States of Jersey
States Assembly

États de Jersey
Assemblée des États

CORPORATE SERVICES SCRUTINY PANEL

DRAFT BUDGET STATEMENT 2018

Presented to the States on 27th November 2017

SR.12/2017

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1. Chairman's Foreword

The 2018 Budget is described as continuing the work of the Council of Ministers in investing in health, education, infrastructure and promoting economic growth. It talks about ensuring we have sustainable finances for the long term.

In the Foreword it talks about achieving broadly balanced budgets by 2019, and states that the Budget 2018 is critical to the delivery of the financial plan and to securing Jersey's future.

These are all very exciting and laudable phrases.

I think it is fair to state that the Jersey economy is improving, and that employment is at an all-time high, however this does come with some caveats. It is also fair to state that this budget bears less electioneering 'give away' items than other budgets which have been produced just before looming elections.

This budget seeks to raise £10,200,000 by 2019, which partially replaces the funding lost by the failed health charge and waste charges. The books are notionally balanced, but this is only to the amount of £332,000 (after depreciation) against income of £788,177,000. I.E. whilst this is positive, it is extremely marginal, and comes after a continuation of an accounting adjustment which boosts income by around £8,000,000 - £10,000,000 in each relevant year. If this bookkeeping amount was not present, the picture would be far less flattering, and the books would not be balanced.

The Corporate Services Scrutiny Panel remain concerned over the medium to longer term income forecasts, and potential threats that face us. Whilst Jersey has to date been successful in meeting the trials with which it has been presented over the past few years, there remain challenges ahead. Not least (at the time of writing) the threat of a European Union blacklist, and also the impact of Brexit either upon the UK financial services industry or directly upon Jersey.

Rather than dealing with the medium term issues, this budget is actually a means of addressing the short-term issues that have arisen during the last year or so.

As part of our work looking at the budget, but also with the forthcoming population policy in mind, we have been undertaking some background work, some of which has already been published, and some of which will be published in the New Year.

It is interesting to note that Ministers have stated that someone earning under £34,000 'is a drain on us'. What that means (we assume) is that in purely monetary terms (i.e. ignoring any economic or social benefit) such an individual may receive more support and benefits than they contribute into the system. This is an extremely emotive and difficult area, but it is something that we need to understand, particular with regard to any new population policy and how we assess the contribution of people coming to this Island. Our initial assessment is that this figure may actually be higher, depending upon individual / household circumstances. This may imply that a significant percentage of the population (between one third and a half) are not paying their way, even before they are retired. This must have affordability questions in a whole range of areas for the future (including pensions).

Looking ahead, at present the total amount of supplementation paid annually has been capped (until 2019) at approximately £65,000,000. This is a grant paid by the States (effectively by tax payers) to assist or subsidise contributions towards the State pension. As a rule of thumb, £65,000,000 is the rough equivalent of 4% GST. This is projected to increase by approximately £15,000,000 (1% GST) in 2020. Again, this is a matter which needs careful consideration, and again is something which will have to be assessed in conjunction with the proposed population policy.

It is interesting to note that in terms of income tax, 62% of money raised is collected from 20% of the population (based on 2014 figures). Therefore it would seem that there are issues at both ends of the scale of tax payers, and that both will need to be handled quite carefully. If we become too expensive for higher earners, then we risk becoming uncompetitive, and potentially the loss in tax would be disproportionately high.

We welcome the review by the Minister into anomalies concerning stamp duty, but do recommend that these should be resolved by the middle of next year. There would seem to be reasonably substantial sums of money that could be raised, with no increase in man power by dealing with this issue.

A more technical matter is the fact that two thirds of us still pay our tax in arrears. This equates to approximately £280,000,000.

For the individual, this means that when they have a year with much reduced earnings (for example when they retire), they will still have the tax from the previous year to pay.

For the States, there is a potential of a one-off timing gain of funds if they were able to properly (and carefully) resolve this matter.

A further matter which will have to be resolved at some point is the issue of the de minimis for GST purposes. The Post Office alone received at least 3 million parcels in 2016, and it has also been confirmed that the amount GST not collected on manifested goods is £1,600,000. The difficulty here will be the two competing tensions between consumers who wish to avail themselves of online goods, and whether this represents a non-level playing field for local retailers.

Perhaps the most alarming issue is what has happened to our standard of living. From the advice we have received it would seem that our standard of living, relative to that of the UK is falling. Indeed the UK may overtake us in around 12 years. One factor here is that whilst the population is increasing, the revenue being generated by each individual, on average, appears to be lower.

In conclusion, this is a budget for now, it is not one that looks to the future to the extent that it claims. Hopefully in a few years' time we will have emerged from this period of uncertainty and Jersey's economy and net position will have returned to the levels we used to know. However for the purposes of planning we should not be betting just on 'hope'.

2. Summary

1. The Draft Budget Statement 2018 (the Budget) was lodged by the Minister for Treasury and Resources on 3rd October 2017, and is scheduled for debate on 28th November 2017.

2. The aim of the Budget is to put forward proposals by the Minister for Treasury and Resources in respect of measures for generating income and outlining the government expenditure for 2018.

3. The Budget reflects upon Jersey's economic outlook and summarises its position, stating *"Jersey's economy is continuing its recovery, with businesses feeling positive and employment at an all-time high."*[1] We have found, in conjunction with the work undertaken by our advisors, that we can generally support this statement, albeit with caveats. Whilst the Budget does reflect to some extent a recovery, this must be understood to lie in conjunction with a myriad of potential threats. Uncertainties surrounding Brexit and in particular its impact on the financial services sector and the future dangers caused by potential "black listing" by the EU, are fundamental concerns. Similarly, the long-term future finances of the Island, including concerns surrounding productivity levels, need urgent address.

4. The 2018 Budget sets out several new taxation measures, as well as amending others. These include:

   - the introduction of a tax on large retailers with profits over £500,000 and 60 per cent or more of trading turnover from retail sales in Jersey
   - modifications made to the High Value Residents tax model; increasing the minimum annual tax payable and proposals to review this figure on a five-year basis
   - raising the "second earner's allowance" so that a married couples income-tax exemption threshold, combined with the second earner's allowance, is equal to the figures for a co-habiting couple
   - widening the definition of "financial services company" to capture more businesses within the 10 per cent tax rate
   - increasing the impôts duties on alcohol and petrol/diesel by RPI
   - increasing the impôts duties on tobacco by RPI plus 5 per cent (and plus 7.5 per cent for hand-rolling tobacco)
   - raising the vehicle emissions duty by RPI, whilst simultaneously lowering the tax-exempt threshold to 50g CO_2/km

5. Whilst we generally support the measures outlined in the Budget, it is felt that specific areas may benefit from increased engagement with stakeholders (such as with the new retail tax). More generally, we acknowledge that whilst this Budget does act sufficiently in the short-term (up to 2019), long-term revenue-raising issues are left unaddressed and will require solutions to be identified in the near future.

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[1] P.90/2017. *"Draft Budget Statement 2018"* (States of Jersey) http://www.statesassembly.gov.je/assemblypropositions/2017/p.90-2017%20full%20budget%20statement.pdf [Last Accessed 10th November 2017] p5

3. Key Findings

1. Finding: The Draft Budget Statement 2018 states that a review of the personal tax system is being conducted. This will seek to address the discrepancies about how similar households are taxed.

2. Finding: The Minister for Treasury and Resources agreed in the public hearing on 7th November that there was a need to review the personal tax system and that this would include modelling both the current system and alternatives for the future.

3. Finding: The Minister for Treasury and Resources agreed in the public hearing on 7th November that there was a need to review the personal tax system and that this would include modelling both the current system and alternatives for the future.

4. Finding: The approximate level at which a household becomes a net positive financial contributor (based on income tax, social security and long term care) is likely to be greater than £34,000.

5. Finding: Existing high value residents are protected by historical agreements from any increases in tax or any new tax models that may be introduced in the future.

6. Finding: New high value residents entering the Island will be subject to new taxation arrangements. These arrangements will not be subject to an annual increase but will be reviewed every 5 years.

7. Finding: There is uncertainty amongst the retail industry surrounding the overall impact of the proposed tax on larger retailers.

8. Finding: Companies trading in the provision of credit/finance to customers are operating in an unregulated market place.

9. Finding: The broadening of the definition of a “financial services company” for the purposes of the 10% income tax rate, will raise £3 million additional annual income.

10. Finding: The finance industry has expressed concern at the impact of the broadening of the definition of a “financial services company”, for the purposes of the 10% income tax rate, on the Island’s competitive position.

11. Finding: The Minister for Treasury and Resources has stated that the likely impact of the ending of the deduction of rates by landlords renting property in Jersey, is that tenants will pay more.

12. Finding: An anomaly in Stamp Duty legislation means that certain properties, including in particular commercial offices, at present are not liable to stamp duty.

13. Finding: The potential income not collected due to the current anomaly in Stamp Duty legislation on commercial properties could be substantial.

14. Finding: The revised cost of the Grainville school capital project is 50 per cent higher than originally estimated, increasing by £5.3 million to £15.5 million.

15. Finding: The capital project to build the new Les Quennevais School has increased by approximately 14 per cent, from £40 million to £45.6 million.

16. Finding: Treasury officials have stated that they are identifying methods to change the way that capital projects are budgeted, so that more of the feasibility planning is done earlier, and therefore better estimates are provided.

17. Finding: The Minister for Treasury and Resources has stated that the 2018 Budget is a mechanism for dealing with short-term funding issues up to 2019, and not providing long-term funding solutions.

18. Finding: The Minister for Treasury and Resources has stated that he will be making an announcement about higher education funding alongside the budget and that he will be lodging funding proposals before the 2018 May election.

19. Finding: The Panel's advisors have raised concerns that the standard of living in Jersey, relative to that of the UK, is falling.

20. Finding: The productivity of Jersey's economy (based on GVA per FTE) is not increasing in line with the population.

21. Finding: The figures for the income tax forecast in 2018 and 2019 have been increased by £8 to £10 million each year, because of an accounting adjustment.

22. Finding: By 2021, on present projections there will have been little or no growth of real term earnings of Islanders in the last decade.

4. Key Recommendations

1. Recommendation: The review of the personal tax system, which is currently underway, should be completed before the 2019 Budget is lodged.

2. Recommendation: The review of the personal tax system, which is currently underway, needs to include modelling for variances to the marginal and standard rates of tax.

3. Recommendation: The threshold at which a person becomes a net positive financial contributor should be assessed, as part of the calculations that the Minister for Treasury and Resources has agreed to conduct as part of reviewing the personal tax system and model. This should also take into account any subsidies towards State pension contributions and the impact of any future population policy.

4. Recommendation: The Minister for Treasury and Resources should identify a mechanism in time for 2019 Budget, whereby historical agreements with high value residents are renegotiated to introduce a minimum increase in taxation, in line with RPI.

5. Recommendation: The Minister for Treasury and Resources should recommend to the Council of Ministers, that they should urgently address the lack of regulation for companies trading in the provision of credit/finance to customers.

6. Recommendation: The Minister for Treasury and Resources should publish the full assessment undertaken as to the impact of the change to the definition of “financial services company”.

7. Recommendation: The Minister for Treasury and Resources should accelerate the work being done on correcting the anomaly in Stamp Duty legislation, and ensure that this anomaly is addressed with effect from 1st July 2018.

8. Recommendation: Given that Jersey’s tax system is traditionally seen as “low, broad and simple”, the Minister for Treasury and Resources should be mindful of the dangers of complicating the tax system in his review of the personal tax system.

9. Recommendation: The Minister for Treasury and Resources should examine options for bringing those of the taxpaying population currently on a prior-year basis of taxation, onto a current-year basis of taxation.

10. Recommendation: The Minister for Treasury and Resources should explore the possibility of fixed, long-term impôts duties on tobacco.

11. Recommendation: The Minister for Treasury and Resources should commence planning for the loss of road fuel duty revenue due to the increase in the number of electric and hybrid vehicles.

12. Recommendation: Planning for the eventual loss of road fuel duty should include considerations for a phased removal of revenue (for example over a 10 year period) for the purposes of estimating revenue receipts for budgetary and planning purposes.

13. Recommendation: The Minister for Treasury and Resources should examine other means of measurement for the Vehicle Emissions Duty, to ensure that CO_2 is still the most effective means of taxation in relation to the health effects of car emissions on the population.

14. Recommendation: The Minister for Treasury and Resources should propose new, more accurate ways, by which to calculate the funding required for capital projects, before the 2019 Budget.

15. Recommendation: The Minister for Treasury and Resources should make public, where possible, the preparatory work being conducted in anticipation of Brexit and its effect on future Budgets.

16. Recommendation: The Minister for Treasury and Resources should produce income figures for the period of the MTFP2, which removes all accounting adjustments and all budget measures introduced during that period, in order to demonstrate the underlying trend of changes in income.

5. Personal Taxation

1. The adjustment of personal taxation levels clearly affects all Islanders. The 2018 Budget sets out several changes, including:

    - increasing the exemption thresholds by 2.5 per cent for working age people
    - changing the tax reductions for married and co-habiting couples to make them more closely aligned.
    - increasing the minimum levels of taxation due to be paid by High Value Residents

Second Earner's Allowance

2. The 2018 Budget commits to making the taxation allowances for co-habiting and married couples more equitable. This follows on from the 2017 Budget, where an increase of £500 to the second earner's allowance was made, narrowing the gap in disparity.

3. The 2018 Budget proposal recommends a further £850 increase to the second earner's allowance, so that the combination of the married couples allowance plus the second earner's allowance is equal to two single person allowances.

4. The proposed increase will cost approximately £2.6 million from the 2018 year of assessment, reducing the State's income from 2019 onwards.[2]

5. The Draft Budget Statement stresses however, that:

    "Although a significant step forward, this proposal does not fully equalise the tax treatment of married couples and co-habiting couples in all situations."[3]

6. The Budget also highlights that:

    "A review of the personal tax system is currently underway which is seeking to address the discrepancies in the way that similar households are taxed."[4]

7. **Finding: The Draft Budget Statement 2018 states that a review of the personal tax system is being conducted. This will seek to address the discrepancies about how similar households are taxed.**

8. **Recommendation: The review of the personal tax system, which is currently underway, should be completed before the 2019 Budget is lodged.**

Tax-Exemption Thresholds

9. The 2018 Budget follows existing policy, by increasing the income tax exemption thresholds for working age taxpayers by 2.5 per cent. This is the most recent published figure for RPI (June 2017), whilst average earnings have increase by a similar 2.6 per cent.[5]

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[2] P.90/2017 p14
[3] P.90/2017 p14
[4] P.90/2017 pp.14-15
[5] P.90/2017 p13

10. This increase would see a single working person's exemption threshold increase by £350 to £14,900, whilst a married couple/civil partnership would see a £600 increase to £23,950.

11. It was queried that why, given equivalent figures are so much lower in Guernsey, the Isle of Man and the UK (£9,675, £12,500 and £11,500 respectively), Jersey was once again increasing its levels and therefore lowering the total income tax revenue collected.[6]

12. The Minister highlighted, that rather than this being a concern, this should be seen as positive difference:

> *"I think it is a positive for local people to have the benefit of a higher exemption level. We have always been very generous in this area and we feel it is a positive thing to do."*[7]

13. It was further stated by the Minister that, as well as being "generous":

> *"It takes into consideration the higher cost of living in the Island and we believe it is appropriate to support families in lower and middle incomes in this way."*[8]

14. We further note that the Minister agreed during the public hearing that there was *"the need to review the personal tax system"* and that this would include *"work in terms of modelling the current system and modelling alternatives for the future."*[9]

15. **Finding: The Minister for Treasury and Resources agreed in the public hearing on 7th November that there was a need to review the personal tax system and that this would include modelling both the current system and alternatives for the future.**

16. **Recommendation: The review of the personal tax system, which is currently underway, needs to include modelling for variances to the marginal and standard rates of tax.**

17. We note that in the States Assembly on the 19th July, Senator Routier commented that £34,000 was the point at which somebody became a net contributor in terms of taxes paid.

> *"If someone is coming into the Island and the job is attracting a salary of around £34,000, they are not paying the full social security contribution, they are not paying a decent amount of tax, so that person, being paid under £34,000, is a drain on us."*[10]

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[6] P.90/2017 p13
[7] Transcript. *Public Hearing with the Minister for Treasury and Resources* (7th November 2017) http://www.statesassembly.gov.je/scrutinyreviewtranscripts/2017/transcript%20-%20draft%20budget%20statement%202018%20-%20minister%20for%20treasury%20and%20resources%20-%207%20november%202017.pdf [Last Accessed: 11th November 2017] p18
[8] Transcript (7th November 2017) p20
[9] Transcript (7th November 2017) p20
[10] Hansard, Wednesday 18th July 2017. http://www.statesassembly.gov.je/assemblyhansard/2017/2017.07.19%20states%20-%20edited%20transcript.pdf [Last Accessed: 23rd November 2017] p76

18. The Panel has undertaken some additional work in this area which will be published in due course. However, it would appear that the level at which someone becomes a net contributor is higher than £34,000.

19. **Finding: The approximate level at which a household becomes a net positive financial contributor (based on income tax, social security and long term care) is likely to be greater than £34,000.** [11]

20. **Recommendation: The threshold at which a person becomes a net positive financial contributor should be assessed, as part of the calculations that the Minister for Treasury and Resources has agreed to conduct as part of reviewing the personal tax system and model. This should also take into account any subsidies towards State pension contributions and the impact of any future population policy**.

High Value Residents

21. A High Value Resident (HVR) is entitled to a preferential income-tax rate, of 1 per cent once their income exceeds a set threshold. For those HVRs arriving since 2011 that income threshold has been set at £625,000. Therefore a HVR must pay £125,000 of tax (£625,000 at 20 percent) before being subject to the 1% tax rate on any income above this amount.

22. The 2018 Budget seeks to introduce a new regime for those granted HVR status after the 1st January 2018. This new regime will mean that:

- the annual minimum income tax contribution will be increased by £20,000 to £145,000. This means that new HVRs will need to have a minimum income of £725,000 (£145,000 being 20 percent tax on a total income of £725,000). Any income above £725,000 will be subject to 1% tax.
- introduction of a mechanism, whereby if a HVR has insufficient income in any given year to pay the minimum £145,000 income-tax required, a top-up sum will be applied to bring it to this minimum level
- the minimum contribution will be assessed every 5 years, but will not increase more than the accumulated RPI[12]

23. It was queried how the increase to £145,000 had been calculated and we were pleased to hear that an in-depth review had been undertaken. This was formed of two approaches; firstly identifying the position of Jersey in relation to other jurisdictions offering similar regimes, and then calculating the increases since 2011 arising from RPI. The Deputy Comptroller of Taxes stated that they had calculated;

> *"…taking those two pieces of work in tandem, looking at the whole package we would stress here, not just tax contributions, the view was that it could be increased from 125 to 145, the income contribution that ultimately arises, while still maintaining a competitive regime on an international basis."*[13]

[11] A household can be more than one individual. This figure also depends on the financial circumstances of each individual.
[12] P.90/2017 p15
[13] Transcript (7th November 2017) p21

24. We were also informed by the Minister that*:*

> *"…in terms of our regime, we are probably one of the more expensive places, but we believe that justifiable by the benefits offered by those choosing to relocate here"*.[14]

25. This is at odds from the concerns expressed by *Jersey Finance,* who state that:

> *"...the proposed changes close the door to certain businesses which in our view are exactly the type of business that the Island wishes to attract...the proposed amendments...may serve as a disincentive, both in respect of individuals looking to establish a fund in Jersey as well as to individuals who are simply looking to invest locally in taxpaying entities."*[15]

26. We agree with an increase in the minimum taxation threshold for HVRs and support the in-depth study that was conducted to ensure Jersey maintains its competitive position alongside similar jurisdictions.

27. We express reservations however, surrounding the five-year delay between reviews of this minimum threshold and feel that the responses given by the Minister in the public hearing were not sufficient. When queried, the Minister stated it was for two reasons:

> *"...largely around competitiveness, but also certainty."*[16]

28. We were concerned however, to hear that there has been no measure proposed in the 2018 Budget to increase the thresholds for those HVRs already resident on the Island. When questioned, the Minister stated that this was because:

> *"There was a regime in place before that did not make provision for upgrading…"*[17]

29. The Minister confirmed, that because of this policy, we were unable to make retrospective amendments:

> ***"Senator S.C. Ferguson:***
>
> *Right, so that your hands are in fact tied due to historic agreements with the 1(1)(k)s.*
>
> ***The Minister for Treasury and Resources:***
>
> *The 2(1)(e)s, Senator, yes. That is right."*[18]

30. **Finding: Existing high value residents are protected by historical agreements from any increases in tax or any new tax models that may be introduced in the future.**

31. **Finding: New high value residents entering the Island will be subject to new taxation arrangements. These arrangements will not be subject to an annual increase but will be reviewed every 5 years.**

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[14] Transcript (7th November 2017) p21
[15] Jersey Finance, *"Draft Budget Statement 2018"* (14/11/17) http://www.scrutiny.gov.je/Pages/Review.aspx?ReviewId=278 [Last Accessed: 15th November 2017] p2
[16] Transcript (7th November 2017) p21
[17] Transcript (7th November 2017) p22
[18] Transcript (7th November 2017) p22

32. **Recommendation: The Minister for Treasury and Resources should identify a mechanism in time for 2019 Budget, whereby historical agreements with high value residents are renegotiated to introduce a minimum increase in taxation, in line with RPI.**

6. Business Taxation

33. Several new measures and modifications are proposed in the 2018 Budget. These include:

- a new tax to be applied to larger retail businesses
- expanding the definition of what constitutes a financial services company
- no longer allowing the deduction of rates by landlords renting property in Jersey

Tax on Large Retailers

34. The proposed introduction of a tax on retailers was agreed by the States Assembly as part of the 2017 Budget. The 2018 Budget brings forward a detailed proposal, setting out the mechanism for introducing the tax.

