STATES OF JERSEY

PUBLIC SECTOR CUTS AND ALTERNATIVE TAXATION MEASURES

Lodged au Greffe on 17th August 2010
by Deputy G.P. Southern of St. Helier

STATES GREFFE

PROPOSITION

THE STATES are asked to decide whether they are of opinion −

(a) to request the Council of Ministers to –

(i) suspend the proposed programme of cuts to public services until 31st March 2011, especially where this will result in redundancies or reductions in front-line services, to allow time to engage in –

(1) full consultation with the users of, and stakeholders in, these services;

(2) full negotiation with employee representatives to find an agreed set of reforms and timescales, to include a new voluntary redundancy policy for 2011 and beyond, and Transfer of Undertakings Protection of Employment (TUPE) legislation; and

(3) an investigation of the potential to extend the period of reform in both service provision and taxation changes from 3 to 5 years to ensure both proper evaluation and acceptance from the public, to include examination of the use some of the interest from the Strategic Reserve Fund ("Rainy Day Fund") to cover the deficits involved during the 5-year period above, or failing this, to borrow on the financial markets (through a bond issue) to do so;

(ii) suspend privatisation and/or outsourcing of public sector services until agreement with employee representatives has been reached as outlined in (a)(i)(2) above;

(b) to agree that no proposals to increase the current 3% rate of Goods and Services Tax should be brought to the States for consideration before 2013;

(c) to request the Minister for Treasury and Resources to bring forward for approval proposals in time for the Budget 2011 debate this year to set targets for raising business tax revenues, especially for non-local, non-finance companies which do not currently pay income tax.

DEPUTY G.P. SOUTHERN OF ST. HELIER

REPORT

Jersey's public services are a vital bedrock in sustaining the local economy and the community both in good times and bad. They ensure essential investment in infrastructure and support for business and families and can alleviate the worst social impact of the recession. Senator Ozouf's fiscal stimulus funding bears witness to the importance of public spending when the private sector spending is low. However, he is now promoting spending cuts to services as the first option. Some of these, even at the 2% level, are to front-line services.This approach needs needs to be robustly challenged. For Jersey to emerge successfully from the current recession in a strong position for the future, we need to sustain and strengthen our public services.

If the Council of Ministers led by the Chief Minister are to succeed in carrying out their very radical proposals to reduce public spending whilst protecting front-line services, then it is essential that they do so with the support of the general public. This must include all the users of our highly valued services and it must engage and achieve support from the employees involved in their delivery. This they have singularly failed to do. By adopting the piecemeal process illustrated here, Ministers have alienated the public from the process.

Already we have seen a great deal of disquiet and anxiety over the 2% cuts and the States are asked to decide on these in the Annual Business Plan (ABP) without sufficient time to properly consider the impact of the 10% cuts, which we will learn about in September. Meanwhile, proposals to increase personal tax are proposed, with the target of raising £22 million in 2011. Consultation on a partial presentation of these is due to close on 31st August. Firm proposals will be lodged in October for debate in the December Budget.

There is a "high-level" technical paper on business tax with no clear targets set and a vague timescale. In the meantime we have an accelerated 6-week programme of voluntary redundancy (VR) to close on 17th September and to be implemented by the end of October. There has been no consultation with employee representatives on this VR scheme or the proposed new VR scheme to operate from 2011.

The fact is that this piecemeal approach is totally inappropriate for the size and scope of the Comprehensive Spending Review (CSR), the Fiscal Strategy Review (FSR) and the content of the Annual Business Plan (ABP). Proposals on public spending and on cuts to that spending and how best to achieve them are inextricably tied up with decisions on taxation. They must be viewed as a whole, along with the widest spectrum of options which might assist the delivery of such an in-depth major reform. This proposition attempts to present a more comprehensive and co-ordinated approach. Proposals so far have been rushed, and the States are being asked to make decisions almost blindly in the absence of fully worked options. Above all, members of the public have not been fully involved.

The Minister for Treasury and Resources is correct when he says that our problems are "minute" when compared to others. The UK has a 12% deficit relative to GDP; Jersey's is a mere 1.6%. Why then does he propose massive cuts of £50 million by 2013 in his Comprehensive Spending Review (CSR)?

Lack of consultation

The proposals so far for £12 million of service cuts in 2011, building to £50 million by 2013, have been rushed and ill-thought through. In the absence of any overarching strategic direction from Ministers, they have been produced by a top-down process with no strategic plan. This is not a carefully considered programme of change to reform the delivery of services, it has meant instead the production of a list of service cuts made under pressure and driven by deadlines and by the accountants' "bottom line".

Many of the proposals appear to be politically unacceptable when viewed in the light of the relatively "minor" deficits we are undergoing. The absence of proper consultation with service users has been illustrated by the U-turns already made on the proposed increase in "user pays" charges on diabetic patients (HSS-UP2) and on the lifeguard at Havre des Pas bathing pool (ESC-S9).

