States of Jersey
States Assembly

États de Jersey
Assemblée des États

Corporate Services Scrutiny Panel

MTFP Addition for 2017-19

Presented to the States on 23rd September 2016

S.R.5/2016

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1. EXECUTIVE SUMMARY

The Panel presents its report on the MTFP Addition for 2017-2019. Included as appendices are reports from the Panel's advisors, the Chartered Institute of Public Finance and Accountancy ("CIPFA") and Dr Michael Oliver of MJO Consultancy Limited.

The MTFP Addition contains some major new policies, in particular charges for the disposal of waste and for the provision of health care, which if approved will have lasting impacts on all islanders, beyond the period covered by the MTFP. It also seeks to move States finances from operating at an annual deficit, to a modest surplus by 2019.

Summary of key points:

- Income forecasts are overly optimistic and there is a lack of detail around savings, efficiencies and proposed charges

- The target for savings and efficiencies during the period of the MTFP Addition has been reduced from £90m to £77m.

- There is a very high level of vacancies across the States. Departments are receiving funding but the posts are not being filled.

- The Panel has therefore lodged an amendment to the MTFP Addition to bring the vacancy rate down to a more reasonable level of 3%. This would generate a saving of £35 million a year across departmental budgets, which means that the introduction of a health charge can be avoided. The balance of the saving would be put into contingency to give flexibility in case a genuine need for additional posts can be demonstrated.

- In the context of an ongoing drive to realise savings and efficiencies in the Public Sector, funding should not be provided to departments where vacant posts are being carried forward year on year.

- The Panel has looked closely at the income forecasts used in the MTFP, as these are critical to the planned levels of expenditure.

- The recent downgrade of income forecasts, although attributed to the impact of Brexit, follows a longer term trend over the last few years of downgraded forecasts.

- The Panel raised concerns about the prudence of income forecasts in its report on the MTFP in 2015 and is disappointed that it is yet again in the same position.

- There is insufficient detail on many of the savings and efficiencies outlined in the MTFP. CIPFA have commented that many appear to be "aspirational". This is disappointing given than departments have been afforded an extra year to work on the detail from when the MTFP was originally lodged in 2015.

- In light of the new charges and taxation measures included in the MTFP, it will be increasingly important that the States operates as efficiently as possible and targets its expenditure where it is most needed.

- Departments are due to receive funding for 2017 growth initiatives through approval of this MTFP.

- Growth funding should only be released where it can be demonstrated that departments have met savings targets. As the savings targets have been lowered (from £90 million to £77 million), it is difficult to assess whether the original targets set out in the MTFP in 2015 have really been met.

- A Waste charge is due to raise £11 million for the Department for Infrastructure by 2019, however planning for the charge is at a very early stage. The charge was first mentioned in the MTFP lodged in 2015, however a year down the line there is still no detail on the mechanics of the charge.

- A Health Charge is due to raise £7.5 million in 2018 and £15 million in 2019.

- Based on the detail provided in the MTFP, the Panel has found it difficult to equate the "charge" that will be paid by taxpayers with the specific service that they will receive.

- Our advisor, MJO Consultancy, has noted that the introduction of charges is a departure from the traditional method of funding public services through direct taxation.

  "the introduction of new charging mechanisms…is a departure for the States of Jersey, which has traditionally raised money through taxation and social security contributions".

In Conclusion:

- The MTFP Addition and accompanying annexes is a substantial document. However, within this there is a significant lack of detail on key areas, particularly in light of the fact that an extra year has been given to the Council of Ministers to provide the detail.

- The Panel asked its advisor CIPFA whether there is sufficient information available in the MTFP Addition for States Members to vote with complete understanding of what it is they were actually voting for. CIPFA said they did not think there was sufficient information within the document.

- In their report, as regards the structure and process of the MTFP Addition, CIPFA comment that it is a *"comprehensive and robust framework"* that *"…in many ways…contains aspects of best practice…"* However, regardless of this, CIPFA go on to comment that:

  "its overall utility as a platform for optimal decision making (tax and spend decisions) is significantly impaired by what we see as imprudent assumptions around Income Tax and a lack of rigour in the detail behind a significant number of efficiency saving proposals."

2. FINDINGS AND RECOMMENDATIONS

The Financial Forecasts

Finding 1

The Panel highlights the fact that the financial forecasts were prepared prior to the BREXIT vote and in light of this, strongly believe updated forecasts should be used for the MTFP Addition.

Finding 2

The last BTS was published in March 2016 and will not be continued. Given the importance attached to the survey by the FPP and in the MTFP Addition, the Panel find this concerning.

Recommendation 1

The relevant funding be reinstated to the States of Jersey Statistics Unit in order for it to continue conducting the Business Tendency Survey.

Finding 3

The Panel finds it highly concerning that the Minister for Treasury and Resources did not recalibrate the income forecasts at an earlier stage and believe the reduction in interest rates and market trends currently speak for themselves. This is likely to result in higher drawings on the Strategic Reserve or mean the Island is running higher forecasted deficits well beyond 2019.

Recommendation 2

In light of repeated instances of downgraded income forecasts, the process by which income is forecast should be reviewed with immediate effect with the early involvement of the relevant Scrutiny Panel.

Recommendation 3

The Minister for Treasury and Resources must explain the full impact of the downgraded income forecasts and the measures he proposes to take to balance expenditure by 2019.

Return to Surplus

Finding 4

The Panel is strongly of the view that achieving a surplus of £1.5m by 2019 was never achievable and will now not be achieved in light of the downgraded income forecasts.

Contingency

Finding 5

Many of the items listed under Contingency in the MTFP Addition are not for unforeseen events and have already been designated for certain purposes. Such use of Contingency artificially distorts departmental budgets.

Recommendation 4

Contingency must only be used for money set aside for unforeseen events. Money already designated for specific purposes should not be held under contingency.

Economic and Productivity Growth Drawdown Provision

Finding 6

Part of the EPGDP has been used to support the budgets of External Relations and Digital, Innovation, Financial Services and Competition which in the Panel's opinion sits outside of the original intent for the Fund as set out in the MTFP 2016-19 and approved by the States.

Recommendation 5

On making any allocations from the EPGDP, the Minister for Treasury & Resources must send a copy of the Ministerial Decision and report, on the date of signature, to the relevant Scrutiny Panel for that department.

Growth

Finding 7

The lowering of the savings and efficiencies target points to the fact that the target has only been met because the goalposts have been moved. As there is no certainty that the targets will not be adjusted again in future years, this makes it virtually impossible for the public or States Members to judge whether or not savings targets have actually been met.

Recommendation 6

Growth expenditure must only be released when savings and efficiencies targets can be demonstrated to have been met. As such, targets for savings and efficiencies must be fixed achievable and realistic in the timeframes envisaged.

Reduction in savings target

Finding 8

The savings and efficiencies target has been reduced from £90 million to £77 million (including user pays charges).

Finding 9

The MTFP does not show the savings and efficiencies opportunities rejected by the Council of Ministers.

Recommendation 7

States Members should be presented with a detailed analysis of all of those areas that were rejected by the Council of Ministers which resulted in a reduced savings and efficiencies target.

Savings vs Efficiencies

Finding 10

The direction from Ministers to Chief Officers to make savings and bring in efficiencies is not robust enough nor precise enough for an organisation of this size.

Recommendation 8

In order to tackle the "almost cultural acceptance" of non-achievement of savings targets, the Council of Ministers must provide stronger direction, leadership and clear policy statements in order to drive savings and efficiencies across the States.

Finding 11

There is a general lack of drive behind the savings programme with savings being made through simplistic departmental budget reductions rather than introducing fundamental structural change to deliver long term savings and efficiencies.

Recommendation 9

In order to bring about fundamental structural change to deliver real savings and efficiencies, recommendation 16 in CIPFA's report in relation to outcome based budgeting and additional zero based budgeting should be put in place by the time of the next MTFP.

"Outcome based budgeting and additional zero based budgeting should be used to complement the prevailing incremental approach."

Vacancy Management

Finding 12

The vacancy rate of 12.9% across States departments is very high and this money is included in departments' annual budgets. The Panel questions whether this funding is really needed by departments if current service levels are deemed to be acceptable.

Finding 13

The level of vacancies across the States is significantly higher than UK levels.

Finding 14

States Members are being asked to approve artificially increased levels of expenditure which include a high level of vacancies.

Recommendation 10

The ongoing vacancy rate for departments should be reduced to 3%

Increases in Expenditure

Finding 15

Despite the savings and efficiencies being targeted within the Public sector for a number of years, overall expenditure to 2015 and also for 2016 has continued to rise year on year. This leads the Panel to question whether the level of savings and efficiencies will actually be achieved.

Recommendation 11

Detailed targets with realistic timeframes for public sector savings and efficiencies should be presented to States Members.

Recommendation 12

States Members should be presented with a detailed breakdown of performance versus targets every six months, explaining where and why targets have not been met for any reason.

Lack of Detail

Finding 16

Despite being given an additional 12 months to prepare the MTFP Addition, there is a significant lack of detail within the document.

The Health Charge

Finding 17

There is no clear link between the amount to be charged and the type and level of service that will be delivered to members of the public. Furthermore, there is no detail yet about how the money will be appropriately ring fenced and channelled to the Health Department.

Finding 18

The Panel is highly concerned with the lack of detail contained within the MTFP Addition with regards to the Health Charge. Given the absence of detail or link between usage and liability, the Panel finds it difficult to see how a "charge" for provision of Health services can be justified and that the argument for imposing this charge has not been adequately made.

Recommendation 13

The proposal for a Health Charge should be withdrawn unless the Council of Ministers can clearly demonstrate that there are no further savings and efficiencies that can be made within Public Sector expenditure.

Finding 19

The capping of the charge results in higher earners paying less as a percentage of their overall income than middle to lower earners. This is non-compliant with the tax principle of low, broad, simple and fair.

Recommendation 14

A complete review of the capping of all charges, both existing and proposed, should be carried out with the outcome of the review presented to all States Members by June 2017.

Waste Charge

Finding 20

States Members are being asked to vote on a waste charge with no detail behind it.

Finding 21

No studies have been carried out in relation to the impact of the Waste Charge on the tourism industry or any other end users.

Recommendation 15

Any proposals to introduce a Waste Charge should be abandoned until further consultation and studies have been undertaken and the results presented to States Members.

Proposals for States Payment of Rates and a Funding Mechanism

Finding 22

An agreement has yet to be reached between the Comité des Connétables and the Council of Ministers as to if, and how, a funding mechanism for the States' payment of Rates will be created.

Funding the new Hospital

Finding 23

The Minister for Treasury and Resources has stated it is likely that a further charge will be levied on tax payers to fund the new hospital.

Finding 24

In light of the statement from the Minister for Treasury and Resources in relation to the likelihood of a future hospital charge and lacking any further detail, States Members are unable to fully comprehend the total additional charges that are being envisaged by COM over the life of this MTFP.

Does 20 still mean 20?

Finding 25

The introduction of new charges will increase the effective rate of tax for taxpayers.

3. INTRODUCTION

P.68/2016 Draft Medium Term Financial Plan Addition 2017 - 2019 (MTFP Addition) was lodged au Greffe on 30th June 2016 by the Council of Ministers. The MTFP Addition is in fact the second stage of the MTFP 2016 – 2019 which was lodged on 14th July 2015. The MTFP Addition provides the detail for spending limits for the years 2017 – 2019. These details were absent from the original MTFP 2016 - 2019 following an amendment to the Public Finance (Jersey) Law 2005 allowing the MTFP to be lodged in two stages.

As part of its evidence gathering in undertaking this review, the Panel engaged the services of the Chartered Institute of Public Finance and Accountancy (CIPFA) and also Dr Michael Oliver from MJO Consultancy. The Panel also wrote to various industry stakeholders and in addition to attending private briefings, also held public hearings with the Minister for Treasury and Resources and the Chief Minister.

Whilst each Scrutiny Panel has undertaken its own review of areas specific to its remit, the Corporate Services Scrutiny Panel has undertaken an overarching review of the key themes of the MTFP Addition.

This Report focuses on the key areas within the MTFP Addition that the Panel believe will have the most impact on taxpayers including the proposed introduction of a health charge and a waste charge.

4. THE MTFP ADDITION

As mentioned in the Introduction, following an amendment to the Public Finance (Jersey) Law, the MTFP Addition is the second part of the MTFP 2016 – 2019 which was lodged in July 2015.

CIPFA have focused on eight key areas which it believes to be critical to the effectiveness of the MTFP Addition. These are:-

- Delivery of key assumptions – tax yields
- Delivery of key assumptions – efficiency savings and measures
- Delivery of key assumptions – health charge and user pays
- Delivery of key assumptions – capital programme
- Operational service planning and financial strategy
- Base budgeting
- Forecasting
- Financial performance management

Although these areas are covered within the Panel's Report, more extensive information can be found within the CIPFA report attached as Appendix 1.

The Fiscal Policy Panel

The Fiscal Policy Panel (FPP) has endorsed the economic assumptions as presented in the MTFP Addition which are then used by the Income Forecasting Group (IFG) to inform the States income forecasts.

4.1 The Financial Forecasts

Following the result of the referendum in June 2016 where the UK voted to leave the European Union, the FPP was asked by the Minister for Treasury and Resources to consider whether the outcome of the vote to leave required it to update its advice which was included within the MTFP Addition. The FPP responded by saying it did not recommend any changes to the economic assumptions, from March 2016 and on review, did not believe there to be sufficient information available at the present time to make a coherent set of revisions. The FPP went on to say it was clear that the referendum result could have potential to impact on growth, inflation and monetary policy assumptions and risks have increased significantly to the downside.

On 30th August 2016, the FPP produced its annual report which included updated economic assumptions, some of which had been downgraded. Based on this new information, the Panel is extremely keen for the Minister to revise the income forecasts to reflect this change. The Minister explained to the Panel that the Income Forecasting Group (IFG) would be considering the revised assumptions and in light of this, would be reporting back to the Council of Ministers on 7th September 2016. The Minister went on to say that it is likely the forecasts would be revised and *"…I would be surprised if they are not…"*[1]

[1] Hearing with Minister for Treasury and Resources – 2nd September 2016

The Minister was keen to reiterate the fact that the FPP had recommended within its Report that the States of Jersey continue to implement the MTFP Addition in line with its previous advice given in March.

The forecasts for income and expenditure which the MTFP Addition is based on were made prior to the BREXIT vote. It appears that income forecasts will now be revised downwards, however it is not proposed to adjust expenditure in the MTFP Addition in light of this.

Page 183 of the MTFP Addition shows the Economic Assumptions provided by the FPP in March 2016. These assumptions indicate that interest rates are due to rise in 2017 to 0.7% based on the FPP central scenario however, the Bank of England has since reduced interest rates to 0.25% in August 2016. Prior to this reduction, the Panel asked the States Economic Advisor what the consequence would be on the income forecasts should interest rates be reduced:

Deputy S.M. Brée:

"…If I may, one of the things that I think most people are considering is a vitally important bit of information. In a recent speech the Governor of the Bank of England stated, and I will quote his words here: "We may need to cut interest rates in the next few months. The markets themselves are indicating a downturn in interest rates." As the income forecasts are predicated on interest rates going up not down, then surely that is going to have an impact on your income forecasts. Do you not agree…?"[2]

Economic Adviser:

"…It is not quite as simple as that. First off, the profile for interest rates was that they would start to go up but, secondly, how that was factored into the forecast was that it would not impact significantly on tax revenues….so changing the interest rate assumption alone would not materially impact on the economic forecasts at this point in time…"

Deputy S.M. Brée:

"…However, your income forecasts did not account for a downturn in interest rates, did it?"

Economic Adviser:

"…That is correct, but also I would point out to you that what the Bank of England has said and the Governor has said is that they would look at all the options they have to support the economy…"[3]

Finding 1
The Panel highlights the fact that the financial forecasts were prepared prior to the BREXIT vote and in light of this, strongly believe updated forecasts should be used for the MTFP Addition.

[2] Hearing with Chief Minister – 08.07.16
[3] Hearing with Chief Minister – 08.07.16

The Panel asked the Minister for Treasury and Resources to put on record whether expenditure should be recalibrated in light of Brexit:

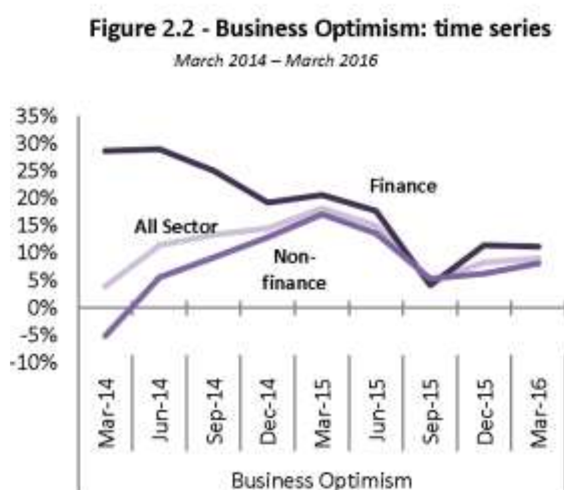
The Minister for Treasury and Resources:

"…Well, the day after the decision by the U.K. to leave the European Union I spoke on the telephone to the chair of the Fiscal Policy Panel. I have asked for an update, if there is anything else we should consider doing, we have had that; the advice, very clearly says, at this stage it is too early to draw any conclusions as to what the impact of the U.K.'s decision is going to be…"[4]

The Panel also reviewed the **UK Business Confidence Monitor (Q3 2016),** (a quarterly report published by ICAEW). This report showed that business confidence in the UK has moved into negative territory since Brexit**.**

"Confidence, already on a firmly downward trend, has been further hit by Brexit. It now stands at -10.2, a fall from +0.8 last quarter. Since the referendum, some recovery in confidence is evident but only modest."[5]

The Jersey Business Tendency Survey (BTS) published by the States of Jersey Statistics Unit in March 2016 showed business optimism as broadly unchanged since December 2016[6]. Following the UK trend, it is possible that optimism will have declined following the Brexit vote**.**



This survey is usually published quarterly. Unfortunately, however, March 2016 was the last publication of this report, as due to a budget reduction the Statistics Unit is no longer able to conduct the survey. This is surprising, given the importance attached to the survey by the FPP in its reports and in the Economic Outlook section of the MTFP Addition.

[4] Hearing with Minister for Treasury and Resources – 15.07.16
[5] UK Business Confidence Monitor – Q3 2016
[6] Jersey Business Tendency Survey March 2016

Finding 2

The last BTS was published in March 2016 and will not be continued. Given the importance attached to the survey by the FPP and in the MTFP Addition, the Panel find this concerning.

Recommendation 1

The relevant funding be reinstated to the States of Jersey Statistics Unit in order for it to continue conducting the Business Tendency Survey.

The Survey of Financial Institutions – GVA and productivity 2015, published by the Statistics Unit, shows that total GVA of the Finance sector declined by 1% in 2015[7]. As the Finance Sector is a large component of overall GVA, this lead the Panel to question the likelihood of achieving the 2.3% growth in GVA predicted in the original economic assumptions. One of the Panel's advisors, MJO Consulting, put together the table below to show the differences between the economic assumptions in the MTFP Addition compared with the FPP's annual report.

Table 4. Differences between economic assumptions in MTFP Addition and FPP's 2016 Annual Report[8]

	2015	2016	2017	2018	2019
Real GVA	-1.4	-1.0	-1.4	0.0	0.0
RPI	0.0	0.4	0.7	-0.3	0.0
RPIY	0.0	0.5	1.0	0.0	0.0
Nominal GVA	-1.4	-0.5	-0.4	0.0	0.0
Company profits	-5.2	-0.3	-0.5	0.0	0.0
Financial services profits	-9.6	-0.5	-0.5	0.0	0.0
Compensation of employees	2.0	-0.7	-0.3	0.0	0.0
Employment	0.4	0.0	-0.5	0.0	0.0
Average earnings	0.0	-0.7	0.2	0.0	0.0
Interest rates (%)	0.0	-0.1	-0.6	-0.8	-1.3
House prices	-0.2	0.0	-2.0	0.0	0.0

For the purposes of clarity, the Panel has highlighted in red the areas that have decreased against those used within the MTFP Addition.

During its final MTFP Addition hearing with the Minister for Treasury and Resources on 2nd September 2016, the Panel reminded the Minister of its recommendation for the first part of the MTFP which was lodged last year. The recommendation was to adopt "an *income forecast between the lower and central scenarios outlined by the Income Forecasting Group*", however, this was rejected by the Council of Ministers. The Panel stand strongly by this recommendation and believe that had it been accepted, more realistic income and expenditure levels would have been set within the MTFP Addition.

[7] Survey of Financial Institutions – GVA and productivity 2015

[8] MJO Consulting Report - September 2016

Finding 3

The Panel finds it highly concerning that the Minister for Treasury and Resources did not recalibrate the income forecasts at an earlier stage and believe the reduction in interest rates and market trends currently speak for themselves. This is likely to result in higher drawings on the Strategic Reserve or mean the Island is running higher forecasted deficits well beyond 2019.

Recommendation 2

In light of repeated instances of downgraded income forecasts, the process by which income is forecast should be reviewed with immediate effect with the early involvement of the relevant Scrutiny Panel.

Recommendation 3

The Minister for Treasury and Resources must explain the full impact of the downgraded income forecasts and the measures he proposes to take to balance expenditure by 2019.