35. We expressed our concern to the Minister that implementing a top-level tax level of 20 per cent may make Jersey uncompetitive with the UK, given that corporation tax is currently set at 19 per cent and may be lowered to 17 per cent by 2020.[19]

36. The Minister gave assurances that the current difference of one per cent would have little impact, stating:

> *"You are talking about transfer pricing opportunities. We do not believe, with the current arrangements, where there is a 1 percent differential, so 19 percent corporate tax in the United Kingdom, that is likely to be the case."*[20]

37. It was further stated, that with the UK intending to reduce its corporation tax levels to 17 per cent, although this was ultimately uncertain given Brexit, that:

> *"…overall our economic analysis that was undertaken and distribution analysis does rather suggest that any changes to pricing are likely to not be affected."*[21]

38. This is at odds with the concerns raised by those in the industry, with the *Jersey Retail Association* (JRA) claiming that the proposed rate is too high:

> *"The proposed tax rate of 20% is uncompetitive against UK corporation rates that are currently 19%, will reduce to 17% in 2020 and the current Government has committed to reducing UK corporation rates to 15%.*[22]

39. The JRA expressed concerns that, if this is indeed the case, legitimate tax avoidance measures may be taken by UK based companies:

> *"Against this background, UK based companies with branches in Jersey will use legitimate transfer pricing to charge head office services, capital charges and brand*

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[19] HM Revenue and Customs. *"Corporation Tax to 17% in 2020"* (16/03/16) https://www.gov.uk/government/publications/corporation-tax-to-17-in-2020/corporation-tax-to-17-in-2020 [Last Accessed: 11th November 2017]
[20] Transcript (7th November 2017) p5
[21] Transcript (7th November 2017) p5
[22] Jersey Retail Association, *"Review of Draft Budget Statement 2017. Budget proposal"* (07/11/11) (http://www.scrutiny.gov.je/Pages/Review.aspx?ReviewId=278) p2

royalty fees to reduce taxable profits to the island. The JRA do not believe that the level of tax that the Treasury hope to raise will be achieved."[23]

40. This assessment is supported by one of our advisors, who states:

> *"Whilst we have no doubt that the Tax Office has strong intelligence around the trend of profits generated by these entities we would have some concerns around any behavioural change that such an extension of scope could drive in the financial strategies of the tax paying entities now in scope. In terms of tax planning it is not inconceivable that shareholders/owners may want to re-calibrate their financial strategies in a way that optimises investment within their businesses and minimises corporate tax exposure."*[24]

41. This clearly conflicts with the position taken by the Minister. The conflicting views raise concerns about the review process that was undertaken before the proposals were made. The JRA highlights this, stating:

> *"There has been no consultation whatsoever with the industry on the proposed tax…Furthermore, the EDTS&C have instructed an officer to develop a new retail strategy for the Island and this work is uncompleted, it is bizarre that the tax proposal has come forward in complete isolation to this strategy."*[25]

42. We feel that clarification is required as to what consultation with the industry did in fact take place. Given the proposals will only raise approximately £5.7 million, the effectiveness and efficiency of raising revenue through this strategy is paramount.

43. This is also queried by one of our advisors, who asks:

> *"We would welcome the opportunity to have sight on the modelling that assesses/estimates the expected £5.7 million liability to tax for the extended range of businesses in scope."*[26]

44. This is echoed by our other advisor, who expresses concern that:

> *"The introduction of the retail tax, for example, will inevitably result in attempts by States members to bring amendments to tinker further with thresholds and tapering provision and if successful, will add further caveats to the tax system and require additional revenue raising measures."*[27]

45. This concern is supported by *Jersey Finance*, who state that:

> *"In our view, the basis for the Treasury and Resource Minister introducing these provisions was not fully articulated and accordingly, the ultimate intention of the provisions is unclear. The risk is that this could lead to uncertainty regarding whether*

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[23] Jersey Retail Association p2
[24] CIPFA, Appendix B, pp. 19-20
[25] Jersey Retail Association p1
[26] CIPFA, Annex B, p20
[27] MJO Consultancy, *"The 2018 Budget: an assessment"* (Appendix C) p6

the long-term plan is to expand the number of companies that will be caught by this law..."[28]

46. **Finding: There is uncertainty amongst the retail industry surrounding the overall impact of the proposed tax on larger retailers.**

Financial Services Company: Expansion of Definition

47. The Budget proposes that the definition for what constitutes a financial services company, for taxation purposes, be widened, so that a larger number of companies are subject to the 10 per cent company income tax rate.

48. The Budget proposes that the definition be widened to include:

- *"Companies registered under the Financial Services (Jersey) Law 1998 to carry out general insurance mediation business ("GIMB")*
- *Companies registered with the Jersey Financial Services Commission as a registrar*
- *Companies holding permits under the Insurance Business (Jersey) Law 1996*
- *"Finance Companies"- companies trading in the provision of credit/finance to customers"*[29]

49. The Budget states that this will result in approximately 25 additional companies, 10 of which are locally owned, paying company income tax for the 2018 year of assessment. This will raise approximately £3 million for 2019.[30]

50. When queried, the Comptroller of Taxes confirmed that mutual insurance societies, if only trading with its own members, would still not be liable to pay tax under the new definition.[31] This was also stated to be the same for co-operative societies, although it was highlighted that tax would be applicable against any profits derived from trading with non-members.[32]

51. It was also confirmed that assessments had been conducted to measure whether there was a risk of any costs derived from the expansion of the definition being passed on to the customer. The Minister stated that *"that was unlikely to be the case."*[33] The Minister further clarified this assessment, stating:

> *"It is a competitive marketplace and it did not appear that there was going to be a material difference in terms of cost resulting from this particular move."*[34]

52. We queried whether there were plans on introducing regulations for *"Companies trading in the provision of credit/finance to customers*" as these would be captured under the new definition. Given that this is still an unregulated marketplace, we were surprised to note the response of the Minister, who stated:

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28 Jersey Finance, p2
29 P.90/2017 p18
30 P.90/2017 p18
31 Transcript (7th November 2017) p3
32 Transcript (7th November 2017) p9
33 Transcript (7th November 2017) p4
34 Transcript (7th November 2017) p4

> *"There are no current plans to progress in the short term regulation of these companies."*[35]

53. When queried whether the Minister was happy for credit companies to continue to operate unregulated, it was suggested to the Panel that the Financial Services Unit in the Chief Minister's Department was looking at regulations, not the Treasury Department.[36]

54. **Finding: Companies trading in the provision of credit/finance to customers are operating in an unregulated market place.**

55. **Recommendation: The Minister for Treasury and Resources should recommend to the Council of Ministers, that they should urgently address the lack of regulation for companies trading in the provision of credit/finance to customers.**

56. We were reassured however, to note the comments of the Deputy Comptroller of Taxes, who stated that as well as *"within the legislation that has been lodged there are a number of targeted anti-avoidance rules"*, preparatory work was undertaken prior to the Budget being made public, to ensure companies did not simply adjust their structures to avoid taxation.[37] We were informed that the Department had gathered accounts and profit data from the companies concerned, in advance of the proposition being publicised. The Comptroller of Taxes stated that this was:

> *"So when we then receive accounts and computations in the future in the Tax Office, one of the things that may well be looked at is have things changes structurally for those business since the imposition of the tax."*[38]

57. We also note the concerns of *Jersey Finance,* who state that,

> *"...it may have been helpful to provide an explanation regarding why the definition is being amended, so as not to, through uncertainty, discourage companies from doing business in Jersey.*
>
> *Specifically we would have liked to see a clear statement, confirming that there is no intention for the Minister to seek to tax investment managers within the zero-ten regime."*[39]

58. **Finding: The broadening of the definition of a "financial services company" for the purposes of the 10% income tax rate, will raise £3 million additional annual income.**

59. **Finding: The finance industry has expressed concern at the impact of the broadening of the definition of a "financial services company", for the purposes of the 10% income tax rate, on the Island's competitive position.**

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[35] Transcript (7th November 2017) p4
[36] Transcript (7th November 2017) p4
[37] Transcript (7th November 2017) p17
[38] Transcript (7th November 2017) p18
[39] Jersey Finance, p2

60. **Recommendation: The Minister for Treasury and Resources should publish the full assessment undertaken as to the impact of the change to the definition of "financial services company".**

Deduction of Rates by Landlords Renting Property in Jersey

61. The 2018 Budget implements the proposition adopted by the States Assembly in the 2017 Budget, which agreed in principle that a landlord renting out property in Jersey would be no longer entitled to deduct the cost of rates paid, when calculating the amount of rental income chargeable to tax.

62. We queried this measure and asked the Minister whether this would impact on those renting accommodation:

> *"**Deputy J.A.N Le Fondré***
> *By removing rates there is a deduction against expenses for landlords. This will inevitably push the cost on to the tenant. Do you agree Minister?*
>
> ***The Minister for Treasury and Resources***
> *It is likely to have an impact on the tenant. I would not necessarily disagree with that."*[40]

63. We note that this proposed measure is likely to only bring in £600,000 of revenue.[41]

64. In a submission to the Panel, we note that *Jersey Finance* states in relation to the 2018 Budget's proposals for Corporate tax that:

> *"For the most part we are satisfied with the proposed amendments outline in the draft statement. However, we feel this was an ideal opportunity to provide clarity in respect of the long-term plan for Jersey tax, to avoid any misconceptions and unnecessary concerns in the interim, so we would have like to see general tax policy issues better articulated and a clear strategy outlined in respect of the future of Jersey corporate tax."*[42]

65. **Finding: The Minister for Treasury and Resources has stated that the likely impact of the ending of the deduction of rates by landlords renting property in Jersey, is that tenants will pay more.**

[40] Transcript (7th November 2017) p18
[41] P.90/2017 p21
[42] Jersey Finance, p1

7. Other Taxation Measures

66. There are a number of taxation measures that warrant review and do not fall directly within either personal or business taxation. These measures are:

- the existing stamp duty loophole
- complication of the tax model
- the de minimis level and GST applied to goods purchased online

Existing Stamp Duty Loophole

67. The 2018 Budget highlights that there is currently no anti-avoidance rule within the Stamp Duty Law. The measures to amend this are being introduced by the 2018 Budget as applicable from the day that the Budget was lodged. This is in order to protect against any losses in the intervening period between the lodging of the Budget and its debate.[43]

68. The Budget refers however, to another area of stamp duty that still requires addressing. The 2018 Budget focuses on this, stating that:

> *"Work is continuing on the issue of the sale of Jersey real estate owned within a corporate structure by way of transfer of shares which crystallises neither a stamp duty charge nor a land transaction tax liability."*[44]

69. The Budget also states that external advice is being sought by the Tax Policy Unit on addressing the loophole:

> *"Based on the advice received it will be determined whether it is feasible to bring forward amendments in the 2019 Budget."*[45]

70. When we queried the timeframe for this work, the Minister stated that:

> *"There is some feasibility work being undertaken and the idea is to bring forward the amendment for the next budget, so that will be 2019."*[46]

71. When asked why this process was so drawn-out, the response given to us was that it was a very complicated issue to resolve, given that the transfer of real property goes through the court, whilst for share transactions, nothing is registered in that manner. We were informed that at present the approaches taken by other jurisdictions was being explored, to see whether measures could be replicated in Jersey.[47]

72. It is worth highlighting the significance of this anomaly. To give one example, prior work by this Panel had identified that a single office block (JIFC Building 1) could be liable for stamp

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[43] P.90/2017 p22
[44] P.90/2017 p31
[45] P.90/2017 p31
[46] P.90/2017 p46
[47] Transcript (7th November 2017) pp.46-47

duty of approximately £1.7 million.[48] This would be unobtainable if the current anomaly was utilised, with no stamp duty being paid on the building.

73. **Finding: An anomaly in Stamp Duty legislation means that certain properties, including in particular commercial offices, at present are not liable to stamp duty.**

74. **Finding: The potential income not collected due to the current anomaly in Stamp Duty legislation on commercial properties could be substantial.**

75. **Recommendation: The Minister for Treasury and Resources should accelerate the work being done on correcting the anomaly in Stamp Duty legislation, and ensure that this anomaly is addressed with effect from 1st July 2018.**

Complication of the Tax Model

76. We raised concern with the Minister that the taxation system was becoming more complicated, with the introduction of multiple taxes in recent years. This was conceded to by the Minister, who stated that:

> *"I would agree and concede with the fact that it has become more complicated since the introduction of Zero/Ten. Zero/Ten was absolutely essential in terms of maintaining our principle industry, in other words financial services…"*[49]

77. The reason for this concern is that the more complicated a tax system gets, the greater the impact on compliance and avoidance issues. When this principle was expressed to the Minister, he stated:

> *"Generally that would be a fair assumption."*[50]

78. **Recommendation: Given that Jersey's tax system is traditionally seen as "low, broad and simple", the Minister for Treasury and Resources should be mindful of the dangers of complicating the tax system in his review of the personal tax system.**

The De Minimis Level and Goods Purchased Online

79. Whilst it is not covered directly in the 2018 Budget, it was felt that it was an area of importance to address with the Minister. The De Minimis level is defined as *"…the minimum amount of GST collected on imported goods. It is for private individuals, not businesses."*[51] At present, this figure (which includes GST, CCT and excise duty) is £12. [52]

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[48]Corporate Services Scrutiny Panel. *"S.R.7/2015: Jersey International Finance Centre* Financial Viability (Interim Report)" http://www.statesassembly.gov.je/scrutinyreports/2015/report%20-%20jersey%20international%20finance%20centre%20-%2030%20october%202015.pdf [Last Accessed: 14th November 2017] p64
[49] Transcript, (7th November 2017) p21
[50] Transcript, (7th November 2017) p22
[51] gov.je *"GST Glossary"* https://www.gov.je/taxesmoney/gst/businesses/introduction/pages/glossary.aspx [Last Accessed: 11th November 2017]
[52] CCT is the "Combined Customs Tariff" (https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/what-is-common-customs-tariff_en) [Last Accessed: 11th November 2017]

80. Jersey Post processed at least 3 million parcels in 2016.[53] During our public hearing the Minister informed us that figures of the total sum for manifested goods processed in 2016, and for which revenue from GST had not been gathered, was £1.6 million."[54] Given that the goods processed by Jersey Post do not include items arriving in the Island via some couriers and that the figure of £1.6 million is only for currently manifested goods, we would assume the total value of GST not gathered would be significantly higher.

81. The Treasurer of the States confirmed to us, that whilst at present not all parcels were manifested, by 2020 they would be.

Current Year/Prior Year Tax

82. We note that the population is still split between current year and prior year taxation payments. Our understanding is that this split is approximately two thirds on a prior year basis to one third on a current year basis calculation.[55] Given that the total income tax revenue forecast to be collected in 2018 is £418m, and assuming these proportions are correct, the tax revenue collected from those on a prior year basis calculation is approximately £280 million. [56]

83. The prior-year system means that retirees will have to pay their final "working-age" tax bill in the year after they have stopped working. This puts a financial strain on a retiree who may not have budgeted for their final tax bill effectively. We note however, that some consideration and effort has already been made to help those approaching the age of retirement.[57]

84. **Finding: The taxpaying population is currently split between prior-year and current-year methods of tax calculations (two-thirds to one-third respectively).**

85. **Recommendation: The Minister for Treasury and Resources should examine options for bringing those of the taxpaying population currently on a prior-year basis of taxation, onto a current-year basis of taxation.**

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[53] Jersey Post *"Business Review for the year ended 31 December 2016"* http://www.jerseypost.com/wp-content/uploads/2017/07/Business_review_2016_web.pdf [Last Accessed: 11th November 2017] p9
[54] Transcript, (7th November 2017) p13
[55] Note: Confirmed by Treasury
[56] P.90/2017. p105
[57] Gov.je *"Planning income tax payments around your retirement"* https://www.gov.je/TaxesMoney/IncomeTax/Individuals/PayingTaxEarnings/Pages/PlanningRetirementTax.aspx [Last Accessed: 20th November 2017]

8. Impôts and Vehicle Emissions Duty (VED)

86. The 2018 Budget has increased the impôts duty on alcohol by RPI and the impôts duty on tobacco by RPI plus 5 per cent (7.5 per cent for hand-rolling tobacco). The duty applicable to road fuels has also increased by RPI.

87. VED rates have been proposed to increase in line with RPI, whilst the CO2 per km level at which no VED is applied has been lowered to 50gm CO2 per km (down from 100gm).

Impôts: Alcohol

88. It was queried as to why the duty paid on alcohol has risen higher than R.P.I. We calculated that between 2003 and 2017, the duty payable on one litre of whiskey rose by 82 per cent, while duty on a bottle of table wine had risen by 62 per cent (see tables 1 and 2 below). If this was in relation to the health benefits associated with reducing the consumption of alcohol, we queried why this year, duties had risen only by RPI and not above it:

Table 11.2
A Comparison of Typical 2003 Tax and Duty Levels for a Range of Commodities

	Jersey £	UK £	Guernsey £	France £	Highest EU state £
Litre of Whisky	7.69	10.35	4.57	6.08	18.94
Litre of Gin/Vodka	7.21	9.77	4.57	5.50	17.83
Bottle of table wine	0.92	1.79	0.73	0.50	2.05
Pint of beer < 5% alcohol	0.21	0.61	0.18	0.39	0.86
Pint of beer > 5% alcohol	0.32	0.75	0.18	0.46	1.08
20 King Size cigarettes	2.10	3.60	1.82	1.84	3.60
Litre of unleaded petrol	0.32	0.57	0.07	0.51	0.57
Litre of Diesel	0.32	0.57	NIL	0.37	0.57

The higher rates of duty in Jersey, compared to Guernsey, reflect our strategies against alcohol and tobacco and similarly those increases in road fuel in support of environmental initiatives.

Table 11.3
Retail Price Margins - Comparisons with the UK

	Jersey Retail Price	Jersey Duty	Duty as % of price	UK Retail price	UK Duty	UK VAT	Duty & VAT as % of price
Litre of Whisky	£14.99	£7.69	51%	£17.00	£7.82	£2.53	61%
Pint of Beer <5%	£2.14	£0.21	10%	£2.25	£0.28	£0.33	27%
20 King Size Cigarettes	£3.72	£2.10	56%	£4.50	£2.93	£0.67	80%
Litre of Unleaded Petrol	£0.69	£0.32	46%	£0.75	£0.46	£0.11	76%

<u>Table 1: 2004 Budget.</u>[58]

[58] States of Jersey. *"Budget 2004"* (04/11/03) https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/FD%20BudgetStmt2004%2020031031%20TR.pdf [Last Accessed: 13th November 2017] pxxviii

FIGURE 10 – 2017 retail price margins – comparisons with the UK (June 2017)

	Jersey Retail Price	Jersey Duty	GST	Price net of Duty & GST	Duty & GST as a % of price	UK Retail Price	UK Duty	UK VAT	Price net of Duty & VAT	Duty & VAT as a % of price
Litre of whisky	£20.96	£14.04	£1.00	£5.92	72%	£21.00	£11.50	£3.50	£6.00	71%
Pint of standard beer	£3.56	£0.36	£0.17	£3.03	15%	£3.06	£0.49	£0.51	£2.06	33%
20 king size cigarettes	£8.38	£5.75	£0.40	£2.23	73%	£9.52	£5.73	£1.59	£2.20	77%
Litre of unleaded petrol	£1.11	£0.47	£0.05	£0.58	48%	£1.16	£0.58	£0.19	£0.39	66%

FIGURE 11 – Comparison of typical 2017 tax and duty levels for a range of commodities (June 2017)

	Jersey Duty	Jersey GST at 5%	Guernsey Duty	UK Duty	UK VAT at 20%
Litre of whisky at 40% abv	£14.04	£1.00	£13.58	£11.50	£3.50
Bottle of table wine	£1.49	£0.34	£1.79	£2.16	£1.00
Pint of beer/lager at 4.5% abv	£0.36	£0.17	£0.43	£0.49	£0.51
20 king size cigarettes	£5.75	£0.40	£4.41	£5.73	£1.59
Litre of unleaded petrol	£0.47	£0.05	£0.64	£0.58	£0.19
Litre of diesel	£0.47	£0.05	£0.64	£0.58	£0.20

Table 2: 2018 Budget[59]

89. It was ascertained by the Panel that, whilst in prior years duty has risen by both RPI and over RPI (and indeed in at least one instance, below RPI), due to the value of alcohol increasing because of Brexit, it was felt that this year's increase should only match RPI.[60]

90. It was also identified, that the limited increase proposed in the 2018 Budget was partly due to the fact that a new licencing law had been lodged. The Minister stated that:

> *"This is a matter that needs to be addressed in our view before considering any further increases."*[61]

91. Given that the increases identified in paragraph 88 were far higher than their equivalents in the UK, it was queried whether this would have had any potential impact on the tourism industry. The Minister did not directly address this concern in his response, but identified the dangers of consumption as a rationale for the higher increases:

> *"I think we also need to be mindful of the consumption. Per-capita consumption levels in Jersey are one of the highest in Europe. That has always been a focus of ours in increasing these rates in the past…"*[62]

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59 P.90/2017 p25
60 Transcript, (7th November 2017) p30
61 Transcript, (7th November 2017) p31
62 Transcript, (7th November 2017) p31

Impôts: Tobacco

92. In the 2018 Budget, impôts duties on tobacco products are rising significantly higher than RPI. For most products the figure is RPI plus 5 per cent, with hand-rolling tobacco rising by RPI plus 7.5 per cent. This means that for hand-rolling tobacco, the increase in the duty is in fact 10 per cent.

93. Such a rise represents an acknowledgement of the dangers of smoking and its subsequent cost to the taxpayer. However, as we heard in a submission to the Panel, there are clearly also side effects which arise from a sharp increase in prices:

> *"There is also the question of any out of proportion rise in Impôts, which would place a much bigger burden on tobacco consumers in the Island. Last year's rise of RPI plus 5% increases the price of 200 cigarettes by £4.29…We all have to ask the question; at what point will tobacco users shun duty-paid tobacco in favour of non-duty paid sources?"*[63]

94. Whilst tobacco is clearly a harmful product, any rise in pricing needs to reflect the understanding that tobacco is also an addictive product and one that people, if faced with a sharp rise in price, will still likely purchase regardless of the cost to themselves. In addition, this could mean that consumers move to the "grey" market, purchasing tobacco from sources where duty has not be applied, which circumvents the impact of increasing impôts entirely.[64]

95. Given the potential side-effects of unexpected increases in prices, we also query whether a different strategy for increasing duties could be considered.