The fact is that we already have a relatively efficient public sector, compared with our rivals. Our spend per head on public services is half that of the Isle of Man. We have 20% fewer staff than Guernsey to deliver similar or better services. After 8 years of "efficiency savings" the public services are already pared to the bone.

The first round of cuts will be debated on 14th September when the 2011 Annual Business Plan (ABP) comes to the States, having had only fairly superficial scrutiny of the impact of the proposals, with little opportunity to get evidence from service user groups or the staff affected. This is also before any tax changes, either personal tax or business tax options, will have been finalised, let alone decided.

It is also clear that little or no consultation has taken place with the representatives of States employees affected by the cuts. The Chief Minister and others have told us often that there has been extensive consultation with employee representatives over the CSR. This is simply misleading. Employee representatives deny that there have been any serious attempts on the part of Ministers or departmental officers to engage in meaningful consultation with them. Union officials have been briefed, but there has been no sign of any willingness on the part of the employer to consult, let alone negotiate, on any of the proposed service cuts or job losses. The package of proposals has been presented as a "fait accompli"; this is what we propose to do; this is how we intend to do it and this is the timescale. Once again, as with the public sector pay freeze, we see government by unilateral "diktat."

Voluntary Redundancy schemes

The recent re-introduction of the voluntary redundancy (VR) scheme, applicable to all public sector workers, has also been done without any hint of consultation. In the press release which refers to the scheme, the Minister for Treasury and Resources states –

> *"The States Assembly agreed to fund the VR scheme in July, so it could go ahead as part of the drive to cut costs. Staff will be invited to apply for voluntary redundancy between 2 August and 17 September."*

The imposition of a 6-week window for applications over August means that by the time that the States next meets, voluntary redundancies will be in place before the provision of those services under threat can be decided by the States. Once again, it appears that the power of the States Assembly to decide policy is being pre-empted. It would appear that with a new VR scheme to be introduced in 2011, the terms of which are likely to be less generous, employees are being encouraged to go early or risk worse conditions later. I say "likely" here because, as members will be aware, no-one, whether a member of the States, a union representative or a States employee, has yet seen the new VR scheme.

Finally, the Minister for Treasury and Resources is embarking on large-scale redundancies, many of which will be accompanied by a programme of outsourcing or privatisation, at a time when there is no legislation in place to offer any protection to employees over employment terms and conditions. Despite being promised on many occasions, such legislation referred to in the UK as TUPE (Transfer of Undertakings Protection of Employment) is an essential step in securing any co-operation over potential outsourcing.

Every redundant worker will cost the taxpayer dear in redundancy payments, loss of Income Tax and Social Security contributions, increased Income Support bills and loss of GST as spending goes down. Senator Ozouf proposes 70 job losses for 2011; by 2013 that may be 400 more jobs lost. This will simply add to the growing unemployment total of 1,000 plus.

Recovery?

'Lesson one in a deep recession is you don't cut public spending until you are into the boom phase.'

These are the words of eminent economist David Blanchflower and former member of the Bank of England Fiscal Policy Committee. Such sentiments are reflected around the world by economists and business leaders, as politicians rush headlong into spending cuts which endanger any recovery.

Michael Geoghegan, Chief Executive of the UK's largest Bank, HSBC, warned on 6th August against the zeal with which many are approaching the implementation of cuts.

> *"I caution this" he said in an address to business leaders, "be careful what you do! It is important that the level you cut is not cutting into the muscle of the western world. The worst thing we could see… is a Europe which has internal conflict, disagreement, strikes, loss of work", he said. "All these things are as damaging as having a high public cost base."*

In criticising the spin that the UK government puts on its debt policy, Lord Eatwell, Professor of Financial Policy at Cambridge University, has the following to say –

> *"Note that the Chancellor (Osborne) refers to the structural deficit, not to the actual deficit. The structural deficit … logically dubious, yet wonderfully convincing … is a theoretical construct relying heavily on contentious assumptions. The Office of Budget Responsibility clearly states that the actual deficit is less".*

In the meantime, figures from the US point to a sluggish recovery. In the UK growth estimates are revised downwards by the Bank of England. There is no evidence in Jersey that we are out of recession yet. The scale of cuts proposed by the Minister for

Treasury and Resources, with his constant references to the “structural” deficit, now risks prolonging the recession, pushing us into a downward economic spiral.

Taxation

Despite being the third weathiest economy in the world, we are an incredibly low-tax, low-spend jurisdiction. If we want to have decent public services to all in need, then we must all be prepared to pay a little more for them. This is perfectly possible, but the costs must be spread across the whole of the community and must be demonstrably fair.

