STATES OF JERSEY

STATES NET REVENUE EXPENDITURE 2011 AND 2012: REDUCTION

Lodged au Greffe on 15th March 2010
by the Public Accounts Committee

STATES GREFFE

PROPOSITION

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

to refer to their Act dated 5th October 2009 in which they approved the Annual Business Plan 2010 and, *inter alia*, approved the indicative total Net Revenue Expenditure for the States funded bodies, as set out in Part Three of the report Summary Table C as amended for the period 2011 to 2014, and requested the Chief Minister to present Annual Business Plans to the States within these indicative total amounts; and

to request the Chief Minister to prepare and lodge for approval draft Annual Business Plans limiting total net revenue expenditure for the States funded bodies, calculated on the basis shown in the financial forecasts, (namely after the Net Revenue Expenditure Allocation has been adjusted for the Repayment of Capital Debt), to a sum not exceeding –

(i) £580.45 million in respect of 2011; and

(ii) £551.43 million in respect of 2012.

PUBLIC ACCOUNTS COMMITTEE

REPORT

"Income, twenty shillings a week, expenditure, twenty shillings and sixpence; result, misery.

Income, twenty shillings a week, expenditure, nineteen shillings and sixpence; result, happiness."

Charles Dickens – David Copperfield – Mr. Micawber

The Public Accounts Committee is concerned that the scale of the financial problems facing the Island is not fully understood. The figure of a £50 million deficit, which necessitates similar savings, has been widely reported. Yet the truth of the matter is that the shortfall is likely to far exceed this figure if no action is taken. Indeed, savings far in excess of £50 million are required on a sustainable long-term basis.

Few would argue against the notion that change in the public sector takes significantly longer than in the private sector. This is for a number of reasons – not least the structure of the public sector and the fact that some areas provide essential services with strict minimum operational issues.

Furthermore, the private sector does not have the luxury of the taxpayer 'tap' – a constant source of funds that is available from taxation. If the private sector does not react quickly to a shortfall in income it could quickly find itself in liquidation. The public sector does not have a similar sword of Damocles hanging over its head.

In its Annual Report (November 2009 update) the Fiscal Policy Panel notes that a higher fiscal deficit is forecast for 2011 as a consequence of higher planned States expenditure than previously envisaged. The Panel also noted the plan to use the Consolidated Fund to finance these larger deficits.

To quote from the document –

> *"The Panel urges the States to tackle the deficit and not to worsen the position further by increasing spending or reducing income."*
>
> *"The depleted balance in the Stabilisation Fund risks leaving Jersey unable to respond to a worsening of the current economic downturn or to the next slowdown."*

The PAC believes that there is greater urgency in dealing with the structural deficit than that implied by the current Annual Business Plan net expenditure figure for 2011 of £611 million (that is the States Expenditure Net Revenue Expenditure excluding Capital Allocation.)

The Comptroller and Auditor General's report 'States Expenditure Forecasts, February 2010' – illustrates the growth in expenditure witnessed during recent years. Taking a pessimistic view, the States' deficit would be of the order of £80 million by 2014. This wouldeliminate most of the Strategic Reserve if allowed to occur.

The PAC believes that we should act in a prudent manner today and not rely on over optimistic economic forecasting to solve our problems. The structural deficit has been caused by a fundamental change in the mechanics of the local economy. The golden goose that allowed a Shangri-La existence of low taxation, coupled with high expenditure, is seeking to fly the nest. We must ensure that this cornerstone of Jersey's economic success is not eroded.

The Minister for Treasury and Resources has acknowledged that the current one year planning process is flawed, as it does not engender long-term planning. The PAC agrees with these sentiments and looks forward to the introduction of a more suitable and robust system in due course.

Most Members of the current States Assembly will have been elected in 2008, conscious of the structure of the 2009 Business Plan which will have been voted on in the summer of 2008. Within this Business Plan, the following predictions regarding Net Revenue Expenditure were made:

Table 2.1 Revised Financial Forecast (July 2008)

Probable 2008		<---- Forecasts 2009	2010	2011	2012	2013 ---->
£m		£m	£m	£m	£m	£m
	States Income					
460	Income Tax	475	490	510	530	550
-	0/10% Corporate Tax Structure	(9)	(77)	(82)	(87)	(96)
30	Goods and Services Tax	45	46	47	48	50
50	Impôts Duty	50	49	49	49	49
30	Stamp Duty	31	32	33	34	34
-	Tax/Stamp Duty on Share Transfer	1	1	1	1	1
44	Other Income	33	27	25	24	23
10	Island Rate	10	11	11	11	12
624	**States Income**	636	579	594	610	623
	States Expenditure					
524	Net Revenue Expenditure	531	549	567	584	602
143	Net Capital Expenditure Allocation	38	40	37	35	16
667	**Total States Net Expenditure**	569	589	604	619	618
(43)	**Forecast Surplus/(Deficit) for the year**	67	(10)	(10)	(9)	5
-	Transfer to Strategic Reserve	-	-	-	-	-
(38)	Transfer to Stabilisation Fund	-	-	-	-	-
13	**Estimated Consolidated Fund balance**	80	70	60	51	56