96. One comment received from a stakeholder in the local tobacco industry, highlights the difference between the strategies employed in both Guernsey and Jersey:

> *"Our main concern for the next budget is that changes to Tobacco Impôts should be transparent and offer more stability, both for the industry and for consumers. We are disappointed there isn't a mention of a particular rate, such as that used in Guernsey, which would avoid the last-minute scramble over pricing."*[65]

97. **Recommendation: The Minister for Treasury and Resources should explore the possibility of fixed, long-term impôts duties on tobacco.**

Impôts: Road Fuel

98. The increase on road fuel duty in the 2018 Budget is in line with RPI, at 2.5 per cent. This will mean an increase of approximately one penny on the current price of fuel. The Budget states that this will raise the duty collected from all road fuels by £500,000, to a total of £22.5 million in 2018.

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[63] Channel Island Tobacco Importers and Manufacturers' Association (CITIMA). *"Letter from CITIMA to the Corporate Services Scrutiny Panel"* (10/11/17)
http://www.scrutiny.gov.je/Pages/Review.aspx?ReviewId=278 [Last Accessed: 15th November 2017]
[64] CITIMA.
[65] CITIMA.

99. In 2007, Jersey had one hybrid and four electric vehicles registered on the Island[66], whilst by 2016 these figures were ninety-eight and fifty respectively.[67] This supports the assumption that there will be a continued trend in the rise in the number of eco-friendly vehicles purchased, with presumably a similar decrease in the number of traditional petrol or diesel powered vehicles to compensate.

100. Given this trend, we queried whether the Minister had planned in the long-term, a measure to replace the loss in revenue raised from fuel duty. The Minister stated:

> *"…we get about £25 million or so from fuel duty in total. This is a considerable amount of money in terms of revenues and we are mindful that over the passage of time that will start to reduce. This is not the case currently so I think it is from a policy development perspective something that will need some fairly urgent attention as to how that might be replaced over time."*[68]

101. **Recommendation: The Minister for Treasury and Resources should commence planning for the loss of road fuel duty revenue due to the increase in the number of electric and hybrid vehicles.**

102. **Recommendation: Planning for the eventual loss of road fuel duty should include considerations for a phased removal of revenue (for example over a 10 year period) for the purposes of estimating revenue receipts for budgetary and planning purposes.**

Vehicle Emissions Duty (VED)

103. The 2018 Budget recommends increasing the VED rates in line with RPI, by 2.5 per cent. It also simultaneously recommends lowering the nil rate VED band (below which no VED is due) to 50gm CO_2 per km (down from 100gm).

104. We queried whether the Minister had in fact considered alternative measures for the taxation of vehicles. This is because, besides carbon dioxide, there are a wide range of pollutants emitted by vehicles.[69]

105. The Minister assured us that:

> *"There is a Government policy to drive towards more sustainable forms of transport and as such there is a keen interest from the Department for Infrastructure to promote communication and travel that is less-impacting on the environment."*[70]

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[66] gov.je *"Number of Vehicles Registered in Jersey (FOI)"* (25/06/15) https://www.gov.je/government/pages/statesreports.aspx?reportid=1462 [Last Accessed: 12th November 2017]

[67] gov.je *"Registered Vehicles (FOI)"* (28/04/17) https://www.gov.je/government/pages/statesreports.aspx?reportid=2823 [Last Accessed: 12th November 2017]

[68] Transcript (7th November 2017) p36

[69] Department for Transport, *"Cars and air pollution"* http://www.dft.gov.uk/vca/fcb/cars-and-air-pollution.asp [Last Accessed: 12th November 2017]

[70] Transcript (7th November 2017) p35

106. However, they also confirmed that:

> *"...there are no particular measures in place at the moment or under consideration, above and beyond what is proposed here."*[71]

107. **Recommendation: The Minister for Treasury and Resources should examine other means of measurement for the Vehicle Emissions Duty, to ensure that CO_2 is still the most effective means of taxation in relation to the health effects of car emissions on the population.**

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[71] Transcript (7th November 2017) p35

9. Capital Spending Programme

108. The capital programme set out in the 2018 Budget is based on the Long-Term Capital Plan (LTCP). The LTCP is currently under review and is proposed to cover the capital projects required over the next 20 years. Each MTFP subsequently sets out the programme of spends in more detail for the years covered by that plan (e.g. the MTFP 2016-2019). The annual Budget then approves a detailed list of projects to be completed in the forthcoming year.[72]

109. The 2018 Budget highlights that there has been a significant increase in the cost estimates for the capital programme in 2018 and 2019:

> *"As a result of the updated 2018/2019 submissions from departments, the cost estimates for a number of projects already in the MTFP indicative capital programme were increased by £10,003,000 in 2018 and £1,598,000 in 2019."*[73]

110. Given that the MTFP 2016-2019 approved a total allocation in 2018 of £43,233,000, this represents approximately a 25 per cent increase in proposed spending.[74]

111. When queried, the Director of Financial Planning and Performance explained that:

> *"As part of the Budget process, we take the indicative capital programme as per the M.T.F.P., we backed out two departments to ask them to revisit the numbers that they had in for 2018 and for 2019 and, as part of that process, we have identified a number of schemes where we have had to reprioritise the funding, a number of schemes like Grainville, for example, and Les Quennevais have identified further costs, largely around inflation, and the hyperinflation that we are experiencing in construction at the moment with that."*

112. Looking in more detail at the Capital Programme, there are a number of projects where the costs have increased significantly. The Budget states that:

> *"The two biggest movements are on the Les Quennevais and Grainville School projects where the estimated total cost of the projects has increased by £5.6 million (to £45.6 million) and £5.3 million (to £15.5 million) respectively."*

113. This means that the budget for the Grainville School Project has increase by a factor of 50 per cent of its original estimate, by £5.3 million to £15.5 million.

114. The Treasurer of the States highlighted that the reason for this increase was that detailed feasibility works had produced a higher estimate than was originally predicted. He stated that this was primarily:

> *"exacerbated by greater inflation, but it is also something we need to look at so that we can understand it, because as you have said, it is against not just this particular build, it is against the other build as well. We are going to be looking to change the*

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[72] P.90/2017 p43
[73] P.90/2017 p43
[74] P.90/2017 p43

way that we budget the capital so that more of this feasibility is done earlier and therefore better estimates are provided."[75]

115. We were pleased to note this commitment from the Treasurer, the need for which is supported by one of our advisors. In referring to an earlier piece of work conducted for the Panel, our advisor states:

"Within our report on MTFP II CIPFA specifically recommended that:

"Consideration should be given to modifying the current controls over locking/securing/committing capital funding to allow for more flexibility and improved utilisation of funding sources.""[76]

116. Our advisor also highlights the dangers of potentially over-funding Capital expenditure:

"Whilst the current position can be viewed as being extremely prudent approach and influenced by Article 10(8) of the Public Finances (Jersey) Law 2005 ("The Minister must not lodge a draft budget that includes a report that shows a deficit in the consolidated fund at the end of the financial year to which the budget relates" there is the potential for a level of volatility on the Consolidated Fund should a significantly higher level of committed capital expenditure crystallises in year."[77]

117. The Treasury Department, following the hearing, presented the Panel with further details on the Grainville School project. These stated that:

"The movement in the estimated cost is attributable to the evolution of the project to accommodate changing service needs, changing regulatory conditions, further detail revealed through feasibility work and the construction market conditions. The feasibility work also identified some difficult site conditions that were not anticipated."[78]

118. The Department also provided a table which set out in detail, the breakdown of the increased costs to the Grainville School project.

Original Budget	£10.2 million
Updated pupil number modelling increasing classroom and circulation space requirements	£1.3 million
Building bye-law changes	£1.1 million
New 10% consequential improvement requirements	£1.0 million
Inflation above assumptions and impact of timing	£1.0 million
Demolition costs (not required in previous refurbishment scheme)	£0.9 million
Revised Cost	£15.5 million

Table 3: Revised Cost for Grainville School Project[79]

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[75] Transcript (7th November 2017) p40
[76] CIPFA, Annex B, p7
[77] CIPFA, Annex B, p7
[78] Treasury Department, *"Corporate Services Scrutiny Panel: Budget 2018 Hearing 7th November 2017-Further Information"* (15/11/17) http://www.scrutiny.gov.je/Pages/Review.aspx?ReviewId=278 [Last Accessed: 15th November 2017]
[79] Treasury Department, *"Corporate Services Scrutiny Panel: Budget 2018 Hearing 7th November 2017-Further Information"* (15/11/17) http://www.scrutiny.gov.je/Pages/Review.aspx?ReviewId=278 [Last Accessed: 15th November 2017]

119. One of advisors noted in relation to the overall position of the States reserve funds and capital project spending, that:

> *"The States of Jersey manages the inter connectivity between the significant funds well. However, given the potential requirement to meet capital commitments as well as significant future capital projects such as provision for a new hospital from the Strategic Reserve, there is an overall lack of clarity on the precise level of balance on these funds which is not encumbered or committed."*[80]

120. **Finding: The revised cost of the Grainville school capital project is 50 per cent higher than originally estimated, increasing by £5.3 million to £15.5 million.**

121. **Finding: The capital project to build the new Les Quennevais School has increased by approximately 14 per cent, from £40 million to £45.6 million.**

122. **Finding: Treasury officials have stated that they are identifying methods to change the way that capital projects are budgeted, so that more of the feasibility planning is done earlier, and therefore better estimates are provided.**

123. **Recommendation: The Minister for Treasury and Resources should propose new, more accurate ways, by which to calculate the funding required for capital projects, before the 2019 Budget.**

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[80] CIPFA, Annex B, p10

10. Future Challenges

124. Given the position of the 2018 Budget in relation to a climate of uncertainty following Brexit, as well as the introduction of several new short-term taxation measures (with further changes to be debated in the coming year), it was felt that the future challenges to the Island's economy warranted consideration separately.

125. The 2018 Budget acknowledges this uncertainty, stating that:

> *"The post-Brexit reality is an uncertain one but our strong public finances and resilient economy are ready to manage both the opportunities and threats that will emerge. With our considerable reserves, minimal debt and net assets of more than £6 billion, our public finances are in a stronger position than those of most other places in the world."*[81]

126. This position was also supported by our advisors, who comment that:

> *"…whilst the short-term deleterious impacts were clearly overstated by many well-respected organisations, the long-term impacts remain uncertain with no agreement between the UK and the EU over the nature of future economic relations."*[82]

127. Indeed, our advisor goes further, stating that:

> *"...the spectre of Brexit looms large over this Budget, particularly the concerns surrounding the future prospects of the financial services sector after March 2019."*[83]

128. **Recommendation: The Minister for Treasury and Resources should make public, where possible, the preparatory work being conducted in anticipation of Brexit and its effect on future Budgets.**

New Taxes/Charges

129. Our advisor identifies, that the current process of introducing new taxes may not be an effective mechanism. In his report, he describes this as "nudging the tax system":

> *"The danger with the current policy of 'nudging' the tax system and introducing new charges to raise revenue is that it creates fewer coherencies and more uncertainty. Businesses, households and the Exchequer all suffer."*[84]

130. When queried whether the Budget was in fact proposing short-term measures rather than long-term economic strategies, the Minister explained that the aim of this Budget was partly:

> *"…to address the shortfall from the States not agreeing to reduce the health charge through budget measures and… if approved by the States Assembly on 28th November, raises £10.2 million and goes towards bridging the gap of the health charge not being introduced. I must emphasise though, this is dealing with the short-*

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81 P.90/2017 p10
82 MJO Consultancy. Annex C p1
83 MJO Consultancy, Annex C p1
84 MJO Consultancy, Annex C p6

term issues up to the end of 2019. The long-term sustainable issues of funding health is something that will have to continue to be worked on until a measure is put in place to deal with it.'[85]

131. The Minister further stated, that what was of long-term concern was that:

"…the States Assembly, had not approved the health charge and so far it has deferred the waste charge. If you take those 2 items together, it is £26 million by 2019.'[86]

132. **Finding: The Minister for Treasury and Resources has stated that the 2018 Budget is a mechanism for dealing with short-term funding issues up to 2019, and not providing long-term funding solutions.**

Higher Education

133. Given that funding proposals were absent from the 2018 Budget, we queried what proposals the Minister would be bringing forward to fund higher education and when:

"Senator S.C. Ferguson:

When are you going to be lodging proposals relating to the funding of higher education?

The Minister for Treasury and Resources:

I think I have made it clear that we would be making an announcement alongside the budget about how we were going to be dealing with higher education. That is still the case.'[87]

134. The Minister further stated that *"There has got to be a process of consultation that will be undertaken as well"* but that also that *"There will certainly be lodging intended before the May election".*[88]

135. **Finding: The Minister for Treasury and Resources has stated that he will be making an announcement about higher education funding alongside the budget and that he will be lodging funding proposals before the 2018 May election.**

[85] Transcript (7th November 2017) pp. 23-24
[86] Transcript (7th November 2017) p26
[87] Transcript (7th November 2017) p42
[88] Transcript (7th November 2017) p43

11. Productivity

136. Productivity at its simplest can be seen as:

> *"…a ratio between the output volume and the volume of inputs. In other words, it measures how efficiently production inputs, such as labour and capital, are being used in an economy to produce a given level of output.*[89]

137. The calculations performed for Jersey are the GVA (gross value added) per FTE (full-time equivalent employee).

138. Our advisor highlights the importance of such a figure in relation to a nation's standard of living:

> *"The level of productivity in an economy is the single most important cause of a country's standard of living: faster productivity growth leads to a better standard of living and falling productivity growth leads to falling living standards."*[90]

139. The Fiscal Policy Panel (FPP) highlighted in their October 2016 Report that:

> *"Improving Jersey's underlying rate of productivity growth is vital to raising Jersey's economic performance and competitiveness, improving public finances and ultimately raising the standard of living."*[91]

140. The importance of improving the Island's productivity was also acknowledged by one of our advisors, who highlighted that:

> *"It is not alarmist to draw attention to the productivity challenge facing Jersey... Currently, Jersey's GDP and GVA per head of population are 53 per cent and 33 per cent higher respectively than the UK's in 2016. However calculations by the Statistics Unit show that if current trends continue, it will only be 12 years before Jersey's GDP per head is level with the UK."*[92]

141. If this forecast is correct, it would mean that within a relatively short period of time, the average standard of living (if defined by GDP) in Jersey, will no longer be higher than that of the UK. It also reflects, that whilst the population is increasing, the revenue being generated by each individual on average is lower.

142. The advisor also queried why at present, it was believed that Jersey could not assess its competitiveness against the methodology set by the World Economic Forum:

> *"It is therefore disappointing to see the number of 'red' flags in the latest update of the innovation review action plan and the conclusion on benchmarking that 'after considering a number of potential frameworks, it is not considered possible to*

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[89] OECD. *"Defining and Measuring Productivity"* https://www.oecd.org/std/productivity-stats/40526851.pdf [Last Accessed: 12th November 2017]
[90] MJO Consultancy, Annex C p18
[91] FPP. *"Jersey's Fiscal Policy Panel Annual Report"* (October 2017) https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Fiscal%20Policy%20Panel%20annual%20report%20October%202017.pdf [Last Accessed: 12th November 2017] p45
[92] MJO Consultancy, Annex C p18

objectively benchmark Jersey's competitiveness using the methodology used by the World Bank or World Economic Forum'. This conclusion is quite bizarre – the list of countries that use the World Economic Forum benchmarking methodology includes Haiti, Chad and Trinidad and Tobago along with developed countries (which surely can include Jersey)."[93]

143. The reasoning for such benchmarking, our advisor highlights in his report, is that without assessment, investment to improve productivity may currently be misdirected:

"If the difficulties with benchmarking are a resource issue then perhaps it would make sense to find resources from the Economic and Productivity Growth Drawdown Provision; after all, if there is no effort being made to benchmark money on productivity outcomes it might be that what is being spent is wasted money."[94]

144. Indeed, one of the conclusions in the advisors Report to the Panel was that:

"Living standards in Jersey will continue to fall and a greater sense of urgency is needed to address the 'productivity challenge'. There should be a requirement that competitiveness outcomes should be computed which conform to World Economic Forum standards."[95]

145. We note that an overall concern with productivity is acknowledged within the 2018 Budget, which recognises that:

"The lack of productivity growth over previous economic cycles has been of particular concern and the most recent trends are not yet showing any real improvement. 2016 saw productivity (as measured by GVA per FTE) fall 2% in real terms. Productivity in the finance sector fell by 3%, primarily due to falling productivity in trust and company administration. Productivity for non-finance was flat, with increases in sectors including hotels, restaurants and bars, and construction, with falls in wholesale and retail and other business activities."[96]

146. The Budget also acknowledges the comments made by the FPP, and further states that:

"The Council of Ministers remains committed to playing its part in trying to achieve this."[97]

147. **Finding: The Panel's advisors have raised concerns that the standard of living in Jersey, relative to that of the UK, is falling.**

148. **Finding: The productivity of Jersey's economy (based on GVA per FTE) is not increasing in line with the population.**

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[93] MJO Consultancy, Annex C p19
[94] MJO Consultancy, Annex C p18
[95] MJO Consultancy, Annex C pp.19-20
[96] P.90/2017 p88
[97] P.90/2017 p89

Income Tax Forecasts

149. The Panel note, that as well as concerns being expressed surrounding productivity, the advisor also highlighted changes within income tax forecasts since the MTFP2.

150. One of our advisors notes that:

> *"Since 2005, personal tax has accounted for a larger share of income tax receipts: in 2009, personal tax accounted for 57 per cent of total income tax and by 2016 this figure has risen to 81 per cent. By 2021, personal tax will account for 84 per cent of all income tax receipts."*[98]

151. The advisor also notes a key aspect of the change in the income tax forecast from the MTFP2. This focuses on the adjustments being made for recognising the current year basis (CYB), which is an accounting adjustment. The advisor states that:

> *"The CYB forecasts have been revised so they now assume £10 million for 2017 and £8 million per annum for 2018 and 2019. In short, the differences…can largely be explained by the CYB adjustment."*[99]

This means that with the accounting adjustment and all proposed tax revenues removed, the income tax forecast is £8 to £10 million lower than that pictured in the 2018 Budget.

152. These forecasts are supported by the advisor's assessment of the real term annual percentage change in earnings. Our advisor highlights:

> *"It's not difficult to translate how the impact of faltering productivity shows up in declining living standards... There have been real-term annual decreases in earnings in eight out of the last twenty-seven years; using recent forecasts for RPI and the growth of average earnings for 2017–2021 suggests that from 2019, inflation will again increase faster than average earnings."*[100]

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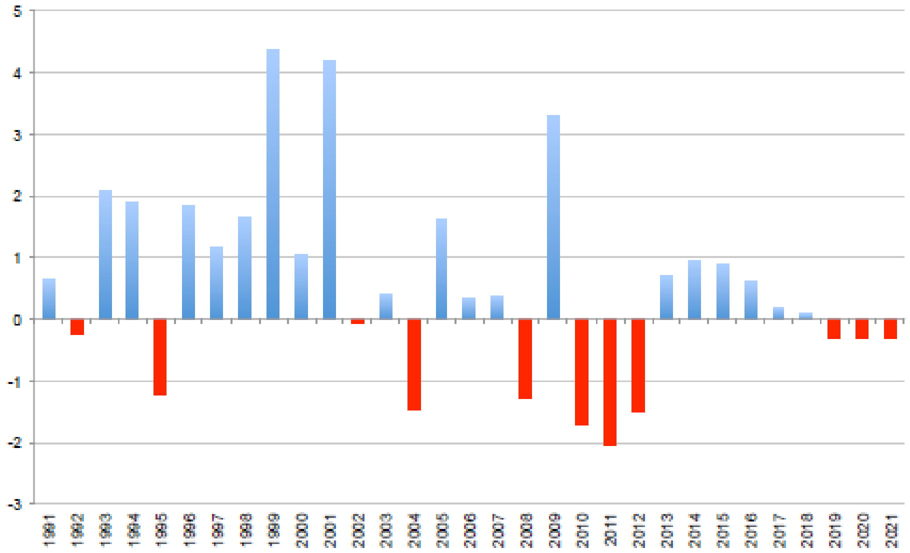
[98] MJO Consultancy, Annex C p11
[99] MJO Consultancy, Annex C p16
[100] MJO Consultancy, Annex C p20

Figure 5. Real term annual percentage change in the Index of Average Earnings, 1991 to 2021 (actual and forecast)



Source: Statistics Unit and FPP forecasts

Graph 1: Real Term Annual Percentage change in Average Earnings[101]

153. **Finding: The figures for the income tax forecast in 2018 and 2019 have been increased by £8 to £10 million each year, because of an accounting adjustment.**

154. **Finding: By 2021, on present projections there will have been little or no growth of real term earnings of Islanders in the last decade.**

155. **Recommendation: The Minister for Treasury and Resources should produce income figures for the period of the MTFP2, which removes all accounting adjustments and all budget measures introduced during that period, in order to demonstrate the underlying trend of changes in income.**

[101] MJO Consultancy, Annex C p20

Appendix A: Panel Membership, Terms of Reference and Evidence Considered

Panel Membership:

Deputy John Le Fondré (Chairman)

Deputy Simon Brée (Vice Chairman)

Deputy Kevin Lewis

Senator Sarah Ferguson

Connétable Christopher Taylor[102]

Review Terms of Reference

1. To consider the proposals of the Minister for Treasury and Resources in the Draft 2018 Budget Statement in respect of:
    a) Personal Tax
    b) Business tax
    c) Impôts duty
    d) VED Proposals
    e) Any other tax proposals, as set out in the Draft Budget Statement 2018
2. To consider the Capital Programme for 2018-2019, as presented in the Draft Budget Statement
3. Evaluate the proposed central growth allocation for 2018
4. To consider the financial forecasts and the economic implications of the Minister's proposals in the Draft 2018 Budget Statement, including the potential impact of Brexit on the economy

Public Hearings

A public hearing with the Minister for Treasury and Resources was held on the 7th November. The attendees were:

- Senator A. Maclean, Minister for Treasury and Resources
- Richard Bell, Treasurer of the States
- Richard Summersgill, Comptroller of Taxes
- Paul Eastwood, Deputy Comptroller of Taxes
- Alison Rogers, Director of Financial Planning and Performance

The transcript for the hearing can be found here:

[102] *N.B. The Connétable of St John was a member of the Panel at the commencement of the review, but resigned on 10th October 2017 following his appointment as Chairman of the Public Accounts Committee.*

Evidence Considered:

The following evidence was also considered by the Panel:

1. P.90/2017, *Draft Budget Statement 2018*
2. States of Jersey Budget 2004
3. Written submissions:
    a. Jersey Retail Association (JRA)
    b. Channel Island Tobacco Importers and Manufacturers' Association (CITIMA)
    c. Jersey Finance
4. Advisors report: CIPFA (Appendix B)
5. Advisors report: MJO Consultancy (Appendix C)

Appendix B: CIPFA Report

CORPORATE SERVICES SCRUTINY PANEL

BUDGET 2018

REPORT

NOVEMBER 2017

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Contents

1. Introduction

1.1 In October 2017, the States of Jersey commissioned CIPFA Business - Finance Advisory (the commercial arm of the Chartered Institute of Public Finance and Accountancy) to support the work of the Corporate Services Scrutiny Panel in an assessment of the States of Jersey Budget Proposals 2018. This draft report outlines CIPFA's preliminary position on this work to 10 November 2017.

