STATES OF JERSEY

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STABILISATION FUND: RESCINDMENT (P.154/2006) – COMMENTS

Presented to the States on 4th December 2006
by the Minister for Treasury and Resources

STATES GREFFE

COMMENTS

The proposition is strongly opposed for many reasons. Its acceptance would cause the Report and Proposition P.133/2006 to fall and therefore jeopardise the whole purpose of the new fiscal framework, which is to improve taxation and spending policy in the Island and to create better conditions for economic growth and low inflation. The acceptance of P.154/2006 would mean that we fail to take an important step in improving the economic management of our Island economy.

The key objections are that –

- It fails to ensure that proper consideration will be given to the economic implications of tax and spending decisions
- The States will not have to balance the financial position over the economic cycle thereby risking additional inflationary pressure in the economy
- It represents a confusing approach to the Strategic Reserve policy that has not been fully thought through
- There is no guidance as to when or how much of the interest on the Strategic Reserve should be used for stabilisation purposes
- No assurance is given as to how the real value of the Strategic Reserve will be protected or increased in future years and hence the real value of the Strategic Reserve could be eroded in time
- No attempt is made to improve on the current policy arrangements and learn from past experience
- The Fiscal Policy Panel will not be established and there is no alternative proposal for feeding independent, public and expert economic advice into tax and spending decisions
- The Deputy is selective in his critique of Stabilisation Funds.

I will now explain these objections to P.154/2006 in more detail.

There is no mechanism to reinforce a prudent approach to fiscal management and it will mean it is quite feasible that money will not be taken out of the economy in good times and that interest from the Strategic Reserve will be put back into the economy at other times. Over the course of the cycle we will not be balancing our budgets and this will clearly undermine economic stability, economic growth and low inflation.

No explanation is given as to how the interest from the Strategic Reserve will be managed and made available to put back into the economy. If only one year’s return is available in any year then there is unlikely to be enough funds available to provide a significant countercyclical effect. If the opposite applies and cumulated past returns are available then there could be far too much money available to invest at any one point in time. How the interest from the Strategic Reserve could be used in the manner intended has clearly not been thought through.

The fact that the nominal return from the Strategic Reserve could be spent repeatedly would actually mean that the value of the Strategic Reserve could fall in real terms. There is no recognition of the need to manage the Strategic Reserve and build it up in the medium to long-term where possible so that we can be more confident it is able to meet its objectives of insulating the Island’s economy from severe structural decline or major natural disaster.

The interest from the Strategic Reserve would have 2 purposes: for strategic spending and to make fiscal policy more countercyclical. These objectives will at times be conflicting and it would be counter-intuitive to decide that it was the wrong time to be putting money into the economy for stabilisation purposes but to do so for strategic purposes. The States Annual Business Plan is the time and means by which to make strategic spending decisions.

No recommendation is made as to how the current arrangements could be improved to prevent us repeating past mistakes and improving the Island’s economic performance.

The lack of distinction between money paid into the Strategic Reserve either to build up the capital value, or to be available for stabilisation purposes or to fund strategic spending will create a very confused policy. There would be a complete failure to put in place a clear and credible framework that businesses and the public can understand and see how it will operate and help deliver low inflation. There is no clear explanation of how the proposed setup would work and it would lead to confusion for members and the wider public.

The independent Fiscal Policy Panel would not be put in place and it follows that their independent advice on tax, spending and stabilisation issues would not be published. A major opportunity to improve the way we make key economic policy decisions in the Island would be lost.

Other Matters

1. There are a number of errors in the report which I would like to correct –

- The Chief Minister did not accept, as stated in the report, amendments to the Strategic Plan in respect of section 1.2.3:

  Improve overall fiscal framework by the immediate establishment of a Stabilisation Fund, into which the following funds will be transferred.

  (ii) The capital receipts from property sales identified in Action 6.2.3 of this Plan, estimated to reach at least £4 million per year by 2009 (being the capital element of the savings arising from the Change Programme) (T&R), or

  (iii) The non-capital element of the Change Programme Efficiency Savings identified in 6.2 of the Strategic Plan (estimated to reach £6.64 million per year by 2009) (T&R).

  and this part of the amendment was also rejected by the States.

- Whatever the merits of the proposals for a Shared Equity Scheme (still to be debated), the first time buyers scheme has not been abandoned, and

- I cannot recall ever having said that we shall "*probably have to sell off all our utilities*".

2. I would also now wish to cover a number of statements in the report accompanying P.154/2006 that are either misleading or ill-informed and to which members' attention should be drawn –

- "*Almost £200m is to be found from the economy at a time when the zero/ten black hole is looming*". This is a complete misrepresentation of the true situation. Firstly, the long-term aspiration is build up the Strategic Reserve by another £100-120 million. This does not mean that these funds will need to be taken from the economy in the next few years. In addition, reinvestment of the return on the reserve would not take money from the economy and would actually help to build up the Strategic Reserve towards this level. Secondly, additional funds could be transferred into the fund from surpluses run in the future, not just the next few years.

- A further £40-70 million could be needed to build up the Stabilisation Fund in future years and there are a number of potential ways that this could be achieved as outlined in my written response to Deputy Southern's question of 7th November 2006. It is clear from the answer to that question that this does not mean that these funds will have to be found through higher taxation/expenditure cuts in coming years as they could come from the consolidated fund, the sale of certain investments or unexpected tax receipts.

- "*The time for the creation of a Stabilisation Fund is clearly not now*". As the economy continues to perform strongly, now is actually the most important time to consider introducing the Stabilisation Fund to ensure that we do not make tax and spending decisions that undermine our economic performance by being pro-cyclical and inflationary.

- "*I believe that the need to top up the Strategic Reserve and to create the Stabilisation Fund will provide the reason and the motivation for the sale of our utilities.*" Any recommendations by the Minister for Treasury and Resources on the sale of utilities will be based on a thorough analysis of the potential benefits it could bring and members will have the opportunity to debate such decisions in the future. Recommendations could be brought to the States if it is considered to be in the Island's best interests, irrespective of whether the Stabilisation Fund is in place and even under the proposals in P.154/2006 could be used to build up the Strategic Reserve. Accepting the rescindment of P.133/2006 will do little to influence the Minister's recommendations regarding sale of utilities and indeed the ultimate decision of the States.

- *"The examples of successful stabilisation funds discussed in P.133 come from countries who took the decision to adopt such policies in times of plenty".* If the report accompanying P.133/2006 is read properly members will see that examples quoted include U.S. States which introduced stabilisation funds during the 1990s when they were not experiencing windfall gains but wanted to try and improve their economic performance. The IMF also recommended a stabilisation approach in Kiribati long after their windfall gains from phosphate mining had subsided.