The PAC notes that the 5 year expenditure forecasts, passed by the States Assembly in 2008, predicted a 2011 Net Revenue Expenditure figure of just £567 million. These are the expenditure levels that were considered achievable just 2 years ago. Yet despite a period of low inflation, rejection of this Proposition would allow expenditure at a much higher level.

It is the responsibility of every States Member to ensure that the economy is run in a manner that achieves longer-term sustainability. A reluctance to work to more stringent spending targets at this stage could lead to severe economic problems for future generations.

The problems faced today are not insurmountable – but they are very serious. Setting a lower expenditure target ahead of the Annual Business Plan debate will give senior managers the opportunity to develop a plan that is tailored to the wishes of the Assembly. The alternative option of bringing an Amendment to the Business Plan does not give the opportunity to tailor the process to the actual requirements.

In 2008, States Members did not question expenditure levels and believed them to be realistic. If the Minister for Treasury and Resources is serious about working to 3 year financial targets this is an opportunity to commit at an early stage.

The PAC is not giving advice in respect of how this reduction in expenditure is to be split between Departments. That is largely political. What is clear is that any decision to cut a budget of a particular Department is one that must be made by the Council of Ministers. During the debate, Members should be wary of potential shroud-waving. The Council of Ministers believed that this was an acceptable expenditure level in 2008, and the decision as to how they split the cake is one of their primary functions. The figure in the proposition remains, in fact, £13.45 million higher than the 2008 predicted figure– more than enough to taken into consideration any budget amendments. This should ensure that the 2009 Amendment 3 (HSS Respite Care) and Amendment 10 (HSS Deficit) are not affected, as these are specific spends that have been passed by the States Assembly.

5% reduction in 2011, with a further 5% reduction in 2012

The PAC believes that a 5% reduction from current anticipated levels is achievable in 2011 with a further 5% reduction in 2012. It believes that these reductions are achievable without significant impact on frontline services.

The PAC also believes that given their competency, Departmental Management Teams should have the capability to elicit such cuts without severely affecting either frontline services or the quality of service provision. Indeed, the remuneration received reflects the requirement to make difficult intelligent decisions if circumstances dictate.

Contrary to the ill-conceived and worrying thoughts of some commentators – we do need to know the cost of our public sector and we must reward them with competitive, but not excessive, terms and conditions. The taxpayer will demand value for money, and the practice of increasing taxation to overpay the inefficient is a long-term recipe for disaster. It is not the job of the taxpayer to provide charity to the greedy, nor is it the job of Government to exploit loyal Public Sector workers by failing to pay a fair day’s pay.

The alternative to this proposition is to remain a profligate greedy generation that is more than willing to pass extreme financial burdens to future generations. We should not be remembered as the ‘takers’ in society – but rather leave a legacy of prudence, honesty, and integrity.

Income Generation won’t bail us out

We cannot trust the Income Calculations to be accurate or, as they have been in the past, extremely prudent.

As the recent comment in the Jersey Evening Post stated –

> *"JERSEY bank deposits were down by 20 per cent while the value of funds under administration fell by 3 per cent in 2009.*

The latest figures released by Jersey Finance show the impact of the economic downturn on the finance industry.

However, there was some room for cautious optimism with the values of specialist funds growing as compared to the previous quarter. These include hedge, private equity and real estate funds.

Meanwhile, the value of funds under investment management increased from £18.4 billion to £19.7 billion – a rise of 4.4 per cent – during 2009.

Jersey Finance chief executive Geoff Cook said that the decrease of almost 20 per cent for Jersey's banking deposits during 2009 was hardly surprising given the very low level of interest rates throughout the year."

Looking behind the figures highlighted in the JEP article, the PAC has some concern as to the recent numbers relating to bank deposits and funds under administration and investment management, together with the robustness of continued strength of the growth drivers.