The Minister for Treasury and Resources describes the current deficit as structural, but the only change to our tax structure is the move to zero/ten. There can be no denying that the decision to adopt zero/ten has transferred around £100 million from company tax to personal tax. In 2008, tax revenues from business were equal to those from individuals; today business tax is less than half the amount collected in personal income tax.

Again, non-local, non-finance companies pay no tax on the business they conduct in the Island. A solution to this issue must be put to the States before any agreement can be reached on any increases in personal tax.

The Minister for Treasury and Resources proposes raising an additional £30 million from personal tax but makes no such proposals for business. He describes his proposals to raise GST and to triple domestic rates as “mildly regressive”. This is completely misleading. Both measures will have greatest impact on the poorest families and those on fixed incomes, like pensioners. Both these measures must be rejected.

The only progressive option proposed by the Minister is a higher rate of tax (30%) on annual incomes over £100,000. But alarmingly, it is still not clear if this refers to couples or individuals. This makes a massive difference to the impact and the revenue produced. We now know that this change discriminates against married couples. The proposal is confused and unclear, and will require a change of the Income Tax Law if it is to work. We cannot proceed on the back of such a confused consultation when the proposal so totally lacks clarity.

Senator Ozouf says his option of raising the ceiling on Social Security contributions from £43,752 to £115,000 is progressive. It is not. It is merely proportional. What is more, it does not go far enough. Eliminating the ceiling altogether would raise £45 million and allow for the removal of the “20 means 20” tax measures which are already hitting middle-earners.

This lack of clarity reveals just how ill-thought out the Minister’s tax proposals are and render the validity of any consultation open to serious doubts.

Timescales

We could and should be taking more time to get the future of our public services and the tax balance of our economy right. We have been told that we must push through these changes now because we have only enough money in the Stabilisation Fund to cover the deficit in 2011. Surely the time has come to use the Stategic Reserve to give us enough breathing space. Failing that, we should borrow whilst rates are low to cover the deficit.

So far we have seen no evidence for any strategic vision over the CSR. One is doubtful whether the proposals to come forward for 2012 and 2013 will show any futher strategic rationale. Many observers of the process have pointed out that the whole scheme seems to have been put together in a rush. The Editor of Business Brief magazine has, in his comment column in the JEP, commented on a number of occasions that a proper reform of public services should be a 5-year plan and not one which is rushed through in 3 years. The opportunity to get the reforms right by taking more time should not be wasted. We have a year in which we can use the Stabilisation Fund to give ourselves a little breathing room.

That little breathing room must of course give us time to plan and build a way through the recession and into recovery. The first thing to note is that as a starting point we have no debt. The route forward contained in the ABP contains 3 elements over its 3-year timescale –

- Use of the Stabilisation Fund
- Public service cuts
- Personal tax rises.

The Council of Ministers is proposing a target for the Fiscal Strategy Review to deliver sufficient additional revenues,together with the savings from the CSR, to return to balanced budgets by 2013.

Targets ABP 2011

	2011	*2012*	*2013*
Proposed targets	*£m*	*£m*	*£m*
CSR Savings	12	25	50
FSR revenues	22	48	56
	34	73	106

Options to deliver the additional tax revenues will be proposed in the 2011 Budget in October.

It must be noted that the proposals are to run deficit budgets in this period.

Furthermore, these figures require drastic reductions in capital spending, so much of our vital infrastructure needs (roads, sewers, housing) may continue to be neglected, and in the absence of any further fiscal stimulus funding, the construction industry may be slow to emerge from recession, if the recovery remains slack as it is elsewhere.

More options

This is a relatively limited range of options. The first thing to do is to spread the measures we are about to take over a longer period. Better to get it right in the long-term than wrong in the short. This starts with the CSR proposals.

What is also missing is any consideration of any of the following –

- Business tax rises (especially for those non-local companies paying zero tax)
- Any use of the Strategic Reserve (Rainy Day Fund)
- Raising funds on the international money market.

Note: here I am talking, as the proposition also does, simply of ***investigation*** of these wider options. But let us make some preliminary sketches of what might be possible if we are to spread the options wider, and over the longer timescale.

First I turn to business tax, and especially to the position of non-local non-finance companies who trade tax-free in the Island. At the time of the introduction of zero/ten the "black hole" in our revenues was estimated as £80 to £100 million, which split into £60 million from finance and £30 million from non-finance companies. The re-establishment of a 10% rate (or its equivalent) on the latter might raise £10 million annually.

The proposition refers specifically to the use of the interest on the Strategic Reserve Fund ('Rainy Day' fund) and not the capital. I am fully aware of the restrictions on touching the capital agreed by the States in 2006 and I am also aware that under the Public Finances (Jersey) Law 2005, only the Minister for Treasury and Resources can formally bring a proposition to .States to use money from the Fund. Although there are many in the Island who would say that the time has come to use this permanent reserve and to consider whether the circumstances are sufficiently exceptional that consideration should be given to insulating the economy from this severe structural decline. I have not ventured there –yet.

