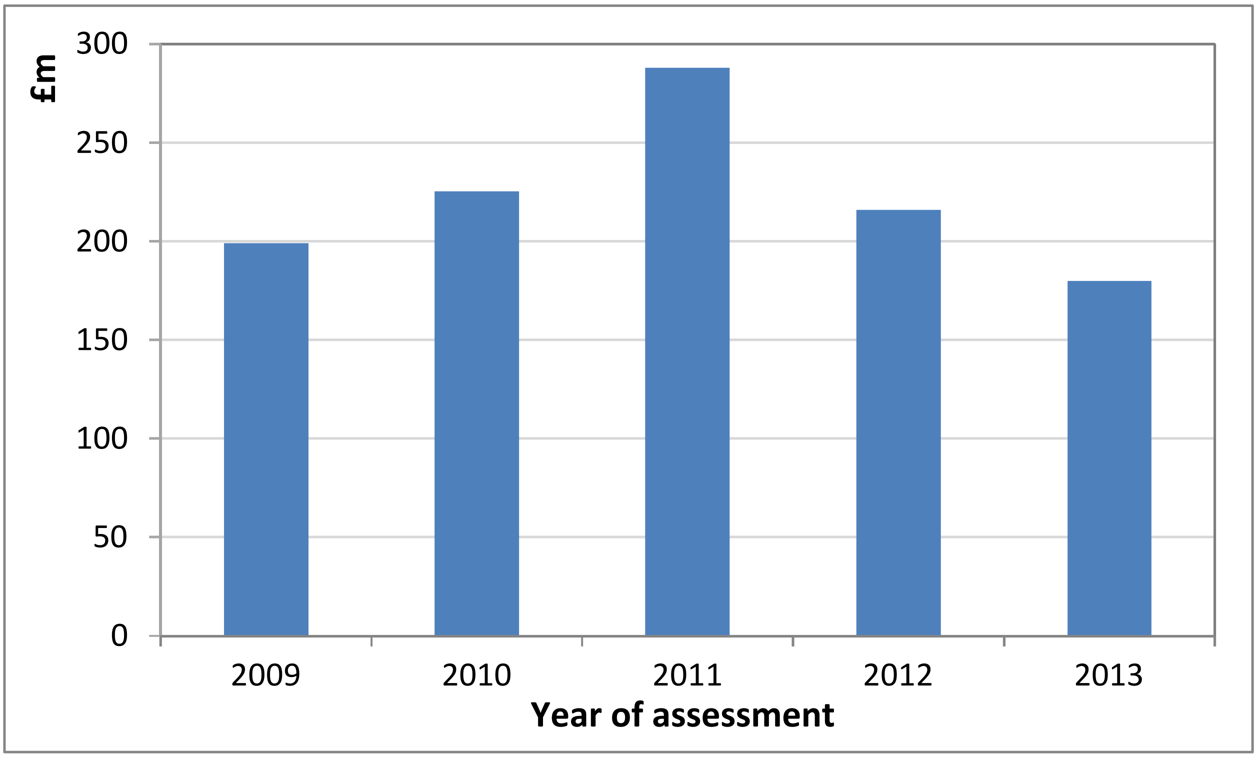
Broadly, the profits of Jersey companies (other than those companies taxed at 20%) are assessed on shareholders at the personal level under the heading of "shareholder income" (Figure 25).

There have been significant changes to the tax rules which affect the amount of shareholder income assessed on taxpayers. For each year of assessment (YOA) the shareholder income would have included the following:

YOA	Company profit assessed on shareholder
2009	Attributed investment holding company profits – accounts Y/E 09
2010	Attributed investment holding company profits – accounts Y/E 10 Deemed dividends minimum 60% trading profits – accounts Y/E 09
2011	Attributed investment holding company profit – accounts Y/E 11 plus profits to 31/12/11 Deemed dividends minimum 60 of trading profit - accounts Y/E 10
2012	Deemed dividends minimum 60% trading profits - accounts Y/E 11 plus minimum 60% profits to 31/12/11
2013	Company distributions only