4.2 Return to Surplus

The Summary of Financial Forecast table below contained within the MTFP Addition[9] shows the financial position in 2019 as being £1.5 million in surplus (amended downwards slightly from the 2015 forecast). This is 0.2% of the total income forecast and the Panel believe it will be a challenge to meet this target. The Panel's advisor from CIPFA has stated that:
"…*Given that the year on year increase position on States Income as formulated by the Income Forecasting Group (IFG)(irrespective of containing expenditure)is 4.2% for 2017, 5.5% for 2018 and 4.7% for 2019, the full delivery of the financial plan to outturn a modest surplus of £1.5m by 2019 depends on this level of income being generated. In context, this will be extremely challenging with significant inherent risks of non- achievement...*"[10]

Summary of Financial Forecast		MTFP Addition Proposals (June 2016)			
	2015 Outturn £'000	2016 Proposed £'000	2017 Proposed £'000	2018 Proposed £'000	2019 Proposed £'000
Total States Income - incl: Proposed Funding Mechanism	691,744	693,774	715,203	759,240	789,360
Total Net Revenue Expenditure (excl: Depn)	697,031	740,317	724,287	733,955	734,845
Forecast Operating Surplus/(Deficit) for the year	**(5,287)**	**(46,543)**	**(9,084)**	**25,285**	**54,515**
Depreciation Forecast	44,676	44,800	40,600	45,500	53,000
Current financial position - Surplus/(Deficit)	**(49,963)**	**(91,343)**	**(49,684)**	**(20,215)**	**1,515**

The Panel asked the Chief Minister and the Minister for Treasury and Resources what they thought of this challenging figure to bring about such a small surplus:

[9] MTFP Addition page 184 – Appendix 12 Figure 69
[10] CIPFA report – August 2016

Deputy J.A.N. Le Fondré:

"…with such a small surplus and with all the volatility that comes with the Brexit vote, the slightest downturn in income could put the M.T.F.P. into deficit. Does the Chief Minister not agree that in order to deliver a balanced M.T.F.P. financial plan by 2019, it would be prudent to plan for a much higher level of surplus…?"

The Chief Minister:

"…No, it would not be prudent to plan for a higher level of surplus, and I think the Chairman knows why, because the assumptions throughout are prudent…"[11]

Deputy J.A.N. Le Fondré:

"…Minister, page 44 of the M.T.F.P. gives a summary of the position and shows a surplus at the end of 2019 of just over £1.5 million. …can you confirm you will judge the success of the M.T.F.P. on the basis of that financial forecast, on the fact, in other words, that the financial position at the end of 2019 will be at least £1.5 million?"

The Minister for Treasury and Resources:

"…What the Council of Ministers set out to do was to balance budgets by 2019. What this plan shows is that we have made significant investment in the key areas of priority that we have identified, health and education, and that although the figure is not particularly large, nevertheless it is showing a balance by 2019…"[12]

Finding 4

The Panel is strongly of the view that achieving a surplus of £1.5m by 2019 was never achievable and will now not be achieved in light of the downgraded income forecasts.

4.3 Contingency

The MTFP Addition contains various amounts allocated to contingency. Contingency funds are universally understood to be for unforeseen items of expenditure, however the Panel is concerned that a number of lines within the Contingency Allocations table in the MTFP Addition[13]appear to have been "earmarked" already and therefore do not fall under the category of contingency.

[11] Hearing with Chief Minister – 08.07.16
[12] Hearing with Minister for Treasury and Resources – 15.07.16
[13] MTFP Addition, page 59

Proposed Central Contingency Allocations	2017 Proposed Allocation £'000	2018 Proposed Allocation £'000	2019 Proposed Allocation £'000
Central Allocation - AME Contingency	2,000.0	2,000.0	2,000.0
less: earmarked carry forwards for AME Contingency	(2,000.0)	(2,000.0)	(2,000.0)
Net Central Allocation - AME Contingency	-	-	-
Central Allocation - DEL Contingency	5,000.0	5,000.0	5,000.0
Central Allocation - Pay, PECRS and Workforce Modernisation	5,643.7	12,293.7	17,606.7
Central Allocation - Restructuring and Redundancy Provision	12,000.0	7,600.0	8,300.0
less: earmarked carry forwards for committed Redundancy	(5,000.0)	(600.0)	(3,300.0)
less: earmarked carry forwards for Restructuring and Redundancy		(3,836.0)	(3,045.0)
Net Central Allocation - Restructuring Provision and Redundancy Provision	7,000.0	3,164.0	1,955.0
Central Allocation - EPGDP	5,000.0	5,000.0	3,548.0
less: prioritised funding from base budgets	(644.0)	(1,204.0)	(1,548.0)
Net Central Allocation - EPGDP	4,356.0	3,796.0	2,000.0
Central Allocation - Earmarked for Initiatives to support vulnerable children	1,650.0	1,650.0	1,650.0
Total Proposed Central Allocations	**23,649.7**	**25,903.7**	**28,211.7**

It was explained to the Panel by the Treasurer of the States that a number of the areas labelled as "contingency" were not contingencies in the true sense of the word and were in fact allocations for specific areas controlled by the Treasury, thus reinforcing the Panel's view that these should not sit under contingency allocations:

Treasurer of the States of Jersey:

"…It is a more general description of contingency which says we are going to hold the fund centrally and control them…"[14]

On questioning further, the Panel established that true contingencies are around £7m (being the AME Contingency and the DEL Contingency detailed in the table above).

Finding 5

Many of the items listed under Contingency in the MTFP Addition are not for unforeseen events and have already been designated for certain purposes. Such use of Contingency artificially distorts departmental budgets.

Recommendation 4

Contingency must only be used for money set aside for unforeseen events. Money already designated for specific purposes should not be held under contingency.

[14] Hearing with Minister for Treasury and Resources – 15.07.16

4.4 Economic and Productivity Growth Drawdown Provision

One of the contingency allocations is the Economic and Productivity Growth Drawdown Provision (EPGDP). According to the MTFP Addition, this is "*designed to support new initiatives that will have a positive impact on economic and productivity growth*"[15].

The proposal in the MTFP 2016-19 was for £5 million to be allocated to this provision (which is generally referred to as a "fund") in each year of the MTFP[16].

The Panel has had concerns around the governance arrangements for this fund since it was originally announced. In its report on the MTFP 2016-19, S.R.6/2015, it highlighted the recommendation of the FPP that:

"strong governance measures should be put in place to control how the £20 million is allocated".[17]

The fund opened in March 2016 and the Panel was provided confidentially with the terms of reference. The fund is in relatively early stages, so it is perhaps too soon to draw conclusions, however the MTFP Addition notes that it is unlikely that the full £5m will be allocated in 2016. The amount allocated to the fund in 2019 has been reduced from £5m to £3.5m. There is no explanation provided in the MTFP Addition, so the Panel asked the Minister for Treasury and Resources about this:

The Minister for Treasury and Resources:

"…Well, the view was taken by the Council of Ministers that, first of all, this fund or drawdown provision, I must make it absolutely clear what it is, was going to be £18.5 million instead of £20 million, which is effectively the difference you are referring to, and the belief was that the sums for 2016, 2017 and 2018 were appropriate and that we could reallocate some of the additional money for 2019 rather than leave it in that fund because we felt that it would not necessarily be required. It is still £18.5 million…"[18]

Also, within the annual £5m allocations in the fund, a proportion has been earmarked to protect the budgets of the External Relations Department and the Digital, Innovation, Financial Services and Competition Team within the Chief Minister's Department, which otherwise would have been subject to savings targets. The justification for this is that protecting these budgets will offer better support to the economy that other new initiatives, particularly post-Brexit.[19]

While this justification may be a valid reason for deferring savings in those departments, it does not fit with the stated aim of the EPGDP fund to support "new initiatives" or the explanation of the fund given to the Panel by the Minister for Treasury and Resources at a quarterly hearing in February 2016:

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[15] MTFP Addition, page 57
[16] MTFP Addition, page 59
[17] Corporate Services Scrutiny Panel Review of the MTFP 2016-2019, page 26
[18] Hearing with Minister for Treasury and Resources – 15.07.16
[19] MTFP Addition, page 57

The Minister for Treasury and Resources:

"…If departments have made a saving, sorry, and then are seeking to use this particular fund to replace a saving that has already been made, that clearly would be disqualified…"[20]

It appears very clear that a proportion of the fund is being used for different purposes than originally envisaged, which might lead to questions around the governance controls for the fund. The Panel notes that the FPP have stressed that it is important that these funds are focused on *"medium term policies that help raise productivity and increase the underlying rate of growth".*[21]

Finding 6 Part of the EPGDP has been used to support the budgets of External Relations and Digital, Innovation, Financial Services and Competition which in the Panel's opinion sits outside of the original intent for the Fund as set out in the MTFP 2016-19 and approved by the States.

Recommendation 5 On making any allocations from the EPGDP, the Minister for Treasury and Resources must send a copy of the Ministerial Decision and report, on the date of signature, to the relevant Scrutiny Panel for that department.

4.5 Contingency Planning

The Minister for Treasury and Resources and the Treasurer of the States have told the Panel that the MTFP Addition contains flexibility with various contingency measures outlined in section 15 (page 120). This is particularly important in light of Brexit and if income does not reach the levels forecast.

One of these measures is to defer growth in 2018-19. However the impact of this would mean, amongst other things, that the annual inflationary rise given to the Health and Social Services Department to maintain an equivalent standard to other jurisdictions, or the growth funding for School demographics (i.e. maintaining service levels in light of a predicted rise in children entering schools) would have to be held back.

Other proposals within contingency planning include increasing income through the EPGDP Fund (although as mentioned earlier, this Fund is still in its early days and it is not clear how any initiatives will lead to tangible economic growth) and increasing taxes in the annual budgets.

[20] Quarterly Public Hearing with Minister for Treasury and Resources – 22.02.16
[21] FPP Report, August 2016, page 4

4.6 Growth

The MTFP Addition details proposals for "Additional Funding for Pressures, Demographics and Growth" (p61). This is funding bid for by departments which falls into one of three categories: maintaining existing standards, projects already committed to or new initiatives.

This funding is referred to as "growth expenditure" in the Public Finances (Jersey) Law 2005 and the release of this funding to departments has to be approved annually by the States through the budget.

In the MTFP Addition, States Members are being asked to approve the allocation of 2017 growth expenditure to departments (see table below)

Summary of Additional Funding Proposals	2016 Approved £'000	2017 Proposed £'000	2018 Proposed £'000	2019 Proposed £'000
Additional funding proposed in MTFP 2016-2019	21,869	12,587	15,808	10,998
Reductions in MTFP 2016-2019 Additional Funding requirement		(709)	(440)	(183)
New Additional Funding Proposed in MTFP Addition		5,608	1,089	1,196
Total Additional Annual Funding Proposed in MTFP Addition 2017-2019		**17,486**	**16,457**	**12,011**
Total Additional Cumulative Funding Proposed in MTFP Addition 2017-2019			33,943	45,954
Total Additional Funding Proposed in MTFP over the period 2016-2019	**21,869**	**39,355**	**55,812**	**67,823**

[22]

Growth for 2018 and 2019 is detailed in the table above and a separate central allocation for those years is included in Summary Table D of the MTFP Addition. Central growth totals £10.4m in 2018 rising to £20.5m in 2019. The release of this funding will be voted on by the States through the 2018 and 2019 budgets (together with the amounts for 2018 and 2019 detailed in Figures 24 and 25).

One of the contingency elements of the MTFP is that growth expenditure could be withheld in the event that income forecasts are not met or savings targets are not delivered. This should also act as an incentive for departments to deliver the savings and efficiencies required of them.

The Panel had understood that growth expenditure would only be released if departments met their targets for savings and efficiencies. Page 63 of the MTFP states:

"if either savings or income forecasts fail to reach the proposed targets the level of additional funding will need to be revisited"[23].

On questioning the Minister for Treasury and Resources on this, it transpired that there is a greater degree of flexibility in relation to the delivery of savings targets and that growth could be released even if targets are not met. This will be a decision for States Members to take when approving the budget each year:

[22] MTFP Addition, page 63
[23] MTFP Addition, page 63

The Minister for Treasury and Resources:

"…I mean the importance here is, about the growth, that we have retained the growth for 2018 and 2019. It is ultimately going to be dealt with through the budget so, yes, it is the decision of States Members and they can decide whether or not they feel it is appropriate that that growth is distributed or not and it could be a whole raft of circumstances."[24]

The way that savings are realised is through the removal of the relevant amounts from departments' annual budgets. This requires departments to live within the lower budget amount, however they are not obliged to deliver the saving/efficiency exactly as detailed in the MTFP as long as they find other ways of operating within their budgets.

In considering the growth expenditure for 2017 (Figures 24 and 25), which is due to be approved through the MTFP Addition, the Panel notes that this is being allocated to departments on the basis that income forecasts have been met and savings for 2017 have already been delivered through removal of the cash from the departments' 2017 budgets (as shown in Appendix 2 and Appendix 3 of the MTFP Addition).

However, it should be noted that the savings contained within the MTFP Addition are lower than those originally set out in the MTFP 2016-19, as a result of a reduction by the Council of Ministers in the overall savings target from £90m to £77m. The original savings target for 2017 (excluding benefit changes) included in the MTFP 2016-19 was £56m[25] This target has now been reduced to £48.2m in the MTFP Addition[26]

Finding 7
The lowering of the savings and efficiencies target points to the fact that the target has only been met because the goalposts have been moved. As there is no certainty that the targets will not be adjusted again in future years, this makes it virtually impossible for the public or States Members to judge whether or not savings targets have actually been met.

Recommendation 6
Growth expenditure must only be released when savings and efficiencies targets can be demonstrated to have been met. As such, targets for savings and efficiencies must be fixed achievable and realistic in the timeframes envisaged.

4.7 Reduction in savings target

Within the MTFP 2016 – 2019 which was debated last year, a package of measures totalling £90 million was presented in staff and non-staff savings. This figure has now been reduced to £77 million (including £4 million of user pays charges).

[24] Hearing with Minister for Treasury and Resources – 15.07.16
[25] MTFP 2016-19, page 83 Figure 31
[26] MTFP Addition, page 82 Figure 29

Finding 8

The savings and efficiencies target has been reduced from £90 million to £77 million (including user pays charges).

The reason given by the Council of Ministers for the figure of £90 million not being met is as follows:

"…Last year we set ourselves a target of £90 million in savings and efficiencies. It became clear that delivering such a target over this time frame would have a disproportionate impact on the community. We took these concerns into account, as well as the better than forecast income in 2015 and the likely distributional impact of the planned proposals. We decided to extend the time frame to enable departments to find efficiencies to meet the target, thereby helping to minimise the impact on islanders. This means departments will continue to restructure and reduce costs but over a longer period. Service reviews are still underway and further efficiencies will come as the public sector adopts a culture of continuous improvement and reaps the benefits of technological change and office rationalisation..."[27]

It was a strong recommendation of both the Panel and its advisors in the report on the MTFP published in 2015 that appropriate impact studies or distributional analysis be undertaken on measures to be included within the MTFP Addition and that these studies be made available to the States Assembly. It would appear that the use of distributional analysis informed the policy decisions which are included in the MTFP, however there is no detail of measures which were not deemed acceptable by the Council of Ministers on the basis of the distributional analysis. It is therefore difficult to assess the decisions made by the Council of Ministers in accepting or rejecting options for savings.

Finding 9

The MTFP does not show the savings and efficiencies opportunities rejected by the Council of Ministers.

Recommendation 7

States Members should be presented with a detailed analysis of all of those areas that were rejected by the Council of Ministers which resulted in a reduced savings and efficiencies target.

The Panel wanted to delve further and asked if the figure of £90 million was over optimistic:

The Connétable of St. John:

"…Effectively, the savings, if I can use the term, there is slippage in producing the savings that were originally targeted of £90 million. Does this mean that the original £90 million target was unrealistic…?"

[27] MTFP Addition, page 17

The Chief Minister:

"…I do not think it ... it was challenging. We were quite clear about it being challenging. The F.P.P. said it was challenging…"

The Connétable of St. John:

"…The target for savings and efficiencies has decreased from £90 million last year to £73 million this year. The impression this gives is that you have taken your foot off the pedal, if I can use that term. Is this true…?"

The Chief Minister:

"…No…"[28]

4.8 Savings vs efficiencies

The MTFP Addition makes reference to savings and efficiencies which are to be targeted throughout the life of the Plan. The Panel found it difficult to ascertain what defined one from the other and asked for an explanation from the Minister for Treasury and Resources:

Deputy J.A.N. Le Fondré:

"…Can you clarify the difference between efficiencies and savings?..."

The Minister for Treasury and Resources:

"…There are clearly many different definitions from different people, but savings typically would involve the ceasing of a service, the cutting of a service, however you want to phrase it, whereas efficiency would be continuing the same service but in a more efficient, cost-effective way, so with less people, utilising technology, perhaps going cross-departmental and so on and so forth, providing the same or a better outcome, but at less cost. That is what we are seeing in terms of the overall savings/efficiencies, the vast majority are efficiencies, not savings…"[29]

The Panel is interested as to how the savings and efficiencies would be delivered without any effect on front line services. When asked, the Chief Minister gave the following response:

The Chief Minister:

"…We have thought very carefully throughout this process about trying to deliver efficiencies that would not affect frontline service delivery, and you will see there is a breakdown between those that may affect, where services may need to be stopped, and that amount is very small. The vast majority is efficiencies and that takes time. We have said to departments that they will continue to need to deliver efficiencies

[28] Hearing with Chief Minister – 07.08.16
[29] Hearing with Minister for Treasury and Resources – 15.07.16

throughout the next M.T.F.P. as well because all organisations - and the States is no different from that - need to continue to make efficiencies…"[30]

The Department for Treasury and Resources has a carry forward mechanism to carry forward genuinely unused resources between financial years. Although CIPFA state they have no reason to believe that Treasury and Resources do not challenge this process, "*it does not extend to resources which departments have a fair idea will not be spent within the forthcoming financial year, or in year, for example the level of outstanding vacancies"*[31] Vacancy management is discussed in more detail later in this report.

CIPFA make the point that there does not seem to be enough challenge for Chief Officers to make budgetary savings as there is a lack of options available to them in order to make the required changes.

"…Although MTFP 2 provides for an element of contingency, should such targets fail to be achieved, there is a lack of precision and definition on alternative options. In our view, there appears to be almost a cultural acceptance that there will be a significant element of non-achievement…"[32]

CIPFA do not see any evidence of a "burning platform" and in general there is a lack of drive behind the savings programme. CIPFA met with a number of senior officers and comment in their report that although extensive departmental work has been carried out, there is still "*a lack of overall precision on the extent of planned service re-engineering/re-provisioning that needs to take place before the proposed/required quantum of saving is delivered"*[33]

Based on this lack of rigour, concerns were also raised by CIPFA with regards to a potential for 'salami sliced' budgets to be produced.

Finding 10

The direction from Ministers to Chief Officers to make savings and bring in efficiencies is not robust enough nor precise enough for an organisation of this size.

Recommendation 8

In order to tackle the "almost cultural acceptance" of non-achievement of savings targets, the Council of Ministers must provide stronger direction, leadership and clear policy statements in order to drive savings and efficiencies across the States.

Finding 11

There is a general lack of drive behind the savings programme with savings being made through simplistic departmental budget reductions rather than introducing fundamental structural change to deliver long term savings and efficiencies.

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[30] Hearing with Chief Minister – 08.07.16

[31] CIPFA Report, August 2016

[32] CIPFA Report, August 2016

[33] CIPFA Report, August 2016

Recommendation 9

In order to bring about fundamental structural change to deliver real savings and efficiencies, recommendation 16 in CIPFA's report in relation to outcome based budgeting and additional zero based budgeting should be put in place by the time of the next MTFP.

"Outcome based budgeting and additional zero based budgeting should be used to complement the prevailing incremental approach."

4.9 Vacancy Management

According to information received from the Department of Treasury and Resources provided to CIPFA, the Panel notes that the number of vacancies across the States of Jersey currently run at 12.9%. These vacancies are included within each Department's expenditure budget and the funds are allocated annually.

Finding 12
The vacancy rate of 12.9% across States departments is very high and this money is included in departments' annual budgets. The Panel questions whether this funding is really needed by departments if current service levels are deemed to be acceptable.

The Panel understands that there will always be a level of vacancies throughout such a large organisation, however CIPFA have commented that the figure of 12.9% is "exceptionally high"[34]. When questioned, the Minister for Treasury and Resources agreed *"…it is on the high side and some work is being done…"*[35]

The Panel has calculated that 12.9% of the total States wage bill in 2016 of circa £361 million equates to close to £46 million. Within their Report, CIPFA have stated that across the UK, public bodies generally run vacancies of between 3% - 5%. CIPFA highlight the fact that the 2010 Comprehensive Spending Review for UK Central Government to 2014/2015 prescribed a freeze on vacancy recruitment which allowed Departments to be fully stripped of any vacancies and in some cases subjected to a further 3%-5% efficiency savings reduction.

On States staffing levels overall, CIPFA have commented "...*Despite the voluntary redundancy scheme, overall staffing FTE numbers are only forecast to show a net reduction of 57.6 FTE…"*[36]

Finding 13

The level of vacancies across the States is significantly higher than UK levels.

