STATES OF JERSEY

FISCAL POLICY PANEL ANNUAL REPORT 2012: RESPONSE OF THE MINISTER FOR TREASURY AND RESOURCES

Presented to the States on 7th November 2012
by the Minister for Treasury and Resources

STATES GREFFE

REPORT

Introduction

I wish to thank the Fiscal Policy Panel (FPP) for the considered and well-argued recommendations set out in their Annual Report for 2012. This takes the form of an updated commentary on prevailing economic conditions, followed by a detailed response to each of the Panel’s 7 recommendations.

The economic situation in 2012

Since the publication of the FPP Annual Report on 1st October there has been further confirmation of the fragile economic conditions the Panel portrayed both internationally and locally. The IMF confirmed in their October 2012 World Economic Outlook what the FPP feared, in that that the global recovery has suffered new setbacks in recent months; and as a result, global economic prospects this year and next have weakened. If EU and US policymakers do not address the economic challenges they face in their respective economies, then the IMF has indicated that it would expect to revise forecasts down further. The IMF analysis reminds us that we cannot expect the global economy to recover quickly and kick-start the Jersey economy.

The latest Jersey Business Tendency Survey published on 10th October shows that the all-sector business activity indicator in the third quarter remained at essentially the same negative level as the previous 2 quarters, which had been the most negative to date. The indicator for employment is also the most negative since the survey began in September 2009, and the net balance of firms reporting that they are operating below capacity is only slightly below the high recorded in the June survey. The survey also indicates that there is more spare capacity in the construction sector than at any time since September 2009, with a net balance of -58% of firms reporting they are operating below capacity.

The IMF also states they may have been underestimating the size of fiscal multipliers – the extent to which changes in government spending or taxation feed through into overall changes in economic activity. Of particular interest for Jersey is that this means the positive impact of fiscal stimulus could be larger than previously thought. In particular, it means multipliers are likely to be larger in today’s world of significant spare capacity in the economy, very low interest rates and fiscal action across many countries. This complements the IMF’s previous work that suggested government spending multipliers tend to be larger than tax multipliers.

Together, these latest findings by the IMF combined with the latest information on the performance of the global and local economies, tell us that in Jersey there is a real opportunity to maximise the impact of fiscal stimulus on economic activity and local employment at a time when it is most needed. At the same time we can get value for money while also investing in important government priorities. This is only possible because we have strong public finances which allow us the flexibility to invest to support the economy at this critical time.

Against this background, the detailed economic analysis set out by the Fiscal Policy Panel in their 5th Annual Report provides valuable advice on the key fiscal and economic considerations for the States ahead of the MTFP debate. The report has helpfully illustrated the difficult balancing act of allocating resources to meet clearly identified spending needs in essential areas, such as health, social care and job creation, supporting the economy in the short term and protecting the competitive system of taxation upon which our Island's economy depends.

Detailed response to FPP recommendations

An initial response was published on 1st October 2012, on the same day of the publication of the FPP's report. Here is an expanded commentary set out in column format so readers can more easily document the proposed actions against each of the recommendations.

Recommendation	**Comments**	**Actions**
1. The Panel's assessment of the economic outlook for the Jersey economy has been downgraded for 2012 and 2013 and there are indications that significant spare capacity will remain in the economy over this period. This leads the Panel to advise that the States should act now to give discretionary fiscal support to the economy in 2012 and 2013 and, if practical, to a greater extent than set out in the MTFP.	Recent data on the local and global economy discussed above, and warnings from the Governor of the Bank of England that the "problems in the world economy mean that we shall have to be patient" all serve to give greater impetus to the FPP's advice that we should be acting now to give discretionary support to the economy, and if practical, to a greater extent than in the MTFP. However, the FPP did highlight that in their view the MTFP did not explain clearly how the stimulus planned for 2012 and 2013 met the 3Ts (timely, temporary and targeted). In response, the Corporate Services Scrutiny Panel (CSSP) report on the Review of the MTFP stated – *The Minister for Treasury and Resources should report back to the States Assembly within three months with confirmation that elements of fiscal stimulus proposed in the draft MTFP are timely, targeted and temporary.* In addition, the response to the second recommendation below explains how the FPP's advice is being followed.	Action 1: The CSSP recommendation is accepted, as work is already underway to demonstrate more clearly how the stimulus planned for 2013 is being assessed to ensure that it meets the 3Ts. The Minister will report back to the States within 3 months on this matter.

