States of Jersey
States Assembly

États de Jersey
Assemblée des États

Corporate Services Scrutiny Panel

Review of the Fiscal Strategy Review

Presented to the States on 2nd March 2011

S.R.2/2011

CONTENTS

1.	CHAIRMAN'S FOREWORD	2
2.	EXECUTIVE SUMMARY	5
3.	KEY FINDINGS AND RECOMMENDATIONS	6
4.	THE FSR PROPOSALS	8
5.	THE STRATEGIC OBJECTIVE	16
6.	THE BIGGER PICTURE	23
7.	CONCLUSION	30
8.	APPENDIX 1 – ADVISOR'S REPORT	31
9.	APPENDIX 2 – PANEL MEMBERSHIP	57
10.	APPENDIX 3 – TERMS OF REFERENCE	58
11.	APPENDIX 4 – EVIDENCE CONSIDERED	59

1. CHAIRMAN'S FOREWORD

1.1 In 2005, the independent consultant engaged by the Treasury to work on the original Fiscal Strategy Review (FSR) identified one of the most important aspects of the future fiscal strategy as being that:

> "*… the burden should be spread across the economy, and that the distribution of the burden should not only be as 'fair' as possible, but should also be seen to be as fair as possible.*"[1]

1.2 The Corporate Services Scrutiny Panel endeavoured to obtain answers to the question as to how does the FSR, as presented in the 2011 Budget, produce a package of measures which were articulated in the draft fiscal strategy paper as resulting "*in a level of public services that Islanders want and public finances that are sound and sustainable in the long-run.*"

1.3 The FSR process included a period of public consultation. One theme which received broad support was that achieving savings in government expenditure should take preference to tax rises. This formed an undercurrent to our report.

1.4 It is fair to say that Jersey is particularly vulnerable to 'tax revenue surprises' because of the dominance of financial services. Favourable developments in asset prices boost the stock market, banking profits and the housing market and provide revenue windfalls. This encourages government to increase expenditure beyond what would be advisable from a medium-term perspective. In a subsequent recession, revenue shortfalls mean that tax revenues are insufficient to meet the planned increased expenditure and lead to deterioration in the fiscal position. Which is where we are today.

1.5 It needs to be remembered that overall fiscal policy relates to taxation and expenditure. Although never popular, history has shown that the creative ability of government to levy new taxes is far easier than controlling expenditure. The report of the Public Accounts Committee has explained why the mechanisms of accountability are diffuse and can lead to problems. Unless there is genuine commitment to deliver spending cuts – that is, unless CSR 2[2] can be delivered to the last pound and pence – and the public can be shown that they are getting value for money then credibility about the seriousness of the government's commitment to expenditure control and to keep to its fiscal promises will vanish.

---

[1] *Which tax is best suited to Jersey's objectives?*, Chris Allsopp, New College Oxford, p. xiv

[2] The second phase of the Comprehensive Spending Review (CSR).

1.6 The FSR must be viewed as part of the overall long-term plan for the Island but it is only part of a wider strategy which must be considered alongside the CSR and the economic growth plans. The current FSR depends for its success as much on the achievement of the savings of £65 million required in the CSR proposals as on the achievement of economic growth. These are long-term objectives and we must have a long term Fiscal Strategy to match.

1.7 Jersey's FSR was not a thorough review of fiscal policy because not all options were addressed in the course of the review; there is little indication that medium and long-term objectives were considered and a discussion of what a future tax structure should look like was excluded.

1.8 Any fiscal consolidation over the medium term requires a combination of tax rises, spending plans and forecasts for economic growth. The supporting research made it clear that economic growth is part of the wider plan to address future fiscal sustainability but Jersey still does not have an updated economic growth plan.

1.9 As yet the Business Tax proposals depend on the results of the review in Brussels. The FSR, as it stands, mainly deals only with personal taxation. No review of taxation should exclude Business Taxation and we will return to this once the situation regarding Zero/Ten is totally clarified.

1.10 In our report on CSR 1[3], we commissioned a social impact report on the effects of the proposals. As a result we realised the importance of considering the interaction between a Fiscal Policy and the benefits system. It is essential that any long term FSR must consider the social implications of the policy and its interaction with the benefit system.

1.11 Again, in our report on CSR 1, we also asked what was the vision for the Island, what was the shape of government after all the changes were effected? We noted that there was no coherent and clearly articulated vision for the Island. We have the same comments with respect to the FSR. This was not a review of fiscal policy which dealt with fundamental issues of strategy but instead adopted short-term tactics. In short, the uncomfortable fact is that Jersey has not really had a 'fiscal strategy review' as is generally understood by the term. Tactics have been confused with strategy.

1.12 In *Imagine Jersey 2035*, the underlying thread was that States expenditure must be brought under control. The evidence from our previous reports and from submissions during this report is that the public is still concerned that States expenditure continues its inexorable rise and there is a suspicion amongst the public that the tax rises in the budget will merely support further increased expenditure.

---

[3] *Scrutiny of the Comprehensive Spending Review* (SR9/2010)

1.13 Yes, there will be some tough decisions, and yes, we will need tough political leadership to guide us through them, but our Island cannot be sustained on continual short term measures. There are other, more responsible solutions to our current predicament than simply taxing the people to plug the holes. A long term Fiscal Strategy would be a start.

Senator S. C. Ferguson

Chairman – Corporate Services Scrutiny Panel

2. EXECUTIVE SUMMARY

2.1 The Fiscal Strategy Review was undertaken in 2010 and led to the inclusion of proposals in the 2011 Budget; namely, that GST should be increased by 2% and that Social Security contributions above the ceiling should be increased by 2% for both employers and employees. Other proposals that the Minister for Treasury and Resources had considered were not pursued and the States ultimately adopted both measures.

2.2 We have found that the precise implications of those proposals remain uncertain as the details have yet to be finalised. We have also found that some measures, such as non-domestic property rates, were not initially considered to the extent that they could have been. More significantly, our Review showed that, notwithstanding the 'Fiscal Strategy Review' undertaken in 2010, the Island does not yet have a 'Fiscal Strategy'.

2.3 The Island's Fiscal Strategy should be long-term and wide-ranging. It should incorporate both personal and business taxation and aim towards a tax structure that is simple and fair – and seen to be fair. The work undertaken by the Minister in 2010 was merely a review of personal taxation although (confusingly) elements of business taxation were involved. Furthermore, it appeared to us to be narrow in scope and short-term in its focus (notwithstanding that the proposals would have long-lasting effects). The Minister's Business Tax Review was undertaken separately and, indeed, has yet to be completed. The Fiscal Strategy as a whole will therefore need to be re-visited in due course.

2.4 Work on a long-term strategy is underway. The Minister has recognised the need for a medium- to long-term strategy and 2011 has seen the establishment of a Tax Policy Unit. More work is required, however, and the Minister needs to ensure that his work is clearly communicated to the States Assembly and to the public so that the ramifications can be understood. We have made recommendations to assist that process, including that the Minister should consult the Fiscal Policy Panel and that he should present an annual progress report on the Fiscal Strategy to the States.

2.5 A fiscal strategy is only one tool to be used in strengthening the Island's financial and fiscal position. There needs to be an Economic Growth Plan while spending also needs to be taken in hand. However, while the Comprehensive Spending Review has begun, and continues, it is clear that spending is not yet under control. And yet taxes have increased in direct contradiction to the message received from the public that the priority should be to control spending. Furthermore, there is no current Economic Growth Plan in the Island. Both these issues must be addressed and, in particular, there should be no further increases in Income Tax, GST or Social Security unless the aims of the CSR are met.

3. KEY FINDINGS AND RECOMMENDATIONS

Key Findings

3.1 The precise implication of increasing Social Security contributions will not be apparent until detailed proposals become available. (4.9)

3.2 The FSR of 2010 was not sufficiently wide-reaching, given that non-domestic rates were not included within the options considered. (4.17)

3.3 If reforms to the tax system are to be fair (and to be seen to be fair), it must be clear that people are not a subsidiary issue and the social impact of any measures on them must be understood and clearly communicated. (4.25)

3.4 The FSR proposals contained within the 2011 Budget were effectively short-term measures taken to address a short-term problem. (5.22)

3.5 Jersey does not yet have a true long-term, wide-ranging Fiscal Strategy. (5.23)

3.6 Long-term and wide-ranging tax reform ought to be possible in the Island. (5.24)

3.7 A true fiscal strategy cannot be developed until the Business Tax Review element has been completed. (6.8)

3.8 Notwithstanding that the FSR was intended to focus on personal taxation, it included elements that were essentially business taxation. (6.9)

3.9 The Island's 'Fiscal Strategy' should be a comprehensive, long-term plan covering all aspects of taxation in order to avoid creating a skewed and therefore potentially unsustainable distribution of the financial burden. (6.10)

3.10 At the time of the FSR, the Island did not have a current Economic Growth Plan. (6.16)

3.11 Contrary to the clear message that spending should be controlled before taxes are increased, this has not occurred. (6.27)

Recommendations

3.12 The Minister for Treasury and Resources should reconstitute the Fiscal Strategy Review to address medium- and long-term issues. (5.25)

3.13 The Minister for Treasury and Resources should consult the Fiscal Policy Panel for guidance on the creation of a medium-term fiscal strategy and on how long-term fiscal objectives may be accomplished. (5.26)

3.14 Before the end of the current States, the Minister for Treasury and Resources should provide the States Assembly with a report on his work on long-term and wide-ranging fiscal reform and strategy. (5.27)

3.15 The Minister for Treasury and Resources should present an Annual Fiscal Strategy Report. (5.25)

3.16 The Minister for Treasury and Resources should not propose any further increases in the rates of Income Tax, GST or Social Security unless the savings identified in CSR Part 2 have been delivered. (6.28)

4. THE FSR PROPOSALS

4.1 The FSR commenced in 2009 and was completed in 2010. Our advisor has described the context and background to the FSR in Chapter 3 of his own report (see Appendix 1). In short, in June 2010 the Department of Treasury and Resources published a Green Paper entitled *Fiscal Strategy Review – A public consultation on personal taxation*.[4] The Green Paper presented four potential options for reform of personal taxation:

- Increasing the Goods and Services Tax (GST) by 2%;
- Raising the Social Security contributions ceiling for both employers and employees to £115,000 per annum;
- Tripling domestic property rates through the Island-wide rate; and
- Establishing an Income Tax rate of 30% for incomes above £100,000 per annum.

Other matters were discussed in the Green Paper but these four measures were, in essence, the 'headline' options of the FSR. It was estimated that each measure, if implemented, could raise approximately £30 million per annum.[5] The Green Paper also emphasised that "*the solution [was] likely to be a combination of some of these measures*."[6]

4.2 Following the public consultation period, firm proposals were developed and included within the 2011 Budget. In particular, it was proposed that GST should be increased from 3% to 5% as of 1st June 2011; and that there should be a 2% increase in Social Security contributions above the ceiling from 1st January 2012. One option from the Green Paper was therefore proposed in full (that relating to GST) while a second (that relating to Social Security) was proposed in a revised format. The 2011 Budget did not include any proposals to increase domestic property rates or to introduce a higher rate of Income Tax for larger incomes.

