STATES OF JERSEY

DRAFT ANNUAL BUSINESS PLAN 2011 (P.99/2010): FOURTH AMENDMENT (P.99/2010 Amd.(4)) – COMMENTS

Presented to the States on 13th September 2010
by the Council of Ministers

STATES GREFFE

COMMENTS

The Council of Ministers opposes this amendment.

Deputy G.P. Southern of St. Helier proposes that –

Parts 1 & 3	the net revenue expenditure of the Economic Development Department shall be increased by £357,000 and to not proceed with the Comprehensive Spending Review proposals –

- ED-S6 £138,000 reducing grants to events;
- ED-S7 £36,000 reducing opening hours in Jersey Tourism Visitor Services;
- ED-S13 £183,000 removing subsidy for the provision for school milk; and reduce net revenue expenditure of Treasury and Resources from Restructuring costs by the same amount; and

Part 2	decrease net revenue expenditure by £400,000 by removing additional support for Jersey Finance Limited and not proceeding with all of the Comprehensive Spending Review proposal ED-S8; and
Part 4	phase out allocation for school milk over three years from 2012.

Comment

Parts 1 & 3

Jersey Tourism Events and Visitor Services Funding

The funding removed for the PGA European Seniors Tour event will be replaced by private sector sponsorship which will be delivered through a partnership between Jersey Enterprise, Jersey Tourism, the European Tour and Sportcel (the event managers). There is also a reduction in funding to the Battle of Flowers, Fête dé Noué and the International Air Display. This funding will be replaced by private sector sponsorship which will be delivered through a partnership between Jersey Enterprise, Jersey Tourism and the event organisers. The proposed reductions will not impact on the events programme and will still remain a key component of Jersey Tourism strategy.

The reduced opening hours saving will not reduce the level of customer service provided to tourists at the Visitor Service Centre, but is related to the provision of reception facilities at Liberation Place, which are no longer needed due to the relocation of Jersey Tourism to Jubilee Wharf. Discussions are underway regarding redeployment or voluntary redundancy with the full agreement of all parties.

Cessation of school milk

Jersey Dairy make little or no profit per annum from the EDD input of £183,000 for the operation of the School Milk Service.

Predicted benefits from the Dairy Industry Recovery Plan including relocation of the dairy and development of an export market are being realised, with strong confidence in the future. The School Milk Service is not critical to the economic wellbeing of the dairy industry, although the dairy sector would argue that there is an advantage to them, in terms of marketing milk to future consumers.

With the exception of the cessation in support for school milk, there will be a net increase in the total of direct and indirect government support payments to the dairy industry in 2011.

The States Chief Medical Officer and the Head of Health Promotion suggest that there is little health benefit to be gained from free school milk in the target age group.

Financial impact

The report accompanying the amendments relating to school milk suggests that removal of government support for school milk is premature and unsustainable, implying that to cut support for school milk will undermine profitability and growth in the dairy industry, although the evidence presented below suggests that this is not the case.

The income received from the School Milk Service by Jersey Milk in 2006 was £164,371.62 (schools requesting 222,123.81 litres), with the States purchasing milk at 74.07ppl from Jersey Dairy.

The costs Jersey Dairy incur providing school milk include –

Milk purchase from farmers @ 33ppl	£86,000
Specialised Packaging	£27,000
Distribution (outsourced)	£25,000
Labour & other production costs	£15,000
Total	**£153,000**

The profit to Jersey dairy of operating the School Milk Service was therefore approximately £11,000 per annum in 2006.

The income received from the School Milk Service by Jersey Dairy in 2009 was £161,592 (schools requesting 218,149 litres), with the States purchasing milk at 74.07ppl from Jersey Dairy.

The costs Jersey Dairy incur providing school milk include –

Milk purchase from farmers @ 42.8ppl	£93,367.77
Specialised Packaging	£28,625.00
Distribution	£25,000.00
Labour & other production costs	£20,776.00
Total	**£167,768.77**

Using the figures provided by Jersey Dairy and the current average milk price, the approximate figures show that the School Milk Service is making a loss of £6176.77.