[34] CIPFA report, August 2016 page 27
[35] Hearing with Minister for Treasury and Resources – 02.09.16
[36] CIPFA Report, August 2016

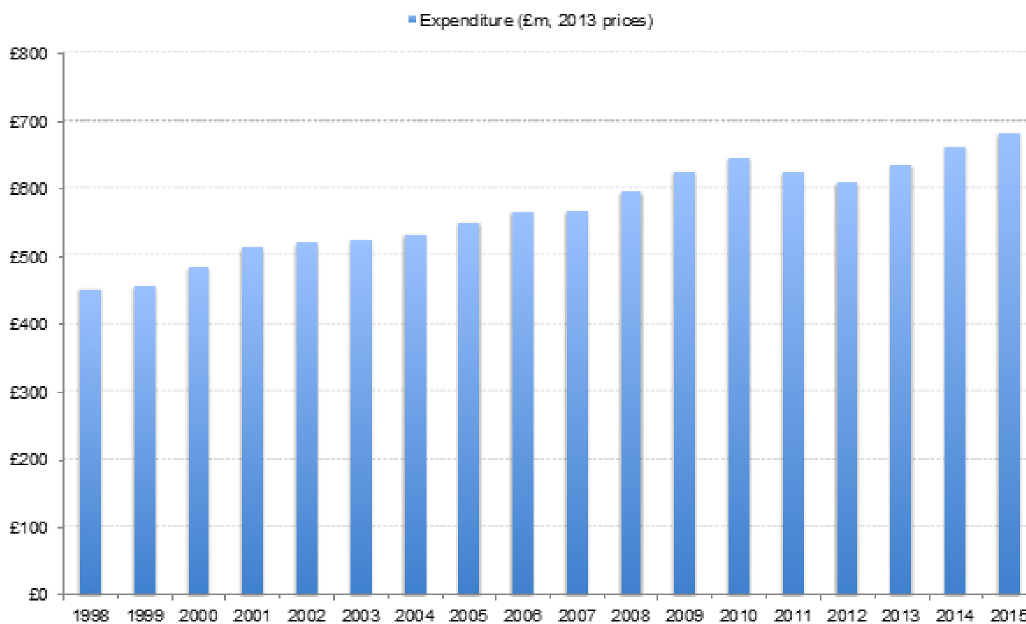
Finding 14
States Members are being asked to approve artificially increased levels of expenditure which include a high level of vacancies.

Recommendation 10
The ongoing vacancy rate for departments should be reduced to 3%

4.10 Increases in Expenditure

Despite the savings and efficiencies being targeted within the public sector, overall expenditure has continued to rise year after year up to 2016. This is demonstrated by the following graph provided by the Panel's advisor, MJO Consultancy:

Figure 5. Growth of net revenue expenditure, 1998–2015 (2013 prices)



Source: States Accounts, various years [37]

The justification behind and rationale supporting the introduction of new charges and taxation measures as contained within the MTFP Addition is questionable when the evidence over the last few years shows the States have been unable to cut its costs. The objective of the Public Sector Reform programme is to reduce costs within the States, however actual expenditure has increased by £43.5m in 2014, almost £20m in 2015 and £18m in 2016.[38]

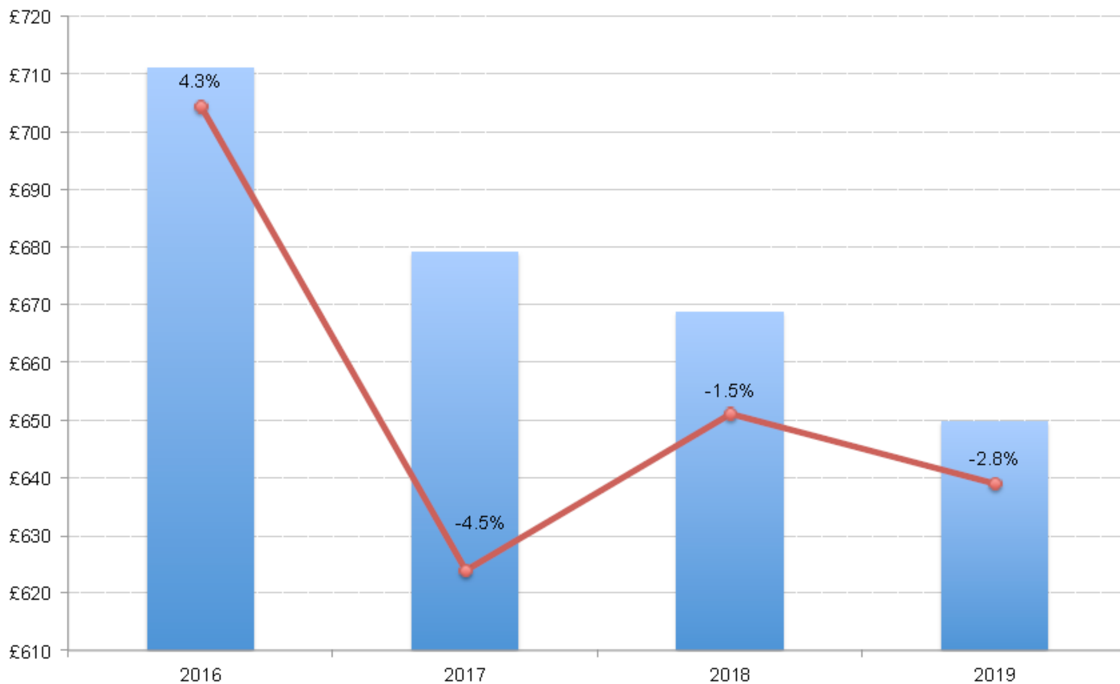
[37] Figures from MJO Consulting – Report September 2016
[38] Figures from MJO Consulting – Report September 2016

Finding 15

Despite the savings and efficiencies being targeted within the Public sector for a number of years, overall expenditure to 2015 and also for 2016 has continued to rise year on year. This leads the Panel to question whether the level of savings and efficiencies will actually be achieved.

The rise in expenditure in 2016 is followed by projected real terms falls in 2017, 2018 and 2019, as demonstrated by the following graph:

Figure 7. Projected net revenue expenditure, 2016–19 (2013 prices)



Source: MTFP 2 Addition [39]

Whilst the reduction in expenditure is welcomed, these cuts will need to be delivered on the back of demonstrable savings and efficiencies from within the public sector, if the new charges and taxation measures are to be in any way justified. The Panel echoes the recent comments by the Fiscal Policy Panel that "*making savings and efficiencies in the public sector is now critical*"[40].

Recommendation 11

Detailed targets with realistic timeframes for public sector savings and efficiencies should be presented to States Members.

[39] MJO Consulting – Report September 2016
[40] Fiscal Policy Panel Annual Report 2016, page 32

Recommendation 12

States Members should be presented with a detailed breakdown of performance versus targets every six months, explaining where and why targets have not been met for any reason.

4.11 Lack of Detail

In 2015, an amendment to the Public Finance Law (Jersey) 2005 was approved by the States allowing the MTFP to be brought in two stages in order for further detail to be provided in this Addition. However, despite this, an appropriate level of detail is still missing and the States are being asked to approve a spending plan without any detail of some of the key components. These include the health charge, the waste charge and the States payment of rates which have been discussed in detail earlier in this Report.

CIPFA has said within its Report *"…the core rationale being that a year was required for departments to work up the detailed estimates beyond 2016. We were expecting the MTFP2 Addition to yield significant detail covering the £90 million of Staff and non-staff efficiency savings from the original £145 million of 'structural deficit'…"*[41]

During its review of the MTFP Addition, the Panel has found the detail provided to be at a relatively high level with little in the way of linear information for States Members to follow. Following a conference call with its advisor, CIPFA, the Panel asked if, in CIPFA's opinion, there was sufficient information available within the MTFP Addition for States Members to vote with complete understanding of what it was they were actually voting for. CIPFA said they did not think there was sufficient information within the document.

At its hearing with the Minister for Treasury and Resources on 2nd September 2016, the Panel asked if any further detail on the savings and efficiencies would be given to States Members prior to the debate on the MTFP Addition. The Minister informed the Panel that he did not consider there was a lack of detail and the information was clear enough for its purposes. The Minister went on to say that States Members would receive briefings leading up to the debate and could ask questions of the Minister and his colleagues. The Head of Financial Planning added that the MTFP was a 3 year plan and it was reasonable that some more detail would need to be worked through.

Finding 16

Despite being given an additional 12 months to prepare the MTFP Addition, there is a significant lack of detail within the document.

4.12 User Pays and Additional fundraising mechanisms

The Health Charge

The States is being asked to approve the introduction of an income based Health Charge to raise £7.5 million in 2018 and £15 million in 2019. Due to a reported improved financial

[41] CIPFA Report, August 2016

position, these figures have changed since the MTFP 2016 – 2019 from original proposed figures of £15 million in 2018 rising to £35 million in 2019:

Chief Minister

*"…These figures differ from last year as the financial position has improved. Income in 2015 was higher than forecast, partly due to a change in accounting policy and this effect will continue into future years. This, and the 2016 budget measures, have enabled us to reduce the amount that needs to be raised through a health charge from **£35 million** in 2019 down to **£15 million**…"*[42]

The Panel asked how the charge would be ring-fenced:

Deputy K.C. Lewis:

"…A charge is supposed to be for a specific service. It would appear that the health charge is just to plug a hole in the health budget…"

Chief Minister

"…The proposal is that that health charge would go into a fund which is administered by Treasury and delivered under certain criteria into health and social services provision…"[43]

The whole system of collecting the charge via ITIS is, in the Panel's opinion, confusing and misleading and indeed the Panel's advisor has raised the question as to whether the term "charge" should be used rather than "tax":

…"Given that there is no linkage between usage and liability, the term charge is inaccurate as it is in effect a tax (perhaps no different from the LTC contribution)…" [44]

Finding 17

There is no clear link between the amount to be charged and the type and level of service that will be delivered to members of the public. Furthermore, there is no detail yet about how the money will be appropriately ring fenced and channelled to the Health Department.

Finding 18

The Panel is highly concerned with the lack of detail contained within the MTFP Addition with regards to the Health Charge. Given the absence of detail or link between usage and liability, the Panel finds it difficult to see how a "charge" for provision of Health services can be justified and that the argument for imposing this charge has not been adequately made.

[42] MTFP Addition, page 12
[43] Hearing with Chief Minister – 08.07.16
[44] CIPFA report, August 2016

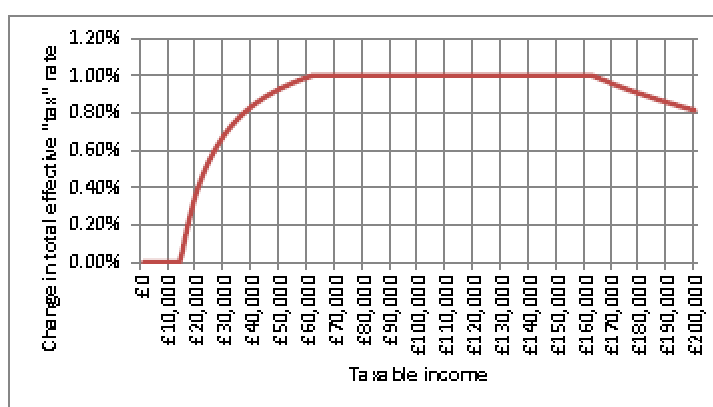
Recommendation 13

The proposal for a Health Charge should be withdrawn unless the Council of Ministers can clearly demonstrate that there are no further savings and efficiencies that can be made within Public Sector expenditure.

4.13 Capping the charge

It is proposed that the health charge will be collected in the same way as the Long Term Care charge which is deducted at source through ITIS and capped at £162,500. Those earning more than £162,500 will pay a lower percentage of their income towards this charge than many people in the income brackets below the cap. The Panel views this as non-compliant with the tax principle of low, broad, simple and fair.

Figure 33 - Case study 1: individual – working age



[45]

Deputy K.C. Lewis:

"…Why should someone earning over £162,500 pay a lower percentage of their income for this charge..?"

The Chief Minister:

"…The bit that it takes out of the tax system is you have got the marginal rate, you have got 30 per cent of people who are not paying tax, so it gives that relief to the lower earners, and then you have got this 15 per cent of people who are paying at the 20 per cent rate. So the 20 per cent rate people are going to be paying the full 0.5 per cent and the full 1 per cent in 2019. All those people on the marginal rate will be paying less than half a per cent and paying less than 1 per cent, and I do not think that is really well understood. We have brought the cap in to mirror the contributory system because what we are trying to do is show that we are contributing towards the increasing costs of health care…"[46]

The Panel also asked the reason why the charge was not being implemented as a percentage across the board to make it fairer and more equitable.

[45] MTFP Addition, page 99
[46] Hearing with Chief Minister – 08.07.16

The Chief Minister:

"…we are bringing together the 2 systems and we are asking people to contribute a little bit more. Some would say we should just have gone down the tax system. Some would say we should have gone on the G.S.T. (Goods and Services Tax) system but what we do is because we think it is a rounded hole, and we have looked at the economic advice on this, mirroring the system of the long-term care charge, which brings together both contributory and tax system, that is the best way forward…"[47]

The Panel asked if a review of the cap charge should be carried out and was informed that the Department of Social Security have already stated publically that they are reviewing the whole of the Social Security system, including the caps with a complete review being undertaken over the next couple of years.

Finding 19

The capping of the charge results in higher earners paying less as a percentage of their overall income than middle to lower earners. This is non-compliant with the tax principle of low, broad, simple and fair.

Recommendation 14

A complete review of the capping of all charges, both existing and proposed, should be carried out with the outcome of the review presented to all States Members by June 2017.

4.14 Waste Charge

The MTFP Addition is proposing a new liquid and solid waste charge. The charge will raise £3m in 2018 rising to £11m in 2019. This is higher than the estimate in MTFP 2016-19 of £10m in 2019.

The MTFP Addition sets out the background and rationale for the charge but does not provide the detail as to how the charge will be implemented. Proposals setting out the detail will be brought to the States in 2017.

It is intended that the charge will only be levied on commercial waste. The Panel is concerned that commercial waste operators collecting waste on behalf of Parishes will be liable for the charge which will potentially increase Parish Rates thus ultimately transferring the burden onto households. The Chief Minister assured the Panel that the charge would not be levied in such cases. However, the Panel is of the view that without the detail it is impossible to ascertain how this will be achieved.

Finding 20

States Members are being asked to vote on a waste charge with no detail behind it.

[47] Hearing with Chief Minister – 08.07.16

It is likely that the waste charges will result in higher prices for consumers. The Distributional Analysis accompanying the MTFP states that:

"such charges should encourage businesses to manage their waste more efficiently but are still likely to feed through into higher costs to some degree"[48]

The charge is likely to be of particular concern to Jersey's tourist industry. In evidence submitted to the Panel, the Chamber of Commerce commented that:

"…at a time when the island's government and Visit Jersey are doing all they can to support the tourism industry, businesses in this sector, such as hotels, restaurants and visitor attractions are likely to be some of the most affected by the tax."[49]

The Panel is also concerned that the charge will hit small local operators as much as larger businesses. The distributional analysis accompanying the MTFP Addition also highlights that hospitals and schools could face higher bills from the liquid waste charge but that the impact is uncertain as there is not sufficient information available at this stage[50].

Various arguments have been provided in favour of the charges, including that most other jurisdictions already have user pays charges for liquid and solid waste, that it will encourage more recycling and that it is a mechanism for taxing businesses who otherwise do not pay tax in Jersey. The Panel considers that justification of new taxes and charges through comparisons with other jurisdictions cannot be used as Jersey's tax structure is very different. Furthermore, despite the justifications put forward for the charge, the fact remains that this charge will mean that businesses will be paying for a service which is currently provided under general taxation and therefore will mean that any business that does pay tax will effectively be paying twice for the disposal of waste.

When discussed at its recent hearing, the Panel queried whether, with the new user pays charges being proposed, the Island's tax system was broad and fair. The Minister explained that compared to other jurisdictions, the Island's tax system was very broad and simple with the Treasurer of the States adding that waste charges already exist elsewhere. The Panel then made the point that inheritance tax and capital gains tax (to name a few) also existed in other jurisdictions and would these also be introduced in Jersey to which the Minister replied *"…of course not…"*[51]

Finding 21
No studies have been carried out in relation to the impact of the Waste Charge on the tourism industry or any other end users.

[48] Distributional Analysis – MTFP Addition, page 59
[49] Written submission – Jersey Chamber of Commerce
[50] Distributional analysis of MTFP proposals, page 61
[51] Hearing with the Minister for Treasury and Resources – 02.09.16

Recommendation 15

Any proposals to introduce a Waste Charge should be abandoned until further consultation and studies have been undertaken and the results presented to States Members.

4.15 Proposals for States Payment of Rates and a Funding Mechanism

It is proposed within the MTFP Addition that the payment of Parish rates on States properties will be implemented together with a funding mechanism to fund this payment. It is estimated that the States liability to Parish rates will be approximately £900,000 per annum. Assuming this proposal is adopted, the Rates (Jersey) Law 2005 will need to be changed and the necessary amendments will be included in the 2017 Budget with the States payment of rates to commence in 2017. The Department for Treasury and Resources has made a growth bid of £900,000 in 2017 in the MTFP Addition to meet the payments of these rates however, this only covers 2017 and an income stream will need to be found for 2018 onwards.

The Council of Ministers has considered options for a compensating income stream and although it favours an increase in the non-domestic Island wide rate, the current rates system contains no mechanism for revaluation with rateable value of property locked in value largely based on notional rental values from 2003. The Council of Ministers is currently working with the Comité des Connétables and the Island's rates assessors to bring forward a suitable proposal for an income stream.

The Panel has written to the Comité des Connétables asking what its position is on the introduction of this charge and the possibility of a consequential increase in Parish rates. The Comité states it has written to the Minister for Treasury and Resources commenting on general matters within the MTFP Addition however, in relation to the issue of States payment of Rates, comments as follows:-

"…The Comité has not, therefore, taken a view on the proposals although it has always been of the view that the Connétables should not take money from ratepayers to enable States Departments to pay their rates but rather Departments should regard rates as a utility bill and seek savings, or raise funds, to meet its liabilities. Connétables are also mindful that ratepayers of rural parishes saw their rates almost double when the IWR (island wide rate) was first introduced so a further increase is likely to be opposed and it could impact negatively on the lower quintile of domestic property. If an increase in the IWR is targeted at businesses, given that rates as a proportion of rents are significantly lower in Jersey that most of the United Kingdom, such an increase would adversely affect small businesses…"[52]

Based on this information from the Comité des Connétables, the Panel cannot see how a funding mechanism will be put in place to fund the income stream required. The Panel is furthermore concerned that the cost will ultimately be borne by the tax payer.

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[52] Letter from Comité des Connétables – 31.08.16

Finding 22

An agreement has yet to be reached between the Comité des Connétables and the Council of Ministers as to if, and how, a funding mechanism for the States' payment of Rates will be created.

4.16 Funding the new Hospital

One of the proposals within *P.82/2012 Health and Social Services – A New Way Forward* was for the Council of Ministers to co-ordinate the necessary steps to bring forward for approval proposals for the priorities for investment in hospital services and detailed plans for a new hospital (either on a new site or a rebuilt and refurbished hospital on the current site). This process has been ongoing with the preferred site option due to be debated by the States later this year. The indicative capital cost estimated for the future hospital provision is in excess of £465 million. The income stream necessary to fund the hospital has not yet been decided however, the MTFP Addition states:

"…A Special Fund, specific to funding the new hospital, is likely to be proposed. The extent to which external funding, possibly in the form of a bond is used will determine the extent to which an income stream is required to service that debt, most likely in the form of additional taxation…"[53]

The Panel asked the Minister for Treasury and Resources if a further income based charge to fund the hospital was imminent and why the funding mechanism was not included within the MTFP Addition:

The Connétable of St. John:

"… We are apparently, as has been hinted at, being asked to approve a further charge for the building of the hospital in 2017. Should this charge not be included in this M.T.F.P…?"

The Minister for Treasury and Resources:

"…First of all, I am not sure that I was hinting, I think I was fairly straightforward about it. I did not mention 2017 with regard to hospital funding either, but nevertheless we will need to come back. Three things need to happen. First and foremost, the site, which has been identified, needs to come to the States, there needs to be approval by the States for the feasibility work that needs to be undertaken for the funding of that, and thirdly, quite understandably, the States needs to consider the funding mechanism and option and that will all come forward in the period between now and the end of the year…" "…The funding arrangements for the hospital are yet to be clarified. I have spoken publicly about this and about the possibility of a blended solution in that regard…"[54]

[53] MTFP Addition, page 129
[54] Hearing with the Minister for Treasury and Resources – 15.07.16

Finding 23
The Minister for Treasury and Resources has stated it is likely that a further charge will be levied on tax payers to fund the new hospital.

The Panel believes that States Members are being put in a difficult position by being asked to approve a new health charge without any detail, following which, a further charge could be enforced to pay for the new hospital, again with no detail. It was originally suggested to the Panel that further detail on the funding options would be provided prior to or alongside the MTFP debate. However, this detail has not yet been forthcoming and the Panel understands that any detail may not be provided until the budget debate towards the end of this year.

Finding 24
In light of the statement from the Minister for Treasury and Resources in relation to the likelihood of a future hospital charge and lacking any further detail, States Members are unable to fully comprehend the total additional charges that are being envisaged by COM over the life of this MTFP.

4.17 Does 20 still mean 20?

The introduction of additional charges on the tax payer seem to suggest that the 20% tax rate applied in Jersey may no longer be sustainable. Taxes should, by definition, be imposed upon a taxpayer (an individual or legal entity) by a State or the functional equivalent of a State to fund various public expenditures. The additional charges being proposed within the MTFP Addition mean that the "effective" rate of tax levied on by some taxpayers might be higher than 20%.