4.3 A good deal of research was published alongside the Green Paper to explain and explore the four main proposals. Indeed, our advisor has indicated that, in his view, the research represents the most detailed economic analysis ever published in the Island. In that initial research, each of the four revenue options was assessed against the following five criteria:

- **Fairness** – taking into account a person's income and ability to pay;
- **Economic efficiency** – taking into account the impact that taxes can have on what people and business do or buy (such changes are also known as distortions);

[4] References to the 'FSR' in this report are to that Green Paper and the proposals contained therein.
[5] *Fiscal Strategy Review – A public consultation on personal taxation*
[6] Ibid, p. 3

- **Competitiveness** – taking into account Jersey's position in relation to other jurisdictions;
- **Revenue stability** – taking into account the level of certainty there would be in tax revenue: the more stability and predictability, the better; and
- **Administrative cost –** taking into account how much it would cost to administer each tax.[7]

4.4 Two amendments to the 2011 Budget were adopted. The first amendment, proposed by Deputy T. A. Vallois, concerned the level of contingency reserves which the States should maintain. The second, proposed by Deputy C. F. Labey, stated that the Minister for Treasury and Resources should consider the situation with regard to the taxation of non-locally owned, non-finance companies. Despite some attempts in the States to amend the specific FSR provisions of the 2011 Budget, however, the proposals relating to GST and Social Security remained unchanged. Notwithstanding this fact, our Review raised questions regarding the four initial options and the manner in which they were taken forward.

Social Security

4.5 Taking the Social Security option first, the proposals contained within the 2011 Budget differed to how the option had been presented in the initial Green Paper. The Green Paper had mooted the possibility of raising the employer and employee Social Security contributions ceiling to £115,000 per annum. We understood from the Minister for Treasury and Resources that those details of the Social Security option had been amended following the response to the public consultation. The results of the consultation had suggested that the proposals, as then revised, were a fairer option and that businesses and individuals should be allowed to prepare for the change; hence the proposals regarding Social Security as they appeared in the 2011 Budget.

4.6 It is somewhat surprising that this option was pursued at all given the findings that informed the previous Fiscal Strategy. In 2005, the States approved *Fiscal Strategy* (P.44/2005) which led to the implementation of GST and the introduction of '20 means 20' measures. The report accompanying P.44/2005 explained the proposals and set out the various options that had been considered. The report stated that there were effectively three options for raising £55 million (the amount that would need to be found through taxation following the introduction of the 'Zero/Ten' corporate taxation regime). Those options were a consumption tax (i.e. GST); increasing Income Tax rates; and introducing a payroll tax.

[7] *Fiscal Strategy Review – A public consultation on personal taxation*, p. 8

However, the option of a payroll tax was rejected as it would increase the cost of doing business (thereby impacting on economic efficiency and competitiveness) and there were issues of fairness, given that unearned income would not be taken into account.

4.7 The Fiscal Strategy of 2005 did not explicitly describe Social Security contributions as a 'payroll tax'. However, during our Review, the Minister for Treasury and Resources associated Social Security with that term.[8] With regard to the Minister for Social Security, this matter came up during the following exchange at our Public Hearing:

> Deputy T.A. Vallois: "*Just quickly on the 2 per cent above the cap, it could technically be seen as a payroll tax. So what is the short term effect for increasing the employer 2 per cent above the ceiling?"*
>
> Minister for Social Security: "*You can call it a payroll tax if you want but you could call Social Security a payroll tax. If you are calling one, you have got to call the other the same thing. I have always preferred not to because of the way that Social Security is looked at, the way that it operates, I prefer to see it as on an insurance basis. But again we have been moving away from that*."[9]

Notwithstanding the views of the Minister for Social Security, it would seem that Social Security could, from a certain perspective, be described as a payroll tax. If it can be described as such, then the question remains of how a measure that appeared so unpalatable in 2005 can now be seen as suitable for implementation in 2012.

4.8 In any event, there remains uncertainty regarding the proposals to be implemented in 2012. As the Minister for Treasury and Resources indicated during the debate on the 2011 Budget, separate proposals regarding the increase to Social Security will need to be brought to the Assembly for approval.[10] And the Minister for Social Security advised us that matters, such as whether unearned income could be incorporated, remained under consideration.[11]

KEY FINDING

4.9 The precise implications of increasing Social Security contributions will not be apparent until detailed proposals become available.

---

[8] Senator P.F.C. Ozouf, Minister for Treasury and Resources, Public Hearing, 27th October 2010 p. 24
[9] Deputy I.J. Gorst, Minister for Social Security, Public Hearing, 25th October 2010, p. 33
[10] Minister for Treasury and Resources, The Official Record, 10th December 2010
[11] Minister for Social Security, Public Hearing, p. 30

Domestic Rates

4.10 In relation to domestic rates, it was interesting to note that the assessment included in the research accompanying the Green Paper showed that an increase in rates would 'score' the same as an increase in GST.[12] However, the option of increasing domestic rates was not pursued and did not appear at all in the 2011 Budget. Initially, we had some concerns that this particular proposal had not been presented clearly: the Green Paper appeared to imply that the Island-wide domestic rate would be tripled although, in reality, the option put forward was a tripling of the overall take in domestic rates to amount to £14 million (to include both Parish and Island-wide rates). However, the £28 million extra revenue would seemingly have gone directly to the States, rather than the Parishes.

4.11 In such circumstances, it would not have been surprising if the Comité des Connétables had objected to an option that would seemingly require the collection of increased Parish rates without the commensurate capacity to deliver improved or additional services within the Parishes.

4.12 Ultimately, we understood that the domestic rates option had not been pursued for two reasons. Firstly, changing rates would have been a complex undertaking and, secondly, it would have been much harder to address issues of unfairness (than it would in the implementation of the other measures that were taken forward). While we understand the issue may be complex, it is slightly surprising that a long-term fiscal strategy could not have built in this proposal, particularly as the supporting research suggested that the domestic rates option was no less fair than the proposed increase to GST.

4.13 A second issue in relation to the possibility of increasing rates was why revenue from non-domestic rates (i.e. business rates) was not included within the consultation, either as a separate option or as a component part of the existing rates option. The supporting research showed that, with the inclusion of non-domestic property rates, the overall figure would only have to have been doubled to achieve a total of £22 million. This was especially significant given that commercial property rates received no mention in the Department's contiguous Business Tax Review. The supporting research to the FSR Green Paper explained the reason for the absence of non-domestic rates as follows:

> "*In terms of competitiveness from the domestic feed-through of taxes, because domestic rates are levied on households, rather than companies, there is likely to be no negative impact on international competitiveness. In terms of*

[12] *Fiscal Strategy Review: Supporting Research*, p. 7

> *competitiveness of tax rates relative to other jurisdictions, domestic rates are unlikely to be a key factor in location decisions.*"[13]

4.14 However, the response of the Comité des Connétables to the FSR Green Paper indicated that a decision to raise domestic rates, but not non-domestic rates, would not respect the initial intentions underlying the Island-wide rate:

> "*When the Island-wide rate was introduced it was strongly argued that commercial rates in other jurisdictions were significantly higher than the rates paid by businesses in Jersey and thus the Island-wide non-domestic rate should be set higher than that for the Island-wide domestic rate. The [FSR] proposals would mean the Island-wide domestic rate […] would be increased to more than three times greater then the non-domestic rate.*"[14]

4.15 As it is, no proposal relating to domestic rates was taken forward. It was interesting to note, however, the advice that was provided when the previous Fiscal Strategy was adopted. In 2005, the independent consultant engaged to inform that work identified one of the most important aspects of the Island's future fiscal strategy as being:

> "*[…] that the burden should be spread across the economy, and that the distribution of the burden should not only be as 'fair' as possible, but should also be seen to be as fair as possible.*"[15]

4.16 On that basis, it would therefore appear that if a decision was made in future to pursue amendments relating to domestic rates, consideration should also be given in the interests of fairness to the question of non-domestic rates.

KEY FINDING

4.17 The FSR of 2010 was not sufficiently wide-reaching, given that non-domestic rates were not included within the options considered.

Income Tax and GST

4.18 With regard to the other two 'headline' options in the FSR Green Paper, an increase to GST was proposed and adopted while proposals to amend Income Tax rates were not included in the 2011 Budget at all. Our Review suggested that this latter decision had come from a desire to maintain the Island's stability. The Minister indicated as such:

---

13 *Fiscal Strategy Review: Supporting Research*, p. 69
14 Response of the Comité des Connétables to the FSR Green Paper, 21st July 2010
15 *Which tax is best suited to Jersey's objectives?*, p. xiv

"*[…] I am clear that the conclusion from the FSR is that the 20% rate of tax has been a cornerstone of our statements of stability over the last 40 years and we tinker with it at our economic and financial detriment. So having considered and looked over the alternative of introducing a higher rate of tax, I have concluded that 20% is vitally important*."[16]

4.19 Politically and competitively, an Income Tax rate of 20% seemed to be sacrosanct and viewed as a foundation of Jersey's stability. It is important to note, however, that stability can be maintained (or, indeed, adversely affected) in other fields. It would not be helpful for the Island's stability, for instance, if the rate of GST were a victim of 'rate creep', a point made to us by the Jersey Law Society:

"*We understand that the proposed rise [of GST] to 5% would raise significant funds for the States. GST on fees for legal services has been accepted without objection, and we believe that clients would tolerate such an increase, and possibly more, provided other personal taxes were not significantly increased. However, we would not be comfortable with "rate creep" becoming an integral part of the Island's tax regime. If it is increased, then we believe there should be a clear guarantee about how long the new rate would be in force for*."[17]

4.20 However, while there was a political guarantee when GST was first introduced that it would remain at 3% for 3 years (a guarantee that was reflected statutorily), there has been no such guarantee on this occasion. So much was apparent from the submissions to us of the Minister for Treasury and Resources:

"*We need to deliver tax neutrality and if we balance our books in the manner in which I am suggesting, then GST ought to be able to remain at its single digit low levels compared to other places*."[18]

4.21 Aside from the fact that use of the term "*single digit*" could imply that GST could feasibly increase to 9%, this statement made it clear that there had been no guarantee on this occasion that GST would remain at a certain level for a prescribed period of time. Care must be taken, however, that efforts to maintain stability in one quarter do not lead to the creation of instability in others.