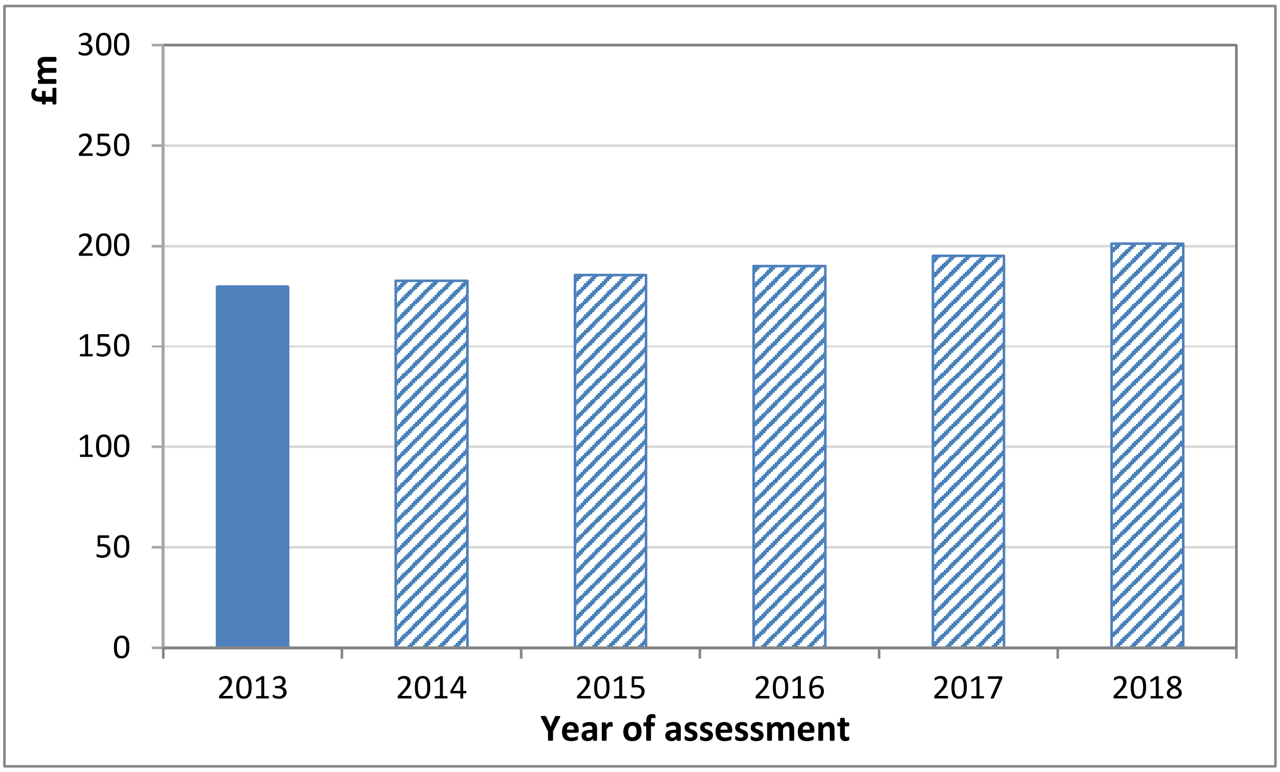
Forecasting shareholder income is particularly difficult because there is little information on which to estimate the profile going forward. Past experience is no guide to the future and there is a risk that some of this income recorded in YOA 2013 may not occur again in future years.

Figure 25: The amount of shareholder income declared by taxpayers



Note: Shareholder income in 2013 impacts on personal income tax revenue in 2014.

Figure 26: Shareholder income provisional central forecast



Note: Shareholder income in 2013 impacts on personal income tax revenue in 2014.

The starting point for the provisional central forecast is based on the most recent amount of shareholder income received for YOA 2013. The central assumption is that this income grows at the rate of inflation over the forecast period because there is no strong evidence to suggest that this income will grow either more quickly or slowly.

However, there is a risk that taxpayer behaviour may change such that shareholder income may fall, rather than grow, and it is not possible to gauge by how much it could fall by. Therefore, there is significant uncertainty and downside risk to this part of the forecast.