The Index of Average Earnings 2016 report produced by the Stats Unit has the average weekly earnings of full-time equivalent (FTE) employees in Jersey in June 2016 at £700 per week. This works out at £36,400 annually[55].

In order to assess the impact of the proposed health care charge when considered alongside the existing tax rate, long term care charge and social security contribution, the Panel has looked at the position of a single taxpayer liable for (a) the marginal rate and (b) the standard rate of income tax (based on someone with a salary of £70,000 which just falls into the standard rate band). The overall rate of tax for a standard rate (single person) taxpayer will now be 22%. If Social Security contributions are included, the total proportion of salary paid to the government approaches 28%.

The calculations will of course change in other scenarios, for example for couples or those with children and do not take into account other measures within the MTFP such as the waste charge or other user-pays charges. It should be noted that for self employed persons, the total proportion of salary payable to the government will be significantly higher.

[55] Index of Average Earnings, June 2016. States of Jersey Statistics Unit

Tax calculations for marginal and standard rate taxpayers				
	Marginal rate		Standard rate	
	Tax Calculation	Effective rate*	Tax Calculation	Effective rate*
Annual income	36,400.00		70,000.00	
single person exemption	14,350.00		N/A	
Excess	22,050.00		N/A	
tax payable	5,733.00	16%	14,000.00	20%
1% Long Term Care Contribution	286.65	17%	700.00	21%
1% Health Charge	286.65	17%	700.00	22%
Total deductions (Tax, LTC, Health)	6,306.30	17%	15,400.00	22%

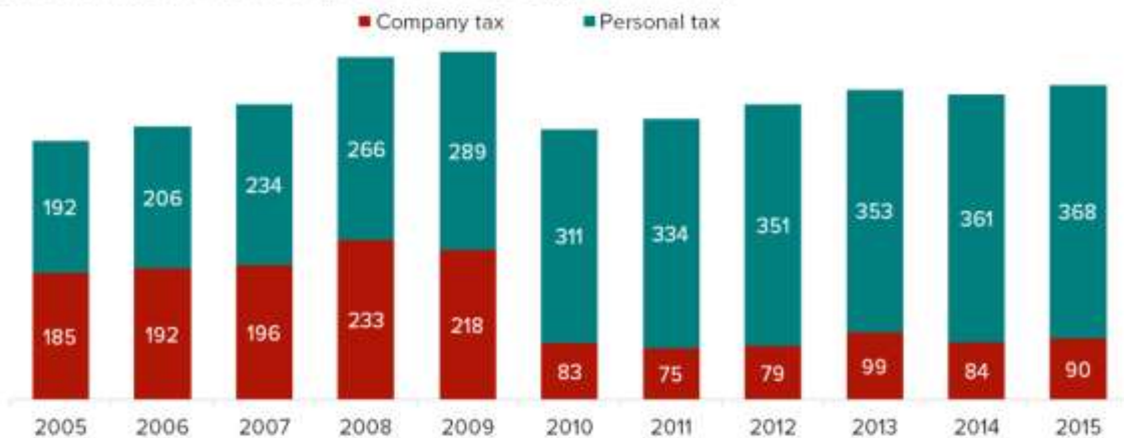
*Effective rate is the percentage of annual income that a taxpayer will pay through ITIS, as shown on their payslip. It includes tax payable and Long Term Care Charge, but not Social Security contributions.

56

Finding 25

The introduction of new charges will increase the effective rate of tax for taxpayers.

Since the introduction of the Zero/Ten tax system in 2008, personal tax has made up an increasing part of the total tax income for the States. This is shown by the graph below produced by the Statistics Unit. Without increasing the headline 20% rate of tax, other measures for raising the amount of personal tax have had to be found to balance income with expenditure.



57

The Panel questioned the Minister for Treasury and Resources on the sustainability of the zero ten tax regime:

[56] Panel calculations based on worked examples available on www.gov.je
[57] States of Jersey Statistics Unit

Deputy J.A.N. Le Fondré:

"…Is it not really just the case that the Zero/Ten income tax structures that we have got are starting to creak, we are finding various ways of bringing in other income? What is the view in terms of perhaps we should be introducing a new headline rate of tax instead?"

The Minister for Treasury and Resources:

No, it is not creaking. You can see that revenues are continuing to rise. I think the issue is they are not rising at the same rate that they were previously, whereas we have significant additional pressures, largely around the ageing population. This is not, as we have said, a Jersey issue, it is happening in many other places as well. That is why the priorities, in particular in health, and why there is £40 million additional investment going into the Health Department to deal with those pressures. So you have got rising costs, income rising, but not as fast as it previously was, and pressures, I may say, that put that income line at risk. We are having to make sure that we have flexibility to adjust to that…"[58]

4.18 Population Numbers used in the MTFP

The Panel is concerned about the population numbers that have been used to formulate the MTFP. The area of population is one the Panel has raised frequently at its quarterly hearings with the Chief Minister, with additional concern around the absence of a current, updated population policy for the Island. The Panel has been told the existing policy is currently being used and is still good for business. This was confirmed in a quarterly hearing with the Chief Minister in June of this year:-

Deputy J.A.N. Le Fondré:

"… when do you think a new population policy will be implemented? Because from what I am hearing that is at least a year and a half away after it is expired, so just give us a ballpark figure, is it 2 years away from now..?"

The Chief Minister:

"…No, the title might have expired but the actual policy is still good for business and that policy is a robust policy of trying to say yes to licences that are going to bring value to our community and no to those that we think are not and you have got a planning assumption underlying that…"[59]

Part of the formulation of the MTFP requires statistics from the Statistics Unit with the latest population figures shown below:

The latest Jersey Resident Population Estimate 2015 report published in June 2016 shows that during 2015:

[58] Hearing with Minister for Treasury and Resources – 15.07.16
[59] Quarterly Public Hearing with the Chief Minister – 13th June 2016

- *the resident population increased by 1,700 people*
- *net inward migration accounted for 1,500 of the increase*
- *natural growth (the excess of births over deaths) accounted for 220*

Total net inward migration of 1,500 in 2015 comprised of approximately:

- *400 net inward 'licensed' employees and their dependents*
- *1,100 net inward 'registered' employees and their dependents*

During the last 10 years, the resident population has increased by 11,700 people with net migration accounting for three-quarters (75%) of the total population growth over the last 10 years.

These numbers are significantly higher than the "base assumption" of 325 - 350 which has been used in the MTFP Addition.

The Panel asked the Assistant Chief Minister what target figures the MTFP Addition is based on:

> ***Senator P.F. Routier:***
>
> *There is no target. There never has been a target for population. We have always worked on the process of each department makes an assumption of what services they are going to provide and what the demands are going to be on their service. Every department is different.*

The Panel is highly concerned that there is no consistency across the States in terms of planning public services for a particular level of population. The base assumption of 325 per annum net migration which is referred to in places in the MTFP is evidently incorrect and a higher figure needs to be used which is based on up to date population estimates. Basing significant expenditure plans on inaccurate figures means that the Island could be storing up trouble for itself in the future, even if not in the period of this MTFP. As the MTFP 2016-19 acknowledged:

"It does, however, mean that the capacity of services and infrastructure to accommodate long term growth in Jersey's population is being eroded faster than intended."[60]

[60] MTFP 2016-19, page 21

APPENDIX 1 – CIPFA REPORT

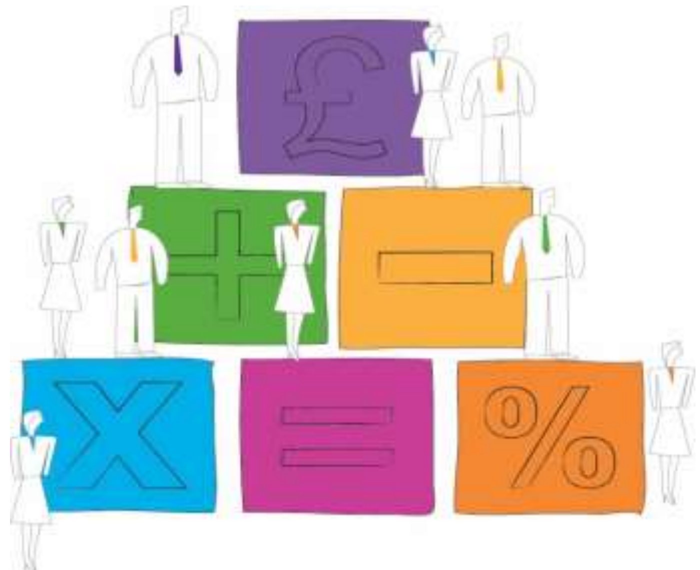
States of Jersey
States Assembly

États de Jersey
Assemblée des États

Corporate Services Scrutiny Panel

MTFP II Addition 2016 – 2019

August 2016



CIPFA (Chartered Institute of Public Finance and Accountancy)
77 Mansell Street
London E1 8AN
Phone: 020 7543 5600
CIPFA FINANCE ADVISORY SERVICE
Email: stuart.fair@cipfa.org

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1. Executive Summary

1.1 In May 2016, the States of Jersey commissioned CIPFA Business - Finance Advisory (the commercial arm of the Chartered Institute of Public Finance and Accountancy) to support the work of the Corporate Services Scrutiny Panel in the Review of the Medium-Term Financial Plan (MTFP) II Addition submission (MTFP II 2016 – 2019).

1.2 The MTFP II Addition document recognises an imbalance between operating income and expenditure and highlights a revised forecasted profile on Operating Surpluses/Deficits – moving from an overall deficit of £91m in 2016 to a modest surplus of £1.5m in 2019.

Key findings

1.3 The MTFP II Addition is a comprehensive and robust framework and should have the modelling capabilities that would allow a highly effective medium term financial strategy to be set to 2019. In many ways it contains aspects of best practice that should allow the model to be an exemplar for other jurisdictions to follow. However, regardless of the MTFP model's obvious strengths in design and coverage, its overall utility as a platform for optimal decision making (tax and spend decisions) is significantly impaired by what we see as imprudent assumptions around Income Tax and a lack of rigour in the detail behind a significant number of efficiency saving proposals.

1.4 The main issues arising from our review include:

Income

- Income growth forecasts of 2017 – 4.2%, 2018 – 5.5%, 2019 – 4.7% and 2020 – 5% do not appear to be realistic in context (even before any uncertainty arising from the UK Brexit referendum) with prevailing and expected economic conditions over the medium term period. We understand that revised core assumptions provided by the Fiscal Policy Panel will be used by the Income Forecasting Group in providing a downward revision of income figure, however, there are no plans to change the MTFP II submission. Failure to incorporate any known changes in the expected operating environment within financial strategy further reduces the utility of MTFP II

Efficiency Savings

- A significant number of efficiency savings proposals contained within the MTFP II Addition submission are not sufficiently advanced in construction, lack granularity and are aspirational/expectational. As relevant legislative provisions of Public Finance (Jersey) Law was specifically amended to allow for the detail on efficiency

savings to be fully constructed over a further period of a year to June 2016, this lack of granularity is disappointing

- A lack of consistent service planning seemed to indicate that for some departments the MTFP process itself was a 'proxy' for this critical 'bottom up' base planning process
- If the June 2016 level of funded vacancies (12.6%)are sustained there is the potential for 'savings' to be generated without significant additional effort running counter to the transformational change agenda on public sector reform

Charges

- The revised Health Charge is a tax levied on income rather than a charge levied on usage, is not directly routed to the Health Account and appears to provide an additional source of income
- The proposed charge for Commercial Waste estimated to raise £3m in 2018 and £11m in 2019 contains little detail on how these figures have been constructed and it is understood that there will be some complex issues to resolve prior to implementation including industry affordability issues in the context of potential economic retrenchment
- If further efficiencies were generated as part of the reform agenda including significantly reducing funded vacancies, the requirement to raise additional income sources could be potentially avoidable

Financial Management

- Our assessment of the MTFP Addition against relevant components of the latest version of CIPFA Financial Management Model (V4) highlighted some scoring improvement on the 2015 position. Whilst the overall MTFP framework is stronger (the MTFP II Addition provides a robust framework for financial strategy to be formulated) there are a number of financial management processes that require to be strengthened including budget setting. We believe the States would benefit from a more outcomes based/zero based approach on budget setting in addition to significantly strengthened forecasting. In terms of improving the effectiveness of financial management arrangements associated with MTFP II we have proposed 23 recommendations

1.5 Overall the structure and scope of MTFP II Addition still provides the capability to provide real insight into factors impacting financial strategy and should allow decision makers with the platform to create an optimal medium term financial strategy. However, this is fully predicated upon the model having robust core assumptions and transparency in the demonstration of resource provision against service needs. The MTFP II 2016-2019 has a number of real strengths however key components within the model appear to be aspirational rather than being based upon detailed and prudent assumptions, to the extent that the utility of MTFP II as currently constituted is seriously compromised. With continuing service delivery and investment pressures including the affordability/funding decisions related to the new Hospital Project, all in the context of a potentially uncertain economic outlook, the value of an effective

MTFP cannot be understated. An effective MTFP can be readily achieved if MTFP II is recalibrated to reflect a more realistic position on specific key assumptions underpinning Income, Efficiency Savings and Charges. In doing so potentially unpalatable decisions on tax, spend and the level of reserves will not go away and the forecasted trajectory on deficits may indeed appear to be even larger and more prolonged, however the States will be able to base its decisions on a more robust financial strategy that can only lead to better outcomes.

2. Background

2.1 In May 2016, the States of Jersey commissioned CIPFA Business - Finance Advisory (the commercial arm of the Chartered Institute of Public Finance and Accountancy) to support the work of the Corporate Services Scrutiny Panel in the Review of the Medium-Term Financial Plan (MTFP) Addition submission (MTFP II 2016 – 2019). The additional submission builds upon the MTFP II 2016-2019 which was lodged in July 2015 adding detailed estimates for 2017, 2018 and 2019 including budget lines where planned efficiency savings have been identified as well as an update on financial strategy building upon the latest activity outturns and profiles on financial performance. This briefing paper highlights high level issues that we believe merit Scrutiny Panel consideration in advance of the Assembly debate on 27 September 2019.

Our Approach

2.2 Our approach to this independent review has sought to draw together a wide range of evidence including work carried out on the original submission – MTFP II 2016-2019 together with addition submission and supplementary material sourced from Scrutiny Panel Hearings, meetings with officers and further documents sourced from these meetings. Best practice on Financial Strategy, Budget Setting and Financial Performance Management have been derived from the latest version (version 4 – July 2016) of the CIPFA Financial Management (FM) Model. Our comments are made on material which was made available before the UK's referendum on continuing membership of the European Union.

2.3 As the original submission contained only control total information for 2017, 2018 and 2019, the MTFP Addition required to be amended to accommodate a more detailed position which was subsequently lodged on 20 June 2015. Article 8A of the Public Finances (Jersey) Law was specifically amended to allow for significant service reengineering and consequential change to line by line departmental estimates within an addition submission. Within our review of this change we expressed some initial concerns whilst recognising the requirement to accommodate the background work in formulating a detailed MTFP submission:-

2.4 As the original submission contained only control total information for 2017, 2018 and 2019, the MTFP Addition required to be amended to accommodate a more detailed position which was subsequently lodged on 20 June 2015. Article 8A of the Public Finances (Jersey) Law was specifically amended to allow for significant service reengineering and consequential change to line by line departmental estimates within an addition submission. Within our review of this change we expressed some initial concerns whilst recognising the requirement to accommodate the background work in formulating a detailed MTFP submission:-

"We had some initial reservations around this proposal - running a four year MTFP based on only one year of detail and three years of control totals with no reasonable detail for these three subsequent years would negate the benefits of the MTFP and significantly reduce its utility."[61] However, notwithstanding the impact on the MTFP we fully acknowledge the rationale for the amendment (the revised planning work to restructure services would be insufficiently advanced by the time of the required submission) although we recommended that such a change be limited to a 'one off' event with a strict time clause on the amendment being applied.[62]"

2.5 Whilst the addition submission is extremely comprehensive and the product of significant work, it effectively re-states the 2015 submission in that changes are made to relevant annual control totals with only limited detail on a reduced scope of required efficiency savings. In essence the MTFP II 2016-19 has been revised and an opportunity has been taken to relax expectations to identify some £145m of funding measures as contained within the Council of Ministers' Executive Summary of MTFP II. This was originally split as follows:-[63]

- Staff and Non Staffing savings - £90m
- Holding benefit spending at 2015 levels - £10m
- Implementing a Health Charge - £35m
- Introducing a 'user pays' charges for liquid and solid waste - £10m

2.6 A reduced headline figures of £77M from £90m is highlighted along with a more relaxed/gradual profile which assumes the challenges reflected in achieving actual delivery[64]:

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

2.7 Proposals for a Health charge of £15m in 2018 originally extended to £35m in 2019 have been modified downwards to £7.5m and £15m respectively on account of an "improved Consolidated Fund position". Commercial waste charges are expected to raise £3m in 2018 and £11m in 2019.

2.8 The addition attempts to balance significant critical additional investment *(This financial plan moves funds into the agreed priority areas. Health and Social Services*

61 CIPFA – Review of proposed amendment to Public Finances (Amendment of Law No.2) (Jersey) Reg 201

62 CIPFA – MTFP II016-2019 – Para 1.11 Page 6

63 MTFP II016 – 2019 – Section 2 Page 9

64 Addition 2016-2019 - Figure 29 – Summary of cumulative expenditure measures P82

will be receiving additional annual funding of almost £40 million by 2019; education will be receiving £11 million of additional funding every year from 2019. £168 million has been allocated to capital projects over the four years of the plan, including £55m for school buildings, £43m for sewage works and £21m for IT systems.)[65] with a shallower profile in cost reduction and additional income generation. The rationale for this is based on an interpretation of the Fiscal Policy Panel's Pre-MTFP advice without any apparent assistance from any distributional analysis:

"The advice of the Fiscal Policy Panel in its Pre-MTFP report was for the States to address any structural deficit with sustainable measures by 2018/2019. The Fiscal Policy Panel also advised that care should be taken to ensure that the range and timing of the measures minimises the risk to the economic recovery, which in the early stages, may involve using the States Reserves.

The Council of Ministers has interpreted this advice to mean that there should be a phased introduction of the sustainable measures which should be carefully planned and implemented over the four year period to 2019."[66]

2.9 In this context our report on the original submission advocated clear immediate action to recalibrate overall expenditure within income:-[67]

1.17 Rather than awaiting for further macro-economic advice it is submitted that strong and immediate action needs to be taken to recalibrate overall expenditure with income. Within our report on the MTFP II016-2016 we had concluded that:

"Proposed total income of approximately £2.94 billion including some £35 million of a Health Charge is incorporated the MTFP submission against what would be approximately £3.11 billion of total net expenditure. By any definition, there has to be a material change in the alignment of income and expenditure if there is to be a reasonable prospect of achieving a 'balanced budget' position over the four year period.

In respect of MTFP 2 the targeted £145 million of savings, charges and other measures by 2019 is highly ambitious and there is an acknowledged risk of non-achievement. Although MTFP 2 provides for an element of contingency, should such targets fail to be achieved, there is a lack of precision and definition on alternative options. In our view there appears to be almost a cultural acceptance that there will be a significant element of non-achievement. It is our view that a number of key assumptions, principally around Income Tax and Savings targets including £70 million of People savings invite an unacceptable level of risk. The introduction of a Health Charge and User Pay strategy scheduled to bring a combined additional income of £45 million per annum in 2019 is considered to be insufficiently developed at this stage to validly incorporate within a meaningful plan designed to eliminate the structural deficit."

[65] Addition 2016-2019 – Council of Minister's Forward Page 10

[66] Addition 2016-2019 – Summary – Sustainability in States Finances - P84

[67] CIPFA – MTFP II016-2019 – Concluding Comments - Paras 5.3/5.4 Page 22 and Review of Council of Ministers Impacts Assessment – MTFP II06-2019 Briefing Paper March 2016

2.10 Whilst it is recognised that the MTFP Addition represents a valid opportunity to update core assumptions, the submission has clearly went with the original intention of highlighting the detailed budget measures required to recalibrate income and expenditure and indeed beyond marginal changes to key baseline parameters. Updating financial strategy to accommodate the very latest intelligence on service activity/developments arising from on-going performance management arrangements is good practice.

Forecasted Operating Surplus

2.11 Appendix 12 of the MTFP Addition document highlights a revised profile on Operating Surpluses/Deficits – moving to a modest surplus of £1.5m in 2019 with consequential integrated impacts on Strategic Reserve and Consolidated Fund balances. This profile of deficits changes to a the project £1.5m surplus in 2019 from running an overall £91m deficit in 2016 as follows:

Summary of Financial Forecast		MTFP Addition Proposals (June 2016)			
	2015	2016	2017	2018	2019
	Outturn	Proposed	Proposed	Proposed	Proposed
	£'000	£'000	£'000	£'000	£'000
Total States Income - incl: Proposed Funding Mechanism	691,744	693,774	715,203	759,240	789,360
Total Net Revenue Expenditure (excl: Depn)	697,031	740,317	724,287	733,955	734,845
Forecast Operating Surplus/(Deficit) for the year	**(5,287)**	**(46,543)**	**(9,084)**	**25,285**	**54,515**
Depreciation Forecast	44,676	44,800	40,600	45,500	53,000
Current financial position - Surplus/(Deficit)	**(49,963)**	**(91,343)**	**(49,684)**	**(20,215)**	**1,515**

2.12 Although the final position is not dissimilar to that original submitted in 2015 – see below - there are significant differences in the profiled deficits for 2017 as well as the actual 2015 position itself – see comparable table below.