Our Approach

1.2 Our approach to this independent review has sought to draw together a broad range of evidence. The majority of the conclusions and recommendations contained within this draft report are based on document review. Budget setting and financial strategy components of the CIPFA Financial Management (FM) Model have been used as guiding principles.

Scope

1.3 Our scope of work included the main components of the Budget Proposition outlined within the Draft Budget Statement 2018 covering the following:-

- Budget Modelling
- Income Tax and Corporate Tax Proposals - yield Forecasts
- Impôts and Stamp Duty land Transaction Tax Changes
- Other Income
- Base Budgets
- Contributions
- Capital Programme

2. Budget Modelling - 2018

2.1 Whilst the 2017 Budget setting process estimated a 2017 deficit of some £12.953 million the 2018 equivalent positions forecasts a surplus before depreciation of £2.481 million. The overall 2018 budget model positions a surplus before depreciation of £17,395 million increasing to £53.332 million by 2019 within the 2016-2019 MTFP Addition period:

Outturn	Financial Forecast	Sept 2017 Forecast	Draft Budget 2018 Forecast	
2016 £'000		2017 £'000	2018 £'000	2019 £'000
	States Income			
487,965	Income Tax	483,000	510,000	530,000
84,798	Goods and Services Tax	87,428	87,828	88,494
58,410	Impôts Duty	58,420	58,777	58,600
30,305	Stamp Duty	29,055	29,641	30,241
12,141	Island Wide Rate	12,427	12,725	13,145
12,568	Other Income (Dividends)	12,332	9,127	15,034
22,760	Other Income (Non-Dividends)	15,726	11,224	12,521
27,856	Other Income (Return from Andium and Housing Trusts)	28,380	29,128	29,942
736,803	**States Income**	**726,768**	**748,450**	**777,977**
-	Proposed mechanism to offset States Payment of Rates	-	-	-
	Proposed Revenue Raising measures (draft Budget 2018)		2,900	10,200
736,803	**Total States Income**	**726,768**	**751,350**	**788,177**
	States Expenditure allocations			
698,454	Departmental Net Revenue Expenditure Allocations	700,637	697,627	686,100
-	Central Contingency Allocations	23,650	25,904	28,212
-	Central Growth Allocations	-	10,424	20,533
698,454	**Total Net Revenue Expenditure (excl: Depn)**	**724,287**	**733,955**	**734,845**
38,349	**Forecast Operating Surplus/(Deficit) for the year**	**2,481**	**17,395**	**53,332**
40,154	Departmental Depreciation	40,600	45,500	53,000
(1,805)	**Surplus/(Deficit) of General Revenue Expenditure over Income**	**(38,119)**	**(28,105)**	**332**

2.2 As with the 2017 budget setting the proposed budget measures around the creation of additional income are, in overall context, relatively modest with £2.900 million being generated within 2018 itself and £10.200 million in 2019. This is illustrated in the following table:

Proposed Measures	Estimated impact on 2018 taxation revenue (£'000)	Estimated impact on 2019 taxation revenue (£'000)
Personal Tax		
Increase 2nd earner's allowance		(2,600)
High Value Resident taxation changes	-	300
Increase income tax exemption thresholds at June 2017 RPI		500
Disallowance of Rates - Deputy Mézec Amendment (Budget 2017)		600
Corporate Tax		
Taxation of larger corporate retailers		5,700
Widening of definition of "financial services company"	-	3,000
Income Tax sub-total	**-**	**7,500**
Increase in ISE Fees	**1,000**	**1,000**
Impôt s Duties:		
Tobacco duty increases	800	800
Fuel duty increases	500	500
VED duty increases	600	400
Impôts Duties sub-total	**1,900**	**1,700**
Total Financial Implications	**2,900**	**10,200**

Consolidated Fund and Strategic Reserve

2.3 The balance on the Consolidated Fund has significantly improved over previous forecasts with the brought forward to 2017 some £36.3 million higher than anticipated "...primarily due to the improvement in the 2016 general revenues income against the Budget 2017 forecast."[1] This has effectively facilitated an increased 2018 funding for the annual capital programme of some £42.233 million which is significantly up from the anticipated 2018 contribution estimated within the 2017 Budget submission of £26.2 million funded by the Consolidated Fund:

[1] Draft Budget Statement 2018 – Page 88

Draft Forecast Consolidated Fund Balance	Forecast Update for Draft Budget 2018 (September 2017)		
	2017 £'000	2018 £'000	2019 £'000
Opening Balance brought forward	**90,941**	**79,486**	**54,648**
States Income Forecast Update (September 2017)	726,768	751,350	788,177
States Net Revenue Expenditure Allocations	(724,287)	(733,955)	(734,845)
Forecast Operating Surplus/(Deficit) - draft Budget 2017	**2,481**	**17,395**	**53,332**
Funding for Capital Programme			
Apply Funding for Annual Capital Programme	(26,209)	(43,233)	(32,975)
Other Funding proposals			
- Les Quennevais School	(39,000)		
Additional In Year Capital Funding		(6,500)	
Proposed Transfers from Strategic Reserve *			-
- Funding for Annual Capital Programme	16,273		
- Funding for Les Quennevais School	39,000		
Proposed Transfers to Strategic Reserve			
- Repayment for Economic and Productivity Growth Provision	(5,000)		
- Repayment for Redundancy Provision			(20,000)
Proposed Asset Disposals	1,000	1,000	1,000
Revised Transfer from Criminal Offences Confiscation Fund		6,500	
Forecast Closing Balance carried forward	**79,486**	**54,648**	**56,005**

2.4 An additional £6.5 million of additional capital programme funding has been met by a transfer from the Criminal Offences Confiscation Fund.

2.5 As noted within the 2017 Budget setting process the actual balance within the Consolidated Fund is significantly greater than the acknowledged de minimis position of £20 million. With in-year positions typically exceeding £100 million it is right that the Fund is able to act as a for unforeseen movements in income forecasts. However a significant contributory factor in the growing size of the fund is unspent capital funding for specific projects typically arising from project 'slippage'.

2.6 For the financial year 2016 the non-trading components of the States spent some £40.9 million on capital expenditure. The 2015 Budget included a capital allocation of some £25.51 million from the Consolidated Fund with an additional £121.6[2] million of unspent approvals brought forward from previous years. Within our MTFP II Addition Report - September 2016 we reiterated previous comments:

[2] States of Jersey Annual Report and Accounts 2016

"Bringing in mainstream capital spend to profile is not one of Jersey's strengths and there has been a consistent track record of underspending to programme"… As the 'mainstream capital programme is mainly funded from revenue allocations this consistent level of underspending can act as 'buffer' and some flexibility in managing capital/revenue funding. This is especially relevant where the initial resources tied up within the allocation approval process for indicative projects, that are likely not to spend, can be withdrawn/modified (subject to Ministerial approval). However, in terms of planning – such is the nature of the capital approval process where the entire funding is allocated in the first year – it must be extremely difficult to accurately predict the overall profile of capital expenditure in any given year and 'over programming' is not an option to account for natural slippage. The significant lack of consistency in profiled spending – particularly in final quarter of the financial year (40% in 2014 and 33% in 2015) does not indicate a controlled and co-ordinated approach being taken to the management of the capital programme.

A negative consequence of such controls could be the potential sub-optimal allocation of capital resources especially where project cost estimates and timescales are inaccurate or impacted by optimism bias. Locking capital resources within the capital approval process – whilst appearing to be prudent, can lead to sub-optimal decision making where there is a lack of rigour in the management of projects. There are processes in place that allows the redirection of such approvals on projects that are not being delivered - subject to ministerial approval – however the current arrangements appear to lack agility and it is not apparent that the performance management arrangements around the Capital Programme produce the effective management and utilisation of such investments.

2.7 Within our report on MTFP II CIPFA specifically recommended that :

"Consideration should be given to modifying the current controls over locking/securing/committing capital funding to allow for more flexibility and improved utilisation of funding sources."

2.8 Whilst the current position can be viewed as being extremely prudent approach and influenced by Article 10(8) of the Public Finances (Jersey) Law 2005 ("The Minister must not lodge a draft budget that includes a report that shows a deficit in the consolidated fund at the end of the financial year to which the budget relates" there is the potential for a level of volatility on the Consolidated Fund should a significantly higher level of committed capital expenditure crystallises in year. As Article 16 of the Public Finance (Jersey) Law 2005 provides that once Capital Project approval has been obtained and Capital Expenditure has been incorporated within the Capital Planning vote this effectively "..authorises a States funded body (other than a States trading operation) to withdraw from the consolidated fund, in one or more financial years, commencing with the financial year for which the approval is given, to make payments due for a capital project, amounts not exceeding, in total, the amount approved for the project, net of any capital receipts that are intended to be used for the project."

2.9 In essence the balance on the Consolidated Fund is likely to be distorted and the prevailing 'ring fenced' commitment of funds does not provide clarity over the actual balance on the Fund or incentivise the most effective utilisation of capital resources. Our previous comments within the Budget setting process of both 2015 and 2016 still have resonance in this area:

"On the Capital Programme we believe that the States face challenges in improving the precision of key assumptions as well as capacity including performance management capability and ultimately, affordability. The appropriate legislative allocation approval process has created a dysfunctional impact upon Financial Performance and Strategy as it is driven largely by aspirational/expectation rather than reality. Continuation of the existing position will act as a significant impediment to the formulation of a robust financial strategy that informs both the annual Budget Setting process and the MTFP." [3]

"In summary, the 2015 forecasted position does not provide overall confidence that optimal resource utilisation decisions are being taken in the management of capital investment. Within our report on the MTFP 2016-2019 we made a specific recommendation which we would re-affirm within our Budget 2016 assessment:

Capital Programme Performance – it is recommended that the legislative framework around the Capital Allocation process and incorporation within the Budget process be reviewed to allow for the realistic delivery of the Capital Programme and that appropriate performance management arrangements are put in place to ensure delivery."[4]

2.10 We understand that in the course of quarterly monitoring departments are asked to identify any unspent capital allocations which are no longer deemed to be required for their original purpose. Such unrequired allocations can either be returned to the Consolidated Fund or can be reallocated to other projects. The 2018 Budget submission identified that the last review identified some £5.8 million across a number of existing capital project allocations which should be shown below to be reallocated. Source projects for this element of reallocation and destination projects are highlighted within the following extracted tables[5]:

Source projects of capital allocations to be redistributed

[3] States of Jersey – Corporate Services Scrutiny Panel – Budget 2015 - CIPFA – Page 35 – Para 11.9
[4] States of Jersey – Corporate Scrutiny Panel – MTFP 2016 – 2019 Section 6 Page 24
[5] Draft Budget Statement 2018 – Figure 25 and 26 – pages 47 and 48

Ministry	Capital Projects	Amount available to Reallocate £	Additional Information
DFI	Adult Care Homes	3,810,575	£1.0 million is being used for the Autism Jersey project and £2.0 million reprioritised towards the Orchard House project
DFI	St Martin's School	651,555	
C&CA	Minor Capital	336,000	
DFI	Replacement Assets	299,999	
T&R	Contingency Fund	160,900	
DFI	Limes Upgrade	158,783	Balance after £1.0 million returned to the Le Seelleur Fund
DFI	Intensive Care Unit Upgrade	95,593	
DFI	Clinique Pinel Upgrade	94,794	
DFI	Office Rationalisation	44,000	
DFI	G&A Hospital Fire Safety Works	16,716	
DFI	Contingency Infrast. Maint.	14,974	
DFI	FB Fields Running Track	14,928	
DFI	T&R Grainville Phase 4a	13,114	
DFI	Fire Fighting System	7,920	
H&SS	Laundry Batch Washer - Planning	6,886	
DOE	Fisheries Vessel Mid Yr Refit	6,507	
DFI	Crabbe Silver Jubilee Works	6,217	
DFI	Mont-a-l'Abbe Phase II	5,228	
DFI	Highlands (A Block)	3,825	
H&SS	PSA Oxyenators	2,707	
DFI	Les Quen. Artificial Pitch	2,245	
DFI	Jersey Opera House	2,145	
DFI	T&R HD Farm Building and Incin	325	
DFI	Integrated Property System	154	
Total		**5,756,090**	

Beneficiary projects of capital re-allocations

Balancing 2018 - 2019 Budget Allocation	Total £'000	2018 £'000	2019 £'000
Remaining Shortfall b/fwd		**(7,153)**	**(2,198)**

Unspent Capital Budget to Reallocate to:	**5,756**		
Haute de la Garenne	(50)	50	-
Autism Jersey	(1,000)	1,000	-
Orchard House	(2,000)	2,000	-
DoE Minor Capital	(68)	-	68
Fisheries Vessels	(96)	71	25
DVS Systems	(300)	300	-
Grainville School Phase 5	(1,906)	401	1,505
Prison Phase 6	(336)	336	
Balance of Unspent Available to Allocate	**-**		
Remaining Shortfall b/fwd		**(2,995)**	**(600)**

2.11 We understand that transferring such unrequired allocations mitigates an oversubscription to the capital allocations (projects against assessed allocations) down to £3.0 million in 2018 and £0.6 million in 2019. However against an overall level of unspent approved allocations of £121.6 million such level of reassignment is considered to be minimal and more needs to be done to ensure approved allocations are still relevant as the lack of certainty on capital funding requirements indicates sub optimal arrangements exist over the management of funds and capital project management.

2.12 In respect of fund management should £121.6 million of unspent approvals be actually required it is it is likely a call on other reserves outwith the Consolidated Fund would be required given the de minimis £20 million - £30 Million operating requirement on that fund. There are strict controls on funding activity from the Strategic Reserve funds and the Strategic reserve should not be used "*to defray directly expenditure of the States*."[6] Whilst funding revenue expenditure is prohibited Capital Expenditure has been funded by transfers from the Strategic Reserve although we note that there are controls around such transfers. Indeed we understand that such funding cannot be withdrawn from the Strategic Reserve unless proposed by the Minister and agreed to by the Assembly although the 2018 Budget proposals do not include the funding of Capital from the Strategic Reserve. The 2018 Budget submission highlights a growing balance with the 2018 forecast being £843.602 million. This is significant up on the 2018 forecast embedded within the 2017 Budget setting process. Tables from both estimate exercises are appended below:

Strategic Reserve balance and estimated returns (September 2017)

Strategic Reserve - Estimated Balances	2016 Actual £'000	2017 Forecast £'000	2018 Forecast £'000	2019 Forecast £'000	2020 Forecast £'000	2021 Forecast £'000
Strategic Reserve - Protected Capital Value [1]	691,152	710,158	727,025	748,835	771,300	794,440
Strategic Reserve - Accumulated Excess Return [2]	128,432	98,083	116,577	156,946	179,770	204,185
Strategic Reserve - Estimated Fund balance	**819,584**	**808,241**	**843,602**	**905,781**	**951,070**	**998,625**
[1] The protected capital value is based on the 2012 Strategic Reserve value increased annually by RPI						
[2] The excess return is based on an assumed return of 2% in excess of RPI						

Strategic Reserve balance and estimated returns (September 2016)

Strategic Reserve - MTFP addition (June 2016)	2015 Actual £'000	2016 Forecast £'000	2017 Forecast £'000	2018 Forecast £'000	2019 Forecast £'000
Strategic Reserve - Protected Capital Value [2]	678,917	691,138	707,725	728,957	750,826
Strategic Reserve - Accumulated Excess Return [1]	92,465	51,789	16,511	31,491	68,145
Strategic Reserve - Estimated Fund balance (April 2016)	**771,382**	**742,926**	**724,236**	**760,448**	**818,970**

2.13 The States of Jersey manages the inter connectivity between the significant funds well. However, given the potential requirement to meet capital commitments as well as significant future capital projects such as provision for a new hospital from the Strategic Reserve, there is an overall lack of clarity on the precise level of balance on these funds which is not encumbered or committed.

[6] Article 4 of the Public Finances (Jersey) Law 2005

Other Funds – Social Security Fund

2.14 It is noted that the Social Security Fund is being increased as a result of an imbalance between Social Security Contributions from contributors, States Grant fixed at £65.3 million for 2018 and 2019 and actual benefits paid including administration costs. The service analysis is highlighted below which shows a net revenue surplus of £8.3 million is budgeted to be achieved in 2018:

Social Security Fund

Net Revenue Expenditure - Service Analysis

2017 Forecast		2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast
(65,300,000)	States Grant to Social Security Fund	(65,300,000)	(65,300,000)	(79,878,299)	(82,274,648)
(180,171,300)	Social Security Contributions	(185,967,300)	(188,724,900)	(194,363,500)	(200,151,300)
	Contributory Benefits				
179,249,500	Old Age Pensions	188,949,500	199,894,300	212,688,700	225,455,400
15,966,500	Long Term Incapacity Benefit	16,912,900	17,953,200	19,108,600	20,228,700
6,119,800	Invalidity Benefit	5,652,800	5,232,500	4,854,300	4,515,400
13,982,500	Short Term Incapacity Benefit	14,782,900	15,378,700	15,998,400	16,643,200
4,291,900	Survivors Benefit	4,451,700	4,628,200	4,772,000	4,920,300
2,703,600	Maternity Benefit	2,883,000	3,027,400	3,177,900	3,334,800
598,100	Maternity Grant	629,500	656,600	684,800	714,000
593,000	Death Grants	634,100	673,100	713,100	756,700
1,976,600	Home Carers Allowance	2,067,500	2,141,200	2,223,600	2,296,400
86,000	Redundancy Protection	250,000	250,000	250,000	250,000
225,567,500	Contributory Benefits	237,213,900	249,835,200	264,471,400	279,114,900
5,006,200	Administration	5,197,700	4,971,400	4,947,500	5,054,200
(14,897,600)	Net Revenue Expenditure - Near Cash	(8,855,700)	781,700	(4,822,899)	1,743,152
563,900	Depreciation	563,900	563,900	563,900	563,900
(14,333,700)	Net Revenue Expenditure	(8,291,800)	1,345,600	(4,258,999)	2,307,052

2.15 A critical aspect in the formulation of contributions is the extent that the burden falls upon contributors and the extent the States is required to provide a grant (£65.3 million in 2018/and 2019). Initial analysis indicates that where annual household income exceeds £44,000 the contributor becomes a "net contributor" in terms of overall tax paid, taking into account supplementation. Below this level the contributor is a net recipient in terms of likely benefits. Background on contributions is produced below:[7]

"Contributions to the fund are paid by working age adults (5.2% of earnings) and their employers (5.3%) up to the Standard Earnings Limit (SEL). Employers also pay 2% on earnings between the SEL and the Upper Earnings Limit (UEL). Individuals without an employer are

[7] Draft Budget Statement 2018 – Appendix 8 – page 128

required to contribute both elements. Contributors with earnings below the SEL, but above the Lower Earnings Limit (LEL) are treated as if contributions up to the SEL have been made to protect pensions and benefit entitlement (known as supplementation). The States provide an annual grant to the Fund, which partly covers the cost of supplementation. The amount is governed by a formula and is set for the period of the MTFP. In the 2016 MTFP the States agreed that, as a short-term measure, the value of the States Grant to the Social Security Fund will be frozen at the 2015 level throughout the MTFP period (2016-2019) to help to maintain balanced budgets throughout the four-year period.

Contributions have been forecast for the period using the central economic assumptions on average earnings (which affects both individuals earnings and the three earnings limits), and employment"

2.16 The two questions that arise are:

- Does the level of £44,000 represent the most equitable placement of net contributor status relative to social security contributions – in the context of overall income tax?

- What is the optimal grant the states should be funding given the likely development of fund balances and any potential adjustment to contributions?

2.17 We aware that a review is currently being carried out in this area. However given the significance of the level of grant and the likely profile of balance on the Social Security Fund it is critical that a considered strategy on contributions is set and a revised profile of grant be formulated based upon an evidence based methodology.

