STATES OF JERSEY

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

Presented to the States on 9th September 2014
by the Minister for Treasury and Resources

STATES GREFFE

REPORT

The Minister for Treasury and Resources welcomed all the recommendations in the Fiscal Policy Panel's (FPP) 2014 Annual Report in his initial response to the report. The report is clear in endorsing the approach that is proposed in the Draft Budget Statement 2015 (P.129/2014), while at the same time highlighting the challenging agenda we face in preparing the next Medium-Term Financial Plan.

The Minister is encouraged that the FPP commend the States for the good progress we have made on their previous recommendations. It is also pleasing that drawing on the latest evidence on the performance of both the international and Jersey economies, they are forecasting an improvement in economic conditions next year.

The next sections of this report consider in more detail each of the Panel's recommendations in turn, showing that each of them is accepted and will be acted upon. It is worth remembering that, as set out in the Minister's initial response to the FPP's report, the Panel make a number of other positive remarks in reference to the proposals set out in Draft Budget 2015 –

- The property tax review is welcome because it could help the States to improve the efficiency of the current tax system.
- The proposed cap on mortgage interest relief is potentially a significant and welcome development.
- Delivering £100 million of fiscal stimulus is appropriate for 2014, and that fiscal policy should be accommodating in 2015 as well because there is still likely to be aggregate spare capacity in the economy next year.

The FPP's 2014 Annual Report is the first published since the Minister appointed the new members to the Panel and since the fiscal framework was strengthened by placing the Panel and their reporting procedures on a statutory basis. Our independent economic experts act as an important check on States economic policy, and the Panel's recommendations will be given full consideration by the Council of Ministers and should guide the States in the important decisions it has to take in the Draft Budget 2015.

SUMMARY OF RECOMMENDATIONS AND THE RESPONSE

	Recommendations	Accept/ Reject	Comments	Target date of action/ completion
1	The focus in 2014 and 2015 should be on supporting the economy (by running deficits) while there is still spare capacity.	Accept	Draft Budget 2015 sets out proposals to put significant amounts of investment into the local economy in 2014 and 2015 to continue to support it while conditions remain weak. The Panel's own analysis shows that the level of support amounts to 3% of GVA in 2014 and nearly 5% in 2015. This is largely a result of the significant investment planned in our infrastructure through the capital programme. It is recognised that there are always risks associated with delivering capital projects on time, and Treasury is clearly focused on delivering the plans for this year and next. Learning from experience in recent years, Treasury has been, and is, improving how it monitors and progresses capital projects which will ensure they are carried out as quickly and efficiently as possible, getting money into the economy while there is still spare capacity.	Already underway and will be achieved through implementation of Draft Budget 2015.
2	This focus should not be deflected in light of lower tax receipts (out-turns or forecasts), especially where this is a result of a weaker than expected economic performance. The Panel supports the Budget's proposed approach to mainly use savings and reserves to fund the potential shortfall in income because it limits the negative impact on the economy in the short term.	Accept	This is a key recommendation and one that should be given due regard as the States makes the decisions for the Budget 2015. Much attention will rightly be given to the latest income tax forecasts, but the Panel have advised that this should not result in us taking actions that damage the economy in the early stages of its return to growth. The Minister acknowledges the support of the Panel and will endeavour to ensure that any potential shortfall in income in 2014 and 2015 is funded in a way which limits any negative impact on the economy.	Already underway and will be achieved through implementation of Draft Budget 2015.

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3	If there is a structural deficit in the public finances, the States should plan to address it once the economy has recovered. Structural changes in taxation, or expenditure programmes are easier to introduce once the economic recovery is fully established. This will be an important consideration for the next MTFP.	Accept	The advice on the timing of any action to address a potential structural deficit is noted, and work is well underway to meet this recommendation as part of the Long-Term Revenue Plan (LTRP) 2013–2020 which analyses the financial position in future years. Treasury will continue to improve this analysis over the coming months in preparation for the next MTFP 2016–2020. In addition, the LTRP will set out in detail the process for assessing the structural position, determining whether any action is required, and how we should plan to make any decisions. A clear and considered process will prevent any knee-jerk reactions that could hinder economic recovery. The tax and spending proposals in the next MTFP will need to include sufficient flexibility to adjust the fiscal position over the 4 year period to allow for changing economic conditions and to address any underlying structural issues. The Panel, elsewhere in their report, state that ahead of their report next year they will undertake additional analysis to help the States better understand the structural position of the States' finances. The Minister believes this work will be extremely important in determining what should be proposed in the next MTFP in terms of the extent and timing of any adjustment of the balance between taxation and spending.	To be included in next MTFP.
4	The States should bear in mind the following principles when forming the next MTFP – ● Aim to balance the budget over the economic cycle – i.e. surpluses and deficits which broadly balance out over more than one MTFP period. ● Adopt prudent	Accept	The FPP's comments are welcome and reflect some of the lessons learned from the first MTFP. In particular, recognising that the next MTFP will cover 4 years rather than 3, so it will be even more important to set an affordable level of expenditure and to build in sufficient flexibility in expenditure proposals and a level of prudence in the assumptions for States income. The Minister for Treasury and Resources will give consideration to certain changes to the Public Finances Law to provide greater flexibility in the management of	To be included in next MTFP