Summary of Financial Forecast	Forecast (June 2015)	MTFP Proposals (June 2015)			
	2015	2016	2017	2018	2019
	Forecast	Proposed	Indicative	Indicative	Indicative
	£'000	£'000	£'000	£'000	£'000
Total States Income - incl: Proposed Health Charge	664,588	685,830	705,491	754,295	792,076
Total Net Revenue Expenditure (excl: Depn)	720,629	734,417	733,387	732,997	733,845
Forecast Operating Surplus/(Deficit) for the year	**(56,041)**	**(48,587)**	**(27,896)**	**21,298**	**58,231**
Depreciation Forecast	50,098	43,613	42,903	47,798	54,593
Current financial position - Surplus/(Deficit)	**(106,139)**	**(92,200)**	**(70,799)**	**(26,500)**	**3,638**

2.13 In order to achieve a return to surplus the forecasted income and expenditure positions requires to be realised. Given that the year on year increase position on States Income as formulated by the Income Forecasting Group (IFG)(irrespective of containing expenditure)is 4.2% for 2017, 5.5% for 2018 and 4.7% for 2019, the full delivery of the financial plan to outturn a modest surplus of £1.5m by 2019 depends on this level of income being generated. In context, this will be extremely challenging with significant inherent risks of non- achievement.

Strategic Reserve – Estimated Changes to Fund Balances

2.14 The MTFP Addition projects an estimated 2016 Strategic Reserve Fund Balance of £743m down from £771m in 2015 and a 2019 balance of some £819m [68] which represents a 5.7% reduction from the June 2015 forecasted position as contained within MTFP II:

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

2.15 Both points in time are well adrift from the corresponding MTFP II 2015 submission[69] position suggesting a significant number of adjustments/changes. As with the Operating Deficit/Surplus forecast, reliance on the revised core assumptions are considered to be integral to the achievement of these forecasts. It is difficult to fully track the downward adjustments, some are substantial, and it would be appropriate to acquire a reconciliation of both positions:

Strategic Reserve - Estimated Balances	2013 Actual £'000	2014 Actual £'000	2015 Forecast £'000	2016 Forecast £'000	2017 Forecast £'000	2018 Forecast £'000	2019 Forecast £'000
Strategic Reserve - Protected Capital Value [2]	664,240	672,875	684,987	702,797	721,070	742,702	764,983
Strategic Reserve - Accumulated Excess Return [1]	78,888	113,647	98,101	64,457	19,819	35,231	103,096
Strategic Reserve - Estimated Fund balance	**743,128**	**786,522**	**783,089**	**767,254**	**740,888**	**777,933**	**868,079**

2.16 Expected deficit outturns returning to marginal surplus in 2019 has an obvious impact upon reserves and this is partially illustrated within the reducing balance on the Strategic Reserve. Given the sustained imbalance between income and expenditure it is critical that prevailing MTFP assumptions are robust.

[68] MTFP Addition - Figure 40 – Estimated balances on the Strategic Reserve 2015 - 2019

[69] MTFP II016-2019 Figure 37 – Estimated balances on the Strategic Reserve 2013 - 2019

3. Assessing the MTFP2 Addition Submission

3.1 The CIPFA Financial Management Model (FM) Model is the "gold standard" globally for best practice on Financial Management in the Public Services and is used extensively in North America, the Middle East and Australasia. In July 2016 CIPFA launched its latest version of the model which sets the standard on the latest advances in best practice Public Financial Management including the internationally based Public Expenditure and Financial Accountability programme (PEFA). In relation to the 2015 submission, we assessed the MTFP II together with aspects of the prevailing FM operating environment against relevant components of the CIPFA Financial Management Model. We have updated our 2015 assessment taking account of the MTFP Addition submission of 30 June 2016. Where there has been FM Model changes arising from the latest version we have applied a mapping that allows a full comparison and tracking.

Assessing the strength of MTFP II – 2016-2019 using the CIPFA FM Model

3.2 Our assessment has been based upon applying the most relevant statements of the latest version of the CIPFA FM Model version 4 together with relevant supporting questions to the MTFP Addition. Using relevant components of the FM Model specific testing was applied to highlight the strength of the following attributes:

- Construction of the MTFP including the Addition submission
- Assessment of Key Assumptions used within the MTFP II Addition
- Performance Monitoring and Reporting of the MTFP II Addition
- Overall effectiveness in the utilisation of the MTFPII Addition

3.3 The relevant statements that were considered appropriate to the assessment of the strength of MTFP I were applied in the same manner for MTFP II and reconfigured to fully align with version 4 of the FM Model. These Statements (9 in total) were categorised between Primary Statements where we would expect the fundamental attributes of good practice to exist within MTFP II Addition, including at a granular level, testing the strength of some of the important assumptions. Each statement is supported by questions which seek to cover a range of relevant evidence which assists with the scoring. Scoring rises in increments of 0.5 from 0 to 4 within a determination as follows:-

Score	- How Far Does the Best Practice Statement Apply to the MTFP2 Addition?
0 / 0.5 / 1	Hardly
1.5 / 2	Somewhat
2.5 / 3	Mostly
3.5 / 4	Strongly

3.4 As with our previous assessment we will represent the scoring for reporting purposes at a high level with a "traffic light" (RAG Rating) approach with the following ranges:-

Colour	Score
Red	**0.0 – 1.9**
Amber	**2.0 – 2.9**
Green	**3.0 – 4.0**

Evidence

3.5 Primary sources of evidence consisted of:-

- Document Review– the MTFP II Addition submission/subsidiary plans and workings
- Attendance at Scrutiny Panel Meetings including transcripts
- Reports received from stakeholders
- Meetings with Senior Finance Staff in Treasury & Resources and Departments

3.6 It should be recognised that this assessment work is carried out on a restricted set of evidence and should be seen as specific to medium term financial planning and associated financial management issues relating to MTFP II rather than an indicator of the overall strength of financial management capability at the States of Jersey. Having carefully considered all the relevant available evidence, our scoring for each of our relevant eight statements in relation to MTFP II Addition is as follows (the relevant MTFP I positions are also displayed):-

Statements of Good Practice

Stateme nt	Primary Statements	MTFP II Add 2016-2019 Scoring	MTFP II 2016-2019 Scoring	MTFP 1 2013 – 2015 Scoring
L3	**Within an annual budget setting process the organisation's leadership sets income requirements including tax and allocates resources to different activities in order to achieve its objectives. The organisation monitors the organisation's financial and activity performance in delivering planned outcomes.**	**2.5**	**2.0**	**2.5**
L4	**The organisation has a developed financial**	**2.0**	**1.5**	**2.0**

	strategy to underpin medium and longer term financial health. The organisation integrates its business and financial planning so that it aligns resources to meet current and future outcome focussed business objectives and priorities.			
PR1	**Budgets are accrual-based and robustly calculated.**	**2.0**	**2.0**	**2.5**
PR6	**The organisation maintains processes to ensure that information about key assets and liabilities in its balance sheet is a sound and current platform for management action.**	**2.5**	**2.0**	**2.5**
PR10	**The organisation's medium-term financial planning process underpins fiscal discipline, is focussed upon the achievement of strategic priorities and delivers a dynamic and effective business plan.**	**2.5**	**1.0**	**2.5**
PR11	**Forecasting processes and reporting are well developed and supported by accountable operational management. Forecasting is insightful and leads to optimal decision making.**	**1.5**		
PR12	**The organisation systematically pursues opportunities to reduce costs and improve value for money in its operations.**	**2.0**	**2.0**	**2.0**
PR13	**The organisation systematically pursues opportunities for improved value for money and cost savings through its procurement and commissioning.**	**2.0**	**2.0**	**2.0**

3.7 Each statement is underpinned by a range of questions that are used to assess the available relevant evidence in detail. Our high level comments for each of the eight statements in scope are outlined below.

Leadership - Delivering Accountability and Supporting Performance

Leadership Delivering Accountability	**L3**	**Within an annual budget setting process the organisation's leadership sets income requirements including tax and allocates resources to different activities in order to achieve its objectives. The organisation monitors the organisation's financial and activity performance in delivering planned outcomes.**	**2.5**
Leadership Supporting Performance	**L4**	**The organisation has a developed financial strategy to underpin medium and longer term financial health. The organisation integrates its business and financial planning so that it aligns resources to meet current and future outcome focussed business objectives and priorities.**	**2.0**

3.8 For the Leadership Financial Management Dimension and Delivering Accountability Financial Management Style, statement L3 relates to the basic requirements of setting a robust annual budget within an existing financial strategy which fully correlates to organisational objectives and outcomes. Scoring has improved in this area from the point of the September 2015 MTFP II submission assessment to 2.5. Four key supporting questions to this statement:

- Is the annual budget setting and allocation process based on sound evidence of costs and income together with an assessment of sensitivities to external and internal influencing drivers of change?
- Are taxes, fees, charges and other sources of income including transfers set in accordance with a robust fiscal/ financial strategy in full alignment with the delivery of strategic objectives and outcomes?
- Does the budget process demonstrate that resources are allocated in alignment with strategic objectives and facilitates the conversion of strategy into the operational delivery of outcomes?
- Is the board/management team responsive to changes in financial assumptions impacting performance and adapt decision making to deliver corrective action?

3.9 L4 relates to setting a robust MTFP based on strong operational service planning. Whilst Departments have worked hard to deliver efficiency saving strategies there is still a general and consistent lack of granularity on service planning. Service Planning should weld together operational service objectives/targets with financial resourcing requirements. Relevant supporting questions are:

- Are operational plans fully aligned with the medium-term/longer-term financial plan?
- Does the medium-term financial plan draw together realistic estimates of funding to support the achievement of strategic objectives?

3.10 In terms of the expected trajectory of income embedded within the MTFP Addition submission we have significant concerns about some basic assumptions used – principally in relation to Income Tax.

Processes – Delivering Accountability and Supporting Performance

Processes/ Delivering Accountability	**PR1**	**Budgets are accrual-based and robustly calculated.**	2.0
	PR6	**The organisation maintains processes to ensure that information about key assets and liabilities in its balance sheet is a sound and current platform for management action.**	2.5
Processes/ Supporting Performance	**PR10**	**The organisation's medium-term financial planning process underpins fiscal discipline, is focussed upon the achievement of strategic priorities and delivers a dynamic and effective business plan.**	2.5
	PR11	**Forecasting processes and reporting are well developed and supported by accountable operational management. Forecasting is insightful and leads to optimal decision making.**	1.5
	PR12	**The organisation systematically pursues opportunities to reduce costs and improve value for money in its operations.**	2.0
	PR13	**The organisation systematically pursues opportunities for improved value for money and cost savings through its procurement and commissioning.**	2.0

3.11 Scoring for PR1 (formerly PR8) is still well below the average global scoring position of 2.8. Key supporting questions include:

- Is the budget setting process accrual based and formulated upon a 'bottom up approach?
- Does the budget setting process incorporate aspects of outcomes based budgeting, targeted zero based budgeting and/or activity based costing approaches?

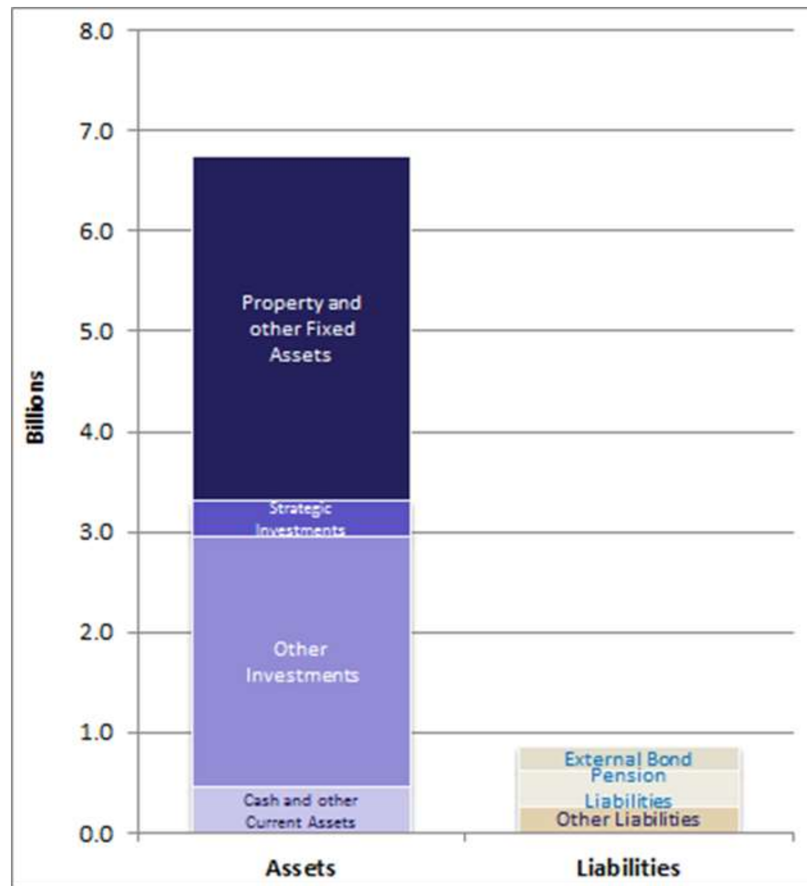
3.12 As outlined within our 2015 report - the key issue with regards to this specific statement is whether or not the budgets produced are robust. Given the current level of vacancies (12.9% at June 2016) and the resourcing of 'approved' structures within base budgets (which may be set beyond resourcing requirements to deliver the current level of service) it cannot fully be said that budgets are formulated in a way consistent with the aims of this statement.

3.13 PR6 relates to the way that information on assets and liabilities are used to inform strategic decision making. Whilst there are apparently robust systems in place to monitor asset condition and calculate depreciation etc, it is still unclear how the depreciation actually informs strategic decision making or how the expected asset sales and estates rationalisation will fully profile over the MTFP. We are aware of ambitious current plans to rationalise office estate and the work of Jersey Holdings, however we are not aware of how robust the financial implications are arising from this corporate initiative. Much has been said about the States having a strong balance sheet, in terms of asset base or net assets – "*Strong balance sheet - The balance sheet has grown further in 2015 with an increase in the net asset balance of £166 million to £5.9 billion, largely as a result of investment returns and the revaluation of property, infrastructure and strategic investments."*[70] *"Jersey is well placed to respond, not only to opportunities that arise from BREXIT but also challenges, particularly during any period of uncertainty impacting States revenues, having plans to balance the books, a history of fiscal discipline, a strong balance sheet and low debt"*.[71]

3.14 Whilst there are a number of high value assets, the bulk of the valuations of most of the infrastructure assets would not be readily realisable through a definable market. A more accurate position can be found within the detail and graph represented on page 133 of the Draft MTFP II Addition:

"The Balance Sheet, as at 31st December 2015 includes £3,443 million of property, land and infrastructure assets and £361 million of Strategic Investments such as Jersey Post, Jersey Telecom etc." Figure 51 – States Balance Sheet as at 31.12.2015[72]

[70] 2015 – States of Jersey Accounts – Page 11
[71] Draft MTFP – 2016-2019 – Page 120
[72] Draft MTFP Addition – 2016-2019 – Section 17 – Page 133



3.15 It is worth noting that the fund balances as at 31 December 2015 was as follows

- Strategic Reserve - £771.4m
- Consolidated Fund Unallocated – £64.7m
- Stabilisation Fund - £0.006m
- Social Security (Reserve) Fund - £1.3bn

3.16 Against the background of major capital investment commitments in respect of a new Hospital, Sewage Treatment facility, public sector reform investment, Pension liabilities of £400m, External Bond of £250m[73] and revenue income failing to keep pace with expenditure, the relative strength of the balance sheet will be further tested. Scoring in this area has improved as evidence suggest that there is now more of a strategic focus on balance sheet management.

3.17 PR11 (formerly PR12) specifically relates to the formulation of medium-term financial planning. The scoring is reflective of the work undertaken in aligning strategic priorities with departmental resourcing however there is still more to do for the plan to fully facilitate fiscal discipline and deliver a dynamic and effective business plan. Core assumptions relating to Income Tax are considered to be optimistic at best, base estimates are largely incrementally rolled forward and a high proportion of the expected efficiency savings are largely aspirational. Within 2015, prevailing Public

[73] States of Jersey 2015 Annual Report and Accounts – Page 36 – para 2.8

Finance (Jersey) law was changed to allow the submission of more granular estimates for years 2017, 2018 and 2019. There was a clear expectation that such changes would be founded upon operationally related plans for the delivery of efficiency savings underpinning MTFP II through to 2019. The MTFP II Addition has only partially delivered on this expectation. Whilst scoring has undoubtedly been significantly improved to 2.5 from 1.0 (1.0 was largely based on the incomplete MTFP) it is still lower than what we would expect to see given the background to the original MTFP.

3.18 PR11 builds upon a previous statement PR9 (which was not previously assessed) and relates to the quality of forecasting and the ability of forecasting to directly inform decision making – "*Forecasting processes and reporting are well developed and supported by accountable operational management. Forecasting is insightful and leads to optimal decision making*."

3.19 Strong forecasting capability is critical to the formulation of the MTFP. Key supporting questions to this statement include:

- Is the base data used for forecasting considered to be robust?
- Are forecasts based on a thorough knowledge of cost/income drivers and activity behaviours e.g. latest intelligence on tax yield/income trends, etc.?
- Are the appropriate quantitative/qualitative techniques and sensitivity analysis used within decision support modelling of forecasts?
- Are assumptions 'stress tested' and validated for risk and uncertainty?
- Are the appropriate techniques used and challenge provided to counter behavioural aspects of forecasting including optimism bias?

3.20 Our evidence on performance management reporting and existence of volatility on key parameters between MTFP II submission and the original 2015 MTFP II Addition suggests that more precision on forecasting is required. Examples include components of income such as Other Income and elements of Income Tax. Some forecasts appear to be aspirational rather than based on robust assumptions and we did not find any evidence that key assumptions were subject to significant stress testing/risk assessed.

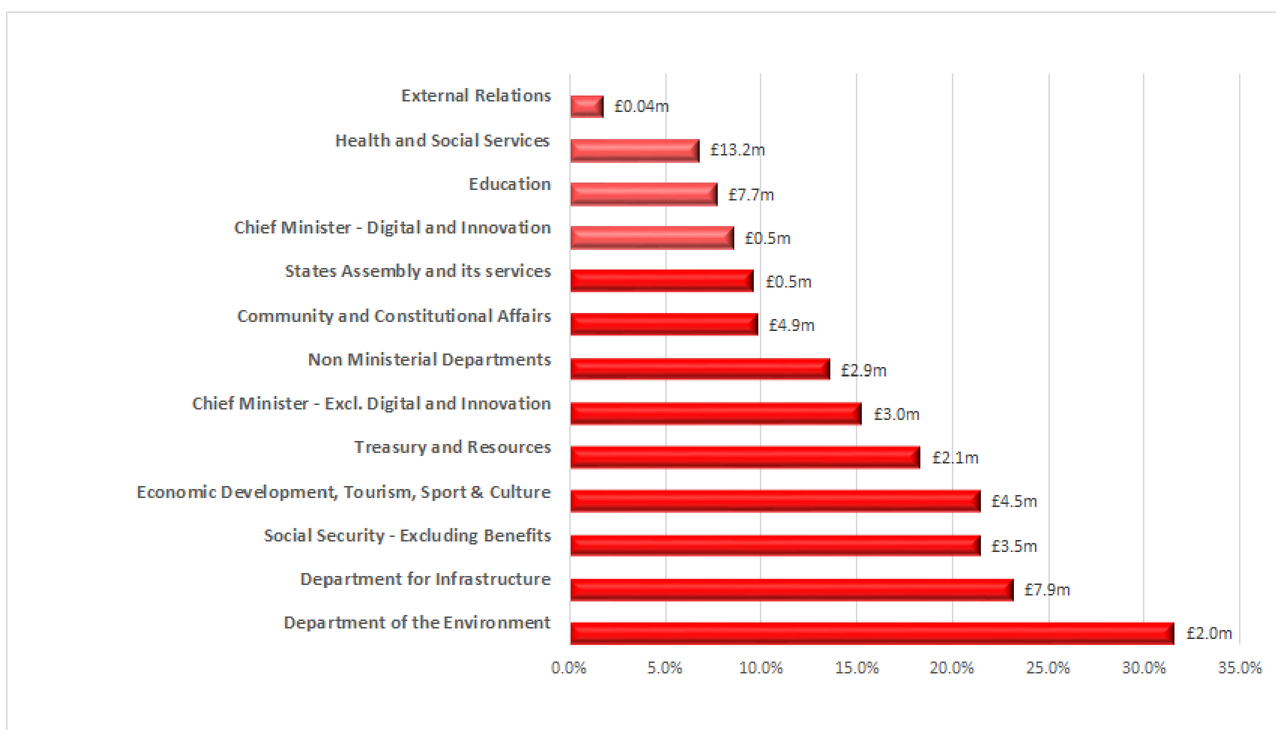
3.21 Consistent underspending to profile on capital expenditure suggest that there might be potentially sub optimal budget behaviours in play which negatively impact accurate forecasting. Given the extent of the sustained level of vacancies and the extent of carry forwards this may be an issue across revenue activities in as much real service resourcing needs may be obscured by a combination of over provision of budgets and behaviours designed to ensure such resources are maintained over time, regardless of immediate and direct service need.