3 Income Tax Proposals and Yield Forecasts

3.1 The proposed Budget 2018 Tax measures apply to both personal and corporate tax streams as follows:

Personal Tax Proposals

- Income tax exemption thresholds to be increased by 2.5% for working age people, delivering a tax reduction of £91 at 26% for a single person, and £156 at 26% for a married couple/civil partnership
- Second earner's allowance to be increased by £850 to £5,850 delivering a further tax reduction of £221 for married couples/civil partnerships where both are earning.
- Enhancements to the tax regime applied to high value residents, including requiring future high value residents to pay more
- Minor amendments to the rules applying to pensions and pension schemes including greater flexibility in accessing small pension funds

Business Tax Proposals

- Subjecting the profits of larger corporate retailers to tax at 20%
- Extending definition of "financial services company" to bring more companies within the scope of the 10% company income tax rate
- Increasing some International Services Entities ("ISE") fees paid by businesses
- Disallowing the deduction of rates by landlords renting property in Jersey consistent with the 2017 Budget amendment
- Legislating for the taxation of non-Jersey limited liability partnerships
- Introduction of a Stamp Duty anti-avoidance provision

3.2 In context the impact of Personal and Business Tax proposals has the following revenue impacts across 2018 and 2019 of matching year of assessment to revenue implications:

Proposed Measures	Estimated impact on 2018 taxation revenue (£'000)	Estimated impact on 2019 taxation revenue (£'000)
Personal Tax		
Increase 2nd earner's allowance		(2,600)
High Value Resident taxation changes	-	300
Increase income tax exemption thresholds at June 2017 RPI		500
Disallowance of Rates - Deputy Mézec Amendment (Budget 2017)		600
Corporate Tax		
Taxation of larger corporate retailers		5,700
Widening of definition of "financial services company"	-	3,000
Income Tax sub-total	**-**	**7,500**

3.3 Overall proposals apply only £2.9 million of additional income growth but there is no Income Tax impact with consequential revenue implications falling within 2019 onwards. This is illustrated within the following table:-

Outturn	States Income	Sept 2017 Forecast	Draft Budget 2018 Forecast			
2016 £'000		2017 £'000	2018 £'000	2019 £'000	2020 £'000	2021 £'000
	Income Tax					
398,153	Personal Income Tax	407,000	426,000	444,000	464,000	485,000
90,688	Companies	78,000	87,000	89,000	92,000	95,000
(876)	Provision for Bad Debt	(2,000)	(3,000)	(3,000)	(3,000)	(3,000)
	Proposed Budget Measures for information only			*7,500*	*7,500*	*7,500*
487,965		483,000	510,000	537,500	560,500	584,500
	Goods and Services Tax (GST)					
71,837	Goods and Services Tax (GST)	74,860	75,209	75,810	76,417	77,028
3,933	Import GST	4,168	4,419	4,684	4,965	5,263
9,028	ISE Fees	8,400	8,200	8,000	8,000	8,000
	Proposed Budget Measures for information only		*1,000*	*1,000*	*1,000*	*1,000*
84,798		87,428	88,828	89,494	90,382	91,291
	Impôts Duties					
5,326	Impôts Duties Spirits	5,300	5,330	5,348	5,414	5,481
8,225	Impôts Duties Wine	8,251	8,544	8,749	9,037	9,336
1,034	Impôts Duties Cider	1,003	1,105	1,143	1,192	1,244
5,766	Impôts Duties Beer	5,673	5,800	5,821	5,893	5,966
14,609	Impôts Duties Tobacco	15,049	14,532	14,137	13,873	13,614
21,855	Impôts Duties Fuel	21,623	22,015	22,015	22,015	22,015
177	Impôts Duties Goods (Customs)	145	145	145	145	145
1,418	Vehicle Emissions Duty (VED)	1,376	1,306	1,242	1,242	1,242
	Proposed Budget Measures for information only		*1,900*	*1,700*	*1,700*	*1,700*
58,410		58,420	60,677	60,300	60,511	60,743
	Stamp Duty					
24,942	Stamp Duty	24,417	25,736	26,285	26,850	27,433
1,934	Probate	2,757	2,200	2,200	2,200	2,200
3,429	Stamp Duty on Share Transfer (LTT)	1,881	1,705	1,756	1,809	1,863
30,305		29,055	29,641	30,241	30,859	31,496
661,478	**Total Taxation Revenue**	657,903	689,146	717,535	742,252	768,030
12,141	**Island Rate Income from Parishes**	12,427	12,725	13,145	13,579	14,027
12,568	**Other States Income - Dividends**	12,332	9,127	15,034	9,667	10,016
22,760	**Other States Income - Non Dividends**	15,726	11,224	12,521	13,056	13,437
27,856	**Other States Income - return from Housing Associations**	28,380	29,128	29,942	30,977	32,049
75,325	**Total Other States Income**	68,865	62,204	70,642	67,279	69,529
736,803	**Total States Income - including proposed Budget Measures**	**726,768**	**751,350**	**788,177**	**809,531**	**837,559**
	% increase on previous year		*3.4%*	*4.9%*	*2.7%*	*3.5%*

3.4 The impacts of previous year Income Tax proposals should feed through to the baseline for 2018. Predicted 2017 Income Tax proposal impacts are shown on the following table:

Measure	Estimated impact on 2017 taxation	Estimated impact on 2018 taxation	Estimated impact on 2019 taxation
Income Tax	(£)	(£)	(£)
- Increase standard income tax exemption thresholds by 0.9% (June 2015 RPI) and maintain age enhanced exemption thresholds	2,200,000	2,200,000	2,200,000
- Grandfather entitlement to age enhanced exemption thresholds	-	-	300,000
- Phasing out standard child allowance and APA from standard rate taxpayers	645,000	1,290,000	1,935,000
- Modernise WEIA and CCTR	100,000	100,000	100,000
- Phase out mortgage interest tax relief	-	100,000	200,000
- Removal of non-residents relief	500,000	500,000	500,000
- Reduction of benefit in kind exemption	360,000	360,000	360,000
- Removal of remaining pension relief	-	350,000	350,000
- Additional Child Care Tax Relief	(100,000)	(100,000)	(100,000)
Income Tax sub-total	3,705,000	4,800,000	5,845,000

3.5 Robust forecasting is critical to underpinning the overall budget model as Income Tax accounts for some 74% of income raised as taxes and is some 68% of overall states income. The latest income tax forecasts reflect marginal adjustments although the transitional adjustment for the transfer of prior year tax payers to current year basis is a consistent theme:

Figure 58 - Revised income tax forecast 2017-2021

Income Tax	Outturn	Draft Budget 2018 Forecast				
	2016	2017	2018	2019	2020	2021
	£'000	£'000	£'000	£'000	£'000	£'000
Personal tax						
March 2017 forecast	379	398	418	438	459	481
New assumptions[1]		-2	-1	-2	-3	-4
ITIS data		+1	+1	+1	+1	+2
New yield calculation		-1	-1	-1	-2	-2
CYB annual increase adjustment		+10	8	8	8	8
Tax collectable (incl: CYB Adjustment)	*379*	*407*	*426*	*444*	*464*	*485*
Corporate tax						
March 2017 forecast	94	77	87	89	92	94
In-year data		+1	+1	+1	+1	+1
New FPP economic assumptions		0	0	-1	-1	-1
Tax collectable	*94*	*78*	*87*	*89*	*92*	*95*
Bad debts	-2	-2	-3	-3	-3	-3
New forecast (incl: CYB Adjustment)	*471*	*483*	*510*	*530*	*553*	*577*
Old forecast (incl: CYB Adjustment)	*471*	483	510	532	556	580
Difference since March 2017 Forecast	+0	+0	+0	-2	-3	-3

Some columns may not sum due to rounding

Notes:

[1] New assumptions includes new FPP economic assumptions, new earnings data and updated employment income regression (from Oxera recommendations)

3.6 On consistent application of the Current Year Basis adjustment we remain to be convinced that this level of adjustment consistently applied - effectively introducing a significant annual additional level of tax to the estimate – reflects the correct treatment. Within our report on the MTFP II Addition we made specific reference to our concerns including reference to a Tax Briefing Note which sought to explain that the recurring impact of the change in the impact of movement to current year basis would be minimal. The recurring adjustment has now increased from £7 million to £8 million with an expected adjustment of some £10 million in 2017. These comments are outlined below. [8]

"It is noted that the IFG have chosen to add some £7m of recurring additional Personal Tax income as a result of the accounting treatment change to CYB. This is arguably inconsistent with previous advice provided as contained within the 2015 Tax Briefing Note for the June 2015 submission of the MTFP. This advice included the following provision outlining the background to the change:

Section 7. Impact on the States of Jersey Financial Report and Accounts
The proposed amendment will require a prior year restatement in accordance with IAS 8. As CYB tax income is currently recognised when the final assessment is raised a year in arrears, ***the recurring impact of this proposal is minimal.*** *There will be a one-off increase in revenue in 2014 to recognise tax charged for the year of assessment 2013 for which payments were received in 2013 as payment in advance and to recognise payments collected in 2014 in respect of CYB taxpayers 2014 year of assessment. The effect on subsequent years is limited to the year on year movement in the CYB assessed income as tax accrued will be recognised in the year of assessment.*

Appendix 5 – Current Year Basis Taxpayers Recommended Basis for MTFP II Addition Forecast outlines the impact of the proposed changes. We remain to be convinced that in the graduated transition in the movement towards estimating Personal Income Tax on a full CYB basis (with only 19.5% of taxpayers meeting this criteria in 2015) would produce a recurring additional Personal Income Tax additionality of some £7m per annum. If CYB tax revenue has previously been recognised a year in arrears in the financial statements, with any tax collected through the Income Tax Instalment Scheme (ITIS) in the current year recognised as a payment in advance, we would have expected the graduated transition to produce a minimal year on year change (consistent with the above advisory note) – not a recurring additional yield of £7m. In any event the change to CYB introduces the requirement to apply a higher level of estimation than with the previous treatment. With this increased level of estimation comes a corresponding higher risk of inaccurate predictive positions. Should there be a lack precision or an unrealistic level of expectation on tax forecasts or component making up the estimate including forecasts on economic growth, such Tax estimates may lack credibility and damage confidence in the MTFP as the central mechanism for the formulation of financial strategy and related political decision making."

3.7 It was our understanding that there would be a reducing 'taper' effect as the number and impact of taxpayers falling into this category would reduce through time – a graduated transition. The consistent embedding of such an annual adjustment in materiality terms requires to be substantiated.

[8] CIPFA – Report to Corporate Scrutiny Panel - MTFP II Addition – Paras 4.28 and 4.29

3.8 The Income Forecasting Group have used the August 2017 economic data endorsed by the Fiscal Policy Panel (FPP) in the formulation of forecasts. The main movements in forecast are extracted from the Draft Budget Statement 2018:

1. **Outturn data** – there have been a number of new data:

   Financial services profits for 2016 were significantly lower than forecast. o FTE Employment growth in 2016 was higher than forecast

   Finance sector compensation of employees grew by only ½ per cent (nominal) in 2016; leading to a lower expectation for compensation of employees overall.

2. **Financial services profit growth** – growth expected to be slower in 2017 and 2018.

3. **Non-finance profit growth** expected to be slower in 2017.

4. **Inflation** – expectations for 2018 are lower.

5. **Average earnings** – 2018 expected to be slightly lower (in nominal terms, due to lower inflation).

6. **Employment growth** – is now expected to be faster in 2017 and 2018.

7. **UK policy interest rates –** are now expected to be slightly lower throughout the forecast period. The changes in these assumptions have had knock-on effects on the nominal and real economic growth (gross value added - GVA) assumptions, with real growth estimated to have been slower in 2016 but a little higher in 2017 and 2018. The FPP has not made any change to forecasts for GVA growth in 20192020.

3.9 For 2017 actuals we have not had access to the latest in-year positions but the forecasted position appear to exceed the 2017 budget position.

Underlying Assumptions on Yield

3.10 Personal Income Tax, in terms of proportionality is the largest component of Income Tax coming in at an approximately 83.5% of overall yield and is significantly influenced by employment related indices. Revised economic metrics (central trend scenario) used by the Income Forecasting Group as at August 2017 were as follows:

FPP central scenario August 2017

						Return to trend		
	2014	2015	2016	2017	2018	2019	2020	2021
Real GVA	4.9	2.2	0.2	1.2	0.6	0.0	0.0	0.0
RPI	1.6	0.6	1.7	2.8	2.4	3.3	3.3	3.3
RPIY	1.6	0.6	1.7	2.8	2.4	3.0	3.0	3.0
Nominal GVA	6.6	2.9	1.9	4.0	3.0	3.0	3.0	3.0
Company profits	12.3	-0.7	0.9	3.9	2.9	3.0	3.0	3.0
Financial services profits	19.4	-7.6	-0.6	4.0	2.4	3.0	3.0	3.0
Compensation of employees	2.1	5.9	2.8	4.0	3.0	3.0	3.0	3.0
Employment	2.3	1.9	2.0	1.0	0.5	0.0	0.0	0.0
Average earnings	2.6	1.8	2.1	3.0	2.5	3.0	3.0	3.0
Interest rates (%)	0.5	0.5	0.4	0.2	0.3	0.4	0.5	0.8
House prices	3.0	4.0	4.0	3.0	3.0	3.0	3.0	3.0

3.11 The changes from the March 2017 to August 2017 are relatively significant and are reflective on the relative uncertainty and instability of current and expected economic conditions including uncertainties around Brexit. The changes were as follows:

Variance August 2017 to March 2017						Return to trend		
	2014	2015	2016	2017	2018	2019	2020	2021
Real GVA	0.0	0.0	-1.3	0.2	0.6	0.0	0.0	0.0
RPI	0.0	0.0	0.0	0.1	-0.6	0.0	0.0	0.0
RPIY	0.0	0.0	0.0	0.1	-0.6	0.0	0.0	0.0
Nominal GVA	0.0	0.0	-1.3	0.3	0.0	0.0	0.0	0.0
Company profits	0.0	0.0	-1.9	0.2	-0.1	0.0	0.0	0.0
Financial services profits	0.0	0.0	-3.2	-0.4	-0.6	0.0	0.0	0.0
Compensation of employees(a)	0.0	0.0	-0.8	0.3	0.0	0.0	0.0	0.0
Employment	0.0	0.0	0.5	0.2	0.5	0.0	0.0	0.0
Average Earnings	0.0	0.0	0.0	0.1	-0.5	0.0	0.0	0.0
Interest rates (%)	0.0	0.0	0.0	-0.1	-0.1	-0.2	-0.3	-0.2
House prices	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

3.12 In using these revised economic indicators (and a central rather than an upper or lower range forecast) a revised set of Income Tax forecasts have been produced based on economic indicators which incorporate rates of growth in average earnings in 2018 of 2.5% and 2019 of 3.0%. However looking at year on year changes overall growth levels on yields exceed these metrics:

Year	2017	2018	2019	2020	2021
Income Tax £'000	£483,000	£510,000	£530,000	£553,000	£577,000
Growth £'000		**£27,000**	**£20,000**	**£23,000**	**£24,000**
% change		**5.59%**	**3.92%**	**4.34%**	**4.34%**
Real GVA%	1.20%	0.60%	0.00%	0.00%	0.00%
Average Earnings	3.00%	2.50%	3.00%	3.00%	3.00%
Financial Services Profits	4.00%	2.40%	3.00%	3.00%	3.00%

3.13 It is difficult to track the impact of the economic indicators used within modelling with the actual expect % changes on budgeted tax yields. Indeed, comparison with MTFP II Addition projections are also difficult to assess the causal drivers behind the latest changes. Within the 2017 Budget setting exercise we previously noted:

"Whilst there has been a general a downward revision arising from the latest economic indicators (see above) although these adjustments do not suggest a significant level of change commensurate with the level of uncertainty. We would consider that the level of average nominal earnings estimate used of 3.8% in 2017 to be overly optimistic especially in the context of acknowledged downside risks."[9]

3.14 Whilst revised earnings metrics were indeed lower in actuality the level of tax yield that is likely to be achieved is higher. This suggests that the tax forecasting model has not yet achieved the relative level of precision that should be expected.

[9] CIPFA – States of Jersey Budget 2017 – Report to the Corporate Services Scrutiny Panel

3.15 In respect of Personal Income Tax it is noted that the forecasted 2018 Personal Tax Yield is set to bring in £418 million which is 5.3% higher than the 2017 forecast of £397 million. The 2017 forecast is 4.7% higher than the 2016 outturn.

	Outturn	Forecast				
	2016 outturn	2017	2018	2019	2020	2021
	£m	£m	£m	£m	£m	£m
Personal tax						
March 2017 forecast	**379**	**398**	**418**	**438**	**459**	**481**
New assumptions[1]		-2	-1	-2	-3	-4
ITIS data		+1	+1	+1	+1	+2
New yield calculation		-1	-1	-1	-2	-2
Tax collectable (excluding: CYB adjustment)	**379**	**397**	**418**	**436**	**456**	**477**
			Some columns may not sum due to rounding			
Notes:						
[1]New assumptions includes new FPP economic assumptions, new earnings data and updated employment income regression.						

3.16 On Corporate Tax whilst there is an expected shift in the annualised profits of the Financial Services industry from 4% in 2017 to 2.4%, the expected change between the 2017 forecast and the 2018 is a 11.5% increase or £9m. Revised forecasting published as R66/2017 produced in March 2017 has been used to inform assumptions on tax collectable:

	2016 outturn	2017	2018	2019	2020	2021
	£m	£m	£m	£m	£m	£m
Corporate tax						
March 2017 forecast	**94**	**77**	**87**	**89**	**92**	**94**
In-year data		+1	+1	+1	+1	+1
New FPP economic assumptions		0	0	-1	-1	-1
Tax collectable	**94**	**78**	**87**	**89**	**92**	**95**
			Some columns may not sum due to rounding			

3.17 Impacts of the following additional sources from 2019 arising from Budget 2018 proposals will naturally change the profile of expected tax collectable:

Taxation of larger corporate retailers - £5.7 million
Widening of definition of "financial services company" - £3.0 million

Taxing Corporate Retailers

3.18 The Minister gave notice in 2016 that extending the corporate tax base was now within scope. The expected yield is assumed to be generated from approximately 20 retailers of which about 15 are not locally owned. A sliding scale of tax paid on profits between £500,000 to £750,000 between 0% and 20% with all profits above this attracting a full 20%. The entity within scope is retail and not wholesale. Additional defining criteria of a "large corporate retailer" will be a company which meets the following criteria:

- 60% of its trading turnover is from retail sales to customers in Jersey
- Retail sales to customers in Jersey are equal to or greater than £2m per annum

3.19 Whilst we have no doubt that the Tax Office has strong intelligence around the trend of profits generate by these entities we would have some concerns around any behavioural change that such an extension of scope could drive in the financial strategies of the tax paying entities now in scope. In terms of tax planning it is not inconceivable that shareholders/owners may want to re-calibrate their financial strategies in a way that optimises investment within their businesses and minimises corporate tax exposure. Another potential impact of this application is the potential for such and extension to negatively impact other sources of States Income. We note that there is a view taken by the Minister that there is little expectation that any substantive additional tax burdens will be passed on to customers of these business in scope. We would welcome the opportunity to have sight on the modelling that assesses/estimates the expected £5.7 million liability to tax for the extended range of businesses in scope.

Widening of the definition of "financial services company"

3.20 The widening of the definition to move more financial services entities within the scope of the 10% tax rate is expected to raise £3 million per annum. As with the retailer proposal it would be important to assess whether tax planning may drive decisions that may remove potentially impacted entities from scope. For example adding to any pre-existing strategy to change jurisdictional location relative to activities.

Alternatives and Risks

3.21 Without sight of the assumptions behind the additional yields to be raised by corporate entities it is difficult to assess the risks that such yields will not materialise. Although prevailing economic uncertainties may mitigate from personal tax increases it is worth considering the recurring impact (approximately £7 million/£8 million per annum) of the 2014 Budget decision to reduce the marginal rate of tax by 1% to 26%. It is accepted that once reduced it become politically more difficult to reinstate. However, it would be our considered view that tax strategy should include similar options to vary income tax in response to changing conditions.

4 Other Income Proposals

4.1 The 2018 Budget proposals cover two main categories of activities totalling net additional revenue for 2018 of £2.900 million. This is split between the following components:-

- Impôts Duty Increases – additional £1.900 million in revenue for 2018 and £1.700 million for 2019
- ISE – Increase in ISE Fees – an additional revenue of £1 million on an annual basis

4.2 A detailed split for 2018/2019 is outlined below:

Proposed Measures	Impact 2018	Impact 2019
Impôt Duties:	£,000	£,000
Tobacco duty increases	800	800
Fuel duty increases	500	500
VED duty increases	600	400
Impôts Duties sub-total	**1,900**	**1,700**
Increase in ISE Fees	**1,000**	**1,000**
Financial Implications	**2,900**	**2,700**

Impôts

4.3 The proposal to generate additional revenue from Alcohol is founded on a 2.5% increase which is in line with RPI as at June 2017 and is estimated to bring in some £21 million in 2018. In line with prevailing policy the proposal tobacco has increased by RPI plus 5% and plus 7.5% for hand-rolling tobacco. Road Fuel is increased by RPI and will equate to some 1 pence per litre on unleaded petrol/diesel. This is expected to bring in an additional £.5 million per annum.

4.4 In respect of Vehicles Emissions Duty proposed changes are attributed to evolving the tariff structure consistent with the States Energy Pathway 2050 strategy. VED are to increase in line with the 2.5% RPI indicator as at June 2017 and are expected to generate an additional £.6 million in 2018.

4.5 Customs duties are expected to realise some £145,000 from good imported from outside of the EU in 2018.

International Service Entity (ISE) Fees

4.6 The main benefit of registration (an elective decision) as an International Service Entity takes the form of being treated as being outside the scope of GST. Fees are charged for registration and figure 6 in page 19 of the Draft Budget Statement highlight the ISE fees collected:

Year	Total ISE fees
2008	£6,113,100
2009	£5,736,100
2010	£5,208,100
2011	£8,911,000
2012	£9,058,000
2013	£9,427,600
2014	£9,166,300
2015	£9,078,700
2016	£8,791,100

4.7 The last time the fees were revalorised was in 2010/11 when fees for entities registered under the Banking Business (Jersey) Law 1991 was increased from £30,000 to £50,000 and other entities outwith this registration was increased from £100 to £200. It is expected that an additional yield in fees of some £1 million per annum will be generated from this source.

4.8 Overall, the proposals outlined above appear to be robust underpinned by strong metrics and are wholly consistent with prevailing policy.