[16] Minister for Treasury and Resources, Public Hearing, p. 20
[17] Jersey Law Society, Written Submission, 29th October 2010
[18] Minister for Treasury and Resources, Public Hearing, p. 21

The Social Impact

4.22 The FSR proposals agreed by the States therefore would in time result in GST at 5% and Social Security contributions above the ceiling of 2%. One question we considered during our Review, however, was whether there had been an assessment of the overall social impact of these measures. This was a matter we discussed with the Minister for Social Security who advised us that:

> "*[…] those on low income would be protected against the rise in GST. Now one of the things with Income Support is we do now have a mechanism which allows us to pretty clearly direct money to those sectors of society that we might want to. We have seen it used before when we first brought in GST, components were uprated to offset against the cost of GST. We saw it again when there were food exemption debates and the components that would have been affected by that were increased again to offset against it. So we do now have this mechanism that can be used. Of course we currently know that there is an amount of money, I think it is about £2 million, which is being proposed to come to Social Security to do this offsetting. We now have to go away and consider how and which components we will uprate, or what will be uprated, to achieve some of that offsetting*."[19]

4.23 A concern arising from these statements is whether there has been any clear assessment of the impact of increases in personal taxation on the section of the population sometimes categorised as 'Middle Jersey'. There needs to be detailed research to determine exactly who these people are and how they might be affected by the FSR proposals. Particularly as our Review at times gave us the impression that a view can sometimes form that the bulk of the Island's population will continue to pay into whatever system is devised without questioning it.

4.24 Furthermore, the impression was sometimes given, albeit perhaps unwittingly, that a 'business first, people second' approach had been taken. This partly arises from the decision we mentioned earlier to explore increases in domestic rates, but not to consider non-domestic rates. Another example is that the FSR was completed (and measures proposed) before the Department's concurrent Business Tax Review was completed. In that regard, options for fiscal reform and decisions regarding the direction of fiscal strategy should be made on an objective basis to ensure fairness. They should not be subjective nor politically motivated.

[19] Minister for Social Security, Public Hearing, p. 15

KEY FINDING

4.25 If reforms to the tax system are to be fair (and to be seen to be fair), it must be clear that people are not a subsidiary issue and the social impact of any measures on them must be understood and clearly communicated.

5. THE STRATEGIC OBJECTIVE

5.1 Beyond the specific proposals contained in the Green Paper (and the subsequent developments that led to the inclusion of some in the 2011 Budget), one of our primary lines of enquiry was to establish the strategic objective of the FSR.

5.2 The immediate stated purpose of the FSR was to provide £50 to £60 million of revenue to complement concurrent efforts to deal with a deficit of £100 million. The other 'efforts' were the Comprehensive Spending Review (CSR) and the encouragement of economic growth, both of which we shall cover in the following chapter of this report.

5.3 It was not entirely clear to us, however, how the FSR was intended to stretch beyond that immediate target of balancing the budget. Our understanding of the term 'fiscal strategy' was that it should be long-term and comprehensive and not merely seek to fill a financial hole in the short-term through the implementation of certain measures.

5.4 The Chief Minister indicated that long-term strategy emanated from the Strategic Plan:

> "*Long-term strategy I suppose follows very much the Strategic Plan, that firstly you need to maintain balanced budgets and we need to get back to that as soon as possible. We need to maintain a strong and diverse economy and, as a personal long-terms strategy, I would like to see us in the longer term returning to a situation of having surpluses that we could put back into a stabilisation fund to follow the excellent principle that we had of being able to provide for economic downturn […].*"[20]

5.5 The Chief Minister's words certainly reflected the priorities contained within *Strategic Plan 2009 – 2014*. The Plan's first priority was to "*support the Island community through the economic downturn*" while its fourth was to "*ensure sustainable public finances.*"[21] Both would appear to be of relevance to the development of a fiscal strategy although the Plan in itself did not provide any specific direction for such a strategy. Indeed, there was only one mention of the term 'fiscal strategy' in the Plan (to say that the previous Strategic Plan from 2006 to 2011 had emanated from the Fiscal Strategy 'in force' at the time).[22]

5.6 The need for a medium- to long-term strategy has been identified elsewhere, however, for instance by the Fiscal Policy Panel in its 2010 report: "*focus should be on a credible*

---

[20] Senator T.A. Le Sueur, Chief Minister, Public Hearing, 27th October 2010, p. 19
[21] *Strategic Plan 2009 – 2014*, p. 5
[22] Ibid, p. 34

medium term fiscal plan."[23] The Minister for Treasury and Resources had himself identified this need in 2009:

> "*The CSR and FSR must identify the information, analysis and options with which to address the medium to long-term challenges on tax and spending. The result must be a strategy which will enable Jersey to remain competitive as a leading finance jurisdiction.*"

The Minister confirmed his long-term intentions during our Review, advising us that his "*time horizon […] is where Jersey is going to be in 2020 or 2030.*"[24]

5.7 The Terms of Reference for the FSR did not indicate the length of its scope: there was no statement to say that it was looking ten, twenty or thirty years into the future. Instead, the impressions they provided were that the FSR was to address the 'immediate' problem of the structural deficit of which there were questions as to its precise nature.

5.8 In that regard, the Chief Minister acknowledged that the deficit had at times been considered as cyclical. However, it was in fact a structural deficit.[25] The Minister for Treasury and Resources, however, advised us that the deficit was effectively one-half structural and one-half cyclical.[26] It is a complex issue and it is not surprising that confusion might arise. The Minister later clarified the position:

> "*There are three [deficits of] one hundred million that people are getting confused about:*
>
> *1. The original one hundred million as a result of the introduction of 0/10 which was dealt with by the original Fiscal Strategy.*
>
> *2. The nearly one hundred million deficit that will be incurred this year as a result of the Fiscal Stimulus spend and the fall-off in taxation revenue.*
>
> *3. The recurring one hundred million deficit which as we have explained and I hope is clear to the Panel is expected to reoccur every year from 2012.*"[27]

5.9 The problem is therefore neither 'one-off' nor straightforward. The challenge in determining the precise nature of the deficit could potentially provide an obstacle to the development of a unified, long-term fiscal strategy. However, in our view, a 'fiscal strategy' should be truly long-term and look beyond immediate difficulties. It should, for instance, be able to provide the public with an indication of the nature of the tax they are likely to be paying in twenty years time.

---

23 *Jersey's Fiscal Policy Panel Interim Report* (September 2010), p. 4
24 Minister for Treasury and Resources, Public Hearing, p. 20
25 Chief Minister, Public Hearing, p. 5
26 Minister for Treasury and Resources, Public Hearing, p. 5
27 Minister for Treasury and Resources, Written Submission, 22nd November 2010

5.10 Similarly, it is our view that a true 'fiscal strategy' should be wide-reaching and incorporate consideration of the tax structure. The supporting research to the FSR indicated that wide-scale tax reform was indeed feasible in the Island, stating that there was:

> "*[…] significant scope for tax reform in Jersey that could support economic efficiency and competitiveness. That, for the tax mix to achieve a better balance between direct and indirect taxation.*"[28]

5.11 Such reform could address issues raised during the development of the previous Fiscal Strategy in 2005. The research then undertaken showed that the "*Island is too dependent on direct taxes*"[29], a situation that remained even with the measures agreed for implementation at that time.

5.12 However, the measures taken in 2005, particularly the introduction of GST, did begin to address some of the problems identified during that earlier Fiscal Strategy. Implementation of those measures reduced the Island's proportional reliance on direct taxation, similarly reduced its reliance on corporate taxation and broadened the tax base. However, while we acknowledge this, our concern lies with the strategic direction underlying current fiscal policy. GST was introduced to address the 'black hole' caused by the implementation of 'Zero/Ten'; it has been increased to address the recurring deficit highlighted above. Taken in that light, the current use of GST therefore appears to have been as a short-term measure in response to immediate problems – not a tool used as part of a long-term fiscal strategy.

5.13 Ultimately, the FSR Green Paper did not spread its net that widely. There was no lengthy consideration of the fundamental question of how the tax system could be reformed overall. For instance, there were no questions on whether the public would like to see a shift from direct to indirect taxation or whether it would prefer a flat rate. Similarly, the FSR did not delve deeply into matters such as the process and structure of tax collection – for instance, the performance of ITIS and whether the expectations regarding that system have been met. The Chamber of Commerce certainly advised us that they felt such matters warranted consideration:

> "*[…] we felt that in terms of description for taxes there needed to be more work done on the paper in terms of explaining to the population at large, and the businesses which we [the Chamber] represent, the pros and cons of the different*

[28] *Fiscal Strategy Review: Supporting Research*, p. 4
[29] *Fiscal Strategy* (P.44/2005), p. 22

> *taxations, the cost of collection, the efficiency, the possible economic impact of one tax over another tax and such like..*"[30]

5.14 Tax reform and fiscal strategy should address these matters and, in doing so, aim for simplicity. This was also a point made in preparation of the previous Fiscal Strategy in 2005. The report accompanying the Strategy stated that "*people should be able to easily understand the tax system*."[31] Without a comprehensive, strategic direction, there is a risk that any changes could in essence be incremental and only increase the potential for confusion. This on top of a system where there already exist matters ripe for simplification, for instance the marginal tax rate.

5.15 Finally, the FSR did not appear to take into account other measures from previous exercises such as *Imagine Jersey 2035*. For example, that earlier exercise had highlighted:

> "*Many participants also felt that there should be incentives such as tax breaks or incremental increases in pension levels to encourage people to work for longer*."[32]

5.16 Such options did not find their way into the FSR. However, they would appear to reflect the type of long-term view that one would expect to find within a 'fiscal strategy'. The Chief Minister, for example, acknowledged that there was scope for tax reform:

> "*It is certainly true that Jersey has a relatively low effective tax rate compared with many countries in the Western world and there may well be scope in that sense to have a higher level of overall effective taxation and a higher level of public services*."[33]

5.17 It must be acknowledged that work is being undertaken. We recently noted the advertisement for a 'Deputy Director of Tax Policy' to work within the Department of Treasury and Resources as part of a Tax Policy Unit. The Minister also spoke of this Unit during the debate on the 2011 Budget:

> "*A new tax policy unit will be formed from 1st January [2011] with a specific remit to raise more tax revenues. The combination of a strengthened tax policy team, a simplified and more automated tax system and efficiencies from sharing information could, I believe, result in an annual net benefit of between £5-10 million within the next 3 years*."[34]

---

[30] Chairman – Financial Sub-Committee, Chamber of Commerce, Public Hearing, 1st November 2010 p. 2
[31] *Fiscal Strategy* (P.44/2005), p. 30
[32] *Imagine Jersey 2035*, p. 23
[33] Chief Minister, Public Hearing, p. 14
[34] Minister for Treasury and Resources, The Official Record, 7th December 2010

5.18 This work could incorporate appropriate statistical modelling that should assist the creation of a long-term strategy. We understand that such modelling is feasible and has been done in the past, for instance in the mid-1990s during a review of Social Security and health insurance schemes that led to the production of a report entitled *Continuity and Change*. This can be painstaking work, however, and in the context of a long-term fiscal strategy would seemingly require the co-operation of the Departments of Treasury and Resources and Social Security. The Minister for Social Security advised us that efforts were indeed being made to see how his Department could work more closely with the Income Tax Department. There were difficulties, however:

> "*But we have got to remember that there are strict requirements around the Income Tax information for perfectly legitimate reasons and if the Comptroller of Income Tax was here before you, I think he would be telling you what they were and why it, perhaps although a nice idea, might be more difficult than we imagine.*"[35]

5.19 Consequently, while there may be the intention for a long-term, wide-ranging 'fiscal strategy', that stage has yet to be reached. Instead, the FSR, such as it was, proposed a series of measures seemingly to address a particular situation. While those measures may undoubtedly be long-lasting, this does not mean that their implementation equates to the introduction of a long-term strategy. As our advisor has indicated to us:

> "*In short, this [the 2010 FSR] was not a review of fiscal policy which dealt with fundamental issues of strategy but instead adopted short-term tactics. In short, the uncomfortable fact is that Jersey has not really had a 'fiscal strategy review' as is generally understood by the term.*"[36]

5.20 In this sense, the Chief Minister also acknowledged that work remained to be done:

> "*The vision is going to be one of more fundamental change but those sorts of changes take quite a lot of planning and quite a lot of implementation. As I say at the moment we need to do one thing properly and the one thing properly that we need to do at the moment is to get back to balanced budgets. I would like to see more significant changes in the longer term, so I do not see 2013 and the return to balanced budgets as the end of the road. I see it as a milestone from which one can then go on to produce maybe some of the more significant things that we are talking about, and at the same time address some of the longer term*

[35] Minister for Social Security, Public Hearing, p. 31

[36] See Appendix 1, Paragraph 5.2

issues that we are talking about. But I do believe in taking one step at a time and making sure that the next step is firmly entered."[37]

5.21 That a long-term, wide-ranging approach is feasible can be seen from the example of other jurisdictions. Our advisor made us aware of the endeavours that have been made elsewhere to create and maintain a medium- to long-term fiscal strategy. To quote him in relation to one example:

> "*New Zealand publishes an annual Fiscal Strategy Report which sets out the government's fiscal strategy and measures how the government is doing against its overall goals in areas such as the balance between operating revenues and expenses, and achieving debt objectives. The government must explain changes in, and/or inconsistencies between, the Fiscal Strategy Report, the Budget Policy Statement and the previous year's Fiscal Strategy Report. Under the Public Finance Act 1989 (as amended in 2004), the New Zealand Treasury is expected to publish a statement at least every four years on the long-term fiscal position and each statement must have an outlook horizon of at least 40 years.*"[38]

It is our view that this represents a truer approach to 'fiscal strategy'. Jersey has yet to reach that stage.

KEY FINDING

5.22 The FSR proposals contained within the 2011 Budget were effectively short-term measures taken to address a short-term problem.

KEY FINDING

5.23 Jersey does not yet have a true long-term, wide-ranging Fiscal Strategy.

KEY FINDING

5.24 Long-term and wide-ranging tax reform ought to be possible in the Island.

RECOMMENDATION

5.25 The Minister for Treasury and Resources should reconstitute the Fiscal Strategy Review to address medium- and long-term issues.

RECOMMENDATION

[37] Chief Minister, Public Hearing, p. 31

[38] See Appendix 1, Paragraph 2.6

5.26 The Minister for Treasury and Resources should consult the Fiscal Policy Panel for guidance on the creation of a medium-term fiscal strategy and on how long-term fiscal objectives may be accomplished.

RECOMMENDATION

5.27 Before the end of the current States, the Minister for Treasury and Resources should provide the States Assembly with a report of his work on long-term and wide-ranging fiscal reform and strategy.

RECOMMENDATION

5.28 The Minister for Treasury and Resources should present an Annual Fiscal Strategy Report.

6. THE BIGGER PICTURE

6.1 The FSR was only one measure that was intended to address Jersey's situation and to restore the stability of the Island's finances. There was also the CSR and the need for economic growth, both of which need to be considered during an examination of the FSR itself. Furthermore, consideration has to be given to the Business Tax Review which was also launched by the Department of Treasury and Resources in 2010.

Business Tax Review

6.2 In June 2010, as well as its FSR Green Paper, the Department published a Green Paper entitled *Business Tax Review – A public consultation on corporate taxation*. While the two were released at the same time, however, we understood that the Minister and his Department viewed these consultations on personal and corporate taxation as separate entities. The Business Tax Review (BTR) focussed on the impact of any possible future changes to Jersey's corporate tax regime and presented some alternative corporate tax structures to the 'Zero/Ten' structure that Jersey had adopted. Unlike the FSR, it was not intended to address the issue of the deficit but to consider how companies in Jersey could be taxed in light of changing international pressures (the outcomes of which consideration would be tax neutral). In that sense, the BTR was linked to the decision of the EU Code of Conduct for Business Taxation Group that Jersey's 'Zero/Ten' regime should be examined. Following an examination by the EU Council's High Level Working Party and its conclusion that the Island's shareholder tax rules fell within the scope of the Code, the 'Code Group' concluded that the Island's regime gave rise to harmful effects. Consequently, the Chief Minister advised the States Assembly on 15th February 2011 that the Council of Ministers had decided to abolish the deemed distribution and attribution provisions of the 'Zero/Ten' regime as of 1st January 2012.

6.3 That the BTR and FSR are, in the Minister's view, separate entities can be seen in the fact that FSR proposals were developed and included in the 2011 Budget, notwithstanding that the BTR had yet to be completed. However, without the full picture of where the Island's economy is heading in terms of revenue generated by its major industry of financial services, it is hard to draw any definitive conclusions about which would be the best long-term fiscal strategy for the States to adopt. In the absence of a completed BTR, we only have half the story. Indeed, the fact that the Island now has to respond to the findings of Code Group would appear to create a situation ripe with the opportunity for a true fiscal strategy to be developed.

6.4 As it is, the FSR (which was styled as an examination of the personal taxation) contained elements of business taxation. Thus, the FSR made reference to International Services Entities (ISEs) and, indeed, the 2011 Budget proposed an increase in ISEs. Furthermore, the proposal to increase Social Security contributions would inevitably impact upon businesses as the increase would affect both employers and employees. Indeed, the 2005 Fiscal Strategy classified employer social security contributions as a 'business tax'.[39] The fact that such measures were incorporated within the FSR (ostensibly concerned with personal taxation) makes it more difficult to understand why personal taxation and business taxation should not be considered together as part of one coherent fiscal strategy.

6.5 It was the view of the Chamber of Commerce that personal and business taxation should be considered together:

> "*If […] we are on to looking at taxation then business and personal taxation needs to be considered as a group because it is very difficult to segregate them, for example GST impacts persons and businesses. Business tax ultimately filters through to the man on the street in some shape or form […].*"[40]

6.6 It is also our view that business and personal taxation should have been considered together in the architecture of a robust and future-proofed fiscal strategy for the Island. Not to do so would be to create a skewed, and therefore potentially unsustainable, distribution of the financial burden. In that regard, the words of the independent consultant used during the production of the previous fiscal strategy in 2005 remain pertinent:

> "*[…] the burden should be spread across the economy, and [...] the distribution of the burden should not only be as 'fair' as possible, but should also be seen to be as fair as possible.*"[41]

6.7 A long-term, wide-ranging fiscal strategy should therefore incorporate both personal and corporate taxation.

KEY FINDING

6.8 A true fiscal strategy cannot be developed until the Business Tax Review element has been completed.

KEY FINDING

6.9 Notwithstanding that the FSR was intended to focus on personal taxation, it included elements that were essentially business taxation.

---

[39] *Fiscal Strategy* (P.44/2005), p. 23
[40] Chairman – Financial Sub-Committee, Chamber of Commerce, Public Hearing, p. 2
[41] *Which tax is best suited to Jersey's objectives?*, p. xiv

KEY FINDING

6.10 The Island's 'Fiscal Strategy' should be a comprehensive, long-term plan covering all aspects of taxation in order to avoid creating a skewed and therefore potentially unsustainable distribution of the financial burden.

Economic Growth

6.11 Economic growth was also one of the three prongs to be used in the attack against Jersey's financial situation. One might therefore expect that, alongside a new 'fiscal strategy', one would see a new Economic Growth Plan. However, it became apparent during our Review that the Island did not have a current Economic Growth Plan. The previous Plan, agreed in 2005, had only been intended to last until 2009. When we questioned the Minister for Economic Development on this matter, he advised us that much of the previous Plan remained effective although the effects of the global financial crisis would need to be taken into account during the production of the new Plan.[42]

6.12 The significance of an Economic Growth Plan was highlighted to us by the Chamber of Commerce:

> "*[…] it [the Economic Growth Plan] creates the right climate of trust and confidence that people will think: 'Right, we can invest in this, we can go down this route, we can try this new idea, we can try this new enterprise.' This sort of thing. I think government creates…where there is a feeling that government understands where business is coming from, it creates that atmosphere and businesses will react.*"[43]

6.13 The challenges in establishing a Growth Plan were apparent to us from the words of economist David Kern:

> "*For Jersey, lack of political will is the main obstacle to a credible growth strategy. Growth policies can only succeed if they enjoy public support. But this requires changes in attitude. People must understand that growth entails hard choices. But accepting a future of low-growth or stagnation will be even more unpleasant for Jersey.*"[44]

[42] Senator A. J. H. Maclean, Minister for Economic Development, Public Hearing, 1st November 2010, p. 2

[43] President - Chamber of Commerce, Public Hearing, 1st November 2010, p. 17

[44] *Jersey Must Develop Credible Growth Strategies* (October 2010), David Kern, Chamber On-line, p. 2

6.14 However, the Minister for Economic Development stated that there was not a lack of political will in the Island.[45] He did, however, highlight another challenge to developing economic growth:

> "*Diversification is a key agenda as far as we are concerned. There is no silver bullet as far as diversification is concerned. I am sure you appreciate that some people step forward and regularly talk about diversification as if there is some magic industry that could be brought forward and developed that is going to replace, for example, financial services. The reality is diversification is diversification of existing successful industries like finance in terms of products and in terms of market and that is why we are investing as heavily as we have done in Jersey Finance, the promotional agency for the finance industry, investing and supporting them, in looking at new markets in Asia and Asia-Pacific and so forth*."[46]

6.15 We understood that the new Economic Growth Plan would be forthcoming during the first half of 2011. Ultimately however, regardless of the challenges in developing a new Plan, the reality was that at the time of this report's presentation and – more significantly – during the undertaking of the FSR in 2010, the Island did not have a renewed, up-to-date Plan.

KEY FINDING

6.16 At the time of the FSR, the Island did not have a current Economic Growth Plan.

6.17 The importance of an Economic Growth Plan, and the significance of its absence, is underlined by a point we made earlier: that the FSR contained elements of business taxation. As has already been mentioned, the decision to increase Social Security contributions above the ceiling by 2% for both employers and employees will have an impact on businesses. This will be particularly so for the self-employed and for small businesses (which, according to the Minister for Economic Development, make up approximately three-quarters of all trading entities in the Island[47]). However, although such measures have been taken that will impact upon businesses, there is no current Economic Growth Plan to show how small businesses will be supported.