3.22 PR12 (formerly PR13) concentrates upon the assumption that the States systematically focusses on opportunities to improve value for money in its operations including cost reduction. This covers both business as usual and investment programmes. The MTFP process itself delivered a variable level of savings across departments. Relevant supporting questions include:

- Does the organisation have a detailed plan of specific value for money improvements that it intends to make (either as a separate plan or as part of the budget)?
- Does the organisation examine the relative cost and performance of services, including financial services, and test them against internal and external benchmarks and performance indicators to identify efficiency gains and spending reductions?
- Do managers focus on managing their costs and reducing inputs to achieve their goals rather than on using up their budgets?
- Are alternative delivery methods (e.g. pooled budgets outsourcing, collaboration and shared services) investigated and pursued?
- Does the organisation routinely undertake end to end business process reviews (e.g. using lean, digital and other technologies) and implement findings?
- Are additional in year savings the result of efficiency gains rather than budget reductions (e.g. confiscation of unspent budgets)?

3.23 The MTFP II Addition exercise required significant detailed work on the identification of departmental efficiencies. In respect of priorities Health, Education and Financial Services were afforded some protection and in terms of 2015 cash limits, Figure 28 within the Addition submission[74] illustrates the extent of departmental savings as a % of cash limits identified:-

Figure 28 – Department Savings as a % of 2015 Cash Limits – illustrating Strategic Priorities



3.24 Despite priority status being afforded to Health, we were encouraged by the degree to which HSS - Health have approached the requirement to optimise available resources. In respect of a continuous process, HSS Health and Education are well experienced in delivering significant aspects of good practice associated with this statement. Such is the operational demand for these services that both services actively challenge and

[74] Draft MTFP Addition 2017-2019 – Sustainability in States Finances Page 81

reprioritise resource provision throughout the year. However, our evidence suggests that for many departments and services there is still some way to go before a value for money approach is embedded within prevailing management processes. For example, there is potential for 'salami sliced' budget reductions to be accommodated through unrequired budget without discernible service output impacts.

3.25 PR13 (formerly PR14) relates to the delivery of arrangements which secure value for money from procurement, commissioning and contract management processes. Key supporting questions are:

- Does the corporate procurement strategy require increased digitalisation (e.g. purchase to pay and e-tendering) as a means of ensuring compliance with controls, reducing administration costs and/or increasing competition?
- Does the organisation have a procurement savings plan (within the strategy or separate) which identifies the levels of savings to be made and the way they will be assessed?
- Does the organisation ensure there is a full business case for major acquisitions which considers whole life costs and whether to lease, buy or make?
- Does the organisation actively performance manage contractor/supplier performance throughout the life of each contract?
- Does the organisation ensure value for money is delivered during the life of a contract through active contract management, creating opportunities for improved methods during long life contracts such as outsourcing or major systems development?

3.26 It is recognised that there is some aspects of good practice in place although digitalisation initiatives are at fairly early stages. Additionally there is significant work required to establish robust performance management arrangements on contractors/suppliers. The scoring is reflective of a lack of maturity in the establishment of these attributes. However we would expect that scoring should rapidly improve in the short term as improved procurement and contract management practice is embedded and continuously delivered.

3.27 Overall scoring on these selected key areas (based on the MTFP II Addition) has improved on the 2015 MTFP II submission. However, there has not been a significant movement from scoring achieved on the original MTFP position 2012 - 2015. This position masks some progress made on strengthening strategic financial planning. However, there are still accountability issues in the delivery of departmental financial strategy and performance, weaknesses in bringing together departmental operational service planning with financial plans and an element of over optimism on forecasting which has effectively impaired the utility of the MTFP as the core foundation for financial strategy.

4. Specific Issues

4.1 Notwithstanding our assessment of specific components of Financial Management best practice, our review of the MTFP II Addition highlighted the following specific issues:-

- Efficiency Savings
- Income Tax Forecasts
- Health Charges and Users Pays
- Investment

Efficiency Savings

4.2 At an elementary level and by definition – efficiency savings should mean doing the same for less or more for the same – in essence, directly managed interventions that produce a more efficient service. Service levels and service quality should not be impaired. Within high FM Model scoring organisations real cashable recurring efficiencies typically arise through the re-engineering of services and not as a result of the availability of 'unrequired/unused budget'. The States have a carry forward mechanism to responsibly carry forward genuinely unused resources between financial years. We have no reason to believe that Treasury and Resources do not provide proper challenge to this process well. However this does not extend to resources which departments know will not be spent within the forthcoming financial year, or in-year, for example the level of outstanding vacancies. This distorts and obscures a transparent determination of resourcing service need.

4.3 As outlined above the MTFP Addition submission facilitated by the change to Article 8A of the Public Finances (Jersey) Law, allowed for only one year of detail to be submitted by June 2015 with the remaining three years to follow by 30 June 2016 incorporating detailed line estimates for the years 2017, 2018 and 2019. The core rationale being that a year was required for departments to work up the detailed estimates beyond 2016. We were expecting the MTFP II Addition to yield significant detail covering the £90 million of Staff and Non Staff efficiency savings from the original £145m of 'structural deficit' required as set out within the June MTFP II submission. Due a combination of factors the original £90m savings requirements to be delivered through to 2019 have been managed down to £77.5m by 2019 and incorporates some £25m of Pay Restraint. As a reminder the mix and profile is outlined below:

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

4.4 Appendix 2 of the MTFP II Addition highlights the extent that Savings, Efficiencies and User Pays are attributed to each Department. Within the appropriate narrative lines there is an inconsistent mix of generic terminology and more precise efficiency savings initiatives. Whilst there has been significant departmental work carried out - and this has been evidenced within our direct meetings with officers, there is still a lack of overall precision on the extent of planned service re-engineering/re-provisioning that needs to take place before the proposed/required quantum of saving is delivered. An example of this can be seen within the following two efficiency savings proposals associated with the Social Security Department:

Department	2015/2016 Saving £'000	2017 Saving £'000	2018 Saving £'000	2019 Saving £'000	Total FTE Impact
Social Security Department					
Efficiencies					
Efficiency Savings Programme 2017-2019 enabled by LEAN, including efficiencies in Grant Aided Bodies		255.0	514.0	772.0	5.0
Review of Back To Work Services		686.9	1,373.8	2,060.7	10.0
Total efficiencies		**941.9**	**1,887.8**	**2,832.7**	**15.0**
Sub Total: Social Security Department		**941.9**	**1,887.8**	**2,832.7**	**15.0**
2015 -2016 savings	**699.0**	**699.0**	**699.0**	**699.0**	
Total: Social Security Department	**699.0**	**1,640.9**	**2,586.8**	**3,531.7**	

4.5 Whilst there appears to be an inherent level of precision (fairly exact numbering) on the profiled savings it is not clear within the narrative from the 2016 Addendum to the Addition, exactly how these two main lines are going to be achieved:

"The department is continuing to drive improvements in the efficiency of its services through the application of the LEAN methodology, which, in addition to improving customer service, will generate additional capacity within the department. This in turn can be translated into savings, for example by not replacing staff who leave. We will also work with the Grant Aided Bodies supported by the department to deliver similar efficiencies.

To support the Council of Ministers' Strategic Priorities, the department is committed to helping more people into employment through Back to Work schemes, including helping more individuals with long term health conditions back into work. The ongoing level of Back to Work investment will depend on the progress against this priority, the success of reducing mainstream unemployment and economic conditions. It is expected that reductions in the overall level of investment in Back to Work will be possible without reducing the quality of the service."[75]

4.6 It is arguable that a reduction in the back to work service provision culminating in the saving of 10 posts may conflict with existing States priorities, especially if the economic downturn is sustained(notwithstanding any impact of Brexit).

4.7 Across most departments, the 2015/16 savings appear to be continuous 'salami sliced' budget reductions within the MTFP II. We have received no contra indications that such savings will not be achieved in 2016. There is a significant number of departmental efficiency savings proposals which are rounded to the nearest £100,000 which may, *inter alia*, suggest a high degree of aspiration/expectation rather than founded in robust detailed costing work.

4.8 Staff costs account for the largest element of subjective spend. We had previously indicated that "The States have set out to capture some £70 million in staff related savings. Savings of this magnitude will inevitably require the release of a significant number of staff."[76] Yet despite the staff voluntary severance scheme being implemented, overall staffing FTE numbers are only forecast to show a net reduction of 57.6 FTEs "between *the reconciled 2016 position and 2019 forecast. Furthermore, the total FTEs in the table above may reduce further by up to 103.5 FTEs depending on the range of outcomes from the Department of Infrastructure transformation*."[77]

4.9 The FTE numbers within the MTFP II Addition relating to approved structures do not illuminate the extent that vacancies are being carried (and financed). The following table shows that some 897 FTE posts were vacant as at June 2016 representing some 12.9% of the overall staffing establishment. The detail across departments and services is outlined below:

States of Jersey FTE Analysis - June 2016

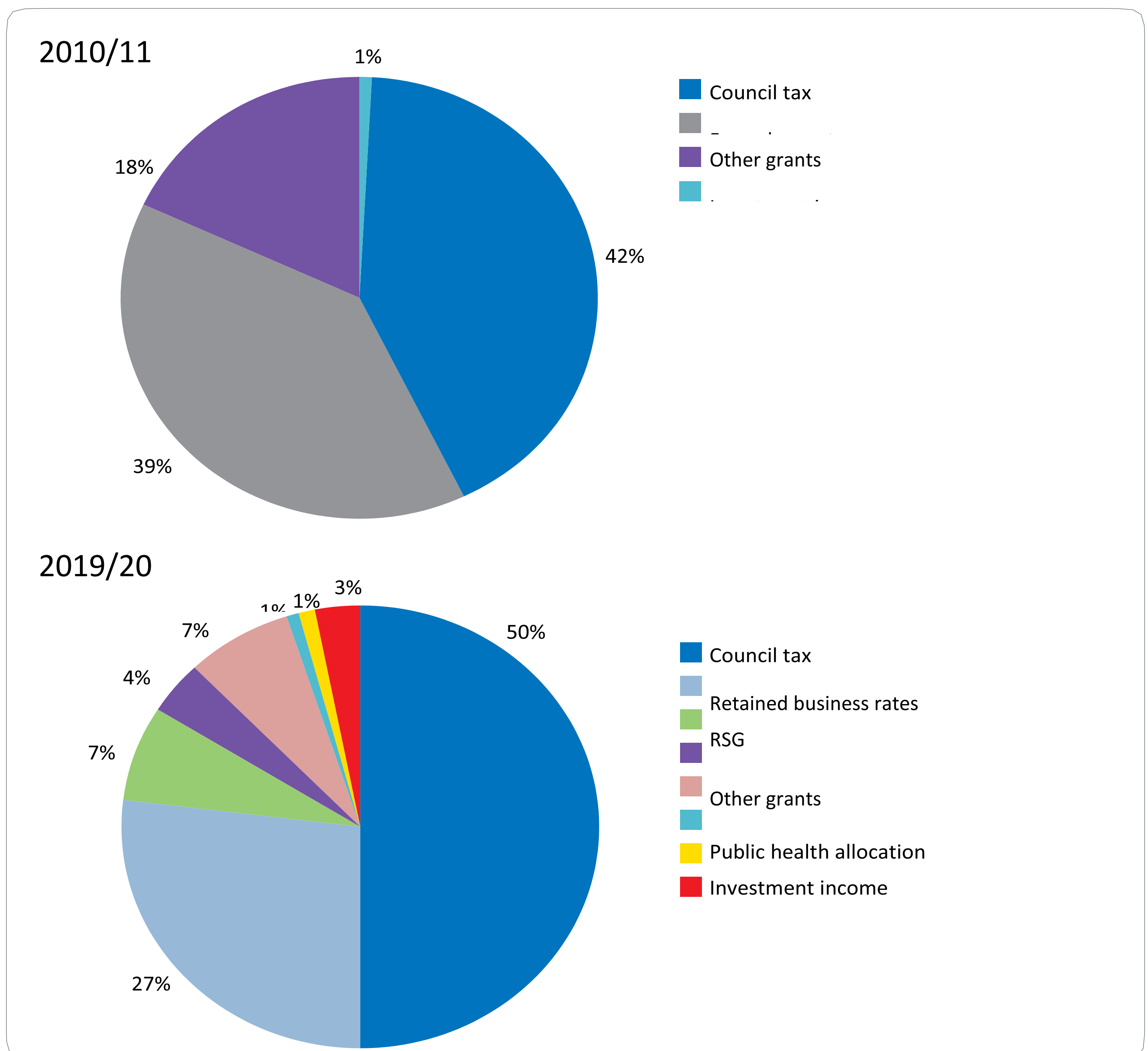
Ministerial Departments	**Budget**	**Actual**	**Vacancies**	
Chief Minister's Department -	242.1	203.0	39.1	16.1%
Non Min SFB-Overseas Aid	*1.5*	*1.0*	*0.5*	*35.1%*

[75] Draft Annex to the Medium Term Financial Plan Addition – 2017-2019 - Page 117
[76] CIPFA – MTFP – September 2015 Page 13
[77] MTFP Addition June 2016 – Managing Manpower – Page 137

Comm and Const Affairs (CCA)	700.1	643.6	56.5	8.1%
Department of the Environment	114.9	103.2	11.7	10.2%
Department for Infrastructure	551.9	437.2	114.6	20.8%
Economic Development	124.4	110.7	13.7	11.0%
Education, Sport & Culture	1,719.5	1,537.7	181.8	10.6%
Health & Social Services	2,748.0	2,342.1	405.9	14.8%
Social Security	253.0	230.4	22.6	8.9%
Treasury and Resources	205.9	186.3	19.6	9.5%
Non Ministerial States Funded	**235.7**	**213.3**	**22.4**	**9.5%**
Bailiff's Chambers	*10.0*	*10.0*	*0.0*	*0.0%*
Law Officers' Department	*72.0*	*66.1*	*5.9*	*8.2%*
Judicial Greffe	*46.9*	*40.6*	*6.3*	*13.5%*
Viscount's Department	*21.9*	*21.8*	*0.1*	*0.3%*
Official Analyst	*9.4*	*6.2*	*3.2*	*34.0%*
Estab. of H.E. Lt. Governor	*13.7*	*13.1*	*0.6*	*4.3%*
Data Protection	*1.0*	*1.0*	*0.0*	*0.0%*
Probation Service	*32.3*	*29.9*	*2.3*	*7.2%*
Comptroller & Auditor General	*1.0*	*0.6*	*0.4*	*40.5%*
States Assembly	*27.5*	*23.9*	*3.6*	*13.0%*
Sub Total (1)	**6,897.0**	**6,008.6**	**888.4**	**12.9%**

States Trading Operations	**Budget**	**Actual**	**Vacancies**	
Jersey Car Parks	24.0	19.0	5.0	20.8%
Jersey Fleet Management	29.0	25.0	4.0	13.8%
Sub Total (2)	**53.0**	**44.0**	**9.0**	**17.0%**
Grand Total	**6,950.0**	**6,052.6**	**897.4**	**12.9%**

4.10 On a comparative basis on Sub Totals (1) at September 2015 the vacancy level was 10.9% and 10.2% at June 2014 (see below). Given these high level of funded vacancies over a period of time it is highly possible that the budget process does not fully equate resourcing with need and produce an element of distortion if salary budgets are not reduced by a vacancy turnover provision that is appropriate – typically this across UK public bodies is between 3% - 5%. Indeed, the 2010 Comprehensive Spending Review (CSR) for UK Central Government to 2014/15 prescribed a freeze on vacancy recruitment. This allowed for departmental budgets to be fully stripped of any vacancies. Funding for Local Government in England has been moving towards self-funding through locally based income – the main change being the retention of business rates and significant reduction on DCLG[78] formula grant[79]:



[78] Department for Communities and Local Government

[79] Local Government Association – Future Funding for Councils – from 2010/11 to 2019/20

4.11 Such an impact on funding Councils has led to a significant recalibration in the setting of staff budgets. This has included resetting staffing structures and budgets to reflect only those employee commitments in post. Within budget setting it is not uncommon for a further % reduction in base budgets to reflect a requirement for services to generate in-year efficiencies. This appears to resemble a % reduction for turnover (typically the 3% - 5% highlighted in paragraph 4.10 above), however this budget reduction on staffing budgets is usually applied to an already revised structure reflecting only posts essential for service delivery in the context of statutory commitments – such is the level of funding retrenchment. In context, the funding of the level of vacancies within the States, within budget setting, is not what we would expect to encounter within the UK. Since 2010 significant application of controls on vacancies and restructuring has produced a significant contraction within the UK Public Sector. Between 2010 and 2015 the UK Public Sector has shed some 15.1% in employee numbers[80]:

Year	Employees 000s
2010	6,317
2011	6,101
2012	5,767
2013	5,701
2014	5,420
2015	5,361

4.12 We have been provided with no evidence to suggest that departmental payroll budgets have been trimmed for such a sustained vacancy levels achieved between 2014 and 2016 to date. The MTFP II Addition makes reference to the use of a 6% rate but it is unclear how, if at all, this vacancy level is applied to staffing base budgets as a reduction:

"Our emphasis is on voluntary programmes, using the 6% staff turnover rate to manage vacancies and reducing headcount naturally as staff leave."[81]

Staffing FTEs - September 2015[82]

FTE Analysis						
Department	**Actual Quarter 3**	**Established Quarter 3**	**Var**	**Actual Average**	**Established Average**	**Var**
	FTE	**FTE**	**FTE**	**FTE**	**FTE**	**FTE**
G05 - Chief Minister's Department	236.6	269.5	32.9	249.0	272.6	23.7
G35 - Department of the Environment	107.4	117.5	10.1	108.8	118.2	9.4
G10 - Economic Development	34.4	40.7	6.3	44.0	50.8	6.7
G15 - Education, Sport & Culture	1,652.0	1,787.9	135.9	1,619.8	1,703.6	83.8
G20 - Health & Social Services	2,397.5	2,731.0	333.5	2,428.1	2,889.7	461.6
G25 - Home Affairs	655.6	697.8	42.2	659.1	691.4	32.2

[80] ONS – Public Sector Staff Survey – 2010 - 2015
[81] MTFP Addition Executive Summary – Page 18
[82] Q3 Quarterly Corporate Revenue report – September 2015 – Treasury and Resources Page 28

G30 - Housing	0.0	0.0	0.0	0.0	0.0	0.0
G45 - Transport and Technical Servic	440.9	518.9	78.0	457.4	525.7	68.2
G50 - Treasury and Resources	235.9	271.4	35.5	241.4	274.4	33.0
G61 - Non Min SFB-Overseas Aid	1.5	1.8	0.3	1.5	1.8	0.3
G60 - Non Ministerial States Funded	189.0	206.0	17.0	186.3	204.8	18.6
G40 - Social Security	237.0	260.5	23.5	232.8	251.5	18.7
G55 - States Assembly	23.4	31.5	8.1	25.8	33.2	7.5
Total	6,211.2	6,934.5	723.3	6,254.0	7,017.8	763.8

Trading Operations (Harbours and Airport FTE excluded - figures held on remote database)

T46 - Jersey Car Parks	17.0	24.0	7.0	17.8	24.0	6.3
T47 - Jersey Fleet Management	26.0	29.0	3.0	25.5	29.0	3.5
Total	43.0	53.0	10.0	43.3	53.0	9.8

Staffing FTEs - June 2014[83]

FTE Analysis						
Department	**Actual Quarter 2**	**Established Quarter 2**	**Var**	**Actual Average**	**Established Average**	**Var**
	FTE	**FTE**	**FTE**	**FTE**	**FTE**	**FTE**
G05 - Chief Minister's Department	247.3	264.8	17.5	234.3	253.4	19.1
G10 - Economic Development	57.4	60.3	2.9	57.8	61.0	3.3
G15 - Education, Sport & Culture	1,594.8	1,672.5	77.7	1,591.1	1,665.2	74.1
G20 - Health & Social Services	2,410.1	2,903.5	493.4	2,395.3	2,829.1	433.8
G25 - Home Affairs	665.0	687.9	22.8	658.3	690.4	32.1
G30 - Housing	50.8	50.8	0.0	46.7	53.1	6.3
G35 - Department of the Environment	107.9	118.5	10.6	107.9	116.8	8.8
G40 - Social Security	226.5	242.5	16.0	220.7	239.5	18.8
G45 - Transport and Technical Servic	481.8	532.9	51.1	478.3	533.6	55.3
G50 - Treasury and Resources	249.1	279.2	30.1	247.6	279.7	32.1
G55 - States Assembly	28.5	33.8	5.4	28.0	33.8	5.8
G60 - Non Ministerial States Funded	185.6	203.9	18.3	185.6	203.2	17.6
G61 - Non Min SFB-Overseas Aid	1.5	1.8	0.3	1.5	1.8	0.3
Total	6,306.3	7,052.4	746.1	6,253.2	6,960.6	707.4

Trading Operations (Harbours and Airport FTE excluded - figures held on remote database)

T46 - Jersey Car Parks	20.0	24.0	4.0	20.0	24.0	4.0
T47 - Jersey Fleet Management	26.0	29.0	3.0	26.0	29.0	3.0
Total	46.0	53.0	7.0	46.0	53.0	7.0