5 Base Budgets

5.1 Departmental Net Revenue Expenditure excluding contingency and depreciation set for 2018 is £697.627 million. This is represented below:

Outturn	Financial Forecast	Sept 2017 Forecast	Draft Budget 2018 Forecast	
2016 £'000		2017 £'000	2018 £'000	2019 £'000
	States Income			
487,965	Income Tax	483,000	510,000	530,000
84,798	Goods and Services Tax	87,428	87,828	88,494
58,410	Impôts Duty	58,420	58,777	58,600
30,305	Stamp Duty	29,055	29,641	30,241
12,141	Island Wide Rate	12,427	12,725	13,145
12,568	Other Income (Dividends)	12,332	9,127	15,034
22,760	Other Income (Non-Dividends)	15,726	11,224	12,521
27,856	Other Income (Return from Andium and Housing Trusts)	28,380	29,128	29,942
736,803	**States Income**	**726,768**	**748,450**	**777,977**
-	Proposed mechanism to offset States Payment of Rates	-	-	-
	Proposed Revenue Raising measures (draft Budget 2018)		2,900	10,200
736,803	**Total States Income**	**726,768**	**751,350**	**788,177**
	States Expenditure allocations			
698,454	Departmental Net Revenue Expenditure Allocations	700,637	697,627	686,100
-	Central Contingency Allocations	23,650	25,904	28,212
-	Central Growth Allocations	-	10,424	20,533
698,454	**Total Net Revenue Expenditure (excl: Depn)**	**724,287**	**733,955**	**734,845**
38,349	**Forecast Operating Surplus/(Deficit) for the year**	**2,481**	**17,395**	**53,332**
40,154	Departmental Depreciation	40,600	45,500	53,000
(1,805)	**Surplus/(Deficit) of General Revenue Expenditure over Income**	**(38,119)**	**(28,105)**	**332**

5.2 The MTFP Addition 2017-19 substantially provides the detailed base budgets that are reflected within the Draft Budget Statement 2018.The revised base Total Net Expenditure by Departments and Non Ministerial Bodies excluding depreciation is £777.188 million for 2017 (down from £789.560 million set for 2016)and the detail relative to departments and other bodies is highlighted[10]:

[10] Draft 2018 Budget Statement – Figure 40 - Total States Net Expenditure Allocations for 2017-2019 from MTFP Addition

States Funded Bodies	MTFP Addition 2017 - 2019 (as amended)		
	Total Net Expenditure	Total Net Expenditure	Total Net Expenditure
	2017 £'000	2018 £'000	2019 £'000
Ministerial Departments			
Chief Minister's	26,482.1	26,210.1	25,473.1
- Jersey Overseas Aid Commission	10,338.5	10,338.5	10,338.5
External Relations	1,746.3	1,746.3	1,746.3
Community and Constitutional Affairs	48,782.7	48,241.9	47,095.2
Economic Development, Tourism, Sport and Culture	19,182.6	18,339.0	17,795.9
Education	105,944.0	106,216.9	106,316.9
Department of Environment	5,856.1	5,393.4	4,675.9
Health and Social Services	207,908.3	210,787.0	210,481.1
Infrastructure	39,981.1	35,367.4	26,449.2
Social Security	186,225.7	187,551.3	189,331.4
Treasury and Resources	21,447.4	20,973.5	20,267.4
Ministerial Departments	673,894.8	671,165.3	659,970.9
Non Ministerial States Funded Bodies			
- Bailiff's Chamber	1,687.7	1,699.7	1,711.8
- Law Officers' Department	7,555.9	7,323.8	7,087.1
- Judicial Greffe	6,558.1	6,497.1	6,429.8
- Viscount's Department	1,341.2	1,349.9	1,345.5
- Official Analyst	600.2	601.3	571.5
- Office of the Lieutenant Governor	734.5	724.9	714.7
- Office of the Dean of Jersey	27.0	27.2	27.5
- Office of the Data Protection Commissioner	374.3	439.7	505.9
- Probation Department	2,013.8	2,017.6	2,021.7
- Comptroller and Auditor General	804.4	817.4	831.2
States Assembly and its Services	5,045.4	4,963.4	4,882.4
Non Ministerial Departments	26,742.5	26,462.0	26,129.1
Total Departmental Net Revenue Expenditure	**700,637.3**	**697,627.3**	**686,100.0**
Central Contingency Allocations	23,649.7	25,903.7	28,212.1
Central Growth Allocations	-	10,424.0	20,533.0
Total Net Revenue Expenditure	**724,287.0**	**733,955.0**	**734,845.0**
Net Capital Expenditure Allocation - Annual Programme	26,273	35,000	32,975
Net Capital Expenditure Allocation - Other Projects	39,000	8,233	-
Total States Net Capital Allocations	**65,273**	**43,233**	**32,975**
Total States Net Expenditure Allocations	**789,560**	**777,188**	**767,820**
For Information:			
Departmental Depreciation	*40,600*	*45,500*	*53,000*

5.3 Whilst we have previously acknowledged that the MTFP 2016-19 Addition II base budget setting process is granular and robust and indeed could be considered to be an exemplar to other public bodies based within the UK we did have concerns about some critical assumptions. A concern previously highlighted was the extent that vacancies were being funded within base budgets – particularly in the context of extremely high staff vacancy levels. This imports the potential for resource allocation to be sub optimal. We are unsighted within the Budget 2018 submission on the extent that vacancies are fully funded. In this respect we would reiterate our previous concerns in that in the formulation of base budget positions on staffing, the incremental budget setting based process on providing full funding for agreed and adjusted staffing structures does not provide the appropriate level of rigour or behaviours needed to encourage a shaping staffing resources to critical need.

Efficiency Savings

5.4 From the MTFP II Addition submission a revised £77.5 million target to 2019 was previously outlined below:

	2016	2017	2018	2019
	£'000	£'000	£'000	£'000
Savings	525	1,087	1,487	1,817
Efficiencies	21,793	29,244	38,020	46,317
Efficiencies - Pay Restraint	10,894	16,725	20,701	24,826
User Pays	695	1,181	2,661	4,575
Total Proposed Department Savings	**33,907**	**48,237**	**62,869**	**77,535**

5.5 The 2018 Budget submission highlights an original target of £123 million per annum on base to be achieved by 2019. This was to be constructed as follows:

- £73 million of efficiencies and savings
- £4 million user pays;
- £10 million of benefit changes
- £11 million of waste charges
- £15 million from a Health charge
- £5 million from the Health Insurance Fund (HIF)
- £5 million from reducing the central provisions for Restructuring and EPGDP in 2019.

5.6 The 2018 Budget submission outlines the deemed progress on this £123 million target made to date as well as forecasted attainment:

MTFP package of measures	Upto 2017 £m	RAG Rating	2018 £m	RAG Rating	2019 £m	RAG Rating	Full Year £m	Target £m
Department Efficiencies/Savings/User Pays	32		10		10		52	52
Pay related savings	17		4		4		25	25
Benefit changes	7.9		1.3		0.6		9.8	10
Non-Domestic Liquid Waste Charges			3		4		4	3
Non- Domestic Solid Waste Charges					7		7	8
Proposed Health Charge			7.5		15		0	15
Proposed Transfers from HIF	5		5		5		0	5
Reduced Central Provisions					5		5	5
Total Proposed Measures	**61.9**		**30.8**		**50.6**		**102.8**	**123**
Proposed replacement measures								
Future revenue raising measures (Budget 2018)			2.9		10.2		10.2	
Replacement for HIF								
- Carry forwards from 2016	5							
- Dept underspends and AME Contingency			5		5			
- Recurring measures to be identified from 2020					5			
Total Revised Measures (Budget 2018)							**113**	
		Delivered						
		On track - subject to final decisions						
		Not identified - further work required						
		Decision to defer or withdraw						

5.7 We are unsighted on the exact departmental budget lines that will deliver the £10 million requirement of Departmental Efficiencies/Savings/User pays and £4 million of Pay related savings but assume base budgets have been adjusted accordingly. On progress we are given some assurance that achievement on this level of efficiencies is 'own track' but cannot see tangible evidence within the Budget Statement of how direct management interventions have driven these savings:

"The £77 million of expenditure measures for efficiencies, savings and user pays and £10 million of benefit changes are largely on track and departments are currently updating their proposals to be published in the Update to the MTFP Department Annex for 2018 in December 2017. "[11]

5.8 Within our previous scrutiny work of the expected savings and efficiencies arising from the MTFP II Addition 2016 – 2019 work, the general absence of detailed departmental workings around efficiencies led us to the view that the lack of detail provided across the departments did not provide an appropriate level of confidence to illustrate that departmental management can actually deliver such plans. If we are now given some assurance that achievement is "largely on track" we would welcome the opportunity to see how such improvements have been achieved.

Growth – allocations

5.9 The Draft 2018 Budget Statement outlines Growth allocations for 2018 and full year impacts on 2019. As with previous years the strategy in targeting service pressure requirements of Health Social Services and Education are met in a highly developed exercise. The allocations are outlined in Figure 20 of the Draft Budget Statement below:

[11] States of Jersey – 2018 Draft Budget Statement –Page 36

Dept	Proposals to be held in Central Growth Provision	2018 Proposed	2019 Proposed		
			Recurring	New	Total
		£'000	£'000	£'000	£'000
H&SS	2% Investment in Service Standards and Healthcare Inflation	4,714	4,714	5,253	9,967
	P82/2012 - Health Transformation (White Paper)				
H&SS	Acute Service Strategy	1,716	2,019	1,389	3,408
H&SS	Mental Health	442	442	99	540
H&SS	Out of Hospital	462	1,045	1,223	2,268
H&SS	Services for Children (Early Interventions)	615	767	226	993
	Sub Total Health Transformation - White Paper programme	3,235	4,273	2,936	7,209
H&SS	**Proposed Central Growth Allocation for Health**	**7,949**	**8,987**	**8,189**	**17,176**
CCA	Healthy Lifestyles (Trf from H&SS)	265	273	88	361
CCA	**Proposed Central Growth Allocation for CCA**	**265**	**273**	**88**	**361**
EDN	Revenue consequences of capital schemes - New schools	90	115	-	115
EDN	**Proposed Central Growth Allocation for Education**	**90**	**115**	**-**	**115**
EDTS&C	Revenue consequences of capital schemes - Jersey Archive	20	25	-	25
EDTS&C	**Proposed Central Growth Allocation for EDTS&C**	**20**	**25**	**-**	**25**
DFI	Tipping Fees Shortfall			796	796
DFI	Revenue consequences of capital schemes - new Sewage Treatment Works	-		1,700	1,700
DFI	Contribution towards DfI cash limit shortfall for 2018	2,100			
DFI	**Proposed Central Growth Allocation for Infrastructure**	**2,100**	**-**	**2,496**	**2,496**
	Unallocated growth funding available for 2019			**360**	**360**
Total	**Total Proposed Central Growth Allocation for 2018 and 2019**	**10,424**	**9,400**	**11,133**	**20,533**

5.10 The latest allocation in 2018 has been adjusted from the original central growth allocation for 2018 and 2019 which was part of the MTFP II Addition submission as laid out in Figure 18 of the Draft Budget Statement:

Dept	Proposals to be held in Central Growth Provision	2018 Indicative	2019 Indicative
		£'000	£'000
HSS	2% Investment in Service Standards and Healthcare Inflation	4,714	9,967
	P82/2012 - Health Transformation (White Paper)		
HSS	Acute Service Strategy	**2,705**	**3,408**
HSS	Healthy Lifestyles	**324**	**360**
HSS	Mental Health	**540**	**480**
HSS	Out of Hospital	**768**	**2,329**
HSS	Services for Children (Early Interventions)	**615**	**993**
HSS	**Proposed Central Growth Allocation for Health**	**9,666**	**17,537**
Edu	Revenue consequences of capital schemes - New schools	360	400
Edu	**Proposed Central Growth Allocation for Education**	**360**	**400**
SA	States Members' Pensions (as amended)	58	100
SA	**Proposed Central Growth Allocation for States Assembly**	**58**	**100**
DFI	Tipping Fees Shortfall	340	**796**
DFI	Revenue consequences of capital schemes - new Sewage Treatment Works	-	1,700
DFI	**Proposed Central Growth Allocation for Infrastructure**	**340**	**2,496**
Total	**Total Proposed Central Growth Allocation for 2018 and 2019**	**10,424**	**20,533**

5.11 As can be seen the changes to proposals represent a constant refinement of service proposals against available funding. Such an approach is considered to be robust and we previously commented on the way Health and Education seek to constantly manage down cost pressures and optimise resources to accommodate service pressures. Growth proposals are obviously additional pressures which cannot be accommodated regardless of the rigour imposed on reallocating resources.

Other Income

5.12 Other income is comprised of four lines of income which do not contain specific budget proposals - however such income streams are regarded as significant. These are highlighted within an extract below[12] together with the corresponding table from the Draft 2017 Budget statement for comparison:

Other Income	Outturn	Forecast (Sept 2017)	Draft Budget 2018 Forecast			
	2016	2017	2018	2019	2020	2021
	£'000	£'000	£'000	£'000	£'000	£'000
Island Wide Rate	12,141	12,427	12,725	13,145	13,579	14,027
Other Income - Dividends	12,568	12,332	9,127	15,034	9,667	10,016
Other Income - Non Dividends	22,760	15,726	11,224	12,521	13,056	13,437
Other Income - Returns from Andium and Housing trusts	27,856	28,380	29,128	29,942	30,977	32,049
Total Other Income	**75,325**	**68,865**	**62,204**	**70,642**	**67,279**	**69,529**
March 2017 Forecast	75,325	66,846	62,491	71,372	68,384	71,107
Variation	-	2,019	(287)	(730)	(1,105)	(1,578)

Other Income	Outturn	Forecast (Sep 2016)	Draft Budget 2017 (September 2016)			
	2015	2016	2017	2018	2019	2020
	£'000	£'000	£'000	£'000	£'000	£'000
Island Wide Rate	11,928	12,142	12,543	12,919	13,346	13,786
Other Income - Dividends	14,023	11,149	8,703	9,017	14,937	9,872
Other Income - Non Dividends	12,506	9,710	10,151	9,697	10,284	11,330
Other Income - Returns from Andium and Housing trusts	27,483	27,785	28,337	29,264	30,186	31,215
Total Other Income	**65,940**	**60,786**	**59,734**	**60,897**	**68,753**	**66,203**
June 2016 Forecast	65,940	61,118	59,682	66,220	63,403	66,244
Variation	-	(332)	52	(5,323)	5,350	(41)

5.13 The Island Wide Rate is collected through the 12 parishes, levied by the States and increased annually based on the March RPI. We understand that the level of forecasting accuracy is relatively high and the incremental movements of expected income are easily tracked within the above table extract.

5.14 As can be seen from comparing 2015 and 2016 outturns the Other Income (Dividends) income source there is a relative consistency although the Other Income – Non dividends is significantly more volatile up from £9.697 million based on a September 2016 forecast to £11.224 million or 15.7% upward change.

[12] Draft Budget 2018 Statement – Figure 66- page 121

5.15 There is a significant downward movement between the level of Other Income Dividend forecasted outturn in 2017 of £12.332 million and the base 2018 position of £9.127 million. We understand that the main contributors are entities in which the States have a shareholding and are as follows:

Entity	**States Control**
Jersey Telecom	100%
Jersey Post	100%
Jersey Electricity	86.4%
Jersey New Waterworks	83.3%
SoJDC	100%
Ports of Jersey	100%

5.16 We did not detect any considered rationale for the expected reduction within the Draft 2018 Budget Statement. Whilst there has been a reduction in the economic assumption for RPI affecting Andium Homes returns the profile of base estimates remains consistent moving beyond 2018.

6 Capital Programme

6.1 The 2018 Draft Budget Statement proposes to add to the MTFP II Capital Allocations for 2018 of £43.233 million by adding some £14.653 million to position the 2018 capital Programme at £57.886 million:

	2018 £'000	2019 £'000	Total £'000
MTFP Approved Allocations	**43,233**	**32,975**	**76,208**
Variations to projects included in the MTFP indicative programme			
ISD Reprioritisation	(499)	251	**(248)**
Grainville Phase 5	4,000	1,271	**5,271**
St Mary's School	1,000	-	**1,000**
Les Quennevais	5,600	-	**5,600**
C&CA Minor Capital	(169)	-	**(169)**
DoE Minor Capital	-	68	**68**
Fisheries Vessels	71	25	**96**
Treasury Replacement Assets	-	(17)	**(17)**
Total Variations to MTFP Project Requirements	**10,003**	**1,598**	**11,601**
Digital Care Strategy	850	600	**1,450**
Autism Jersey	1,000	-	**1,000**
Orchard House	2,000	-	**2,000**
DVS Systems	550	-	**550**
Haute de la Garenne	50	-	**50**
La Collette Fire Equipment	200	-	**200**
Additional Capital Heads of Expenditure	**4,650**	**600**	**5,250**
Total Changes from MTFP	**14,653**	**2,198**	**16,851**
Total Capital Programme	**57,886**	**35,173**	**93,059**

6.2 The overall Capital Programme includes two categories - Major Projects and 'all other projects'. Two 'major projects' are not included within the overall 2018 provision of £57.886 million and are:

- Future Hospital
- Office Consolidation Project

6.3 The full programme is highlighted by department heading below:

Capital Head of Expenditure	Proposed Programme (Gross) £'000 2018
Chief Minister's	
Corporate Web Platform Refresh Cycle	326
Hardware Refresh	201
Open Data	53
Data Warehouse Platform	647
CRM Platform Renewal	396
Replacement Assets - CMD	200
Corporate Data Platforms Upgrade	500
Chief Minister's Total	**2,323**
Education	
Grainville Phase 5 *	8,458
St Mary's School *	6,500
Les Quennevais School *	5,600
Replacement Assets and Minor Capital - EDU	200
Education Total	**20,758**
Health & Social Services	
Replacement Assets (Various)	2,351
Barrier Washer Extractor	229
Ironer Line	420
Digital Care Strategy	*850*
*Autism Jersey Facility**	*1,000*
*Orchard House **	*2,000*
Health & Social Services Total	**6,850**
Department for Infrastructure	
Replacement Assets	2,250
Infrastructure Rolling Vote	14,003
La Collette Waste Site Development	2,500
DVS Systems	*550*
*Haute De La Garenne**	*50*
La Collette Fire Equipment	*200*
Department for Infrastructure Total	**19,553**
Department of the Environment	
Fisheries Vessels	125
Department of the Environment Total	**125**
Community and Constitutional Affairs	
Prison Phase 6 *	8,233
Community and Constitutional Affairs Total	**8,233**
Non Ministerial	
Replacement Assets - Non Mins	44
Non Ministerial Total	**44**
Total Capital Programme	**57,886**

	Proposed Programme 2018 £'000
Car Park Enhancement and Refurbishment	3,404
Sustainable Transport and Road Safety Schemes	300
Jersey Car Parking	**3,704**
Vehicle and Plant Replacement	2,169
Jersey Fleet Management	**2,169**

Funding Sources

6.4 Funding sources for this proposed programme totalling some £57.886 million is as follows:

- Consolidated Fund - £43.233 million is the main source
- Additional sources – see below

	Proposed Funding 2018 £'000	Indicative Funding 2019 £'000	Indicative Funding 2020 £'000	Indicative Funding 2021 £'000
Departmental Capital Allocation	**43,233**	**32,975**	**55,000**	**55,000**
Funding Sources				
Consolidated Fund	(43,233)	(32,975)	(55,000)	(55,000)
Total Funding of Allocation	**(43,233)**	**(32,975)**	**(55,000)**	**(55,000)**

	Proposed Funding 2018 £'000	Indicative Funding 2019 £'000
Additional Capital Identified	**14,653**	**2,198**
Funding Sources		
Apply COCF to Prison Phase 6	(6,500)	-
Transfer from anticipated unspent Contingencies carried forward	(1,000)	-
Transfer of unspent capital	(4,158)	(1,598)
Transfer of revenue budgets	(2,995)	(600)
Total Additional Funding	**(14,653)**	**(2,198)**
TOTAL CAPITAL PROGRAMME FUNDING	**(57,886)**	**(35,173)**

6.5 We previously commented on the apparent disconnect between the calculation of depreciation and the utilisation of depreciation in asset replacement/investment decision strategy. It could be readily argued that asset replacement and investment - sources of capital funding should be largely be provided for the substantive Capital Programme (excluding the major projects) from the Consolidated Fund without recourse to transfers from other funds – even such as the COCF. However given the relative materiality of the sums involved this is a mute-point. However, as highlighted in Section 2 of this report the States have a poor record in utilising capital allocations and it is likely that significant unspent approvals will be carried forward to 2018 from 2017.

7 Concluding Comments and Recommendations

7.1 The 2018 Draft Budget Statement is substantially an iteration of MTFP II Addition financial strategy, is relatively consistent with the detail used to formulate the 2017 position and provides good detail on most aspects of the overall budget. We would commend the work of the Financial Planning Team at Treasury and Resources in the compilation of the Draft 2018 workings against the MTFP II Addition strategy.

Fiscal Policy Panel

7.2 Within their October 2017 Annual report, Jersey's Fiscal Policy Panel well highlighted considerable economic uncertainties moving forward especially around the impact of Brexit and challenges faced by Financial Services sector. The Annual report has excellent analysis and provides sound guidance for the formulation of financial strategy moving forward. Crucially the panel agreed that the "*profile and scale of the measures set out in the MTFP Addition and Draft Budget 2018 is broadly appropriate and advise that the remaining measures for 2018 and 2019 need to be implemented on time*".[13] The panel further made recommendations around the following which we would fully endorse:

- The need to ensure that there is a permanent programme for ensuring additional efficiencies are secured
- Ensuring that unspent contingencies " that are returned to the Consolidated Fund are not used to weaken fiscal discipline and delay required permanent revenue or expenditure measures"
- Clarity required on the size of contingency allocations
- Delivering key capital projects on time

7.3 Whilst the Draft 2018 Budget Statement proposals allow a highly considered financial strategy to be set for the year in question it will not, in itself, provide the appropriate management dimensions of Leadership, People, Processes and System improvements that will optimise resource utilisation.

2018 Budget Proposals

7.4 The 2018 Income Tax proposals are relatively modest in terms of overall significance with only £7.5 million of tax yield impacting 2019. However we would have some concerns over estimated impact and risks associated with the taxation of larger corporate retailers which is scheduled to yield £5.7 million in 2019. Outwith our concerns on this specific measure the tax proposals appear to be in full alignment with long term tax policy and along with previous year tax proposals will provide an additional incremental impact on the bottom baseline yield. As with 2017 the 2018 proposals for Impôts and Stamp Duty Land Transactions appear to be consistent with public policy.