Comprehensive Spending Review

6.18 The third and final 'prong' to deal with the Island's deficit was the Comprehensive Spending Review (CSR), a subject we have covered in other Scrutiny Reviews. As with the question

---

[45] Minister for Economic Development, Public Hearing, p. 16
[46] Ibid, p. 3
[47] Ibid, p. 5

of economic growth, one would expect to see moves to cut spending alongside any endeavours to develop a fiscal strategy for the Island. And this has occurred: the States has already agreed that States expenditure should be cut by £65 million over the period 2011 to 2013. Nevertheless, questions remain in relation to what is happening.

6.19 Although the FSR related to taxation (or, more particularly, personal taxation), an overriding message received to the consultation was that spending should be controlled before taxation measures were introduced. This was made clear to us by the Chief Minister:

> "*I would say that what the consultation exercise highlighted was the desire by the public to see the States get its spending under control before we raise more taxes.*"[48]

6.20 This view was also put forward by the Chamber of Commerce:

> "*Before you consider tax increases is first of all to balance the spending part of the element, and the black hole, if you will, is estimated at £100 million, and our view is of managing that black hole of £100 million by reducing expenditure to where it was supposed to be per the 2005 Budget. That is our view and our broad comments on the consultation paper were that is really the most important one.*"[49]

6.21 This message has been consistent for a number of years now. The following quote from *Imagine Jersey 2035* illustrates there were similar caveats attached to the public's consent to raise taxes in 2008:

> "*There were mixed feelings among participants about the proposals to increase taxes and contributions to maintain current levels of public services. The submissions to the written consultation revealed a level of support for paying more, although some respondents stated that they would only support this if the finance industry would not be adversely affected, or only if the States of Jersey did more to control spending.*"[50]

6.22 Evidently, the CSR has begun and is due to continue. However, it has not yet been completed, notwithstanding the clear message that spending should be controlled before taxation measures are taken. The fact is that taxes have been raised at a time when spending is not fully under control and when it is unclear whether the precise reasons for uncontrolled spending in the past have been clearly understood. This has been shown in

[48] Chief Minister, Public Hearing, p. 10
[49] Chairman – Financial Sub-Committee, Chamber of Commerce, Public Hearing, p. 3
[50] *Imagine Jersey 2035*, p. 4

work undertaken by the Comptroller and Auditor General (C&AG) and subsequently the Public Accounts Committee (PAC). For instance, the C&AG found that:

> "*Of the total annual recurring savings said to have arisen from the FSR process (£20.132 million), there is some doubt whether 'savings' amounting to £4.064 million (i.e. 20%) can be said to have arisen. These amounts were:*
>
> *(1) transferred to other funds (and so did not represent cuts in expenditure in any way);*
>
> *(2) resulted from factors that were not within the control of the States and thus would have occurred whatever action the States may or may not have taken; or*
>
> *(3) could not be achieved in practice.*
>
> *Further reductions in Net Revenue Expenditure amounting to £2.512 million were achieved by increasing departmental income rather than by reducing expenditure.*
>
> *Of the remaining total reduction of £13.556 million whilst the Departments concerned have 'lived within' their reduced budgets (i.e. reduced by the agreed FSR reductions), and to this extent this total represents an actual reduction in expenditure.*"[51]

6.23 This in turn led to the PAC making the following comment:

> "*The result of these issues was that of the £35 million the Comptroller and Auditor General estimated that:*
>
> *£21.9 million represents a reduction in expenditure*
>
> *£1.5 million represents deferred expense*
>
> *£5.8 million represents Corporate efficiencies*
>
> *£4.06 million was a reduction in expenditure from other sources or from exogenous factors*
>
> *£2.5 million arose from increased income.*"[52]

In other words, the answer is that spending is not yet under control and yet tax increases have been implemented.

6.24 In some respects, a reliance on taxation and the difficulties in implementing true reductions in expenditure can be understood. As our advisor stated in his report:

---

51 *States Spending Review: £35 Million Cost* Reduction(R.12/2008), p. 2

52 *Report on the States' £35m expenditure reductions* (PAC2/2008), p. 5

> "*It needs to be remembered that fiscal policy relates to taxation and expenditure. Although never popular, history has shown that the creative ability of government to levy new taxes is far easier than controlling expenditure.*"[53]

6.25 It is also perhaps not surprising that taxation can be an 'easier' option: the regulation of taxes requires legislation and the obligation to implement and collect taxes therefore becomes a statutory one. The 'obligation' to reduce spending is generally policy driven, rather than statute driven. It can therefore be easier to raise taxes rather than cut expenditure.

6.26 It is ultimately our view, however, as the evidence suggests, that this situation is unsatisfactory, particularly given the clear indications from the FSR consultation that the public wishes to see spending controlled before taxation is increased. Notwithstanding this imperative, taxation has risen.

KEY FINDING

6.27 Contrary to the clear message that spending should be controlled before taxes are increased, this has not occurred.

RECOMMENDATION

6.28 The Minister for Treasury and Resources should not propose any further increases in the rates of Income Tax, GST or Social Security unless the savings identified in CSR Part 2 have been delivered.

[53] See Appendix 1, Paragraph 5.4

7. CONCLUSION

7.1 Whatever questions might arise in relation to the specific proposals contained in the FSR Green Paper and, subsequently, the 2011 Budget, the primary issues to have arisen during our Review are broader in nature.

7.2 A 'fiscal strategy' should be long-term and comprehensive. It should not merely aim to 'plug holes' or address immediate issues but should, ideally, look at the tax regime and structures that Jersey would like to have in place in ten, twenty, thirty years time – or even beyond. Similarly, it should include both personal and corporate taxation; it should incorporate questions of direct versus indirect taxation and of tax collection. Without the inclusion of these matters, it could be claimed that what is produced is not really a 'fiscal strategy' in the true sense of the term.

7.3 Similarly, a 'fiscal strategy' should be, and be seen to be, in its proper place. Reform of taxation measures is indeed only one tool in the box, alongside those of economic growth and the reduction in spending. However, the implementation of a 'Fiscal Strategy Review', without a current Economic Growth Plan in place, with spending yet to be fully controlled and with the question of business taxation 'up in the air', can give the impression either that too much reliance has been placed upon (personal) taxation measures or that the public is indeed being hit first. As the evidence has shown us, there is a need for both financial and fiscal problems and their potential solutions to be clearly explained and understood. The Island is not quite there yet.

7.4 This is notwithstanding the work of the Minister (and his Department) alongside his colleagues on the Council of Ministers. After all, a new Economic Growth Plan is being developed, the Comprehensive Spending Review is underway and the Department is in the formative stages of considering and developing longer-term fiscal strategies. As the Minister stated to us:

> "*Of course, there will be very highly-charged debates about increases in taxes. As politicians we have got to be absolutely transparent with people and say what the problem is that we have found, and what we are going to do to do it, and to say to people, not to promise people unrealistic things.*"[54]

The Minister is aware of the challenges and work has begun to address them. As our Review has shown, however, there remains a good deal of work to be done.

[54] Minister for Treasury and Resources, Public Hearing, p. 52

8. APPENDIX 1 – ADVISOR'S REPORT

Observations on the 2010 Fiscal Strategy Review

Michael J. Oliver

1. INTRODUCTION

1.1 At the beginning of the 2000s, there was a perception that Jersey was mismanaging its expenditure and a belief that the public service was overstaffed or at least inefficient in how it operated. Growing expectations of public service provision was putting considerable pressure on the exchequer and there was evidence the political structure was unable to assert itself over the bureaucracy leading to a growing disillusionment with government.

1.2 As a response to this, and a sharp fall in GVA between 2001 and 2004, the States of Jersey began reform on a number of fronts:

1.2.1 There were major changes to the political structure when the States accepted the principles of ministerial government. There were hopes that it would be possible for a Chief Executive to run the civil service as a coherent organisation and not one that was fragmented to reflect a myriad of political committees.

1.2.2 Matters like intelligence and statistical gathering and monitoring were also given more attention through the establishment of functions in the Chief Minister's Office such as International Relations and Statistics.

1.2.3 In June 2004, the States agreed to double the annual rate of economic growth to 2% for the next 5 years and in March 2005, it published an economic growth plan (Economic Development Committee 2005). This was followed by a series of measures which aimed to diversify the economy, increase productivity and uplift the skills of the workforce (e.g. Economic Development 2007).

1.2.4 The States agreed to balance government income and expenditure and improve the delivery of public services (States of Jersey 2005).

1.2.5 A new fiscal framework was agreed by the States in October 2006 and outlined the purpose of a Stabilisation Fund and the Strategic Reserve (States of Jersey 2006). Concomitantly, the introduction of a Fiscal Policy Panel (FPP) in 2007 allowed three outside independent experts to provide comments on the appropriateness of the States financial position and forecasts.

1.3 *Plus ça change*, *plus c'est la même chose*. Despite these initiatives, at the end of the 2000s, criticisms about the growth of expenditure had become shriller and there were louder calls for reform of ministerial government, Scrutiny and more recently the composition of States members. The economy entered a very steep recession, and there were predictions of on-going budget deficits. In recent months there has been significant pressures placed on the Zero/Ten tax regime, which will undoubtedly require modification by the authorities in Jersey. In a world where many international experts believe that the financial services industry is going to shrink, the implications for future tax revenues in Jersey is potentially bleak.

1.4 Although the politico-economic challenges now facing Jersey should not be underestimated, in order to tackle at least one of the most demanding, namely delivering sustainable levels of public expenditure and returning to balanced budgets, a number of initiatives have been announced to address the way in which the States executes financial planning and forecasting. These are grouped under the Integrated Business Improvement Programme (IBIP) comprised of a Comprehensive Spending Review (CSR), financial management improvements, organisational development and a Fiscal Strategy Review (FSR). As the Treasury Minister announced in 2009:

> The CSR and FSR must identify the information, analysis and options with which to address the *medium to long-term* challenges on tax and spending. The result must be a strategy which will enable Jersey to remain competitive as a leading finance jurisdiction
>
> (Minister of Treasury and Resources 2009, p. 6, emphasis added)

1.5 This short report is intended to consider why the FSR was needed; the process of the FSR and the outcome of the FSR. In so doing, it will address two specific questions. First, did the FSR identify the options for increasing income so as to deal with the potential structural deficit and return the economy to balanced budgets? Secondly, did the FSR address Jersey's medium and long-term fiscal problems? It will conclude that Jersey's FSR was not a thorough review of fiscal policy because not all options were addressed in the course of the review; there is little indication that medium and long-term objectives were considered and a discussion of what a future tax structure should look like was excluded. Four recommendations follow.

