STATES OF JERSEY

ECONOMIC STIMULUS PLAN (P.55/2009): COMMENTS

Presented to the States on 18th May 2009
by the Corporate Services Scrutiny Panel

STATES GREFFE

COMMENTS

The Corporate Services Panel has undertaken a review of P.55/2009 – 'Economic Stimulus Plan', lodged *au Greffe* by the Minister for Treasury and Resources on 9th April 2009. It is understood that this is the first part of 2 pieces of work relating to the Economic Stimulus Plan by the Minister for Treasury and Resources, with the second section expected to be debated by the States on 16th June 2009. In view of that, the Panel has elected to respond to the first part of the plan in 2 parts: a comment relating to P.55/2009, and a full report prior to the debate of the second half.

The Panel fully accepts that the establishment of a Stabilisation Fund was for the purpose of making fiscal policy more counter-cyclical and to create in the Island a more stable economic environment with low inflation. It further accepts, without reservation, paragraph (a):

> ***(a)*** ***to agree to transfer the £18 million surplus funds currently available from the special fund known as the Dwelling House Loans Fund established under the Building Loans (Jersey) 1950 to the Stabilisation Fund;***

The Panel examined the rest of the proposition in 5 parts.

1. Intervention or no intervention.

2. Discretionary use of funds.

   The transfer of £44 million from the Stabilisation Fund to the Consolidated Fund to provide funding for the proposed discretionary economic stimulus package.

3. Automatic Stabilisers.

   The earmarking of the balance of £112 million on the Stabilisation Fund to cover the impact of the economic downturn on States' finances forecast for 2010 and 2011.

4. A cyclical or structural problem?

5. Process.

   The request for agreement, in accordance with Article 11(8) of the Public Finances (Jersey) Law 2005, to amend the expenditure approval for 2009 approved by the States on 23rd September 2008 in respect of the Treasury and Resources Department, to permit the withdrawal of up to £44 million from the Consolidated Fund to be re-allocated for the net revenue expenditure of a number of departments in order to fund the proposed discretionary economic stimulus package, with the funding only being made available to departments from the allocation following referral to the Corporate Services Scrutiny Panel and by public Ministerial Decision of the Minister for Treasury and Resources.

1. Intervention or no Intervention?

From evidence taken during several Hearings, the Panel has established that there is significant concern about the short-term outlook of the economy. The outlook for the global economy is probably worse than any time in the last 60 years. Financial markets across the world have suffered and, as a result, governments around the world have acted in a co-ordinated manner to support their economies. This is being done to help businesses, individuals and to ensure that there is no more unemployment than is unavoidable. The Panel has found no evidence to suggest that Jersey is in a different position in that respect. The Panel agrees, therefore, that there must be some positive action using the resources available to the Island. During the Hearing of 1st May 2009, the Minister for Treasury and Resources stated –

> *The best forecast that we have got for the Jersey economy is for a pretty prolonged downturn for 2009 and 2010. Our central G.V.A. (Gross Value Added) forecasts for those 2 years are minus 4 and minus 2 per cent respectively.*

The Panel notes that Jersey is in a unique position, having the benefit of a Stabilisation Fund that provides the option of injecting money into the economy and supporting the automatic stabilisers during the downturn period, which would mitigate the impact of the global downturn on Islanders. The Panel also notes that this is not an exact science. There has been nothing like this in living memory to assist, and history tends to suggest that previous attempts at intervention were instigated only during the depths of the recession. The influence of such intervention has been too late, causing inflation during the recovery period rather than mitigation of the worst of the recession.

Given that the Treasury forecasts are endorsed by the Jersey Fiscal Policy Panel (FPP) in their Annual Report for 2009, it is accepted by the Panel that they are the best currently available. It should, however, be noted that the Treasury forecasts are not the only forecast. Other significantly worse scenarios have been offered to the Panel.

The FPP state in page 18 of their Annual Report 2009 –

> *The Stabilisation Fund should be used to cover the deficits that will result from the expected contraction of the economy in 2009 and 2010.*

That is a clear endorsement for intervention by the States of Jersey and the Panel concurs with that premise. Further, it agrees that the Stabilisation Fund was created to assist in circumstances such as those faced by Jersey at this time and is the correct tool for the job.

2. Discretionary Use of the Stabilisation Fund

The Panel has many unanswered questions relating to the discretionary use of the Stabilisation Fund. Clearly, most of these questions revolve around the detail of the intervention. The Panel notes that the intention is to obtain agreement in principle to make £44 million available to the Minister for Treasury and Resources, with the detail to be examined in June. The Panel further notes that the Minister wishes the sum to be available for discretionary intervention on 3 main areas –

(i) New programmes of maintenance/infrastructure spending;

(ii) Supporting employment in the Island by assisting individuals affected by the economic downturn;

(iii) Business support and new programmes to help individuals retrain/skills.

Once again, these areas are discussed within the FPP Annual Report 2009, and advice concerning this was offered to the Minister in a letter dated 26th March 2009. Whilst the FPP consider that a discretionary policy is necessary, it carries a caveat of various health warnings, including –

- Given the lack of economic data and the uncertainties related to the effects on the Jersey economy of any given stimulus, the Panel is not in a position to quantify the size of the stimulus that is appropriate for Jersey.

- There is a risk that any stimulus put into the economy by the States will quickly leak out of the economy through spending on imports.

- Any given policy may be less effective than would be the case in larger economies.

- Any discretionary policy should not allow the States to be distracted from its longer term strategy.

- To be truly counter-cyclical, the policy must meet the '3 Ts', i.e. Timely, Targeted and Temporary.