[13] Jersey's Fiscal Policy panel Annual Report – October 2017 – Page 4

7.5 Overall we identify four risks around the 2018 Budget:

- Income Tax modelling and growth assumptions
- Base Budgets – funding vacancies
- Efficiency Savings/Public Sector Reform Agenda - departmental capabilities in delivering efficiency savings
- Capital Programme performance

7.6 These four areas remained substantially unchanged from the listing of five identified in the 2017 Budget setting processes. We believe more clarity is required around the following:

Income Tax Modelling and Growth Assumptions – clarity on the precise extent to which the economic indicators are applied to the formulation of both Corporate and Personal Income Tax base estimates – particularly where overall year on year growth is expected to reach 5.59% from 2017 to 2018 in the face of expected economic metrics:

Year	2017	2018	2019	2020	2021
Income Tax £'000	£483,000	£510,000	£530,000	£553,000	£577,000
Growth £'000		**£27,000**	**£20,000**	**£23,000**	**£24,000**
% change		**5.59%**	**3.92%**	**4.34%**	**4.34%**
Real GVA%	1.20%	0.60%	0.00%	0.00%	0.00%
Average Earnings	3.00%	2.50%	3.00%	3.00%	3.00%
Financial Services Profits	4.00%	2.40%	3.00%	3.00%	3.00%

There appears to be a lack of correlation between the year- on- year increase and the relevant economic indicators used in the modelling. More clarity is required on the continuing significant level of Current Year Basis Adjustment (CYB) running at some £8 million on an annual basis. Our original understanding was that this adjustment to reflect the transition from prior year basis to current year basis would quickly taper off as tax payer transitioned

Base Budgets – there is a lack of detail on the funding of vacancies within base budgets – the prevailing incremental budget setting based process on providing full funding for agreed and adjusted staffing structures can obscure the appropriate assessment of critical staff resource service need

Efficiency Savings/Public Sector Reform Agenda - departmental capabilities in delivering efficiency savings – whilst some £14.0 million of efficiency savings/user pays/pay related savings (£4 million is Pay related savings) has been as identified for 2018 as being 'on track' there is little transparency on how such savings are going to be achieved. Additionally – the Draft Budget Statement 2018 does not provide any further assurance on progress on the pace on components such as the Office Accommodation project and eDigital initiatives within the Public Reform agenda

Capital Programme Performance – we have consistently commented on the low level of capital programme expenditure against programme. Whilst this does not fully correlate to overall performance in the management of capital projects it is an enduring theme. We previously commented on the critical need to improve on the precision of key assumptions as well as capacity including performance management capability. There is evidence of significant programme slippage, specific project overspending and an overall lack of precision on the capital cost build up and the estimation of risk within and outwith cost. As highlighted earlier, whilst an inherently prudent approach is adopted in the funding of mainstream capital projects is achieved the appropriate legislative allocation approval process has created a dysfunctional impact upon financial performance and strategy setting. This position is influenced by aspirational/expectation and optimism bias rather than reality

Direction of Travel on Budget Setting

7.7 The 2018 Draft Budget Statement formulated within the MTFP framework provides a strong and consistent level of granularity. However, the process itself would benefit from more aspects of the budget setting methodology moving towards outcomes based budget formulation where possible rather than the traditional core incrementally based budget setting approach currently used. More transparency is required on core assumptions used around Income Tax modelling, staffing budgets and efficiency savings that will impact individual budget lines. There does not appear to be a fully worked strategy on maintaining an optimal balance on the Social Security Fund. Given the likely increase in the balance of the fund over immediate need (in the short to medium term) and the relative size of the fixed level of states grant of £65.3 million in 2018 and 2019, it is essential that an appropriate strategy is formulated on setting an appropriate grant funding, expected benefit exposure and the framework generating the different level of contributions – the impact on contributors at all levels of household income including the positioning of social security contributions against personal income tax liabilities. The objective should be to eliminate negative contributor distortion and set an optimal states grant – such issues will be integrated in any strategy. Given the relative size of the grant in the context of the overall financial model this should receive priority.

7.8 Whilst the modelling of financial strategy at the States of Jersey is extremely robust there is much more work required in translating that strategy into management action that optimise available resources in the delivery of quality public services. Socio/demographic led demands on services are increasing and the economic backdrop is growing increasingly uncertain and there is a clear need to use resources more effectively. As highlighted in our report on the Draft Budget 2017 :

“..there is a clearer need to drive improvement in the use of resources and budget setting has a clear role to play. However, actual delivery will require full ownership and accountability of operational and financial performance across the departments – an issue which is much wider than the annual budget setting process. As highlighted within our corresponding scrutiny work for the 2016 Budget the ‘big issue’ will be improving the cost effectiveness of core of service delivery. “

7.9 Overall the Draft Budget 2018 sits well within the MTFP II Addition strategy and appears to follow the high level guidance set out by the Fiscal Policy Panel. The 2018 Budget provides a continuation of the stability provided within the MTFP framework - a stability wholly required in the increasingly uncertain economic conditions.

7.10 It is likely that some 'headroom' will be required to enable the financing of the New Hospital Project as well as the other major projects not incorporated within the substantive capital programme. In this respect difficult decisions are going to have to be made around the optimal level of reserves together with a renewed approach to Public Sector Reform/service cost reduction and modifications to tax strategy if expected yields underperform. A range of alternative tax yield options should be considered such as reversing the marginal rate tax cut decision of 2014 - especially if the seemingly recurring current year adjustment (CYB) of £8 million is not considered to be sustainable over the medium term.

7.11 In context the budget States Net Expenditure position is set for 2018 a deficit position after deprecation of £28.105 million is set. A return to a marginal surplus £0.332 million by 2019 is set within this period. During this time management focus will be influenced by public sector reforms including digitalisation as well as the new Hospital proposal. The Draft Budget 2018 should provide part of the overall financial strategy to enable such initiatives as well as wider service improvement to be facilitated.

7.12 Finally we would wish to take this opportunity to record our sincere gratitude to Members of the States Assembly, Management and Staff at the States of Jersey for the provision of extremely valuable support in the course of our work.

APPENDIX C

Appendix C: MJO Consultancy Report

The 2018 Budget: an assessment[1]

MJO Consultancy

[1] We would like to acknowledge all the help received from the Treasury and the States Statistician.

1. Introduction

Jersey's 2018 Draft Budget was published shortly before the Fiscal Policy Panel (FPP) produced their Annual Report. Both the FPP and the commentary in the Draft Budget refer to the momentum in the rate of world economic growth but note that significant risks remain to the global economy (e.g. China and the US fiscal situation). For the European Union (EU) and particularly the UK, there remain additional uncertainties because of Brexit. Whilst the short-term deleterious impact of the UK's decision to leave the EU result were clearly overstated by many well-respected organisations, the long-term impacts remain uncertain and there is still no agreement between the UK and the EU over the nature of future economic relations.

For Jersey, the spectre of Brexit looms large over this Budget, particularly the concerns surrounding the future prospects of the financial services sector after March 2019. Additional endemic worries also surface, such as the impact of any current and proposed international tax initiatives (e.g. the impact of any 'black listing' of the Island by the EU) and the impact of changes to UK tax policy, anti-avoidance measures and the changes in sentiment to tax avoidance. Whilst the island's authorities can contribute to the external debate and seek to represent the island's interest whenever possible, they have no decision making powers outside the jurisdiction of Jersey. *Per contra*, policymaking in Jersey enables fiscal policy and supply-side policy to be made independently, although some might argue that scope of fiscal autonomy is contingent on initiatives pursued by the EU and the OECD against offshore international financial centres. Nevertheless, the 2018 Budget demonstrates that the Island can independently raise new taxes; pursue public sector reform; plan on future capital expenditure; and continue to try and implement initiatives to increase the Island's low rate of productivity.

This report for the Corporate Services Scrutiny Panel considers the 2018 Budget in the context of the economic background and MTFP2; the income tax forecasts and some issues surrounding productivity. A summary of the key points is provided at the end of the report.

2. THE 2018 BUDGET IN THE CONTEXT OF THE ECONOMIC BACKGROUND AND MTFP 2

2.1 Updated economic assumptions from the FPP

The economic assumptions that are used as the basis for income tax forecasting by Jersey's Income Forecasting Group (IFG) are provided by the FPP. Box 1 provides a brief narrative on the outturn data and the revised economic assumptions as of September 2017.

BOX 1:
Revised economic assumptions and outturn data, September 2017

1. Outturn data:
   a. Financial services profits for 2016 were significantly lower than forecast.
   b. FTE Employment growth in 2016 was higher than forecast.
   c. Finance sector compensation of employees grew by only ½ per cent (nominal) in 2016; leading to a lower expectation for compensation of employees overall.
2. Growth in financial services profits expected to be slower in 2017 and 2018.
3. Non-finance profit growth expected to be slower in 2017.
4. Inflation – expectations for 2018 are lower.
5. Average earnings in 2018 expected to be slightly lower due to lower inflation.
6. Employment growth – expected to be faster in 2017 and 2018
7. UK policy interest rates – are now expected to be slightly lower throughout the forecast period.

Despite the growth in Jersey's economy in 2016 (which was largely due to the increase in rental income of private households), considerable uncertainties remain for headline GVA growth in future years. The non-finance sector has seen a recovery but profits are currently under pressure and the finance sector is subject to the uncertainties mentioned above. The positive news about the growth in employment – and unemployment falling – suggests a potential tightening in some sectors of the labour market. Real earnings growth is sluggish and there are serious challenges ahead in terms of productivity growth (see Section 4).

2.2 The 2018 Budget in the context of MTFP 2

The 2018 Budget is the third to occur within Jersey's second MTFP, covering the period 2016 to 2019.[2] The key objectives of the second MTFP are first, to provide additional sustainable investment for health and education, promoting economic growth and investing in St Helier; secondly, to find efficiencies and savings in the public sector; and finally, to balance budgets by 2019. The progress on each objective is considered in turn.

Sustainable investment and the Draft Budget 2018

Table 1 shows the progress of the first objective, finding sustainable investment for the additional expenditure. Two key funding measures contained in the MTFP Addition, namely the introduction of the health charge (worth £15 million by 2019) and the liquid waste charge, have not been implemented. The proposed transfer of £5 million from the Health Insurance Fund has been met by underspends and a Waste Charge is expected to raise £11 million by 2019. Budget 2018 proposes to make good the shortfall in revenue by measures which will raise £10.2 million by 2019 (Box 2). At the time of the MTFP Addition, it was proposed that £123 million would be raised by 2019; the total revised measures suggest that £113 million will be raised by this date.

[2] MTFP 2 covers the period 2016-19. The States Assembly approved MTFP 2 (P70/2015) in October 2015 and the MTFP Addition approved by the States Assembly in 2016 set out detailed expenditure plans for the period 2017-19.

Table 1. Update of the progress on the expenditure and funding measures from the MTFP Addition

MTFP package of measures	Upto 2017 £m	RAG Rating	2018 £m	RAG Rating	2019 £m	RAG Rating	Full Year £m	Target £m
Department Efficiencies/Savings/User Pays	32		10		10		52	52
Pay related savings	17		4		4		25	25
Benefit changes	7.9		1.3		0.6		9.8	10
Non-Domestic Liquid Waste Charges			3		4		4	3
Non- Domestic Solid Waste Charges					7		7	8
Proposed Health Charge			7.5		15		0	15
Proposed Transfers from HIF	5		5		5		0	5
Reduced Central Provisions					5		5	5
Total Proposed Measures	**61.9**		**30.8**		**50.6**		**102.8**	**123**
Proposed replacement measures								
Future revenue raising measures (Budget 2018)			2.9		10.2		10.2	
Replacement for HIF								
- Carry forwards from 2016	5							
- Dept underspends and AME Contingency			5		5			
- Recurring measures to be identified from 2020					5			
Total Revised Measures (Budget 2018)							**113**	
		Delivered						
		On track - subject to final decisions						
		Not identified - further work required						
		Decision to defer or withdraw						

Source: States of Jersey (2017, p. 35).

Box 2:
Summary of revenue raising measures in Draft Budget 2018

- Second earner's allowance to be increased by £850 to £5,850
- Income tax exemption thresholds to be increased by 2.5%
- Changes to the tax regime applied to high value residents
- Taxing the profits of larger corporate retailers at 20%
- Bring more finance companies within the scope of the 10% company income tax rate Increasing some International Services Entities ("ISE") fees paid by businesses
- Disallowing the deduction of rates by landlords renting property in Jersey
- Impôts duties on alcohol and road fuels increased by RPI
- Impôts duties on tobacco increased by RPI +5%
- Vehicle Excise Duty increased by RPI (plus a change to incentivise the purchase of the least polluting vehicles)

MJO Consultancy notes with interest the FPP's comment that the proposed measures summarised in Box 2 are 'more ad hoc in nature and that in the medium term a more strategic approach will be required' (FPP 2017, p. 29). In our review of Budget 2014 we expressed serious reservations with the coherence of fiscal policy in general and taxation policy in particular. The decision to reduce the marginal rate of taxation from 27 per cent to 26 per cent in Budget 2014 had significant recurring loss for the States finances: current estimates suggest with data from YOA 2015, this is lost revenue to the Treasury of £8 million per annum. This criticism was extended in our review of Budget 2015 and echoed by CIPFA; subsequent comments by MJO Consultancy have also raised concerns.

The danger with the current policy of 'nudging' the tax system and introducing new charges to raise revenue is that it creates fewer coherencies and more uncertainty. Businesses, households and the Exchequer all suffer. The introduction of the retail tax, for example, will inevitably result in attempts by States members to bring amendments to tinker further with thresholds and tapering provisions and if successful, will add further caveats to the tax system and require additional revenue raising measures. Surely all of this is the opposite of the intention of policymakers? In short, nothing less than a fundamental root and branch review of Jersey's taxation system is now essential.

Efficiencies and savings in the public sector

The Draft Budget notes that the £77 million of efficiencies, savings and user pays are 'largely on track' (States of Jersey 2017, p. 36). Since the publication of the Budget, the Chief Executive of the States has left his position. The new Chief Executive is intending to introduce a step change to the process of public sector reform and to drive efficiencies that are more structural in nature. On the 8th November 2017, Workforce Modernisations plans were announced. The published proposals will be funded within the MTFP 2 expenditure limits and any recurring expenditure after 2020 is currently deemed affordable within the latest financial planning assumptions.

A full update of progress being made with efficiencies, savings and user pays will be provided as part of the MTFP Department Annex update in December 2017.

Balancing the budget by 2019

Tables 2 to 4 show summaries of the structural financial position published in the 2016 MTFP 2 Addition, Draft Budget 2017 and Draft Budget 2018 respectively for the period down to 2019. The most recent forecast, of an overall surplus of just over £300,000 by 2019, in Draft Budget 2018 is the most pessimistic of the three published assessments. This also foreshadows the scale of the challenge faced by policymakers post-2020 to balance budgets during the next decade during MTFPs 3 and 4, with increasing pressures on expenditure and uncertain income streams.

Table 2. Updated financial forecast of structural financial position 2016-2019 (September 2016)

Summary of Financial Forecast	2015 Outturn £'000	MTFP Addition Forecast (September 2016) 2016 Forecast £'000	2017 Forecast £'000	2018 Forecast £'000	2019 Forecast £'000
Total States Income - incl: Proposed Funding Mechanism	691,744	697,301	708,807	747,653	788,331
Total Net Revenue Expenditure (excl: Depn)	697,031	740,317	724,287	733,955	734,845
Forecast Operating Surplus/(Deficit) for the year	**(5,287)**	**(43,016)**	**(15,480)**	**13,698**	**53,486**
Depreciation Forecast	44,676	44,800	40,600	45,500	53,000
Current financial position - Surplus/(Deficit)	**(49,963)**	**(87,816)**	**(56,080)**	**(31,802)**	**486**

Source: States of Jersey (2016a, p. 200)

Table 3. Summary of Financial Forecast Update for Draft Budget 2017 (October 2016)

Outturn 2015 £'000	Financial Forecast	Forecast (Oct 2016) 2016 £'000	Draft Budget 2017 Forecast Update (October 2016) 2017 £'000	2018 £'000	2019 £'000
691,744	**Total States Income**	**697,301**	**711,334**	**750,605**	**791,274**
	States Expenditure (per MTFP Addition)				
697,031	Departmental Net Revenue Expenditure	697,377	700,637	697,627	686,100
	Central Contingency Allocations	42,940	23,650	25,904	28,212
	Central Growth Allocations	-	-	10,424	20,533
697,031	**Total Net Revenue Expenditure (excl: Depn)**	**740,317**	**724,287**	**733,955**	**734,845**
(5,287)	**Forecast Operating Surplus/(Deficit) for the year**	**(43,016)**	**(12,953)**	**16,650**	**56,429**
44,676	Departmental Depreciation	44,800	40,600	45,500	53,000
(49,963)	**Surplus/(Deficit) of General Revenue Expenditure over Income**	**(87,816)**	**(53,553)**	**(28,850)**	**3,429**

Source: States of Jersey (2016b, p. 52)

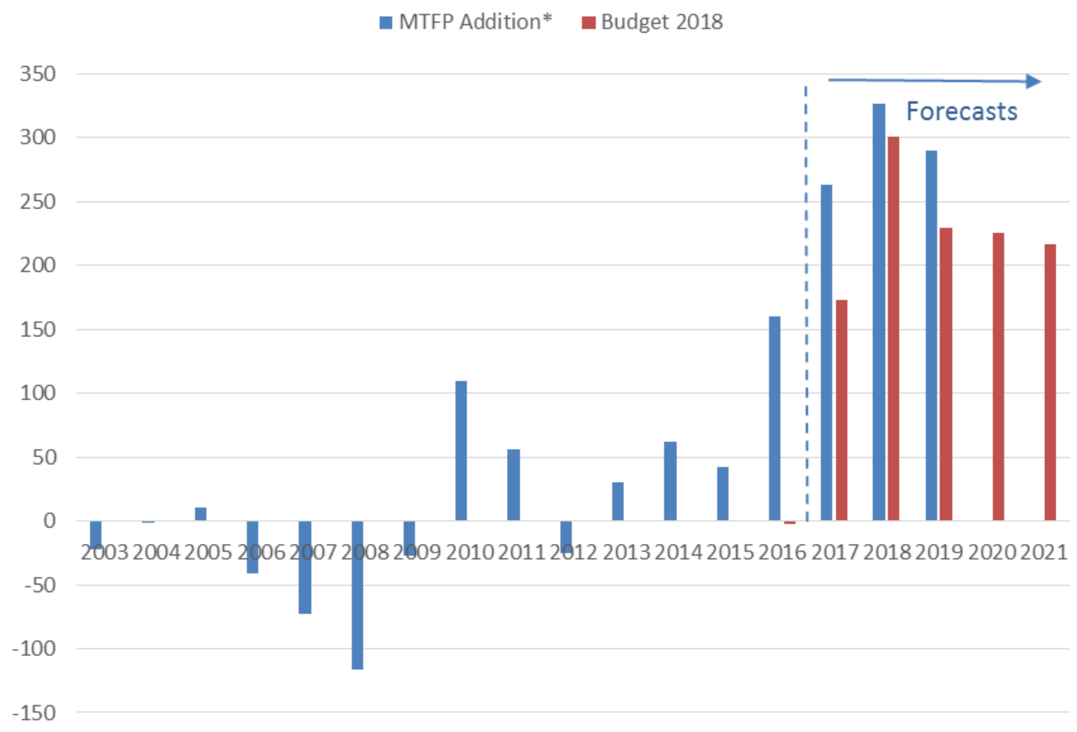
Table 4. Updated financial forecast of structural financial position 2016-2019 (September 2017)

Summary of Financial Forecast	Outturn 2016 £'000	Draft Budget 2018 Proposals (September 2017) 2017 £'000	2018 £'000	2019 £'000
Total States Income - incl: Additional revenue raising measures	736,803	726,768	751,350	788,177
Total Net Revenue Expenditure (excl: Depn)	698,454	724,287	733,955	734,845
Forecast Operating Surplus/(Deficit) for the year	**38,349**	**2,481**	**17,395**	**53,332**
Depreciation Forecast	40,154	40,600	45,500	53,000
Current financial position - Surplus/(Deficit)	**(1,805)**	**(38,119)**	**(28,105)**	**332**

Source: States of Jersey (2017, p. 124)

Of more immediate concern, however, is why the advice of the FPP was ignored over the last twelve months. In their 2016 report, the FPP called for the States to run a countercyclical fiscal policy in 2016. Instead of adding £150 million to the economy, the adjusted fiscal position shows that the outturn was broadly in balance (see Figure 1).

Figure 1. Estimates of adjusted fiscal position, £ million (current prices)



Source: FPP (2017, p. 36)

The adjusted fiscal position is reached by first calculating the operating surplus/deficit, adding the capital expenditure profile and flows into and out of additional funds (e.g. trading funds, social security fund, health insurance fund, long-term care fund). The predicted operating deficit for 2016 of £43 million turned into a £38 million surplus which explains about half the variation in the adjusted fiscal position between the MTFP Addition and the actual outturn for 2016. The other major contributor to the difference was lower than planned capital expenditure.

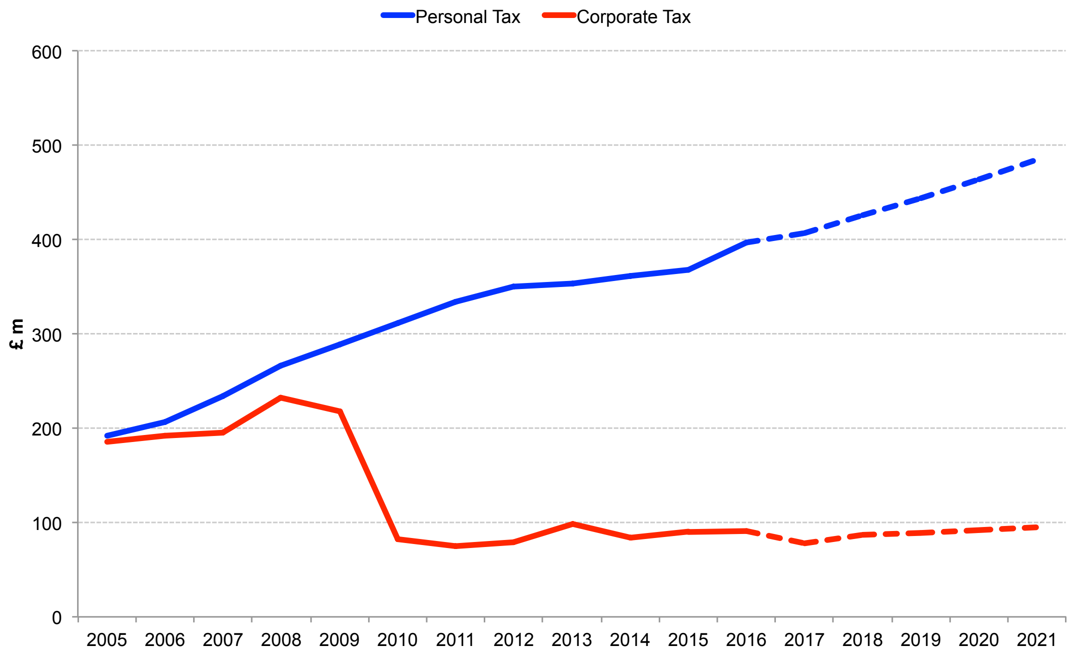
The concerns that this fiscal profile raises are twofold. First, fiscal policy is likely to be less supportive to the economy than was planned for a year ago in the MTFP Addition. Secondly, there is a risk that the timing of the large capital projects will occur at precisely the time when the economy is expected to have returned to capacity. If so, there is a danger that this will put pressure on resources locally and add to inflationary pressure. As the FPP (2017, p. 36) observe, 'if only half of the projected capital expenditure is delivered in coming years [between £200-£300 million is planned to be added to the economy in each of the years 2018-21]…the States would still be putting more into the economy than it takes out at around between £50-£150m each year in the 2017-21 period'. Policymakers should take heed of the warnings given by the FPP that suggest that the seeds for the next inflationary boom (pump primed by explicit government policies) are already being sown.