2. WHY HAVE A FISCAL STRATEGY REVIEW?

2.1 In the wake of the financial crises of the late-2000s, the public finances in many countries deteriorated sharply. The OECD estimated at the beginning of 2010 that gross general government debt for advanced economies would rise from 75% to 115% of GDP between 2008 and 2014 and that by 2014, debt ratios would be close to or exceed 90% in all G7 countries except Canada (OECD 2010, p. 3). As Reinhart and Rogoff (2008) have shown in their masterly survey on eight hundred years of financial crises, debt ratios at this level become a threshold for slower economic growth.

2.2 It was clear that Jersey would not be immune from the financial crisis. Although she has historically run budget surpluses, calculations in the Treasury revealed that from 2011, Jersey was facing on-going budget deficits. The implications of this were that Jersey would be tilted in the direction of the majority of OECD countries, who have been increasing government debt since the end of Bretton Woods in the early-1970s.

2.3 Although it might be difficult for some to believe that Jersey could emulate most modern democracies – which either suffer from an inherent deficit bias and a tendency to accumulate debt – there are five observations which Calmfors (2010) has made on the experience of other countries which clearly resonate with the Island's recent politico-economic history.

2.3.1 First, both politicians and the electorate are not fully cognisant about the long-run constraints on fiscal policy. This could either be because of over-optimism or overconfidence about the future.

2.3.2 Secondly, politicians have a good record of acting in their own interests rather than the wider interests of the electorate. This manifests itself though rent-seeking behaviour, i.e. prestigious

projects with little value for society or benefits to the own constituency and various interest groups. As Andersen and Westh Nielsen (2010) have shown, this rent-seeking behaviour coupled with 'fiscal murkiness' can lead to pro-cyclical policy, because voters demand more government consumption and lower taxes in good times to prevent higher tax revenues from being wasted on political rents. Rogoff and Sibert (1988) have also drawn attention to the impact of the political business cycle: voters have difficulties in evaluating macroeconomic outcomes which gives governments an incentive before elections to signal their competence through deficit-increasing measures that boost the economy in the short run.

2.3.3 Thirdly, there is a danger that politicians are myopic and don't attach enough weight to the future. This is because an incumbent political party knows that future costs of current deficits will be borne by other parties if they are not re-elected. Linked to 2.3.2, political parties have interests aligned to particular constituencies who have their own priorities regarding the composition of government spending, or the trade-off between government spending and taxes.

2.3.4 Fourthly, there is the problem of time inconsistency. Governments may make plans for fiscal retrenchment but later renege on them. Why this is so can be easily understood with the simple example of a government who wishes to induce expectation of low inflation which would result in low wage increases. Once this has been done, the government will pursue a more expansionary fiscal policy to reduce unemployment, which can then be achieved at a lower cost of inflation than would otherwise be the case. If the private sector realises what the government is doing, expectations will never adjust to the government's announced plans and the economy ends up in a

bad equilibrium with high deficits. Policies that are optimal *ex ante* are no longer *ex post*.

2.3.5 Finally, there are 'common-pool' problems which can arise because government spending, financed out of general taxation, is targeted on individual groups. Lobbying amongst the individual groups can be intense as they push for their preferred programmes to be implemented without considering the full budgetary costs now and in the future. The result is over spending and excessive debt accumulation. As Alesina and Drazen (1991) note, a special case of the common-pool problem is a war of attrition over budgetary consolidations: in a situation of unsustainable deficits each group in society – and the political party representing it – tries to postpone the necessary fiscal adjustment in the hope that the burden of adjustment can be shifted on to other groups.

2.4 It might be countered that Jersey is different to the above for all sorts of reasons e.g. it does not have political parties, it has an independent FPP which guards against pro-cyclical policies, it has a Stabilisation Fund and so on. However, attention needs to be drawn to the following:

2.4.1 Jersey is particularly vulnerable to 'tax revenue surprises' (Barrios and Rizza 2010, p. 13) because of the dominance of financial services. Favourable developments in asset prices boost the stock market, banking profits and the housing market and provide revenue windfalls. This encourages government to increase expenditure or reduce taxation beyond what would be advisable from a medium-term perspective. In a recession, revenue shortfalls will mean that tax revenues are insufficient to meet the planned increased expenditure and lead to deterioration in the fiscal position.

2.4.2 Following on from the above point, despite the advice of the FPP in 2008 one of their key recommendations not to increase expenditure was ignored with deleterious consequences for the public finances. The FPP can only provide guidance and can't enforce fiscal discipline.

2.4.3 The Stabilisation Fund is now empty and given the uncertain economic outlook, it is very unclear when it will be replenished.

2.4.4 Jersey does not have political parties and this could lead to even greater rent seeking behaviour by 53 individual politicians.

2.4.5 For an advanced economy, lines of accountability for centralised States spending are unclear; there are ambiguities within the Public Finance (Jersey) Law 2005 and there is a lack of collective responsibility engendered by the Council of Ministers (Public Account Committee 2010).

2.4.6 As noted above, the economy is heavily dependent on the financial services industry for revenue generation and employment. In 2009, the finance sector accounted for 43 per cent of total GVA, and for 50 per cent of all economic activity excluding the rental income of private households (States of Jersey Statistics Unit 2010, p. 5). However, this was the lowest percentage for at least a decade and as the Independent Review of British Offshore Financial Centres (Foot 2009, p. 29) recognised, reviews by many large financial service firms on their location could lead to a net loss of employment across the British offshore financial centres over time.

2.4.7 When the economy has been experiencing positive economic growth, various reports have shown how difficult it has been for the States of Jersey to control spending. As several commentators have noted, not only does this mean that there

needs to be better mechanisms for controlling public expenditure but there also needs to be a cultural change if expenditure is to be controlled (for example, Fiscal Policy Panel 2010, p. 17).

2.4.8 Medium and long-term commitments require significant amounts of public sector investment. Required investment in social overhead capital (e.g. States buildings, sewage and solid waste) require between £20 million and £35 million annually. The implications of an aging population (which includes high pension and long-term care costs) could require an additional £190 million per annum by 2035.

2.4.9 Historically Jersey has had little interest (if not aversion) to borrowing in the capital markets, but the change in her economic circumstances would make it impossible to pay for everything out of the Consolidated Fund. There is also a strong case to be made that on the grounds of fairness, future generations who will benefit from this investment should pay for it (although it must be noted that this argument is yet to be had!). On the other hand, that States are not paying up their pension deficits and are thus deferring to a future generation the cost of employing staff now (a classic example of politicians avoiding a tax increase).

2.5 Despite the difficulties listed above, in 2009 it was recognised that in order to deliver sustainable levels of public expenditure and to return to balanced budgets, a number of changes need to be made to the way in which the States of Jersey executes financial planning and forecasting. It is also worth noting that the independent review of British offshore financial centres suggested jurisdictions needed to adopt several benchmark standards (summarised in Table 1).

Table 1. Benchmark standards for public sector finance problems in nine jurisdictions

- Timely and accurate measurement of economic variables including public revenues and public expenditure.
- Effective measures to control public spending and improve public sector efficiency.
- Identification of options to maximise sources of revenue, including diversifying the tax base.
- Building sufficient reserves to improve economic resilience.
- Medium-term economic planning (ideally with independent input) to support the fiscal planning process

Source: Foot (2009, p. 29)

2.6 Reviews of fiscal policy and the framework in which they are set are periodically undertaken by governments, often but not always, when they hit a financial crisis. Over the last thirty-five years, many countries have sought to avoid a fiscal crisis by moving to consider policy in a more medium-term framework. Some examples, drawn from around the world include:

- The Medium Term Financial Strategy, unveiled by the UK's Conservative government in 1980, was a pioneering attempt to set policy on an explicit medium-term nominal framework and to place monetary targets at the centre of economic policy, supported by reductions in government borrowing and plans to reduce public spending in real terms by 4 per cent. Despite the rhetoric and the reforming zeal of the Conservative government, public expenditure overshot its target and rose on average by 1.9 per cent per year in real terms from 1978-79 to 1992-93, and then by 2.7 per cent in the period from 1992-93 to 1995-96 (Thain 2010).
- Barbados has a fiscal strategy which aims to ensure fiscal sustainability over the medium term. Its 2010-2014 Medium Term Fiscal Strategy aims to achieve a primary budget surpluses of 5.9% of GDP on average over the medium term; it sets targets for both revenue and expenditure as a share of GDP consistent with the medium term objective for the primary surplus; and intends to improve the Government's net financial worth over the medium term.

- New Zealand publishes an annual Fiscal Strategy Report which sets out the government's fiscal strategy and measures how the government is doing against its overall goals in areas such as the balance between operating revenues and expenses, and achieving debt objectives. The government must explain changes in, and/or inconsistencies between, the Fiscal Strategy Report, the Budget Policy Statement and the previous year's Fiscal Strategy Report. Under the Public Finance Act 1989 (as amended in 2004), the New Zealand Treasury is expected to publish a statement at least every four years on the long-term fiscal position and each statement must have an outlook horizon of at least 40 years.
- Many UK councils publish a medium term financial strategy or framework as part of their overall strategic planning process. Several councils note that without such a strategy, they run the risk of not being able to deliver their objectives and priorities in future years. The hallmarks of such strategies range from delivering investment in clean streets and low council tax increases through to delivering value for money to local taxpayers, continually reviewing budgets to ensure that resources are targeted on key objectives and exercising probity, prudence and strong financial control.

2.7 As has been noted in the Introduction, over the last decade Jersey has tried to improve its fiscal practices. In the wake of the credit crunch, she is not alone in needing to re-think her fiscal strategy going forward and many economies have been forced to do this because of the financial crises. Whether it is Barbados or New Zealand, states across the world are all having to address common problems such as the growth of government expenditure, a slowing of revenue yields/growth, sustainable fiscal balances, high debt to GDP ratios, inefficient performance of public sector enterprises, fiscal commitment to international, regional and domestic protocols, better balance sheet management and clearly defined long-term objectives. The crucial

question however, is whether Jersey's 2010 FSR was a review which sought solutions to address the medium and long-run challenges, or whether it was merely short-term sticking plaster.

3. THE PROCESS OF THE FSR IN JERSEY

3.1 The path to the 2010 FSR can be traced back to the 13 March 2009. On this date, the Minister for Treasury and Resources wrote to the FPP and noted that the latest research from the Economics Unit indicated that Jersey was about to enter a period of significant contraction in 2009 and the economy could further weaken in 2010. During the previous week, the FPP had visited Jersey to collect data for its annual report. Given that the economic conditions had changed markedly since their report in November 2008, the Minister requested whether the FPP could advise whether economic conditions could now justify the use of the Stabilization Fund to support the local economy.

3.2 Recognizing that the economic outlook for 2009 had deteriorated more sharply than they had previously expected, the FPP judged that Jersey would experience a significant cyclical downturn in 2009 and that the economy would decline further in 2010. The FPP noted that because of a lack of economic data and the surrounding uncertainties related to the effects on the Jersey economy of any given fiscal stimulus, it could not quantify the size of stimulus appropriate for Jersey. Drawing attention to the fact that the amount in the Stabilization Fund was in the order of £160 million (equivalent to 4% of GVA over a two to three year period) and that, as the cyclical impact of the downturn would occur in 2010 and 2011, the FPP urged 'the time to act is now' (States of Jersey 2009).