4.13 Reference is made to rationalisation:

> *"The reduction in staffing forms part of all Departments' commitment to driving efficiencies through service rationalisation and achieving greater value for money through a combination of outsourcing and service re-design."* [84]

[83] Q2 Quarterly Corporate Revenue report – June 2014 – Treasury and Resources Page 32

[84] MTFP Addition June 2016 – Managing Manpower – MTFP Addition Savings for 2017-2019 Page 136

4.14 However it is clear that the States are still only at a relatively early stage in delivering reform in service provision that would generate the level of efficiency savings that will be needed. This opinion is reinforced by the extended narrative following on from the above:

*"Some of the Departments are in the process of staff consultation and tendering for provision of services. It is still not clear which services will be outsourced, which will be retained "in-house" and which may be retained, albeit in a streamlined format. The savings detailed in the summary of financial information are in the form of net targets only. It is not currently possible to identify the exact totals for FTEs reductions, although it is expected that the totals will be under those shown as a maximum in **Figure 53**, which depend on the outcomes of the reviews for the services mention above."*[85]

The overall expected movement through to 2019 by Department is illustrated below :

States Funded Bodies	Approved 2016 FTE from MTFP	Service Transfer and Other Changes	Indicative Growth	Indicative Savings (up to)	Revised 2017 - 2019 FTE for MTFP Addition (up to)	Establishment FTE (up to)	Contingency FTE
		2017 - 2019	2017 - 2019	2017 - 2019			
Ministerial Departments							
Chief Minister	235.3	11.5	-	(20.5)	226.3	226.3	
- Jersey Overseas Aid Commission	1.5	-	-	-	1.5	1.5	
External Relations	7.0	-	-	-	7.0	7.0	
Community and Constitutional Affairs	699.0	0.5	-	(33.5)	666.0	651.1	14.9
Economic Development,Tourism, Sport and Culture	137.7	(12.4)	-	(7.0)	118.3	118.3	
Education	1,719.4	-	31.2	(26.6)	1,724.0	1,724.0	
Department of the Environment	114.9	14.0	-	(8.0)	120.9	115.9	5.0
Health and Social Services	2,748.0	(11.5)	59.5	(12.0)	2,784.0	2,756.0	28.0
Department of Infrastructure[1]	551.9	(3.0)	-	up to (103.5)	up to 544.9	544.9	
Social Security	253.0	-	-	(15.0)	238.0	238.0	
Treasury and Resources	200.9	1.0	-	(21.0)	180.9	180.9	
Non Ministerial States Funded Bodies							
Bailiff's Chambers	10.0	-	-	-	10.0	10.0	
Law Officers' Department	72.0	-	-	-	72.0	72.0	
Judicial Greffe	45.2	0.5	-	-	45.7	45.7	
Viscount's Department	21.9	-	-	-	21.9	21.9	
Official Analyst	9.4	-	-	(0.8)	8.6	8.6	
Office of Lieutenant Governor	13.7	-	-	-	13.7	13.7	
Office of the Dean of Jersey	-	-	-	-	-	-	
Office of the Data Protection Commissioner	-	-	-	-	-	-	
Probation Department	32.3	-	-	-	32.3	32.3	
Comptroller and Auditor General	1.5	-	-	-	1.5	1.5	
States Assembly and its Services	27.0	-	-	(0.5)	26.5	26.5	
States Trading Operations							
Jersey Car Parking	24.0	-	-	-	24.0	24.0	
Jersey Fleet Management	29.0	-	-	-	29.0	29.0	
Total[2]	6,954.6	0.6	90.7	up to (248.4)	up to 6,897.0	up to 6,849.1	47.9

[85] *MTFP Addition June 2016 – Managing Manpower – MTFP Addition Savings for 2017-2019 Page 137*

4.15 Given the overall lack of precision on the movement in staff numbers and limited progress in generating service change/re-engineering it is still unclear how the largest component of efficiency savings will be generated. If the current level of vacancies are sustained at current levels there is the potential for 'savings' to be generated without significant additional effort assuming the current level of service outcomes are considered to be acceptable. Chief Officers appear to have the unrestricted ability to move resources between budget headings – an example of this was highlighted within our evidence on the work of the Financial Services unit.

4.16 Section 11 outlines expectation and progress on Public Sector Reform:

The programme focuses on four main elements, delivered through multiple projects and programmes:

- *Service redesign*
- *eGovernment*
- *workforce modernisation*
- *workplace modernisation*

4.17 In respect of Phase 1 of the Reform agenda it is reported that:

During 2015 departments reduced their spending by £12 million. By the end of 2016 this is expected to reach £33.6 million and £5 million on benefit changes.

These savings were made through:

- *the voluntary release programme*
- *stringent vacancy management*
- *service redesign*
- *Lean*

4.18 Apart from the approval of some 162 staff for voluntary release, "which has produced annual savings of £5.5 million per year"[86], the actual extent of the level of budgetary savings from staffing changes remains unclear. Given the overall lack of movement in staff numbers and the lack of precision on service redesign it is still very much unclear how the largest component of efficiency savings will be generated other than maintaining the capacity to continue with the non-filling of vacancies within a funded yet hypothetical structure.

4.19 We have previously made repeated comments on the weaknesses of using predominately incremental budget setting techniques and the ability of departments

[86] MTFP Addition - Executive Summary Page 18

to offer up savings without any apparent direct management intervention to counter a loss in resource or service delivery. The lack of overall FTE movement, the current exceptionally high level of vacancies (12.9%) and the rounded nature of efficiency saving initiatives suggests that there is still an element of unrequired budgetary provision (save HSS – Health)being incorporated within base budget positions which may be incrementally rolled forward between years. In this context budgets are not predominately outcomes based and there appears to be little motivation for Chief Officers to fill budgeted posts in the face of the level of efficiency savings now required.

4.20 We would suggest that the budget setting process (with an element of zero basing) would be substantially strengthened with an outcomes based approach rather than the traditional development of defined resource inputs. Outcomes based budgeting would require budgets to be built around all known costs and income directly attributed to core organisational objectives (outcomes) rather than formatted around traditional models of service subjective and objective analysis. Options around changes would be framed against comparative analysis on the net cost of each outcome and changes organised into 'decision packages'. In many ways this can be more radical than zero based budgeting as focus it firmly fixed on defining acceptable outcomes then working out how much resources need to achieve such outcome delivery.

Income Tax Forecasting

4.21 The MTFP II Addition [87] provides some limited background to the way States Income Forecasts are constructed including the level of scrutiny in formulation by the Income Forecasting Group (IFG) including the apparent endorsement of the economic indicators or metrics used to guide growth factors. That said, we have yet to receive evidence that shows a step by step formulation of the Personal and Corporate Income Tax estimates across the MTFP II Addition. Essentially we would expect a model that shows exactly how the estimates are put together including the extent and calculation associated with the core economic assumptions.

4.22 What we do know is that overall Income forecasts are formulated within a range and the MTFP II Addition recognises that there is material uncertainty on potential future income. This uncertainty is highlighted within the following MTFP II Addition reference yet the income forecasts, following a central scenario trajectory, fail to fully reflect the commensurate level of risk that is outlined within the MTFP II Addition itself. This approach appears to be inconsistent with the actual approach taken in formulating the estimates although as we cannot see the step calculation itself, such factors may well be considered. These risks are highlighted as :

"The uncertainty in the forecasts reflects a general uncertainty in the outlook but certain factors which are emphasised by the IFG relating to:
- *income tax from shareholder income,*

[87] MTFP Addition 2016 – Financial Forecasts 2016-2019 P45

• the combined impact of future changes in fiscal policy such as public sector reform and future capital expenditure,
• the impact of the UK banking reforms,
• the impact on business decisions of the UK referendum on its future relationship with the EU and the uncertainties surrounding Brexit issues.
• the impact of international-tax developments and the international response to the "Panama Papers".
• prospects for the global economy highlighted by the FPP and the IMF for a loss of momentum in advanced economies, transition in China and risks to emerging economies.

For this reason it is important that the States must continue to include appropriate flexibility in the proposals for the MTFP Addition to recognise the potential range of outcomes and the risks for States income forecasts around the downside of the central scenario.[88]

4.23 On Personal Income Tax there has been a number of adjustments [89] which refine the 2016 budget position as follows:

	Outturn	Forecast				
	2015	2016	2017	2018	2019	2020
	£m	£m	£m	£m	£m	£m
Budget 2016 forecast	**358**	**368**	**389**	**411**	**428**	
New data[1]	+3	+4	+5	+5	+5	
New assumptions[2]		-1	-4	-4	-5	
Faster growth for pension income		+1	+2	+3	+4	
Faster growth in yield		+1	+1	+2	+6	
Reverse previouse IFG below-the-line adjustments[3]		+2	+2	+2	+2	
Tax collectable	**361**	**375**	**395**	**420**	**441**	**465**
			Some columns may not sum due to rounding			
<u>*Notes:*</u>						
[1]This includes higher outturn data for YOA14 and improved IT IS data for YOA15.						
[2]This includes the new FPP economic assumptions and new estimates of the relationship between economic variable and the outturn for employment and investment income respectively.						
[3]MTFP forecast and Budget 2016 forecast both included below-the-line adjustments of personal tax, which will now be in the base for YOA14.						

4.24 This is markedly different from the position illustrated within the MTFP II submission in June 2015 below:

[88] MTFP Addition – Financial Forecasts Page 45
[89] MTFP Addition – Appendix 4

	Actual	Forecast					
	2013	2014	2015	2016	2017	2018	2019
	£m	£m	£m	£m	£m	£m	£m
Personal tax							
Budget 2015 forecast	**357**	**364**	**373**	**386**	**404**	**425**	**452**
2014 outturn		-8	-8	-8	-8	-8	-8
2015 Budget measures				2	2	2	2
2015 in-year estimate of employment income			-4	-4	-4	-4	-4
Updated economic assumptions			0	0	3	4	-5
Current provisional forecast	**357**	**356**	**361**	**376**	**397**	**419**	**437**
Company tax							
Budget 2015 forecast	**98**	**84**	**85**	**91**	**97**	**103**	**109**
2014 outturn		-1	-1	-1	-1	-1	-1
2015 in-year estimate of top 100 taxpayers			2	2	2	2	2
Updated economic assumptions			0	-3	-5	-7	-10
Current provisional forecast	**98**	**83**	**86**	**89**	**93**	**97**	**100**

4.25 The level of refinement is attributed to a range of factors including the change in accounting treatment on Personal Income Tax to reflect Current Year Basis (CYB). Looking at overall changes there is a marked difference between the restated MTFP Addition position on Income Tax compared to the MTFP II submission in June 2015. The differential between forecasts on Personal Income Tax, made only a year apart, grows from some £9m in 2016 (£467m - £458m) to £19m(£538m - £519m) in 2019:-

June 2015

June 2015	Forecast				
	2015	2016	2017	2018	2019
	£m	£m	£m	£m	£m
Personal	359	375	395	417	434
Companies	82	85	82	85	88
Bad debts	-3	-2	-2	-3	-3
Total	**438**	**458**	**475**	**499**	**519**
Annual growth	1	19	17	24	21
Annual growth, %	0%	4%	4%	5%	4%

May 2016

Income Tax	Outturn	Forecast (Jun 2016)	Forecast MTFP Addition (June 2016)			Forecast (Jun 2016)
	2015	2016	2017	2018	2019	2020
	£'000	£'000	£'000	£'000	£'000	£'000
Previous (September 2015) forecast						
Personal tax	358	368	389	411	428	
Corporate tax	86	89	88	91	94	
Bad debts	-1	-2	-2	-3	-3	
Tax collectable (IFG Forecast)	***443***	***455***	***475***	***499***	***519***	
Estimated impact of Budget measures			+4	+5	+6	
Revised Forecast Budget 2016	***443***	**455**	**479**	**504**	**525**	
Updated (May 2016) forecast						
Personal tax	364	375	395	420	441	*465*
Corporate tax	89	87	87	90	93	*96*
Bad debts	-3	-2	-2	-3	-3	-3
Tax collectable	***451***	***460***	***480***	***507***	***531***	**558**
CYB Proposed adjustment	+7	+7	+7	+7	+7	+7
IFG MTFP Addition Forecast	***458***	**467**	**487**	**514**	**538**	**565**
Difference since Budget 2016	+15	+12	+8	+10	+13	

4.26 As at 30 June 2016 we were advised that Income Tax was some £17m down on profiled estimate for the year. Adjustments are attributed to the following factors:

- *Improvements in personal income tax:*
  - ✓ *Improved 2015 outturn and 2014 year of assessment*
  - ✓ *Improvements indicated in 2015 IT IS data*
  - ✓ *Faster growth in pension income*
  - ✓ *Improvements in personal tax yield assumptions from 2014 YOA and 2016 budget measures*
  - ✓ *Partly offset by the impact of reduced economic assumptions*

- *A small net reduction to corporate income tax forecasts:*
  - ✓ *Improvements in 2014 YOA and 2015 outturn*
  - ✓ *Improvements more than offset by indications from 2015 YOA provisional assessments for the Top 88 company tax payers showing a 4% reduction in tax collectable – extrapolating this variation across all company tax results in a net reduction in forecasts from 2016.*
  - ✓ *Previous adjustments reflecting knowledge of significant anticipated changes for corporate taxpayers have been re-assessed and are maintained.*

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

Section 7. Impact on the States of Jersey Financial Report and Accounts

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

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

4.29 On the central economic assumptions used within Income Tax estimate formulation, we are pleased to note that some recognition of current economic trends has been considered (see our previous comments on slightly over ambitious base metrics and the inherent risk associated in adopting UK measures/forecasts). We understand that the MTFP II Addition indicates that the Fiscal Policy Panel (FPP) have endorsed the latest metrics (pre Brexit) and the IFG have used them within their projections. An extract against the metrics used within the MTFP II June 2016 submission is highlighted below along with the 2015 comparative position used within the original submission:

FPP central scenario March 2016

	2014	2015	2016	2017	Return to trend 2018	2019	2020
Real GVA	4.9	2.3	1.4	1.4	0.0	0.0	0.0
RPI	1.6	0.6	1.8	2.6	3.3	3.3	3.3
RPIY	1.6	0.6	1.8	2.4	3.0	3.0	3.0
Nominal GVA	6.6	2.9	3.2	3.8	3.0	3.0	3.0
Company profits	10.5	2.5	3.1	3.4	3.0	3.0	3.0
Financial services profits	19.4	2.1	3.1	3.3	3.0	3.0	3.0
Compensation of employees(a)	4.9	3.3	3.3	4.1	3.0	3.0	3.0
Employment	2.3	1.5	0.5	0.5	0.0	0.0	0.0
Average earnings	2.6	1.8	2.8	3.6	3.0	3.0	3.0
Interest rates (%)	0.5	0.5	0.5	0.7	0.9	1.5	1.5
House prices	3.0	4.2	4.0	5.0	3.0	3.0	3.0

Central scenario - updated 14 April 2015

	Forecast 2014 %	2015 %	2016 %	2017 %	Return to trend 2018 %	2019 %
Real GVA	1.6	1.2	1.1	1.4	0.0	0.0
RPI	1.6	1.6	3.1	3.1	3.3	3.3
RPIY	1.6	1.8	2.6	2.6	3.0	3.0
Nominal GVA	3.2	3.0	3.7	4.0	3.0	3.0
Company profits(a)	2.5	2.4	3.3	3.7	3.0	3.0
Financial services profits	1.8	1.1	3.1	3.3	3.0	3.0
Compensation of employees(b)	3.7	3.5	4.0	4.3	3.0	3.0
Employment	1.0	1.0	0.5	0.5	0.0	0.0
Average earnings	2.6	2.5	3.0	4.0	3.0	3.0
Interest rates (%)	0.5	0.5	1.1	1.6	2.0	2.5
House prices	3.3	3.0	4.0	5.0	3.0	3.0

4.30 The Organisation for Economic Co-operation and Development (OECD) projected UK growth of some 1.75% for 2016 (prior to the BREXIT referendum). Post BREXIT referendum, some commentators are agreeing on UK GDP being reduced to 1.25% with only 0.2% being achieved in 2017.[90] Interest rates are likely to be even lower in the short to medium term (on 4 August 2016 the Bank of England cut the Bank Base Rate to 0.25%) and there may be the potential for additional inflationary pressures.

4.31 In context, the potential to achieve the Fiscal Policy panel (FPP) endorsed expected growth in earnings for Jersey of 2.8 in 2016, 3.6% in 2017, and 3% in both 2018 and 2019 now looks extremely optimistic. If this is a component of Income Tax estimate calculation set by the IFG (we are still to see the 'building blocks or formula for Personal or Corporate Income Tax estimates), we would be of the view that a lower

[90] City economists slash UK growth forecasts - Goldman Sachs - FT 27 June 2016

range scenario trajectory rather than a central range scenario be used as the expected level of growth within the Tax Estimates is unlikely to be achieved - if indeed the Tax estimates are founded upon such optimistic rates of growth. The following table highlights the year on year % change on the Income Forecasting Groups tax estimates:

Year	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m
IFG MTFP Addition Forecast	467	487	514	538	565
Change		20	27	24	27
% Change		**4.2%**	**5.5%**	**4.7%**	**5.0%**

4.32 Even without additional uncertainty arising from Brexit we would be of the considered view that these year on year changes could not be considered to be reasonable central scenario positions. Such forecasts carry an unacceptably high level of risk of non-achievement and require to be recalibrated downward to a more appropriate trajectory of income increases. As there was already a £17m adverse variance in the year to 30 June 2016 it is clear that forecasts will need to be adjusted to reflect the latest intelligence on the factors that are influencing movements against budget.

4.33 The Fiscal Policy Panel (FPP), within its Annual Report 2016, has published revised downwards the relevant core central economic assumptions:

Central [91] economic assumptions

% change year on year unless otherwise stated, bordered numbers indicate outturns.

Note: Changes in profits, earnings, employment costs and house prices are in nominal terms

Sources: Economics Unit calculations and Panel judgement

	2014	2015	2016	2017	2018	2019	2020
Real GVA	4.9	0.9	0.4	0.0	0.0	0.0	0.0
RPI	1.6	0.6	2.2	3.3	3.0	3.3	3.3
RPIY	1.6	0.6	2.3	3.4	3.0	3.0	3.0
Nominal GVA	6.6	1.5	2.7	3.4	3.0	3.0	3.0
Company profits	12.3	-2.7	2.8	2.9	3.0	3.0	3.0
Financial services profits	19.4	-7.5	2.6	2.8	3.0	3.0	3.0
Compensation of employees	2.1	5.3	2.6	3.8	3.0	3.0	3.0
Employment	2.3	1.9	0.5	0.0	0.0	0.0	0.0
Average earnings	2.6	1.8	2.1	3.8	3.0	3.0	3.0
Interest rates (%)	0.5	0.5	0.4	0.1	0.1	0.2	0.4
House prices	3.0	4.0	4.0	3.0	3.0	3.0	3.0

4.34 On economic growth relative to Brexit the FPP also indicate that:

"The Panel's July 2016 Update Report set out three possible scenarios for the impact of the UK decision – a cyclical downturn in output, a structural loss in potential/trend output or a combination of the two. At this stage it is not yet clear which of these will most accurately represent the outcome for Jersey's economy.

Figure 1.21 sets out one potential outcome, that the UK decision results in a loss of potential output over the next three years; such that the economy returns to balance by 2019, but at lower level of output than previously anticipated.

[91] Fiscal Policy Panel – Annual Report 2016 – Page 25

Impact on trend GVA

GVA levels (solid line) and updated assumptions (dashed lines).

Updated estimate of trend GVA (dark red dashed line) and September 2015 estimate (pale red dashed line)

£m, constant 2013 prices

Sources: States of Jersey Statistics Unit and FPP calculations

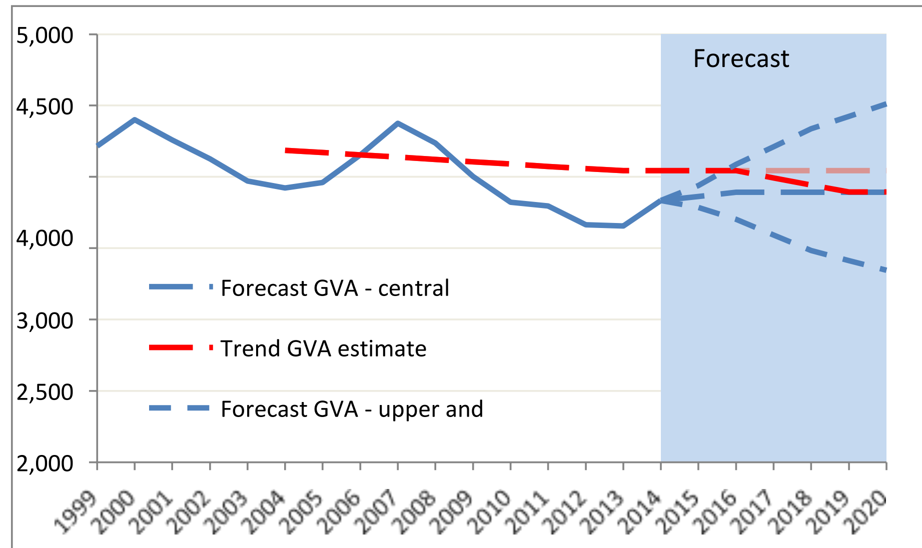


Figure 1.21 assumes that the impact is largely structural. However, there may also be some cyclical impact – the timing of which is not yet clear. This might see the economy dip further in 2017 or 2018 due to the uncertainty during negotiations; before seeing some cyclical recovery – possibly in 2019 or 2020. However, there is the potential that the cyclical recovery could be delayed until after 2020; in which case some spare capacity would remain beyond the forecast period."[92]

4.35 We understand that the Income Forecasting Group (IFG) is intending to revise income forecasts as a result of the advice contained within the FPP Annual Report. However, we are also led to believe that any resultant changes in income forecasts/estimates to 2019 will not be incorporated within MTFP II. Failure to incorporate any latest material changes may seriously impair the utility of the MTFP II.