Company tax

Future growth in company tax revenue will be partly determined by when interest rates increase and how this positively affects the profits of the banking sector. Since the FPP provided their economic assumptions, the financial market expectations of when interests may go up has worsened. Should these expectations be founded, this would be a downside risk to the company tax forecast.

The impact of this might be that company profits, and therefore company tax revenue, grows at a similar rate to inflation. This is because a slower increase in interest rates would delay any pick up in finance sector profits that would have otherwise resulted from higher interest rates. Figure 27 illustrates that this risk could be around £6m less company tax revenue by 2019.

Figure 27: Illustrative impact of latest interest rate profile on company tax revenue

Budget year	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m
No real growth	86	87	90	92	95
Central forecast	86	89	93	97	100
Difference in growth	0	-2	-3	-5	-6

Banking reform in the UK (the Vickers proposals) is another uncertainty that could impact on banking sector activity and profitability. Interviews with executives of Jersey banks suggested that there were risks and opportunities (and relatively evenly balanced) from the proposed reforms but some uncertainty still remains.

Other uncertainties

There is also some uncertainty about the impact of higher interest rates on mortgage interest relief claims towards the end of the forecast period, particularly since the introduction of the interest cap in 2015 Budget.

6. Sensitivity analysis

This section looks at how the central income tax forecast would change by changing some of the underlying key assumptions.

Economic growth rate

The impact of economic growth on income tax revenue depends on the exact nature of the economic growth and the extent to which it increases personal employment income and company profits.

A 1% increase in the economic growth assumption where employment income and profits in the economy increase by 1%, would result in a £2m-£3m increase in the income tax revenue forecast each year from 2015. A similar decrease in the economic growth rate assumption would have the opposite effect.

Growth that is more focused on earnings growth due to higher productivity, or employment growth in higher wage jobs, would bring in slightly more tax revenue than the estimate above (£3m-£5m) given its impact on the tax base.

Conversely, growth that is focused more on profit growth, particularly in the non-finance sectors of the economy, or employment growth in lower wage jobs, would result in a slightly lower increase in tax revenue (£0m-2m).

Interest rates

An interest rate profile that is 1% higher than the central assumption from 2015 onwards would impact on tax revenue from 2016.

There are two impacts on personal tax which work in opposite directions and are expected to largely offset each other:

1. An increase in investment income (£11m @ 13.5% yield)
2. An increase in mortgage interest relief (£5m @ 27%/26%).

The impact of the higher interest profile on financial services profits is uncertain, unlikely to be uniform and the subject of the ongoing work mentioned above. However, if the existing profile of corporate profits was adjusted to reflect a proportionate 1% increase in interest rates then it would increase tax revenue by approximately £2m by 2017. A slower increase in interest rates would delay the expected timing of the impact on financial services profits and therefore company income tax revenue.

Appendix 1

Economic assumptions: Current provisional compared to 2015 Budget forecast

CURRENT February 2015

						Return to trend	
	2013	2014	2015	2016	2017	2018	2019
Real GVA	0.0	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.5	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.5	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	1.3	3.2	3.5	3.7	4.4	3.0	3.0
Company profits	tbc	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	tbc	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees	tbc	3.7	3.5	4.0	4.3	3.0	3.0
Employment	-0.3	1.0	1.0	0.5	0.5	0.0	0.0
Average Earnings	2.2	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	0.6	1.2	1.5	2.0	2.5
House prices	-1.3	3.3	3.0	4.0	5.0	3.0	3.0

PREVIOUS May 2014 (Budget 2015)