Recommendation	Comments	Actions
2. While the consideration of additional discretionary stimulus should not be limited purely to capital expenditure it is clear that, with such significant capital allocations over the life of the MTFP, consideration could be given as to whether, in a timely, temporary and targeted manner – Capital allocations in 2012 and 2013 can be spent in the year of allocation Capital allocations from 2014 and 2015 can be brought forward to 2012 and 2013 Unspent allocations in 2012 from previous years can be spent as quickly as possible in late 2012 and 2013.	Bringing forward capital allocations from 2014 and 2015 may not be possible without borrowing or using reserves in order to finance projects early. There are also a number of projects that are also subject to planning permission. The Construction Council have identified a list of 18 planning applications that they estimate are worth £200 million and are currently awaiting planning permission. While some of these projects are familiar, such as the proposed Co-op development at Charing Cross; and public sector projects such as the Police HQ and St. Martin’s School, there is still clearly a significant number of private sector projects that, if granted permission, would assist in getting money into the economy in a timely manner and give greater stimulus than set out in the MTFP.	Action 2: States departments have been asked to make rapid progress on tendering the capital schemes that have been funded in 2012 and 2013 so as to inject this spending into the local economy at the time when it is most needed. Other aspects of expenditure, such as repairs and maintenance for social housing, are also being reviewed to ensure that projects are being completed in as timely a manner as possible. Action 3: A review is being undertaken to examine whether any of the unspent capital allocations in 2012 can be fast-tracked to be spent in 2012/2013. Consideration will also be given as to whether any schemes that are unlikely to be funded this year or next could be “swapped” with those that can take place in this timeframe. Action 4: The Minister for Treasury and Resources will work closely with the Ministers for Planning and Environment and Economic Development to identify and address any unnecessary obstacles in the way of private sector planning applications with the continued objective of securing speedy planning decisions in a way that would respect the necessary rigorous planning processes that are in place.

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3. The extent of stimulus should not be limited by the balances on the Consolidated or Stabilisation Funds. The States should give consideration as to the best way to fund needed stimulus if it is constrained by the availability of funding from these sources, not least because any constraint would be one of cash-flow, and funds could be repaid from future revenue.	If the approach outlined above in response to recommendation 2 highlights that there are projects that can be brought forward, but which do not have a funding source that is similarly flexible, then consideration will be given as to how they can be funded and, if necessary, whether external and internal borrowing may be appropriate.	
4. It is too early to judge whether the stimulus that will be provided to the economy in 2014 and 2015 by capital expenditure financed by one-off receipts will be warranted, but contingency plans should be made as to what measures could be implemented to reduce the extent of the stimulus if economic conditions merit such an approach.	Detailed allocation of funding for capital schemes in 2014 and 2015 will be made by the States as part of consideration of the annual Budgets for those years. If prevailing economic conditions dictate, then the level of capital funding in those years could be adjusted downwards. However, the projects set out in the capital programme, whilst they have the added advantage of providing fiscal stimulus, are necessary projects that the States must carry out to meet service delivery needs for local people. The annual Budget for each of these years provides the final mechanism for the approval of projects, and there is the opportunity to vary the schemes at this stage.	Action 5: The Treasury will consider the economic situation when formulating the 2014 and 2015 Budgets.

Recommendation	Comments	Actions
5. No transfers into the Stabilisation Fund are recommended in 2012 or 2013. However, further consideration needs to be given as to how the Stabilisation Fund will be rebuilt through counter-cyclical fiscal policy once the economy begins to recover. The Panel does not recommend a transfer into or out of the Strategic Reserve at this stage.	FPP advice will be critical in determining when the States should be running a surplus and rebuilding the Stabilisation Fund. That is, this should be done at a time when the economy is operating above capacity and the advice of the FPP will inform in determining when this is the case, so that the States can, if necessary, adjust fiscal policy accordingly. In the meantime, one way in which the Stabilisation Fund could be rebuilt during the period 2013 to 2015 is that any general revenue income that is achieved above our current target could be allocated to the Stabilisation Fund. This is in line with previous recommendations from the FPP and is an option discussed within the MTFP.	Action 6: Advice from the FPP will be taken in advance of 2014 and 2015 Budgets.
6. The Panel cannot rule out that there is an underlying structural imbalance between expenditure and revenue. The Panel’s view is that further analysis is required by the Treasury and Resources Department to consider the nature of proposed capital expenditure, the way it is funded and what it implies for the underlying position of States’ finances. If this analysis suggests that there is a structural deficit then consideration should be given to its extent and nature, including a more detailed plan of action to rectify it.	It is accepted that the Council of Ministers has agreed an ambitious programme of capital expenditure amounting to £222 million for the period 2013 to 2015. The Treasury has identified a range of sources of funding to meet the costs of this programme, including the repayment of the Preference Share from Jersey Telecom, which will yield £20 million, of which £15 million has been applied to the programme.	Action 7: The Treasury will undertake further analysis as suggested by the FPP, looking at the nature of future capital expenditure; in particular whether it can be separated out into expenditure that is investment with clear returns for the economy/taxpayer, and whether other elements may be repair and maintenance. In addition, the Treasury is already committed to presenting a report of future Health funding.

Recommendation	Comments	Actions
7. The Panel has had to make significant adjustments to the financial forecasts presented in the MTFP to try to assess the underlying economic impact of the proposals. In future the presentation of States' finances would be more informative, leading to a better-informed policy debate, if these types of adjustments were already included in the analysis accompanying any proposals in the MTFP or Budget.		Action 8: This was agreed in the Minister's initial response to the FPP report, and the Treasury will include this analysis in future Budgets and MTFPs, starting with Budget 2014. However, the Minister considers that the analysis carried out by the Corporate Services Scrutiny Panel and their adviser is overly-cautious and could not be considered as a central scenario. In particular, its assumptions on economic growth, average earnings and inflation, paint too pessimistic a picture, especially as we reach 2014 and 2015.