The Panel also notes that the FPP has suggested that 4% of Gross Value Added (GVA) would be considered appropriate, and that is the approximate content of the Stabilisation Fund.

Having considered this, the Panel concurs that discretionary use of the Stabilisation Fund is appropriate at this time.

3. Automatic Stabilisers

The larger part of the Stabilisation Fund is proposed to be used to offset the financial deficits expected during 2010 and 2011. This deficit is forecast to come about because the automatic stabilisers will be unable to cope with the extraordinary pressures brought about by the downturn, through the loss of tax revenue due to lower earnings and profits and an increase in expenditure in areas such as income support.

The FPP agrees with the use of the Stabilisation Fund to assist in this manner and again, the Panel accepts this is the purpose for which the Fund was created and notes the proposition wishes to earmark £112 million for the purpose.

However, the FPP report (p.24) shows that by transferring £50 million and £62 million during 2010 and 2011 there would be a balance of £32 million and £33 million left in the Consolidated Fund during the respective years. The Panel questioned whether there should be such an amount in that Fund, having regard for the recommendation within the FPP report for a balance of £20 million in the fund. The Panel understands that there are unexpected spending pressures for 2009, such as the Haut de la Garenne Enquiry and the Health Reciprocal Funding that are unaccounted for within the chart. This will account for a proportion of the 2009 Consolidated Fund balance. Should this amount to £10 million (for example), that would permeate through the chart, leaving balances in the Consolidated Fund of around £20 million for 2009/10 and 11. The Panel further acknowledges that £20 million in the Consolidated Fund is expected to be available for just such unexpected and unavoidable expenditure as experienced by the States in 2009. In addition, this sum is intended to offer some protection against any variations from the forecast tax revenue.

The Panel concurs with the premise to transfer money to cover the pressures on the automatic stabilisers, and wishes to acknowledge that the creation of the Stabilisation Fund was due to the good work by the previous Corporate Services Scrutiny Panel, which was chaired by the then Deputy P. Ryan.

4. A cyclical or structural problem

During the examination of the proposition, the Panel noted a forecast of no recovery from the downturn, with a deficit of over £50 million continuing through 2013. This suggests the problem is structural and not cyclical.

The forecast contained within paragraph 6 and Annex A of the report and proposition appear to carry weight and conviction. The Panel are not satisfied with the robustness of this prediction in view of the comments from the Minister for Treasury and Resources during Hearings on 1st May, which were confirmed again on 11th May, when he stated that there was a "risk" and a "scenario" that a structural deficit could arise. He went on to say on 1st May –

> *The reason that deficits appear in the forecast beyond 2011 are a result of the economic assumptions that are underpinning it. That is global economic growth and financial market performance go through a very steep fall and then only recover at average rates thereafter as is the case for Jersey economy. This means that it will take a long period for the global economy and the local economy to return to the previous levels. This means that there is sustained loss in tax revenue over the forecast period. The extent and the size of any structural deficit is linked to what the post turmoil global and the local economy look like in the longer term. A more positive outlook could mean that there is no lasting impact on States finances and that the forecast future deficit does not materialise. Conversely, a longer, more protracted downturn and a weak recovery could mean that a sizeable structural deficit does materialise. It is important I think at this stage to say that we do not base our plans on optimistic scenarios, especially given the uncertainty surrounding the outlook.*

The FPP have examined the medium to long-term outlook and suggest, in 2.4 of their 2009 annual report, that there could be a structural shortfall. The corrective action that would be needed once the economy is recovering would necessarily involve tough decisions on cutting expenditure or increasing taxation. The FPP go on to recommend that a strategy should be developed to deal with this threat.

The Panel questions the robustness of forecasts of the structural deficit, in the light of the limited data and experience of such a downturn as is being experienced at this time. In addition, it is concerned that, should this be correct, serious measures need to be undertaken soon to deal with the deficit.

5. <u>Process</u>

Paragraph (c) of the proposition –

> *(c) to agree, in accordance with Article 11(8) of the Public Finances (Jersey) Law 2005, to amend the expenditure approval for 2009 approved by the States on 23rd September 2008 in respect of the Treasury and Resources Department to permit the withdrawal of up to £44 million from the Consolidated Fund to be re-allocated for the net revenue expenditure of a number of departments in order to fund the proposed discretionary economic stimulus package with the funding only being made available to departments from the allocation following referral to the Corporate Services Scrutiny Panel and by public Ministerial Decision of the Minister for Treasury and Resources.*

The Panel has examined the process by which the Minister for Treasury and Resources intends to assess the bids. An open flow of information exists between the Minister and the Panel, and whilst no bids have been received at the time of drafting this comment, it is expected that some bids will be supplied for the Panel's consideration prior to the debate on P.55/2009. To this point, it considers the intended selection process appears to be robust and suitable. It notes the referral contained within the proposition, and will be putting time aside to undertake such process as it considers suitable to engage in the selection process in the time available.

The Panel concurs with the process proposed for the allocation of funds to departments from the Consolidation Fund.

<u>The Corporate Services Scrutiny Panel supports all parts of the proposition.</u>

<u>Caveat</u>

The Panel acknowledges that forecasting is not an exact science and that the continuing deficit in 2012 and 2013 is not yet a certainty. The Bank of England quarterly report has today (13th May 2009) suggested that the U.K. recovery may be slow and, given that Jersey's economy is so closely tied to that of the U.K., it would be sensible to make contingency plans for such an eventuality. The Panel is particularly concerned that, should the forecasts be correct, the window of opportunity for the serious measures to be undertaken is such that planning is needed to be commenced now to deal with any such deficit.