This proposition limits itself to the interest, which stood at £18.7 million in 2009, down significantly from the £27.7 million surplus in 2008. Let us suppose that a return of £20 – £25 million can be expected if and when markets stabilise, this too can offset the need for inordinate personal tax rises. The table below builds on the Minister for Treasury and Resources' figure to include the very simple adjustments outlined above.

This model contains only 2 simple adjustments in addition to the logical spread of the burden over 5 years instead of three. The result is that the CSR cuts are spread, giving ample time to get them right and get them accepted. In addition, the extra personal tax burden is reduced and rendered less harsh. The Strategic Reserve stays intact (although it does not grow), and the deficit grows from £70 million over 3 years to £129 million over 5 years.

Targets ABP 2011 – Revised

	2011	*2012*	*2013*	*2014*	*2015*
Proposed targets	*£m*	*£m*	*£m*	*£m*	*£m*
CSR Savings	10	20	30	40	50
Business tax	0	10	10	10	10
Strategic fund	18.7	20	20	20	20
FSR revenues	5.3	10	15	20	35
Total	34	60	75	90	105
Additional deficit	0	-13	-31	-15	0

I certainly believe that we could and should be able to live with these revised deficits. There is plenty of scope for further adjustments or additions during those 5 years, if and when we want to adjust the mix and circumstances allow.

Borrowing and Bonds

Faced with the prospect of massive cuts to services, and with personal tax rises the only other option, one would have thought that the Minister for Treasury and Resources might have explored alternatives. Has the time come to borrow in the international money markets?

As the Editor of the Business Brief usefully pointed out in his column in the JEP recently, Bermuda, which is faced with an economic situation which is worse than ours, has recently raised \$500 million (about £328 million) in public bonds, which were 6 times oversubscribed. It was in fact Bermuda's debut offering in the global debt markets.

As the editor puts it –

> *"It simply points to an alternative which avoids severe cuts damaging public services. In many ways it just buys time so that any necessary cuts or restructuring can be handled in a more considered way, without panicking to meet a deadline. If Bermuda, which relies on a good reputation as a stable, responsible finance centre, can sell bonds on the international market for more than £300m, then Jersey should be able to raise a fraction of that with little problem at all."*

A second example comes from Gibraltar –

> *"Gibraltar is also a similar size to Jersey and is also heavily reliant on financial services. The lesson Jersey could perhaps learn from them is how to escape the recession altogether. Gibraltar's GDP was up by 5.5% last year (Jersey's fell 4%) and their budget surplus was £30m, with revenue going up 9% while expenditure only increased by 6%. But Gibraltar is reducing its company tax from 22% to 10%, so other taxes have had to be increased – a lesson that Jersey has hopefully already learned. Most importantly, with a smaller population than Jersey, Gibraltar is able to spend £106m on capital projects this year and £160m next year. So how can tiny Gibraltar afford this? Well, most capital spending is funded by borrowing, that's how."*

The author ends with this challenge to the Minister for Treasury and Resources –

> *"So we have two small 'island' jurisdictions, which both rely on a good reputation to bolster their vital financial services sectors, who find it necessary to borrow. Indeed, both of them (and many others), borrow in the normal course of events, not just when there's a crisis that hits their budgets. But Jersey doesn't even consider the option when there's a crisis. It appears frightened to follow the example of others, because some of them have gone too far. But if we can't borrow a modest amount at a time of extremely rare deficits caused by the worst recession in living memory, when can we?"*

If properly used, a bond issue can be a useful mechanism for maintaining the economy. The plan has to be one for creating local investment out of the bond which creates local employment now, and which is then capable of earning a long-term income to cover the interest – the capital need never be repaid, it's just rolled over.

A bond issue could be used, for example, to create new social housing or creating a new business – perhaps green electricity generation – a Jersey venture capital fund partnering the private sector. The point is that keeping people at work and paying tax will more than cover the interest cost during the development phase and the savings and investment returns thereafter should pay the interest.

This proposition asks the same question as the editor of Business Brief. What is wrong with borrowing prudently to avoid the worst of the cuts, and postpone punishing rises in personal taxes, whilst at the same time funding much-needed capital spending which will stimulate the economy? This proposition asks the Council of Ministers to investigate and report their findings to the Assembly before taking precipitate action.

Financial and manpower implications

Extending the period of restructuring to 5 years instead of 3 will mean a lower rate of job losses and may result in fewer jobs lost. The addition of an extra £30 million revenue (from business tax and the Strategic Reserve interest), as illustrated in the report, allows lower personal tax rises and increases the deficit from £70 million to £129 million.