The Jersey Milk Marketing Board (JMMB) 2010 Report and Financial Statement, states that the milk supplied by farmers to the JMMB from 1st April 2009 to 31st March 2010 amounted to 12,561,000 litres whilst turnover in that year was £10,656,000 equating to a sales value of 84.8 pence per litre.

The JMMB under the School Milk Service Level Agreement (SLA) provided the 218,149 litres to fulfil the school milk contract to 31st March 2010 at a price of 74.07 pence per litre.

The above figures suggest that each litre provided for school milk by the JMMB is subsidised by approximately 10.73 pence per litre or in total over a financial year by £23,407.39p equating to an increased return to farmers of 0.2 pence per litre.

In future the above differential is likely to increase as the milk products export market is developed and a greater proportion of the milk delivered to the dairy is sold as value added products generate increased returns per litre.

Sustained funding to the dairy sector

The dairy industry receives by far the largest proportion of total subsidy in the agricultural sector and it is proposed that the level of dairy industry specific support will continue in 2011 and 2012 on the basis that transitional arrangements are required to consolidate present growth, with the first reductions in the Quality Milk Payment (QMP) proposed in 2013.

The dairy industry receives direct aid in the form of the Single Area Payment and the Quality Milk Payment, indirect aid through the Dairy Services provision via the Royal Jersey Agriculture and Horticulture Society SLA and Market Support by the States imposing import licensing, which in 2003 was estimated by the McQueen Report to be worth £2.7 million per year based on the differential between Jersey and UK milk price, in addition to a consumer subsidy via the School Milk Scheme.

No other cuts specific to the dairy sector, other than the cessation of the School Milk Scheme are being proposed in 2011 or in 2012.

A confident future

As of summer 2010, all the elements of the dairy industry restructuring plan 'Road Map to Recovery' have been put in place. The new dairy at Howard Davis Farm is now fully operational, enabling Jersey Dairy to concentrate on the development of new value-added export markets, with Jersey Dairy currently in negotiations with 2 large UK multiples for the use of over 2m litres of milk per year, to produce added value export products.

The 2009–10 season has seen increasing confidence and a substantial increase in milk production. The Dairy Industry Costings Scheme has shown growth on the farms monitored of 10%, with expansion coming from the yield per cow rising by 400 litres, in part due to a reduction in dry cow numbers. The positive effect of improved genetics will begin to add to this improvement in the summer of 2011.

Producers are now being asked to increase milk output for the first time in 5 years, with a target of a 15% increase in the second half of the current milk year (1st April 2010 to 31st March 2011). The JMMB annual report and financial statement shows an improved set of trading results to 31st March 2010, compared to 2009, with an improved operating surplus of £188,000, compared to £17,000 in 2009, a reduced level of debt and a higher milk price being paid to milk producers, 43.2ppl, compared to 42.8ppl.

Once the full value of the Five Oaks site has been realised, it is the JMMB''s intention not to exceed a £1 million debt level, compared to the £3.14 million debt in June 2002, at the time when relocating the dairy was first discussed. The above demonstrate that the benefits now being realised of the implementation of the 'Road Map to Recovery' developed by the industry and supported by Government.

World markets for dairy have also improved significantly, with commodity prices over 80% higher than 2009. This is likely to improve returns from the sale of surplus milk in the coming year. In addition, Jersey consumers should benefit this year from the stable pricing model, bearing in mind the volatility of world dairy prices, which could increase milk prices for consumers in the UK in 2010.

The new dairy industry 5-year plan, predicts significant improvements in profitability, with optimism concerning the export trade for livestock and added value milk products. Imported pure Jersey bull semen has been widely used to boost efficiency and milk yields, with the first calves entering the dairy herd in 2011.

The ability to import genetically superior Jersey bull semen for use on cattle in the Island under the Bovine Semen Legislation of 2008 has stimulated interest in the export bovine embryos to the EU and other countries around the world.