3.3 Despite endorsing the use of the Stabilization Fund, the FPP gave a warning that following preliminary forecasts from the T&R Department there was clearly a danger to the short-run deterioration of the States finances, but also, there was 'also a risk that once the economy recovers, the States could be running a structural … deficit'. (States of Jersey 2009). It should be recalled that in mid-2008, the FPP had

recommended that the 2009 Business Plan and Budget should, if possible, avoid taking decisions that undermine the tax base or increase expenditure at a rate above that currently forecast (Fiscal Policy Panel 2008a, p. 30). With the forthcoming election in October 2008, the States did not heed this advice and approved a number of amendments which permanently reduced income and increased expenditure by approximately £10m a year. In addition a couple of smaller amendments were made to the 2009 Budget that also permanently weakened the States financial position.

3.4 The scale of the structural deficit in the medium-term was initially downplayed in oral evidence given by Treasury officials to the Corporate Services Scrutiny Panel on the 1 May 2009. The 2009 Budget had also contained forecasts that revenue and expenditure would broadly balance from 2010 onwards (Minister for Treasury and Resources 2008, p. 14) but the FPP had drawn attention to the optimism contained in these forecasts, commenting that 'there is a risk that rather more [expected income] proves to be cyclical as a result of recent strong economic growth, and rather less proves to be structural and thus sustainable, than the Treasury department has assumed' (Fiscal Policy Panel 2008b, p. 8). The FPP (2008b, p.1) recommended that:

> given the uncertainties facing the economy and the public finances in the medium-term, the Treasury and Resources Minister and Council of Ministers should draw up contingency plans for each of the following eventualities: – a structural deficit in the medium-term; and – an economic slowdown that merits discretionary fiscal policy changes.

However, it does not appear to have been until after the publication of the FPP's annual report on 5 May 2009 – which urged policymakers to begin immediate planning for the deficit after the recession – that the Panel was assured by Treasury officials that contingencies to address the structural deficit were being considered.

3.5 In September 2009 a Ministerial Steering Group on the FSR was

formed. On 9 October 2009, the terms of reference for the review were published and it was announced that the Ministerial Steering Group would undertaking research and assess the appropriate fiscal options until May 2010. A public consultation process would then follow, planned between June 2010 and August 2010. The outcome of the FSR would then be taken to the Council of Ministers and the States for approval in the 2011 Budget, which would be debated in December 2010.

3.6 At this point, it is important to emphasize several things in light of developments by December 2010. First, the terms of reference for the FSR made it clear that the purpose of the review was fourfold: (i) to ensure sustainable public finances and to support economic objectives; (ii) to plan for potential future changes in global fiscal norms and the possible impact on Jersey; to address the potential structural deficit once the economy has recovered; (iii) to fund essential public services; (iv) to take account of funding sources for the future spending pressures. Secondly, the review intended to consider 'all options' to meet the future costs of public services including fiscal changes and income generation. Thirdly, the review would consider how much individual groups could contribute, the distributional consequences, efficiency considerations, administrative simplicity and the impact on competitiveness. These terms of reference clearly qualify as a review of fiscal strategy, broadly construed. Fourthly, it was decided by mid to late-October 2009 to separate a personal tax review from a business tax review. This was a response to the ongoing developments on 0/10 within the EU Code group and it was felt that separate consultations were required because of the nature of the different issues. The main drivers for change in business taxation are the need to meet international standards and obligations (in order to secure access to world financial markets) and the need to be competitive with other jurisdictions.

3.7 On 21 April 2010, the Treasury and Resources Minister gave a speech

to the Institute of Director in which he outlined why Jersey was taking the measures it was. Three sentences are worth quoting from the speech:

> [First], the Comprehensive Spending Review will result in a plan to reduce States expenditure by 10% over three years. Secondly, we are working hard to improve productivity and boost growth. This includes for example delivering on Esplanade Square. Finally, and only then, will we consider tax increases.

(http://www.gov.je/News/Speeches/Treasury/Pages/IoDSpeech.aspx)

It thus appeared that other measures were going to be implemented and would be applied before tax increases were introduced; however, the Minister did make it clear in the speech that he would be starting a review of Jersey's fiscal strategy.

3.8 In June 2010, a consultation paper on personal taxation was published (States of Jersey 2010a). Acknowledging that controlling spending and economic growth would help towards bringing the budget back into balance by 2013, the Green Paper also offered four tax raising options. These were increasing GST, social security contributions, domestic property rates and Income Tax. Other options which the Green Paper considered were increasing import duties, raising stamp duty and introducing a land development tax. The Green Paper emphasized that the solution was likely to involve a combination of some of these measures.

3.9 On 21 June 2010, a public consultation on the FSR Green Paper was launched. This was conducted through online questionnaires, paper based forms, letters, emails and face-to-face events. The total number of attendants or responses to the consultation exercise was placed at 950 (Anderson and Ingram 2010, p. 6). The report concluded that most respondents stated a preference for expenditure reductions before tax increases and a common theme was that the public sector was inefficient and that savings were needed. Increasing GST and domestic rates was seen to be less damaging to businesses but deleterious for

residents and employees. Unsurprisingly, there was no consensus on the concept of ‘fairness’ with some respondents suggesting that those on higher incomes should be made to pay proportionally more Income Tax in the name of fairness. Others opposed an increase and felt it was unfair for people who worked hard for a high income to pay more.

4. THE OUTCOME OF THE FSR

4.1 When the draft Budget statement for 2011 was published on the 22 October 2010, the decision had been made to increase GST from 3 per cent to 5 per cent from June 2011 and to introduce 2 per cent social security contributions above the ceiling for both employers and employees from January 2012. How did this decision relate to the evidence supporting the Green Paper and the consultation evidence which had been undertaken?

4.2 The supporting research paper is probably the most detailed economic analysis ever published by the Economic Section (States of Jersey 2010b). It set out the framework for assessing the options discussed in the Green Paper, analysed the main tax options and did some comparative work on tax regimes of other jurisdictions. In assessing the strength of each tax option, five criteria were used: fairness, economic efficiency, competitiveness, revenue stability and administrative cost. A summary of how these criteria scored against the options being considered is reproduced as Table 2.

4.3 It is unclear whether the supporting research paper was written before the Green Paper, but 'revenue stability' and 'administration costs' were excluded from a similar table, which was produced as Figure 2 in the Green Paper. The conclusions in the supporting research are worth quoting in full:

> In summary, the *evidence on economic efficiency* implies that *GST and domestic rates would be preferable to social security and higher personal tax rates*. The *evidence on competitiveness* from domestic tax feed-through and relative to other jurisdictions *both imply that GST and domestic rates would be preferable to social security*, with mixed evidence on a higher personal tax rate. This is consistent with the advice of Oxera (2004), which noted that "from the perspective of preserving Jersey's competitiveness as a location for financial services, it would appear that measures with a first-order effect that increase net business costs [such as raising employer social security contributions] may pose more of a risk than

those with an impact that relies initially on being translated into costs through wage demands [such as raising the GST rate], where there may be more scope to manage those demands."

(States of Jersey 2010b, p. 89; emphasis added)

Thus according to the supporting research, on both economic efficiency grounds and competitiveness grounds, raising GST and domestic rates scored better than the other options. They both also score better on a further criteria listed in the above table, namely revenue stability (administration costs are low for all the options outlines). However, according to the supporting research, on grounds of fairness both increases to GST and domestic rates were judged to be mildly regressive.

Table 2. Assessing the tax options against the five criteria

Measure	Revenue	Fairness	Economic efficiency	Competitive-ness	Revenue Stability	Admin. costs
Main options						
Income tax						
Freeze exemptions	£4m	Regressive	Negative	Negative	Volatile	Low
Raise basic rate by 1%	£8m	Progressive	Negative	Negative	Volatile	Low
30% rate over £100k	£30m	Progressive	Negative	Negative	Volatile	Low
Extend '20 means 20' *	£4m	Progressive	Neutral	Negative	Volatile	Low
Social security						
Raise rate by 1%**	£15m***	Neutral****	Negative	Negative	Volatile	Low
Raise ceiling to £115,000	£30m#	Progressive	Negative	Negative	Volatile	Low
Remove ceiling	£45m#	Progressive	Negative	Negative	Volatile	Low
GST						
Raise GST by 1%	£15m	Mildly Regressive	Positive	Positive	Stable	Low
Domestic rates						
Double Island wide rate	£6m	Mildly Regressive	Positive	Positive	Stable	Low
Other options						
Raise impôts by 10%	£5m	Mildly Regressive	Neutral	Positive	Stable	Low
Removing MITR	£20m	Unclear	Positive	Positive	Neutral	Low

* Remove remaining allowances for higher earners
** 0.5% on employees and employers
*** net of supplementation
**** Progressive for incomes up to the ceiling/regressive above it
# Excludes any increase in revenue to the Health Insurance Fund, should changes apply to those contributions

Source: States of Jersey (2010b, p. 7)

4.4 As Involve noted following their consultation on the FSR Green Paper:

> …there seem to be two widely held perspectives; one which emphasises the high cost of living for those on lower incomes and wants to see a more progressive taxation system……..and another perspective of concern that increased taxes on the wealthy will lead to Jersey losing financial services and affluent residents to international competitors
>
> (Anderson and Ingram 2010, p. 3)

So if the final options taken by the CoM were influenced more by considerations of fairness than any other criteria, why was it that one of the two options which were chosen was mildly regressive? Furthermore, it is not clear why the excellent work contained in the supporting research on economic efficiency and competitiveness – which echoed the work of Oxera in the last Fiscal Strategy Review – was overlooked.

4.5 The Corporate Services Panel learnt that after the publication of the Green Paper and an article appearing in the *Financial Times* on 11 July 2010 with the headline 'Jersey eyes big rise in Income Tax', several 1.1ks decided not to move to Jersey. Given that civil servants have spent many years in previous decades trying to attract 1 (1)ks to the Island, this appeared to run counter to the aspiration of trying in increase income into the Island. Unfortunately, the decision announced on 17 January 2011, that the Island would like to attract fifteen new 1 (1)ks a year to the Island, has yet to be picked up by the *Financial Times*.

4.6 During the course of gathering evidence, the Panel discovered that increasing the domestic rates option was not thoroughly considered nor explained in the consultation which was undertaken in the summer of 2010. This is discussed in the Panel's report.