						2018+ averages	
	2013	2014	2015	2016	2017	2018	2019
Real GVA	0.2	0.3	1.3	2.0	2.3	1.9	1.8
RPI	1.5	2.2	3.0	3.3	3.3	3.5	3.5
RPIY	1.5	2.2	2.7	2.7	2.7	3.0	3.0
Nominal GVA	1.7	2.5	4.0	4.7	5.0	4.9	4.8
Company profits	1.8	2.6	4.6	4.6	4.9	5.2	5.0
Financial services profits	1.0	2.0	6.0	6.0	6.0	5.0	5.0
Compensation of employees	1.6	2.5	3.5	4.7	5.0	4.7	4.7
Employment	-0.5	0.0	0.5	1.0	1.0	0.5	0.5
Average Earnings	2.2	2.5	3.0	3.7	4.0	4.2	4.2
Interest rates (%)	0.5	0.5	0.9	1.7	2.5	3.0	3.3
House prices	-1.3	0.0	2.0	3.0	4.0	5.0	5.0

DIFFERENCE

	2013	2014	2015	2016	2017	2018	2019
Real GVA	-0.2	1.3	0.7	-0.8	-0.6	-1.9	-1.8
RPI	0.0	-0.6	-1.5	-0.8	-0.3	-0.2	-0.2
RPIY	0.0	-0.6	-1.2	-0.2	0.0	0.0	0.0
Nominal GVA	-0.4	0.7	-0.5	-1.0	-0.6	-1.9	-1.8
Company profits	tbc	-0.1	-1.2	-0.7	-0.4	-2.2	-2.0
Financial services profits	tbc	-0.2	-2.7	-1.7	-0.9	-2.0	-2.0
Compensation of employees	tbc	1.2	0.0	-0.7	-0.7	-1.7	-1.7
Employment	0.2	1.0	0.5	-0.5	-0.5	-0.5	-0.5
Average Earnings	0.0	0.1	-0.5	-0.7	0.0	-1.2	-1.2
Interest rates (%)	0.0	0.0	-0.3	-0.5	-1.0	-1.0	-0.8
House prices	0.0	3.3	1.0	1.0	1.0	-2.0	-2.0

Key:

OUTTURNS

Appendix 2 – The economic assumptions for the optimistic and pessimistic scenarios

FPP central scenario

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	3.2	3.5	3.7	4.4	3.0	3.0
Company profits(a)	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.6	1.2	1.5	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

FPP central scenario - upper range

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	2.6	3.5	2.7	3.2	1.5	1.5
RPI	1.6	3.0	4.0	4.5	4.8	4.8
RPIY	1.6	2.5	3.5	3.7	4.0	4.0
Nominal GVA	4.2	6.0	6.2	6.9	5.5	5.5
Company profits(a)	3.0	4.5	5.0	5.5	4.0	4.0
Financial services profits	4.8	6.3	7.3	8.1	4.0	4.0
Compensation of employees(b)	5.2	7.1	7.1	8.1	6.6	6.6
Employment	2.5	2.5	2.0	2.0	1.5	1.5
Average Earnings	2.6	4.5	5.0	6.0	5.0	5.0
Interest rates (%)	0.5	1.3	1.9	2.2	2.7	3.2
House prices	3.3	6.0	7.0	8.0	6.0	6.0

FPP central scenario - lower range

					Return to trend	
	2014	2015	2016	2017	2018	2019
Real GVA	0.6	0.5	-0.3	0.2	-1.5	-1.5
RPI	1.6	0.0	1.0	1.5	1.8	1.8
RPIY	1.6	0.5	1.5	1.7	2.0	2.0
Nominal GVA	2.2	1.0	1.2	1.9	0.5	0.5
Company profits(a)	2.2	2.3	2.7	3.0	1.5	1.5
Financial services profits	-1.2	0.3	1.3	2.1	1.5	1.5
Compensation of employees(b)	2.1	0.0	0.0	1.0	-0.5	-0.5
Employment	-0.5	-0.5	-1.0	-1.0	-1.5	-1.5
Average Earnings	2.6	0.5	1.0	2.0	1.0	1.0
Interest rates (%)	0.5	0.5	0.5	0.8	1.3	1.8
House prices	3.3	0.0	1.0	2.0	0.0	0.0

(a) Gross profits for all companies, including traders.
(b) The number of employees multiplied by the costs of employment (wages, bonuses, pensions).

Appendix 3 – Discussion of additional forecasting information provided to Treasury

This section outlines the information that we provided to Treasury in May and November 2014 and how these compare to the current provisional forecast.