The Royal Jersey Agriculture and Horticulture Society (RJA&HS) have received enquires from several countries wanting to import bovine embryos from Jersey originating from the island's top female bloodlines, sired by top international Jersey bulls. This has prompted the RJA&HS and other individuals within the dairy industry, to request that legislation be enacted as soon as possible, that will enable them to export bovine embryos to the EU and other Third Countries.

Highly significant business opportunities currently exist with Australia and Argentina, as well as with China and Russia, following recent high level visits from their respective Ambassadors, who expressed an interest in developing export links.

The final draft of the proposed legislation to govern the trade in bovine embryos has now been completed and is currently with the Law Officers to assess compliance to human rights legislation and consider appropriate penalties for non compliance. Once these issues have been resolved a proposal and proposition will be drafted in order for the new legislation to come before the States Assembly. This proposed legislation is supported by both those farmers who have used the new genetics from imported bovine semen and those who have maintained their herds under traditional breeding management because the demand for the export of bovine embryos from Jersey will have a positive effect on industry profitability.

Dairy Industry Recovery Plan (DIRP) set a measure of an economically sustainable industry being one that achieved an average farm EBITDA of 20% of turnover, which in 2003, became the benchmark target accepted by industry and government and provided a ‘trigger point’ to reduce the QMP, based on monitoring the costings for producers and reducing the payment when the ‘trigger point’ was reached.

As of summer 2010, the key elements of the DIRP are now in place, with the first signs of growth in output for 5 years and recognition, by dairy producers, that they need to play their part by being constructive about reducing support for the dairy sector.

The top 50% of dairy farms, ranked on margin for investment by Kite Consulting (KC) – the dairy industries consultant of choice - averaged 3.81ppl margin on a cost base of 45.31ppl. Previous reports from KC have highlighted the target of a margin for investment of 3ppl. This is required to give farmers the confidence to invest and build a sustainable supply of Jersey island milk over the long-term. The top 50% of producers are now achieving this level of margin. In addition, the core (milk) price increases implemented in 2007 and 2008 now appear to have overcome the increases in costs and this will now allow a margin to emerge.

In June 2010, the dairy industries own consultant, KC, identified that the use of a trigger point going forward has significant limitations, not least that such a mechanism does not provide a known figure for either policy makers or farmers to budget, that financial data could be withheld or manipulated if farmers felt that it were being used to reduce their incomes and that there will be significant debate on what the trigger is to be.

The subsequent recommendation from KC was that to counter the above uncertainty, an agreement is made with the States to put in place an agreed reduction over 5–10 years, so that both parties will be able to plan and budget.

Government have responded positively. The proposals in the RES Green Paper to reduce the QMP by 100% over the period 2011–2015, have been revised following consultation with the Jersey Dairy, the JMMB and the RJA&HS, such that the RES White Paper now proposes a 40% reduction to QMP from 2013-2015 (i.e. no reduction in the QMP for nearly 2.5 years) and further transitional arrangements to reduce the QMP to zero by 2019, at which point the full benefits of improved genetics (which will have been accruing year on year from 2011), will be fully realised.

Nutritional benefit

There is no doubt that milk and other dairy produce form part of a child’s balanced diet. Nutritionists recommend that, as part of a healthy diet, children consume three portions a day from the milk and dairy food group. School milk is one way of getting one portion into a child’s daily diet. National surveys, however, have identified that the majority of school children achieve recommended levels of calcium from other sources outside of school milk. This is in part because many non-dairy food products are now fortified with calcium.

Part 2

Withdrawal of support for Jersey Finance Limited (JFL)

Tax revenue and employment provided by the financial services sector is fundamental to the success of the Jersey economy and the health of the public finances.

Benefits derived from JFL activity in promoting and developing the finance sector are realised by all Island residents and not simply the JFL membership – put simply, a flourishing financial services sector is good for Jersey. This is the premise on which EDD funding for JFL is based.

JFL is a successful organisation, a statement that is based, in no small part, on an overwhelming body of feedback from the finance industry, both in Jersey and overseas. EDD's 2011 business plan seeks to support the further development of Jersey's financial services through the further development of activity undertaken by JFL.