4.7 More widely, there is a concern that the final outcomes of the FSR

reflects a narrow interpretation of some of the original terms of reference mentioned above in 3.6. If the purpose of the review *inter alia* was to ensure sustainable public finances, support economic objectives and in so-doing, was going to consider 'all options' to meet the future costs of public services, the outcome of the review leaves many questions unanswered. These include:

- How does raising GST and increasing social security meet any of the medium to long-term spending issues which face the Island?
- What are the economic objectives going forward?
- How are the economic objectives going to be realised in an economic growth plan and support the FSR?
- Where is the detailed work on how much individual groups could contribute and the distributional consequences?
- Why were efficiency considerations, administrative simplicity and the impact on competitiveness seemingly given second-order consideration in the final discussions by Ministers?
- Where are the indications that Jersey and Guernsey have worked/are working together to review their fiscal strategies (see Foot 2009, p. 25)?
- Why was there not a proper consultation on the different types of taxation available, broadly grouped under the headings of direct or indirect taxation?
- Finally, as the Panel's report discusses, how does the FSR produce a package of measures which were articulated by the draft fiscal strategy paper as resulting 'in a level of public services that Islanders want and public finances that are sound and sustainable in the long-run', if this was not part of the FSR consultation process?

5. CONCLUSIONS

5.1 Lying at the heart of public fiscal administration are policies shaped by the socio-economic and political interaction of the internal and external policy environment. Experience has shown that the internal policy environment can frequently be problematic for Jersey and it is only recently that she has begun to engage more with the external environment (e.g. appointing an assistant minister responsible for external relations and a director of European Affairs to represent the Channel Islands). This is a difficult time to play catch-up in an external landscape which has become more hostile to offshore financial centres.

5.2 The focus of the 2010 FSR was on personal Income Tax and in 2011, it is expected that the focus will shift towards the completion of a review of business taxation, which was put on hold following the discussions surrounding Zero/Ten. However, in the original terms of reference for the FSR, it was made very clearly that the review was focusing on short, medium and long-term issues and the expectation was that the review would be a holistic examination of fiscal policy. The Zero/Ten issue prompted the authorities to abandon this approach and in subsequent developments, much of the sound premise behind the FSR was replaced by the immediacy of filling the 'black hole' in the public finances. It appears that the worsening of the economic outlook and the implications for the State's finances in the short-run also encouraged this shift. Due to this change in focus, many other surrounding issues have been ignored. For example, it would have been instructive to have had some discussion about the tax structure in Jersey which might have prompted a wider review of taxation policy. In short, this was not a review of fiscal policy which dealt with fundamental issues of strategy but instead adopted short-term tactics. In short, the uncomfortable fact is that Jersey has not really had a 'fiscal strategy review' as is generally understood by the term.

5.3 Any fiscal consolidation over the medium term requires a combination of tax rises, spending plans and forecasts for economic growth. The supporting research made it clear that economic growth is part of the wider plan to address future fiscal sustainability but Jersey still does not have an economic growth plan.

5.4 It needs to be remembered that fiscal policy relates to taxation and expenditure. Although never popular, history has shown that the creative ability of government to levy new taxes is far easier than controlling expenditure. The PAC report has explained why the mechanisms of accountability are diffuse and can lead to problems. Unless there is genuine commitment to deliver spending cuts – that is, unless CSR 2 can be delivered to the last pound and pence – and the public can be shown that they are getting value for money (CSR 3 and 4?), credibility about the seriousness of the government's commitment to expenditure control and to keep to its fiscal promises will vanish.

6. RECOMMENDATIONS

6.1 Any future increases in the rate of Income Tax, GST and social security should not be introduced until CSR 2 has been delivered.

6.2 The Fiscal Strategy Review needs to be reconstituted to address medium and long-term issues.

6.3 The States of Jersey should publish a new fiscal framework and principles of fiscal implementation.

6.4 Consideration should be given as to how the FPP could be used to provide more articulate guidelines on creating a medium term financial strategy and how long-term fiscal objectives could be accomplished.

REFERENCES

Alesina, A. and Drazen, A. (1991), 'Why stabilizations are delayed', *American Economic Review*, Vol. 81, No. 5, pp. 1170–88.

Andersen, A. L. and Westh Nielsen, L. H. (2010), 'Fiscal Transparency and Procyclical Fiscal Policy', EPRU Working Paper Series 2010-01, Department of Economics, University of Copenhagen.

Anderson, E. and Ingram, H. (2010), *Fiscal Strategy Review – public consultation on personal taxation. Consultation report*, London: Involve.

Barrios, S. and Rizza, P. (2010), 'Unexpected changes in tax revenues and the stabilisation function of fiscal policy: evidence for the European Union 1999-2008', *Economic Papers*, No. 404, Brussels: European Commission.

Calmfours, L. (2010), 'The role of independent fiscal policy institutions', Report to the Prime Minister's Office, Finland, 1 September.

Economic Development Committee (2005), 'Growing Jersey's economy: an economic growth plan', 1st March.

Economic Development (2007), *2007 Business Plan*, Jersey: States of Jersey.

Fiscal Policy Panel. (2008a), *Jersey's Fiscal Policy Panel Annual Report 2008*, September.

Fiscal Policy Panel (2008b), *Jersey's Fiscal Policy Panel Annual Report*, November Update.

Fiscal Policy Panel (2010), *Jersey's Fiscal Policy Panel Annual Report 2010*, November.

Foot, M. (2009), *Final report of the independent review of British offshore financial centres*, London: HMSO.

Minister for Treasury and Resources (2008), *Budget Statement 2009*, Jersey: States of Jersey.

Minister for Treasury and Resources (2009), *Budget Statement 2010*, Jersey: States of Jersey.

OECD (2010), 'Restoring fiscal sustainability: lessons for the public sector', Working Party of Senior Budget Officials.

Public Account Committee. (2010), *Report on the Accounts of the States Of Jersey for the year ended December 31st 2009*, PAC 4/2010, Jersey.

Reinhart, C. and Rogoff, K. (2009), *This time is different. Eight centuries of financial crises*, Princeton, NJ: Princeton University Press.

Rogoff, K.S. and Sibert, A. (1988), 'Elections and macroeconomic policy cycles', *Review of Economic Studies*, Vol. 55, No. 1, pp. 1–16.

States of Jersey. (2005), *Strategic Plan 2005–2010*, Jersey: States of Jersey.

States of Jersey. (2006), *Establishment of a Stabilisation Find and Policy for the Reserve*, P133/2006.

States of Jersey (2009), 'Jersey's Fiscal Policy Panel reply to Minister', *New Release*, 26 March.

States of Jersey (2010a), *Fiscal Strategy Review: a public consultation on personal taxation*, June.

States of Jersey (2010b), *Fiscal Strategy Review: Supporting research*, June.

States of Jersey Statistics Unit (2010), *Jersey Economic Trends 2010*, Jersey.

Thain, C. (2010), 'Budget reform in the United Kingdom – the rocky road to "controlled discretion"', in John Wanna, L. Jensen and J. de Vries (eds.), *The Reality of Budgetary Reform in OECD Nations: Trajectories and Consequences*, Cheltenham: Edward Elgar.

9. APPENDIX 2 – PANEL MEMBERSHIP

9.1 At the time of this report's presentation, the Corporate Services Scrutiny Panel comprised the following members:

- Senator S. C. Ferguson, Chairman
- Deputy T. A. Vallois, Vice-Chairman
- Deputy J. A. N. Le Fondré
- Deputy D. J. de Sousa
- Senator F. du H. Le Gresley [Co-opted Member under Standing Order 138(5A)]

9.2 The membership of the Panel changed during the course of the Review. When the Review began in October 2010, the Panel comprised Senator Ferguson and Deputy Vallois alongside Connétable D. J. Murphy and Deputy C. H. Egré. Connétable Murphy resigned from the Panel in November 2010 while Deputy Egré resigned on 19th January 2011. Deputy Le Fondré was elected to the Panel on 18th January 2011 and Deputy de Sousa was elected on 1st February 2011.

9.3 For the purposes of the Review, the Panel appointed Professor M. J. Oliver BA PhD as its expert advisor.

10. APPENDIX 3 – TERMS OF REFERENCE

10.1 The Panel approved the following Terms of Reference for the purpose of the Review:

1. To examine the rationale behind the Fiscal Strategy Review, and the feasibility of its savings target
2. To discover which alternatives to the measures set out in the Fiscal Strategy Review have been considered by the Treasury and Resources Department
3. To identify the long-term repercussions of the measures suggested in the Fiscal Strategy Review, both on the Island's population and on the future of its economy
4. To evaluate the aims of the Fiscal Strategy Review within the context of previous tax and spending reviews adopted by the States
5. To examine any further issues relating to the topic that may arise in the course of the Scrutiny Review and which the Panel considers relevant

11. APPENDIX 4 – EVIDENCE CONSIDERED

Documents

1. *Fiscal Strategy* (P.44/2005)
2. *Imagine Jersey 2035 – Preparing for the future* (February 2008), Involve
3. *States Spending Review: £35 million cost reductions* (R.12/2008)
4. *Report on the States' £35m expenditure reductions* (PAC2/2008)
5. *Draft Fiscal Strategy Issues Paper: Future funding pressures and options to deal with them* (September 2009)
6. *Terms of Reference for the Fiscal Strategy Review* (October 2009)
7. *Fiscal adjustments: lessons from recent history* (April 2010), Alesina, Alberto
8. *Fiscal Strategy Review – A public consultation on personal taxation* (June 2010)
9. *Fiscal Strategy Review: Supporting Research* (June 2010)
10. *Business Tax Review – A public consultation on corporate taxation* (June 2010)
11. *Report on International Standards for the States of Jersey in connection with a Business Tax consultation* (June 2010), Deloitte
12. *Fiscal Strategy Review – Public Consultation on personal taxation: Consultation Report*, Involve (Andersson Edward and Ingram, Hally)
13. *Jersey's Fiscal Policy Panel Interim Report* (September 2010)
14. *Jersey Must Develop Credible Growth Strategies* (October 2010), Kern, David, Chamber On-Line
15. *Expenditure Proposals for 2012 and 2013 and Draft Budget Statement* (P.157/2010)
16. *Zero/Ten Corporate Tax Regime – A statement from the Chief Minister*
17. *Zero/Ten Corporate Tax Regime – Background Information*
18. *Recruitment Information – Deputy Head of Tax Policy*

Written Submissions

1. Jersey Law Society

2. Senator P. F. C. Ozouf, Minister for Treasury and Resources, and the Department of Treasury and Resources

Public Hearings

<u>25th October 2010</u>

1. Deputy I. J. Gorst, Minister for Social Security

   Mr R. Bell, Chief Officer – Social Security

<u>27th October 2010</u>

1. Senator T. A. Le Sueur, Chief Minister

   Mr W. D. Ogley, Chief Executive

   Mr M. MacGregor, Tax Policy Advisor

2. Senator P. F. C. Ozouf, Minister for Treasury and Resources

   Mr H. McGarel-Groves, Interim Treasurer of the States

   Mr M. MacGregor, Tax Policy Advisor

<u>1st November 2010</u>

1. Senator A. J. H. Maclean, Minister for Economic Development

   Mr M. King, Chief Officer – Economic Development

   Mr J. Mews, Finance Industry Development

2. Mr R. Shead, President – Jersey Chamber of Commerce

   Chairman – Financial Sub-Committee, Jersey Chamber of Commerce