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	assumptions for income and realistic assumptions for expenditure. ● Include flexibility within a clear framework for expenditure.		States' finances over the MTFP period. The first MTFP focussed on providing resources to create jobs, stimulate economic growth and provide essential investment in healthcare. This meant investing heavily in the early part of the MTFP period and leaving less flexibility than was initially intended in 2014/2015. The current Public Finances Law already allows the MTFP to retain greater flexibility in growth, capital and contingency allocations until the later years of the new plan and this will be used to a much greater extent in the next MTFP. The new Council of Ministers will also review the underlying Resource Principles as part of the work on the proposed Long-Term Plan and new Strategic Plan.	
5	It is very important that the States makes plans about how to deal with the expected improvement in economic conditions and reduction in spare capacity from 2016 onwards. It is even more important to consider how fiscal policy would need to change if growth turns out to be higher than expected, or if capacity constraints started to be felt. In either case, this would mean running tighter fiscal policy and topping up the Stabilisation Fund. The plans could include – ● Reducing departmental expenditure and/or raising revenue to run surpluses (or at least	Accept	Work is already underway as part of the LTRP to assess the options for a balanced budget over the period of the next MTFP and beyond. These options will include balancing requirements for growth and service improvements with a level of compensating savings or efficiencies. The Minister for Treasury and Resources has confirmed the rules for the future operation of the Stabilisation Fund, and the LTRP will consider options to replenish this Fund when economic conditions deem it appropriate. A Long-Term Tax Policy is also being developed and will provide the framework within which revenue-raising options for the next MTFP and beyond can be considered if necessary. Officers in Treasury have been working with representatives from the Construction Council for some time to assess the overall (public and private sector) level of construction activity going forward. This work will provide essential information to assess the resources required on- and off-Island, and how this relates to the capacity of the local construction sector. In addition, consideration will be given to the appropriate responses should there be indications that on-Island capacity may be	Work underway as part of LTRP and next Strategic Plan will need to focus on improving Jersey's economic potential.

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	smaller deficits). ● Managing how capital projects are delivered so as to put less strain on local capacity. ● Continuing with policies which will improve Jersey's economic potential, such as those which aim to increase productivity, innovation and reduce structural unemployment.		exceeded at any point. A Long-Term Capital Plan has already been developed over 25 years, which will make it easier to identify the opportunities to profile and adjust capital spending to reflect the state of the economy and the wider political and strategic priorities. Improving Jersey's economic potential in the future will be key to improving living standards, prosperity and in turn, public finances. The Minister for Treasury and Resources in previous Budgets and the MTFP has continually supported policies which will improve economic potential and, in particular – ● Supporting the economy through the downturn through discretionary fiscal stimulus that helps maintain employment, reduces the loss of capacity in the economy and delivers valuable investment in our infrastructure. ● The different Back to Work schemes to help unemployed people and prevent key target groups from being frozen out of the labour market (reducing the associated costs with people being out of work for long periods or at critical stages in their skills development). ● The new Economic Growth and Diversification Strategy with the renewed focus on innovation and competiveness (including the new Jersey Innovation Fund), growth in financial services and implementation of the McKinsey report, the new enterprise strategy and raising productivity across the economy. However, it is recognised that there is more work to be done on improving Jersey's productivity performance across all sectors. This will be an important challenge for the next Council of Ministers and must be a key priority for the next Strategic Plan.	