3. INCOME TAX FORECASTS

3.1 Actual and forecast income tax

Figure 2 illustrates the growth of actual and forecast income tax receipts between 2005 and 2021, bifurcated between personal tax and corporate tax. The big fall in corporate tax receipts from 2010 was due to the move to 'zero/ten' and subsequent fluctuations are largely the result of volatility in the financial services industry. Since 2005, personal tax has accounted for a larger share of income tax receipts: in 2009, personal tax accounted for 57 per cent of total income tax and by 2016 this figure has risen to 81 per cent. By 2021, personal tax will account for 84 per cent of all income tax receipts.

Figure 2. Growth of personal tax and corporate tax, 2005–2021 (actual and forecast)



Note: This is before Budget 2018 measures are introduced, excluding any provision for bad debt and including Current Year Basis.

Source: http://www.gov.je/Government/JerseyInFigures/GovernmentAccounts/Pages/TaxReceipts.aspx and States of Jersey (2017)

The forecast trend in the growth of personal tax post-2016 appears bullish.

The review by Oxera into the income tax forecasting model was an acknowledgement that there have been some problems with the way in which the model has been functioning. We have produced an assessment of Oxera's report and have discussed how the problems with the model go beyond mere calibration and suggest that the economic relationships in Jersey's economy have been changing. Subsequent discussions with policymakers since our forecasting report was written have reaffirmed this view. Until some of the issues we have raised about the model are addressed, we remain uncomfortable with the methodological basis of the income forecasts.

3.2 Income Forecasts

A full annual review of forecasts was carried out in March 2017 and published in June 2017. The IFG incorporated the latest economic assumptions from the FPP in August 2017 and took into account the latest in-year information on actuals for 2017 before producing the latest forecast in September 2017. The impact of the revisions of the economic assumptions on income tax receipts is summarized in Box 2. The latest forecast shows an improvement over the March forecast of £4 million for 2017, a little over £1 million for 2018 followed by a growing deterioration down to 2021 (see Table 5). Suffice to say, forecasting to 2021 is extremely hazardous with so many unknowns particularly as it covers the post-Brexit period.

BOX 2:

Impact of the economic assumptions on income tax receipts

- The lower outturn for financial services profits in 2016 has reduced the forecast for personal tax by approximately £2 million throughout the forecast period.
- The lower outturn for financial services compensation of employees in 2016 has reduced the forecast by approximately £1million throughout the forecast period.
- Increases to the employment growth assumption is partially offset by lower expectations for earnings growth.
- Lower assumptions for interest rates reduce the forecast by around £0.5 million in 2019, increasing to £1 million in 2020 and 2021.
- Lower interest rates reduces the forecast for unearned income.
- The new economic assumptions are for financial services profits to grow around 0.5 per cent more slowly in both 2017 and 2018. This results in slightly less corporate tax in 2018, and approximately £1 million less in 2019-2021.

Note: Since the August economic assumptions were published, new earnings figures were incorporated into the forecast results in a further £1 million reduction to the forecast for 2018, increasing to £2 million for 2019-2021.

Table 5. Summary of variations in September 2017 forecast v March 2017

Central Forecast from Range (September 2017)	Forecast	Draft Budget 2018 forecast (September 2017)			
	2017 £'000	2018 £'000	2019 £'000	2020 £'000	2021 £'000
States General Revenues Income					
- Income Tax	483,000	510,000	530,000	553,000	577,000
- GST	87,428	87,828	88,494	89,382	90,291
- Impôt Duties	58,420	58,777	58,600	58,811	59,043
- Stamp Duty	29,055	29,641	30,241	30,859	31,496
Income from Taxation and Duty (excl: Budget measures)	**657,903**	**686,246**	**707,335**	**732,052**	**757,830**
- Other Income	68,865	62,204	70,642	67,279	69,529
Total States Income (excl: Budget measures)	**726,768**	**748,450**	**777,977**	**799,331**	**827,359**
March 2017 Forecast	**722,763**	**747,457**	**779,621**	**802,342**	**830,836**
Variation to March 2017 Forecast	***4,005***	***993***	***(1,644)***	***(3,011)***	***(3,477)***

Source: States of Jersey (2017, p. 74).

Table 5 reflects variances on economic assumptions and improved forecasting information but excludes any 2018 Budget measures. This appears as Figure 34 in the published Draft 2018 Budget. Figure 35 in the Draft Budget 2018 includes the Budget measures and further variances. Treasury have clarified this figure which is reproduced below as Table 6.

In essence, the variations in funding measures are as follows. The March 2017 forecasts assumed that equivalent measures would be raised in the Budget 2018 to replace the £0.9 million to Fund Rates from 2018, and equivalent measures would be raised in the Budget 2018 to replace £7.5 million from 2018 and £15 million from 2019 to replace the Health Charge. The Draft Budget 2018 actually proposes no replacement for Rates funding as there is no proposal to pay rates, and revenue raising measures equivalent to £2.9 million from 2018 and £10.2 million from 2019 to replace the Health charge.

Table 6. Variations in Total States Income Forecasts September 2017 v March 2017

Central Forecast from Range (September 2017)	Forecast	Draft Budget 2018 forecast (September 2017)			
	2017	**2018**	**2019**	**2020**	**2021**
	£'000	£'000	£'000	£'000	£'000
Income tax	483,000	510,000	530,000	553,000	577,000
GST	87,428	87,828	88,494	89,382	90,291
Impot duties	58,420	58,777	58,600	58,811	59,043
Stamp Duty	29,055	29,641	30,241	30,859	31,496
Income from taxation and duty	**657,903**	**686,246**	**707,335**	**732,052**	**757,830**
Other income	68,865	62,204	70,642	67,279	69,529
Total states income before funding measures	**726,768**	**748,450**	**777,977**	**799,331**	**827,359**
March 2017 Forecast - before funding measures	**722,763**	**747,457**	**779,621**	**802,342**	**830,836**
Variation to March 2017 forecast before funding measures	**4,005**	**993**	***(1,644)***	***(3,011)***	***(3,477)***
Proposed revenue raigins measure - Budget 2018	-	2,900	10,200	10,200	10,200
Funding Measure assumed in March 2017 Forecast	-	8,400	15,900	15,900	15,900
Variation to March 2017 Forecast - Funding Measures	**0**	**5,500**	**5,700**	**5,700**	**5,700**
Total Varations to March 2017 Forecast - including Funding Measures	***4,005***	***(4,507)***	***(7,344)***	***(8,711)***	***(9,177)***

Source: States of Jersey Treasury

As income tax is almost three quarters of States income from tax and duty, it is worth examining in a little more detail the proximate reasons for the change in the forecast profile of income tax over the next few years.

3.3 Personal Income Tax

In 2017, 62 per cent of the States income from tax and duty is derived from personal income tax. Table 7 shows the profile of the personal tax forecast over the 2017-21 period. The variation between the March and September forecasts is negligible in the first part of the period but then worsens slightly each year. The explanation given in the Budget narrative is that this is a 'result of lower employment income assumptions, which now includes financial services profits, translating to reduced forecast revenues when extrapolated through the updated personal tax model' (States of Jersey 2017, p. 73).

Table 7 excludes the CYB adjustment (which was included in Figure 1 above and which is also included in the Personal Income Tax row in Summary Table A of the Draft 2018 Budget). The average growth rate of tax collectable between 2017 and 2021 shown in Table 7 is 4.7 per cent per annum.

Table 7. Updated personal tax forecast

	Outturn	Forecast				
	2016 outturn	2017	2018	2019	2020	2021
	£m	£m	£m	£m	£m	£m
Personal tax						
March 2017 forecast	**379**	**398**	**418**	**438**	**459**	**481**
New assumptions[1]		-2	-1	-2	-3	-4
ITIS data		+1	+1	+1	+1	+2
New yield calculation		-1	-1	-1	-2	-2
Tax collectable (excluding: CYB adjustment)	**379**	**397**	**418**	**436**	**456**	**477**

Some columns may not sum due to rounding

Notes:

[1]New assumptions includes new FPP economic assumptions, new earnings data and updated employment income regression.

Source: States of Jersey (2017, p. 105)

3.4 Corporate tax

Corporate tax contributes around 11 per cent of the States income from tax and duty. Table 8 shows the latest forecast which is essentially unchanged from March 2017. The new economic assumptions estimate financial services profits grow 0.5 per cent more slowly in 2017 and 2018. The narrative in the Draft Budget notes that the forecast is unadjusted for analysis into likely future performance of large corporate taxpayers by the Taxes Office.

Table 8. Updated corporate tax forecast

	2016 outturn	2017	2018	2019	2020	2021
	£m	£m	£m	£m	£m	£m
Corporate tax						
March 2017 forecast	94	77	87	89	92	94
In-year data		+1	+1	+1	+1	+1
New FPP economic assumptions		0	0	-1	-1	-1
Tax collectable	94	78	87	89	92	95

Some columns may not sum due to rounding

Source: States of Jersey (2017, p. 106)

3.5 Evolution of the income tax forecast from MTFP 2

Table 9 summarizes the evolution of the income tax forecast from MTFP 2. It is noteworthy that (a) from row 20, the outturn for 2016 was £30 million higher than was forecast in MTFP 2; (b) from row 16, there was an assumption in the MTFP 2 Addition forecast that over the period 2016-19 there would be £46 million *more* tax compared to the MTFP 2 forecast, of which £28 million was the result of the current year basis (CYB) adjustment in June 2016; (c) from row 18, in Budget 2018 there is an assumption that over the period 2017–20 there will be £28 million *less* in tax compared to the MTFP Addition forecast; (d) from row 19, there is an assumption that over the period 2017-19 there will be £30 million *more* in tax compared to the MTFP 2 forecast. On this last point, the assumption made in June 2016 was that the move to CYB would result in an additional £7 million per annum being added to the income tax forecast between 2016 and 2019. In 2016, the outturn was a year-on-year increase of £13 million. The CYB forecasts have been revised so they now assume £10 million for 2017 and £8 million per annum for 2018 and 2019. In short, the differences in row 19 can largely be explained by the CYB adjustment.

Table 9 Evolution of the income tax forecasts from MTFP 2

	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m	2021 £m	Total (£m)
(1) MTFP 2 Upper	476	499	535	568			
(2) MTFP 2 Central	**458**	**475**	**499**	**519**			
(3) MTFP 2 Lower	440	451	462	471			
(4) September 2015 forecast	**455**	**475**	**499**	**519**			
(5) Revised forecast Budget 2016	**455**	**479**	**504**	**525**			
(6) May 2016 forecast	**460**	**480**	**507**	**531**	**558**		
(7) CYB Proposed adjustment	**7**	**7**	**7**	**7**	**7**		
(8) MTFP 2 Addition Upper	476	506	540	576	616		
(9) MTFP 2 Addition Central	**467**	**487**	**514**	**538**	**565**		
(10) MTFP 2 Addition Lower	458	468	488	500	514		
(11) Forecast for Budget 2017	**471**	**481**	**508**	**532**	**556**		
(12) Forecast for Budget 2018	$\boxed{488}$	**483**	**510**	**530**	**553**	**577**	
(13) Difference between (4) and (2)	-3	0	0	0			-3
(14) Difference between (5) and (2)	-3	4	5	6			12
(15) Difference between (6) and (2)	2	5	8	12			27
(16) Difference between (9) and (2)	9	12	15	19			46
(17) Difference between (11) and (9)	4	-6	-6	-6	-9		-23
(18) Difference between (12) and (9)		-4	-4	-8	-12		-28
(19) Difference between (12) and (2)		8	11	11			30
(20) Difference between outcome and MTFP 2 forecast	30						30

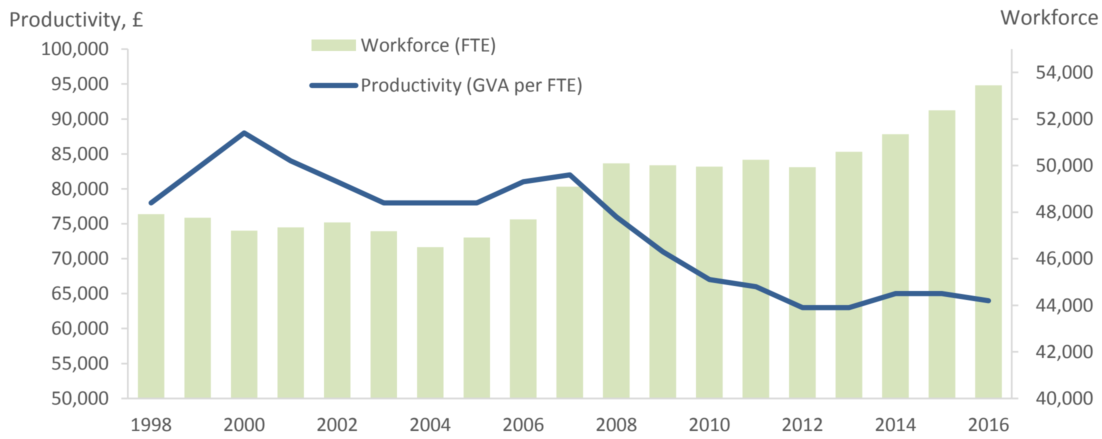
Note: outturn for 2016 is shown in the box

4. ISSUES SURROUNDING PRODUCTIVITY

The level of productivity in an economy is the single most important cause of a country's standard of living: faster productivity growth leads to a better standard of living and falling productivity growth leads to falling living standards.

It is not alarmist to draw attention to the productivity challenge facing Jersey. Two key figures from 'Measuring Jersey's Economy' (Statistics Unit 2017) are reproduced below as Figure 3 and 4. Currently, Jersey's GDP and GVA per head of population are 53 per cent and 33 per cent higher respectively than the UK's in 2016. However calculations by the Statistics Unit show that if current trends continue, it will only be 12 years before Jersey's GDP per head is level with the UK.[3]

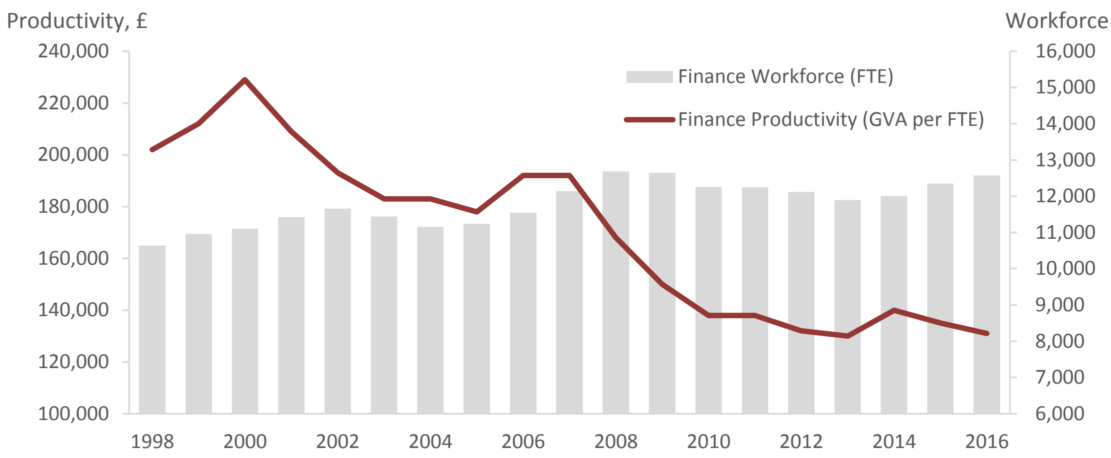
Figure 3. Productivity (GVA per FTE) of Jersey's economy in real terms and total employment, 1998-2016 productivity index numbers (2013=100)



Source: Statistics Unit, States of Jersey

[3] The last three years (2014-16) have seen annual average growth rates of GDP per capita of 0% in Jersey (i.e. unchanged) and 0.9% per annum in the UK. Assuming these growth rates continue, then there is convergence in 32 years. However, if we adjust for the relative cost of living (Jersey's cost of living is greater than the UK by 20% in 2013 – and assuming that this has not changed and continues), then convergence is reached in 12 years.

Figure 4. Financial services productivity (GVA per FTE) in real terms and employment, 1998-2016 productivity index numbers (2013=100)



Source: Statistics Unit, States of Jersey

In their annual reports the FPP have discussed the scale of the productivity challenge and this is reinforced in a recent interview with the chair of the FPP.[4] As part of the drive to improve productivity, the review of innovation by Tera Allas (2015) was an important step. It is therefore disappointing to see the number of 'red' flags in the latest update of the innovation review action plan and the conclusion on benchmarking that 'after considering a number of potential frameworks, it is not considered possible to objectively benchmark Jersey's competitiveness using the methodology used by the World Bank or World Economic Forum'.[5] This conclusion is quite bizarre – the list of countries that use the World Economic Forum benchmarking methodology includes Haiti, Chad and Trinidad and Tobago along with developed countries (which surely can include Jersey). If the difficulties with benchmarking are a resource issue then perhaps it would make sense to find resources from the Economic and Productivity Growth Drawdown Provision; after all, if there is no

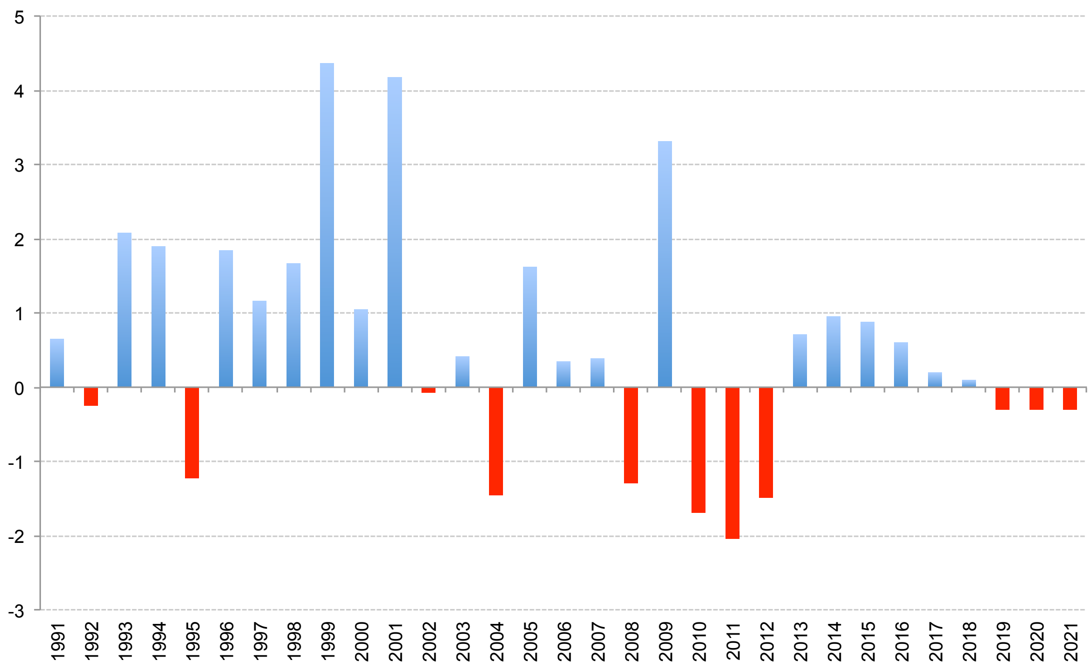
[4] http://online.fliphtml5.com/ktlu/msri/#p=25

[5] https://www.gov.je/Government/PlanningPerformance/Innovation/Pages/InnovationReviewActionPlan.aspx#anchor-27. See Appendix D of the World Economic Forum which contains the technical notes required for the survey: https://www.weforum.org/reports/the-global-competitiveness-report-2017-2018.

effort being made to benchmark productivity outcomes it might be that money spent is money wasted.

It's not difficult to translate how the impact of faltering productivity shows up in declining living standards. Figure 5 illustrates the real-term annual percentage changes in average earnings from 1991 to 2017 and forecast changes from 2018–2021. There have been real-term annual decreases in earnings in eight out of the last twenty-seven years; using recent forecasts for RPI and the growth of average earnings for 2017–2021 suggests that from 2019, inflation will again increase faster than average earnings.

Figure 5. Real term annual percentage change in the Index of Average Earnings, 1991 to 2021 (actual and forecast)



Source: Statistics Unit and FPP forecasts

Summary of key points

1. Despite the revenue raising measures outlined in the 2018 Budget, balancing the States' finances by 2019 is a challenge. Currently, planning for budget surpluses in the 2020s will be even more challenging.

2. The ad-hoc nature of the revenue raising measures of Budget 2018 demand a more strategic approach. A fundamental root and branch review of Jersey's taxation system is now essential.

3. There are significant risks that fiscal policy will become more pro-cyclical over the remaining period of the MTFP 2 and will put pressure on resources locally and add to inflationary pressure.

4. Due to issues surrounding the income tax forecasting model, there are uncertainties with the robustness of the forecasts.

5. Unless there is a reversal in the productivity rate, living standards in Jersey will continue to fall and converge with the UK within 12 years. A greater sense of urgency is needed to address the 'productivity challenge'. There should be a requirement that competitiveness outcomes should be computed which conform to World Economic Forum standards.

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