May 2014

In May 2014, the Treasurer asked for the central income tax forecast to be extended until 2019 using the income tax forecasting model to help with the early stages of developing the Long Term Revenue Planning Review. Figure 28 shows the extended forecast for 2018 and 2019 in italics.

Figure 28: Budget 2015 central forecast – extended to 2019

	Forecast					
Budget year	**2014 £m**	**2015 £m**	**2016 £m**	**2017 £m**	***2018 £m***	***2019 £m***
Personal	364	373	386	404	*425*	*452*
Companies	84	85	91	97	*103*	*109*
Bad debts	-3	-3	-2	-2	*-3*	*-3*
	444	**455**	**475**	**499**	***525***	***558***
Annual growth	-8	11	20	24	*26*	*33*
Annual growth, %	-2%	2%	4%	5%	*5%*	*6%*

Figure 29: Budget 2015 central forecast compared to current provisional central forecast

	Forecast					
Budget year	**2014 £m**	**2015 £m**	**2016 £m**	**2017 £m**	**2018 £m**	**2019 £m**
Personal tax						
Budget 2015 forecast	**364**	**373**	**386**	**404**	**425**	**452**
2014 outturn	-8	-8	-8	-8	-8	-8
2015 Budget measures			2	2	2	2
2015 in-year estimate of employment income		-4	-4	-4	-4	-4
Updated economic assumptions		0	0	3	4	-5
Current provisional forecast	**356**	**360**	**376**	**397**	**419**	**437**
Company tax						
Budget 2015 forecast	**84**	**85**	**91**	**97**	**103**	**109**
2014 outturn	-1	-1	-1	-1	-1	-1
2015 in-year estimate of top 100 taxpayers		2	2	2	2	2
Updated economic assumptions		0	-3	-5	-7	-10
Current provisional forecast	**83**	**86**	**89**	**93**	**97**	**100**

Actual ; Forecast

For personal tax, the main difference is due to the £8m lower than expected outturn in 2014 that has been built in to the provisional forecast. Assuming a lower trend rate of average earnings and employment growth from 2018 onwards (corresponding to 0% growth in real terms rather than about 1.5%) also reduces the expected growth in personal income tax revenue relative to the 2015 Budget forecast.

Company income tax is expected to grow more slowly now than it was in May (and November) 2014. Following a series of interviews with executives from financial services companies, more gradual increases in financial services profits are now expected between 2015 and 2017, impacting on income tax revenue 2016-2018.

Furthermore, following the FPP's Pre-MTFP report which analysed Jersey's trend rate of growth, a slightly lower rate of financial services profit growth is now expected from 2018 onwards, affecting 2019 revenue (corresponding to 0% growth in real terms rather than about 0.5%).

November 2014

In November 2014, the Treasurer asked for a provisional update of the income tax forecast using the income tax forecasting model to inform the Council of Ministers development of initial proposals for the new Strategic Plan and next Medium Term Financial Plan.

Figure 30: November 2014 update: central forecast extended to 2019

	Estimate	Forecast				
Budget year	**2014 £m**	**2015 £m**	**2016 £m**	**2017 £m**	***2018 £m***	***2019 £m***
Personal	356	364	382	402	*424*	*448*
Companies	83	84	90	96	*102*	*106*
Bad debts	-2	-3	-2	-2	*-3*	*-3*
	437	**446**	**470**	**495**	***523***	***551***
Annual growth	-15	9	24	26	*28*	*28*
Annual growth, %	-3%	2%	5%	5%	*6%*	*5%*
Difference vs 2015 Budget	**-7**	**-9**	**-5**	**-4**	***-2***	***-7***

The November update was lower than the 2015 Budget forecast because Treasury expected the income tax outturn for 2014 to be about £8m lower and expected this to be a permanent reduction in the tax base.

Offsetting this in later years is the impact of slightly more positive economic assumptions in 2014 and 2015, lower inflation and the 2015 Budget measures (£2m from 2016) (Figure 31).