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6	The Treasury should look at how budgeting for capital projects and the use of capital allocations can be improved, because the current system may make it harder to adjust capital expenditure and therefore fiscal policy. During our fact-finding visit, the Treasury confirmed that work is already underway and it will be important that this is finalised in time to influence the next Medium-Term Financial Plan.	Accept	The Treasury is considering potential changes to the way funding is allocated to capital projects and how the Consolidated Fund balance is managed – this will also include consideration of what changes may need to be made to the Public Finances Law. This work will be planned such that any Law changes are taken forward for States' approval before the next MTFP is lodged in July 2015. Capital monitoring information has also increased, and information relating to specific project updates, projected cashflows and reasons for any delays, will also be valuable in managing the overall capital programme.	Before July 2015
7	The delay to introducing the long-term care charge was appropriate, but there is no need for further delays given the planned fiscal stance in 2015 and 2016.	Accept	This recommendation is consistent with the adoption of the Draft Budget 2015, as it does not propose any further delays in the introduction of the long-term care charge. The Minister for Treasury and Resources acknowledges that given expected economic conditions, the planned deficits in 2015 and 2016 will provide appropriate support to the economy without delaying the introduction of the long-term care charge any further.	Underway and will be achieved through implementation of Draft Budget 2015
8	The States should monitor the value of the Strategic Reserve relative to the size of Jersey's economy and States' expenditure. The States should give an indication of the desired size of the Strategic Reserve.	Accept	The Minister for Treasury and Resources is committed to maintaining the value of the Strategic Reserve in future relative to inflation, and ensuring that it is only used in the manner set out in the revised policy for the Strategic Reserve alongside the Draft Budget 2015. The size of the Strategic Reserve is a key indicator of the strength of Jersey's public finances, and the Minister is determined that this strong position will not be eroded over time. It is agreed that the size of the Strategic Reserve should also be monitored relative to the size of the economy and States' expenditure. Future decisions about payments to and from the Strategic	Future reference to the value of the Strategic Reserve will include monitoring it relative to the size of the economy and States' expenditure.

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			Reserve should only be made after due consideration of how the value of the Fund has varied relative to the these factors. In their report, the Panel state that "it is hard to say what the optimum size of the Strategic Reserve should be", and the Minister agrees with this view. The matter is complicated by the fact there are competing uses for any funds that could be paid into the Reserve, such as other government expenditure priorities or rebuilding the Stabilisation Fund. Nonetheless, the Panel's recommendation does require the States to give an indication of its desired size. Further consideration will be given to this issue as work on updating the fiscal framework ahead of the next MTFP continues, including seeking the views of the FPP on any proposals, and this issue in particular.	
9	The States should produce projections for future States' income and expenditure for the next 20 years, adopting an approach similar to that used by the UK's Office for Budget Responsibility. This will complement the balance sheet information the States already publishes in its annual accounts.	Accept	The Minister acknowledges the Panel's views, and supports the further extension of States' planning horizons. Much progress has been made in the last 5 years in relation to extending both the horizons and the context of States' financial planning. We have – ● Moved from annual to 3/4 year budgeting. ● Incorporated these improvements in financial planning and budgeting into our legislation. ● Been developing the LTRP over 2 MTFP periods to support that process. ● Been developing a Long-Term Capital Plan over 25 years for the replacement of our essential infrastructure and assets. The next States Strategic Plan is proposed to be set within the context of a first States Long-Term Plan looking much further ahead than we have before, and encouraging co-ordination of all States' long-term planning in one document. Progress on this work should mean that this recommendation is fully implemented into our planning procedures by the time of the next MTFP.	To be completed to inform next MTFP and Long-Term Plan.

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10	The States should continue to monitor the outlook for the Social Security Funds through the planned 3 yearly actuarial reviews, and include the uncertainties and projections in its medium-term fiscal plans and long-term assessments of sustainability.	Accept	In line with past FPP advice, the States' Accounts for 2013 included the position on the Social Security Funds for the first time; and in Draft Budget 2015 the States' financial position was also presented, including the impact of the Social Security Funds. In addition, the 3 year actuarial review of the Social Security Funds will continue. Ensuring that these recent developments are an integral part of our financial planning will allow this recommendation to be implemented, and will mean that future medium-term fiscal plans will continue to include the implications of the uncertainties and projections on the Social Security Funds. This will allow a consistent and more holistic assessment of the States' fiscal position on an ongoing basis.	Already completed and to be repeated as part of future financial planning.