For example, PAC is aware of the negative sentiment expressed by Hedge Fund Managers in relation to the EU proposal for a Directive on Alternative Investment Fund Managers and its potential negative impact on seed/launch/existing hedge funds. Further, the 4.4% rise in funds under investment management figures are to be considered in light of a rise over the same period in major markets of 22%. This under-performance looks to be a major outflow of funds and may indicate a structural change in the industry.

It is recognised there are opportunities in real estate due to large falls in asset values and rising income yields; however these large falls have meant many investors are still nursing significant losses from holding these funds through the period of market dislocation in 2007 and 2008. Whilst there are signs of recovery in the U.K. Commercial Property market over a compressed period in Q4 2009, the PAC believes it remains to be seen whether investor demand will return at sufficient levels to see growth return to pre-credit crisis levels.

The new Foundations Law with resultant structures created by Jersey financial services companies will likely slow the fall in AuAs (assets under administration). The increase in required deferral of benefits demanded by central banks/regulators/ politicians will likely further stem the losses of AuA for Jersey financial service companies providing corporate trustee services.

Low interest rates traditionally squeeze margins, and by the absolute nature of returns in cash/cash deposit instruments, a 20% decline would indicate a structural change. One could argue a decline in deposits would be matched by an increase in assets under administration or management as investors seek to beat meagre cash-based returns. However, this does not appear to be reflected in actual reported numbers.

With some financial institutions carrying large carry-forward losses, which will rule out tax payments for some time, there is a distinct possibility that income shortfalls will lead to a much higher deficit in the future. If action is not taken in a timely manner, the significant increase in personal taxation that shall be necessary may not be sufficient to maintain current services, and the penalty will be sharp decreases in public sector pay and numbers, a decline in frontline services, and an unacceptable but necessary decrease in social benefit levels – particularly income support.

Financial and manpower implications

The PAC recognizes that there will be financial and manpower implications in respect of this proposition. The financial implications are quantifiable as the proposition proposes a reduction in NRE of 5% in 2011, with a further 5% in 2012.

The manpower implications are more difficult to quantify. The impact of the proposition on manpower levels will be dependent on how the reduction in NRE is handled and the level of co-operation received from the workforce, together with the skill of Senior Management in re-organising their departments. The renegotiation of terms and conditions and removal of restrictive or inflexible practices could, in theory, mitigate to an extent the loss of employees from States employment. In contrast, a failure to engage in change and a stubborn attitude could result in forced high levels of redundancies which would serve little long-term purpose as it would also leave the system rife with inefficiencies. Similarly, the financial implications of making employees redundant are a cost when the redundancy payments are made, but a longer-term saving in future years. The PAC would expect that commonsense prevails and that any reduction in expenditure is handled in a manner that retains employment at competitive and prudent levels.

Clarification Summary

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

(a) to refer to their Act dated 5th October 2009 in which they approved the Annual Business Plan 2010 and, *inter alia*, approved the indicative total net revenue expenditure for the States funded bodies, as set out in Part Three of the report Summary Table C as amended for the period 2011 to 2014, and requested the Chief Minister to present Annual Business Plans to the States within these indicative total amounts; and

(b) to request the Chief Minister to prepare and lodge for approval draft Annual Business Plans limiting total net revenue expenditure for the States funded bodies 2011 to a sum not exceeding –

(i) £580.45 million in respect of 2011; and *(note – it is currently £611 million– this represents a 5% reduction);*

(ii) £551.43 million in respect of 2012.*(note – it is currently £620 million– this represents a further 5% reduction equating to £59.57 million overall = 9.74% from £611 million or 11% (£68 million) from £620 million).*

APPENDIX

Figure 3.2 Revised Financial Forecast (October 2009) (as amended)

Probable 2009 £m		<---------- Forecasts 2010 £m	2011 £m	2012 £m ------------>
	States Income			
499	Income Tax	**472**	469	495
(11)	0/10% Corporate Tax Structure	**(81)**	(78)	(82)
50	Goods and Services Tax	**51**	52	54
51	Impôts Duty	**52**	55	55
	Proposed Environment Tax	**2**	2	2
	Amendment - Deputy Power	**(4)**	**(4)**	**(4)**
19	Stamp Duty	**21**	22	24
	Land Transaction Tax (Share Transfer)	**1**	1	1
34	Other Income	**29**	30	29
11	Island Rate	**11**	11	12
653	**States Income**	**554**	560	586
	States Expenditure			
542	Net Revenue Expenditure	**586**	611	620
18	Additional expenditure			
38	Net Capital Expenditure Allocation	**32**	21	19
598	**Total States Net Expenditure**	**618**	632	639
55	**Forecast Surplus/(Deficit) for the year**	**(64)**	**(72)**	**(53)**