Figure 31: Differences between the November 2014 update and 2015 Budget forecast

Budget year	2014 £m	2015 £m	2016 £m	2017 £m	*2018 £m*	*2019 £m*
			Forecast			
Personal tax						
2015 Budget forecast	**364**	**373**	**386**	**404**	***425***	***452***
Estimated outturn	-8	-8	-8	-8	*-8*	*-8*
2015 Budget measures			2	2	*2*	*2*
Updated economic assumptions	0	1	2	3	*3*	*2*
Other	0	-2	0	1	*2*	*0*
November update	**356**	**364**	**382**	**402**	***424***	***448***
Company tax						
2015 Budget forecast	**84**	**85**	**91**	**97**	***103***	***109***
Estimated outturn	-1	-1	-1	-1	*-1*	*-1*
Updated economic assumptions	0	0	0	0	*0*	*-2*
November update	**83**	**84**	**90**	**96**	***102***	***106***

Economic assumptions: Current and November 2014 update

CURRENT February 2015

	2013	2014	2015	2016	2017	Return to trend 2018	2019
Real GVA	0.0	1.6	2.0	1.2	1.7	0.0	0.0
RPI	1.5	1.6	1.5	2.5	3.0	3.3	3.3
RPIY	1.5	1.6	1.5	2.5	2.7	3.0	3.0
Nominal GVA	1.3	3.2	3.5	3.7	4.4	3.0	3.0
Company profits	tbc	2.5	3.4	3.9	4.5	3.0	3.0
Financial services profits	tbc	1.8	3.3	4.3	5.1	3.0	3.0
Compensation of employees	tbc	3.7	3.5	4.0	4.3	3.0	3.0
Employment	tbc	1.0	1.0	0.5	0.5	0.0	0.0
Average Earnings	2.2	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	0.6	1.2	1.5	2.0	2.5
House prices	-1.3	3.3	3.0	4.0	5.0	3.0	3.0

PREVIOUS November update 2014

	2013	2014	2015	2016	2017	2018+ averages 2018	2019
Real GVA	-0.2	1.4	1.7	1.7	1.8	1.1	1.1
RPI	1.5	1.8	2.7	3.2	3.3	3.3	3.3
RPIY	1.5	1.8	2.5	2.6	2.7	3.0	3.0
Nominal GVA	1.3	3.2	4.2	4.4	4.5	4.1	4.1
Company profits	tbc	2.6	4.6	4.7	4.7	3.7	3.7
Financial services profits	tbc	2.0	6.0	6.0	6.0	3.8	3.8
Compensation of employees	tbc	3.7	3.8	4.0	4.3	4.5	4.5
Employment	tbc	1.0	1.0	0.5	0.5	0.5	0.5
Average Earnings	2.2	2.6	3.0	3.8	4.0	4.0	4.0
Interest rates (%)	0.5	0.5	1.0	1.8	2.3	3.5	3.5
House prices	-1.3	1.0	3.0	4.0	5.0	5.0	5.0

DIFFERENCE

	2013	2014	2015	2016	2017	2018	2019
Real GVA	0.2	0.2	0.3	-0.5	-0.1	-1.1	-1.1
RPI	0.0	-0.2	-1.2	-0.7	-0.3	0.0	0.0
RPIY	0.0	-0.2	-1.0	-0.1	0.0	0.0	0.0
Nominal GVA	0.0	0.0	-0.7	-0.7	-0.1	-1.1	-1.1
Company profits	tbc	-0.1	-1.2	-0.8	-0.2	-0.7	-0.7
Financial services profits	tbc	-0.2	-2.7	-1.7	-0.9	-0.8	-0.8
Compensation of employees	tbc	0.0	-0.3	0.0	0.0	-1.5	-1.5
Employment	tbc	0.0	0.0	0.0	0.0	-0.5	-0.5
Average Earnings	0.0	0.0	-0.5	-0.8	0.0	-1.0	-1.0
Interest rates (%)	0.0	0.0	-0.4	-0.6	-0.8	-1.5	-1.0
House prices	0.0	0.0	0.0	0.0	0.0	-2.0	-2.0

Key:

OUTTURNS