The proposition and accompanying report, in seeking to reduce the EDD grant to JFL, fails to recognise –

1. **The true nature of the finance sector financial contribution to JFL activity.**

The finance sector contributes to JFL activity in two ways –

- Membership subscriptions, event revenue etc.
- Participation in industry working groups including, but not limited to, technical working groups on the development of legislation. This contribution is provided *pro bono* and represents a very significant financial value.

The table below details the true split of government and industry contributions to JFL activity. Based on this more accurate analysis it can be seen that the total industry contribution has exceeded the EDD grant in the period 2007 to 2010 and will continue to do so in 2011 based on an EDD grant of £2.2 million.

Year	States	JFL Members Cash Subscription	JFL Members Pro Bono Contribution	% JFL Members Contribution
2007	£1,000,000	£420,000	£1,000,000	58.68%
2008	£1,400,000	£450,000	£1,500,000	58.21%
2009	£1,800,000	£480,000	£2,000,000	57.94%
2010	£1,800,000	£600,000	£2,000,000	59.09%
2011	£2,200,000	£600,000*	£2,000,000*	54.14%

* estimated

2. **The true return on investment for the tax payer of the EDD grant to JFL**

In contrast a significantly higher grant is made to agriculture and tourism which contribute a much smaller amount to the economy. Based on 2009 GVA: 53% finance, 3% tourism (as measured by "hotels, restaurants and bars") and 1% agriculture.

Whilst the grant to Jersey Finance in cash terms is a material figure, in relative terms it is modest when related to the contribution of the finance industry to the Jersey economy.

Any further reduction in this figure would be interpreted by the finance industry both at home and abroad as a signal of a reduction in support and priority for this key industry, and could well affect investment decisions. It would also be exploited by competitors and by Jersey's detractors.

3. The impact of the proposed reduction of JFL activity

It should be noted that the annual grant support for JFL is based on detailed business plans and objectives which are specific, measurable, attainable, and relevant. These are subject to constant scrutiny, review, monitoring and reporting by States officers on the JFL Board and through EDD's grant monitoring process.

The draft 2011 JFL business plan shows that levels of expenditure on staff, marketing activity and office accommodation in Jersey, the UK and Hong Kong have been held at 2010 levels. Increases that have been applied in 2011 are wholly consistent with the key objectives of JFL in that they develop both products (e.g. pensions) and markets for Jersey's financial services sector and broaden the emphasis of JFL activity from attracting **more business** for existing financial services companies to include financial services inward investment to attract **new businesses** to the Island. As this has a direct benefit to the employment and tax base of the Island it is appropriate for this incremental activity to be funded by government.

If the proposed amendment were to be successful product development, market development and inward investment activity which are pivotal to fulfilling JFL's strategic objectives would have to stop.

Part 4

Part 4 of the Proposition proposes phasing out support for school milk over a 3 year period. Given the nature of the supply of school milk it is very difficult to phase out provision in practice.

Options that have been considered are –

1. Removing supply to certain year groups over 3 years. Whilst this option appears to have merit, there is a volume of supply below which it is not commercially viable to provide the service. The most likely scenario is that phasing would fail and EDD would need to fund the full cost over the 3 years by reducing funding in other areas of the department's activity.

2. Based on current rates for advertising on Jersey Dairy's 1 litre packs it would be difficult to raise sufficient sponsorship revenue to offset the reduction in States funding. Again, the most likely scenario is that phasing would fail and EDD would need to fund the full cost over the thr3ee years by reducing funding in other areas of the Department's activity.

Financial implications

The total financial impact of this amendment on the Consolidated Fund is a decrease of £400,000 in 2011, an increase of £122,000 for 2012 and an increase of £61,000 for 2013.

The majority of the amendment proposes that the financial implications are neutral and this is achieved by reducing the central provision for restructuring costs held by Treasury and Resources.

Members are referred to the Council of Ministers comment to P.99/2010 Amd. where the Council has explained in detail the implications of using this central provision for restructuring to offset funding increases.