Other Income changes

4.36 Changes to the central economic forecasts will also impact the estimate calculation for components of other income. It is interesting to note whilst expected growth has be incorporated within Income Tax estimates increases the impact on Goods and Services Tax appears to be more neutral. The MTFP II Addition recognises a slight reduction in Impot Duty income to recognise that the "overall variation is a reduction of approximately £2 million per annum and is mainly influenced by the reductions in alcohol and tobacco goods 2015 outturn."[93]

4.37 Notwithstanding expected fluctuations in GST, Impots and Stamp Duty, there has been more volatility on budget lines related to Dividends and Non-Dividend Income:

[92] Fiscal Policy Panel Annual Report August 2016 – page 27

[93] MTFP Addition - Appendix 7 – IFG : Impôts Duty Forecast 2016-2020 Page 173

Other Income	Outturn 2015 £'000	Forecast 2016 £'000	Forecast MTFP Addition 2017 £'000	2018 £'000	2019 £'000	Forecast 2020 £'000
Island Wide Rate	*11,928*	*12,142*	*12,458*	*12,832*	*13,217*	*13,613*
Other Income - Dividends	*14,023*	*11,461*	*8,703*	*14,517*	*9,744*	*10,117*
Other Income - Non Dividends	*12,506*	*9,710*	*10,151*	*9,697*	*10,285*	*11,327*
Other Income - Returns from Andium and Housing trusts	*27,483*	*27,805*	*28,371*	*29,173*	*30,158*	*31,186*
Total Other Income	***65,940***	**61,118**	**59,682**	**66,220**	**63,403**	**66,244**
Budget 2016 Forecast	*63,643*	*61,294*	*60,823*	*69,653*	*65,645*	-
Variation	*2,297*	(176)	(1,141)	(3,433)	(2,242)	66,244

4.38 Whilst there is a downward movement from the 2015 MTFP II submission (see table below) we would have expected more of a change to the Non Dividend forecasts relative to the current market instability as part of this income line is derived from investment returns from the Consolidated Fund and Currency Fund. Both of these funds benefit from the pooled investments in the Common Investment Fund (CIF). It is also noted that the dividend figures rely upon special dividends from both Jersey Telecom and Jersey Post which are forced notwithstanding tougher trading condition and consequential lower 'trading' dividends.

Other Income	2014 £'000	Forecast 2015 £'000	2016 £'000	2017 £'000	2018 £'000	2019 £'000
Island Wide Rate	*11,896*	12,079	12,381	12,715	13,097	13,490
Other Income - Dividends	*8,284*	13,761	10,968	8,354	14,515	9,276
Other Income - Non Dividends	*18,234*	12,255	11,687	11,335	10,546	10,277
Other Income - Returns from Andium and Housing trusts	*13,581*	27,547	28,021	28,769	29,672	30,680
Total Other Income	***51,995***	**65,642**	**63,057**	**61,173**	**67,830**	**63,723**
Budget 2015 Forecast	*50,798*	67,394	68,433	75,208	78,834	81,820
Variation	*1,197*	(1,752)	(5,376)	(14,035)	(11,004)	(18,097)

4.39 Overall other income estimate differentials between 2016 and corresponding 2015 positions are marked – particularly on Dividend income.

Health Charge and User Pays Charges

4.40 Whilst the proposed charge has been reduced from an original £15m in 2018 and £35m in 2019 as a result of "*better than expected financial position in 2015 and improved income forecasts for 2016-2019, we are proposing to introduce an income-based charge which would raise £7.5 million by 2018, increasing to £15 million in 2019*"… the MTFP II Addition clarifies that the method of collection will be based on income with the detail being produced/released within the 2017 Budget. However page 98 of the Addition outlines (under Proposals for Fiscal Measures and Funding Mechanisms) the following structure of application and assessment;

"The proposed structure of the health charge is outlined below:

- *Levied by the Treasury and administered/collected by the Taxes Office.*

- *Based on personal income tax principles: income for the purposes of the health charge will be determined by the individual's income for personal income tax purposes – it will therefore include investment income together with employment income/benefits in kind; prima facie it will also apply to all individuals regardless of age.*

- *Individuals will be entitled to the same exemptions, allowances and reliefs as are available in the personal income tax system – so consistent with the LTC contribution, if an individual does not pay personal income tax, because their income is less than the exemptions, allowances and reliefs to which they are entitled, they will not pay anything under the health charge. It is estimated that approximately 30% of the population with the lowest incomes do not pay personal income tax and hence will not pay anything under the health charge.*

- *The income assessable under the health charge will be subject to an upper cap in the same way as income is capped for the LTC contribution. In the context of married couples/civil partnerships who are jointly assessed for income tax purposes, this cap will be applied to each spouse's/partner's income separately.*

- *Where an individual has their income tax collected by way of ITIS, the health charge will also be collected by way of ITIS on a current year basis. Individuals who do not pay their income tax by way of ITIS will have the health charge collected through the payment on account mechanism.*

- *In order to raise the additional revenue required, the rate of the health charge will be set at 0.5% in 2018 and 1% in 2019 for standard rate taxpayers. For marginal rate taxpayers the effective rate of tax will be less than 0.5% in 2018 and less than 1% in 2019. Approximately 85% of taxpayers are marginal rate taxpayers and hence will pay the health charge at effective rates lower than 0.5% and 1%, in many cases, much lower."*

4.41 Given that there is no discernible linkage between usage and liability, the term 'Charge' is inaccurate as it is in effect a Tax (perhaps no different from the Long Term Care Contribution). Essentially it appears to be a hypothecated tax yet the Health Account does not directly benefit from the resultant income appearing within the revenue account for Health. We are advised that the 'charge' is routed through the Consolidated Fund with the Health Account getting the additionality through growth.

4.42 Principle 1 of Jersey's Long Term Tax Policy is "Taxation must be necessary, justifiable and sustainable."[94] Given the significance of the level of reduction from the £35m figure quoted within the original 2015 submission, due to a better than expected financial position there is the obvious potential for this levy (tax) to be variable. The rationale behind the setting of the level of Health Charge and the application as a tax on income is difficult to fully understand other than to provide some phased additional income. It is difficult not to conclude that if further efficiencies were generated throughout the States re the reform agenda, the requirement to 'plug' the

[94] MTFP Addition - P 98 long term tax policy principles agreed by the States Assembly in the 2015-2018 Strategic Plan,

Health Budget with a tax which may be disproportionately problematic may be avoidable.

4.43 The 2% investment in service standards and healthcare inflation is the largest single component of the central growth allocation for 2018 and 2019:

Dept	Proposals to be held in Central Growth Provision	2017 Proposed £'000	2018 Proposed £'000	2019 Proposed £'000
HSS	2% Investment in Service Standards and Healthcare Inflation		4,714	5,253
	P82/2012 - Health Transformation (White Paper)			
HSS	Acute Service Strategy		**2,705**	**703**
HSS	Healthy Lifestyles		**324**	**37**
HSS	Mental Health		**540**	**-60**
HSS	Out of Hospital		**768**	**1,561**
HSS	Services for Children (Early Interventions)		**615**	**378**
HSS	**Proposed Central Growth Allocation for Health**	-	**9,666**	**7,871**
Edu	Revenue consequences of capital schemes - New schools		360	40
Edu	**Proposed Central Growth Allocation for Education**	-	**360**	**40**
SA	States Members' Pensions (as amended)	-	58	42
SA	**Proposed Central Growth Allocation for States Assembly**	-	**58**	**42**
DFI	Tipping Fees Shortfall*	-	340	**456**
DFI	Revenue consequences of capital schemes - new Sewage Treatment Works	-	-	1,700
DFI	**Proposed Central Growth Allocation for Infrastructure**	-	**340**	**2,156**
Total	**Total Proposed Central Growth Allocation for 2018 and 2019**		**10,424**	**10,109**

4.44 It is noted that some of this growth meets recurring expenditure requirements. Stripping out the 2% annual uplift the level of the remaining HSS growth provisions, in context with overall service Revenue Expenditure, is not especially significant. Again in context it could be argued that this level of revenue growth is slightly inconsistent with the Ministerial message on this priority service.

4.45 On the detail behind the growth items (and perhaps in contrast with the appearance of some of the savings lines) there is no doubt that some robust work has been carried out to substantiate each item within Health as illustrated in the detail highlighted with Page 66 onwards within the MTFP II Addition. Whilst this investment appears to be fully expected by the service the final commitment is predicated upon the realisation of efficiency savings or indeed approval by the States on the funding mechanism on health – presumably the 'Health Charge'. Between 2018 and 2019 the additional £17.5m of growth is considered to be hugely important to the service.

4.46 Proposed Commercial Waste Charges are estimated to raise £3m in 2018 and £11m in 2019 but there is little detail on how these figures have been constructed although we are advised that there is reliable proxy indicators that can be used to determine output for this service. It is understood that there is a level of complexity in relation to

the assimilation of the proposed charge with the current arrangements in place covering the 12 parishes.

4.47 We understand that Chief Minister indicated within the latest hearing with the Corporate Services Scrutiny Panel that further work was on-going to assess the impact on businesses especially the Tourism Industry – Hotels etc. The MTFP II Addition provides a clear strategic narrative on the rationale for the charges and makes a compelling case for the charge. However, there is nothing on how the estimate and profile of recovery is calculated.

4.48 In a response to a question on the level of waste charges the Minister for Treasury and Resources (and in the context of the Fiscal Policy Panel recently downgrading their core economic assumptions[95]) – at a public hearing with the Corporate Services Scrutiny Panel the Minister indicated:

"It is an interesting point because, bearing in mind the advice of the Fiscal Policy Panel, the response to a slowdown in the economy may well be to defer, or could be to defer something like a health charge or a waste charge if one wanted to increase the level of stimulus into the economy. So that could be delayed. Equally, if the economy is recovering faster, the opposite could happen."[96]

4.49 The above comment suggests that, outwith a range of administrative challenges in securing implementation and capturing income to £11m by 2019, there is an acceptance that economic factors may well play a big part in a final decision to levy these charges.

Major Projects – Hospital and Office Modernisation Project

4.50 There are currently five Projects categorised as 'Major. These are outline within the table extract below.

Other Projects Excluded Above	2016	2017	2018	2019
Sewage Treatment Works – Upgrade				
Future Hospital				
Office Modernisation Project				
Les Quennevais School Rebuild	1,000	39,000	-	-
Prison Improvement Works - Phase 6	-	-	8,233	-
Total Other Projects	**1,000**	**39,000**	**8,233**	**-**
Total Proposed Capital Programme	**26,691**	**65,273**	**43,233**	**32,975**

4.51 The MTFP II June submission had already provided for the funding for the Sewage Treatment Works (funding has been approved for £75m although the latest revised specification comes in at approximately £58m) and provision for Les Quennevais

[95] Jersey's Fiscal Policy Panel – Annual Report August 2016

[96] Corporate Services Scrutiny Panel – Medium Term Financial Plan – 02.09.16 – page 45 – Minister of Treasury & Resources

School rebuild and Prison Improvement Works were already established. However the MTFP II Addition 2016 has introduced some detail behind related forecasted costs and timescales associated with the Future Hospital and Office Modernisation Projects.

4.52 In context with existing public investment within Jersey the overall cost exposure for the Hospital Project is likely to dwarf an aggregate of most other projects on Jersey. There is a "*project cost of the developing the concept*"[97] known as a provisional cost estimation. Figure 49 below outlines the various components associated with this project although crucially, there is no indication of any linked recurring revenue running costs:

Figure 49 – Indicative capital cost for future hospital provision

Cost element	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	Total £m
Main Works Cost	-	-	11.517	68.368	94.393	72.484	11.709		258.472
Fees	5.627	11.255	7.142	3.418	3.538	3.662	1.862		36.505
Non-works	0.205	8.755	1.263	0.058	0.913	1.102	4.265		16.560
Equipment	-	-	-	-	-	5.850	17.754		23.603
Contingency	-	-	4.016	23.838	32.912	25.273	4.083		90.121
Relocation works	0.789	21.810	12.495	-	-	-	0.685	4.592	40.371
Project total	**6.621**	**41.819**	**36.433**	**95.683**	**131.755**	**108.370**	**40.357**	**4.592**	**465.631**

4.53 In terms of funding we are advised that all options are being actively considered:

> *"With the advice of an external advisor, the Treasury have developed provisional funding considerations and options. This options analysis will progress to consider and propose a preferred solution which is likely to be blended solution of using existing Reserves and internal or external financing options. A Special Fund, specific to funding the new hospital, is likely to be proposed. The extent to which external funding, possibly in the form of a bond is used will determine the extent to which an income stream is required to service that debt, most likely in the form of additional taxation. Further work will be undertaken to prepare detailed proposals for potential funding of the future hospital, which would be submitted in conjunction with the decision set out for States Assembly consideration in 2017."*[98]

4.54 It has been said that Brexit may offer a sustained period of 'cheap' finance as interest rates appear to be maintained at low levels into the medium term. In terms of Bond Finance it is noted that Jersey's credit rating fell to AA - on Friday 8 July. Whilst there appears to be a level of confidence amongst Ministers surrounding Jersey's ability to

[97] Draft MTFP Addition –Page 129
[98] MTFP Addition 2016 – Update on Capital Programme P 129

raise Bond finance, the emerging level of uncertainty and economic turbulence may well be important factors around market expectations on investment returns. In any event, given the variability on investment returns on investments, Bond finance may well require to be met from recurring annual income. With a current trajectory of imbalance between overall States current income and expenditure it may be difficult to accommodate significant borrowing to wholly finance this project through this route and it is likely that the States will need to take a 'mixed' approach in sourcing finance for this project.

4.55 Indicative Office Modernisation Costs of some £48.8m are envisaged to 2021 - £35.5m to 2019. This is considered a key project within the Public Sector Reform Programme and :

> "*includes the delivery of the development of modern office facilities as a priority project within the Public Sector Reform programme. The implementation phase of the Office Modernisation Project (OMP) will reduce the number of office buildings and portfolio operating costs, deliver a fit for purpose and flexible portfolio which will support future reform, improve customer service, increase the utilisation of buildings and enable greater collaboration, productivity and reduced operating costs across departments*."[99]

4.56 These are outlined within Figure 50 within the MTFP II Addition submission in respect of indicative capital cost estimates for Office Modernisation Project.

Cost element	**2016** **£000s**	**2017** **£000s**	**2018** **£000s**	**2019** **£000s**	**2020** **£000s**	**2021** **£000s**	**Total** **£000s**
Feasibility Study	338	-	-	-	-	-	350
Central Administrative Building	-	3,040	13,643	14,683	3,378	-	34,744
Highlands Office and PDC				1,093	1,748	970	3,811
Howard Davis Farm			621				621
Morier House					2,372	3,557	5,929
States Building					32	287	319
Allowance for Decanting		300	900	900	900		3,000
Project total	**338**	**3,340**	**15,163**	**16,676**	**8,429**	**4,815**	**48,761**

4.57 As with the Hospital Project the Office Modernisation initiative is embryonic and legislative and funding sources are yet to be finalised:

[99] MTFP Addition 2016 – Update on Capital Programme P 130

"…future amendments to the Medium Term Financial Plan and appropriate legislation as necessary will be brought forward for approval to facilitate the funding for the gross capital allocation requirements for this project.

A funding source will need to be identified that provides for the capital investment and recognises the inflow of funds from disposals and the impact of efficiency savings generated from the reduced footprint and application of modern ways of working. The project team will continue to work with Treasury officers with the aim of providing a means for funding for inclusion in the 2017 Budget proposals."[100]

4.58 Given the relative early stage to this work it is obvious that robust business cases will require to be worked through incorporating all investment and recurring revenue consequences. This may mean the realisation of efficiencies in the medium term but it is unlikely that such business case consequentials can be readily incorporated within the 2016 – 2019 MTFP II Addition modelling.

4.59 As at 31 December 2015 there was £121.6m of unspent capital approvals with approximately £74.8m of capital approval being agreed within 2015. Only £45.6m of capital expenditure was spent in 2015 and during 2014 actual capital expenditure from the Consolidated Fund amounted to a total of £51.7 million. The total capital expenditure allocations for 2016-2019 are outlined within figure 47 of the MTFP Addition together with funding sources:

	2016	2017	2018	2019
Total Proposed Departmental Capital programme	25,691	26,273	35,000	32,975
Total Proposed Other Projects	1,000	39,000	8,233	-
Total Proposed Capital Programme	26,691	65,273	43,233	32,975
Proposed Funding Sources				
Consolidated Fund	(25,691)	(26,273)	(35,000)	(32,975)
Criminal Offences Confiscation Fund (Prison Phase 6	-	-	(8,233)	-
Strategic Reserve - Les Quennevais School (to be repaid from				
Total Proposed Funding Available	(26,691)	(65,273)	(43,233)	(32,975)

4.60 Within our September 2015 Report we suggested that "*Bringing in mainstream capital spend to profile is not one of Jersey's strengths and there has been a consistent track record of underspending to programme"… As the 'mainstream capital programme is mainly funded from revenue allocations this consistent level of underspending can act as 'buffer' and some flexibility in managing capital/revenue funding. This is especially relevant where the initial resources tied up within the allocation approval process for*

[100] MTFP Addition 2016 – Update on Capital Programme P 130

indicative projects, that are likely not to spend, can be withdrawn/modified (subject to Ministerial approval). However, in terms of planning – such is the nature of the capital approval process where the entire funding is allocated in the first year – it must be extremely difficult to accurately predict the overall profile of capital expenditure in any given year and 'over programming' *is not an option to account for natural slippage. The significant lack of consistency in profiled spending – particularly in final quarter of the financial year (40% in 2014 and 33% in 2015) does not indicate a controlled and co-ordinated approach being taken to the management of the capital programme*.

A negative consequence of such controls could be the potential sub-optimal allocation of capital resources especially where project cost estimates and timescales are inaccurate or impacted by optimism bias[101]

4.61 Locking capital resources within the capital approval process – whilst appearing to be prudent, can lead to sub-optimal decision making where there is a lack of rigour in the management of projects. There are processes in place that allows the redirection of such approvals on projects that are not being delivered - subject to ministerial approval – however the current arrangements appear to lack agility and it is not apparent that the performance management arrangements around the Capital Programme produce the effective management and utilisation of such investments. Given the significance and magnitude of the major projects now being contemplated, including the Hospital and Office Modernisation Projects – it is critical that the States ensure that improved arrangements are in place.

[101] Corporate Services Scrutiny Panel – Review of MTFP – September 2015 – Page 17

5. Strengths and areas for further development

5.1 Building upon our assessment of the MTFP II submission in 2015 we have updated our view on the relative strengths and areas for development that the States of Jersey should address in relation to developing MTFP II further. These are outlined below.

Strengths

5.2 During the course of our work we were able to identify a number of relative strengths associated with the MTFP II and wider financial management arrangements. We have revised some of the strengths identified within the 2015 arrangements along with some improvements noted arising from the arrangements in formulating the MTFP II Addition submission. These are listed below:

- MTFP II Addition provides a robust framework for financial strategy to be formulated
- Financial strategy – strong corporate co-ordination and overall strategic direction
- Impressive drive and commitment for improved financial management capability – this is notable across Treasury & Resources and Departmental Finance Officers
- Basic Financial Management Information (MI) is robust
- Positive departmental work relating to on-going service resource prioritisation – although this is more variable outwith Health and Education

Development Areas

5.3 Although MTFP II Addition provides a strong framework for the setting of financial strategy, there are a number of areas, particularly concerning the testing and delivery of critical assumptions that require strengthening. We have focussed on eight areas which are critical to the effectiveness of MTFP II Addition. These are:

- Delivery of key assumptions – Tax Yields
- Delivery of key assumptions – Efficiency Savings and Measures
- Delivery of key assumptions – Health Charge and User Pays
- Delivery of key assumptions – Capital Programme
- Operational Service Planning and Financial Strategy
- Base Budgeting
- Forecasting
- Financial Performance Management

5.4 Our high level comments, some of which are interconnected) can be summarised as follows:

Delivery of Key Assumptions – Tax Yields

- Year on year IFG Tax estimate growth 2017 – 4.2%, 2018 – 5.5%, 2019 – 4.7% and 2020 – 5% carry an unacceptably high level of risk of non-achievement
- Inadequate clarity/transparency on the calculation of base Income Tax estimates
- Income tax estimates appear to be more aspirational than prudent

Delivery of Key Assumptions – Efficiency Savings and Measures

- A high level of proposed efficiency savings have still to be accorded detailed service design plans – some appear to be highly aspirational
- Staffing element of £46.3m of efficiency savings potentially 'masked' by a 12.9% current vacancy level
- Difficulties in establishing true recurring cashable savings as a result of 'unrequired budgetary provision' and relatively unrestricted ability of Chief Officers to apply virement as necessary
- Lack of pace on transformational service re-engineering work and uncertainty on the phasing of key savings
- Difficulties in establishing true recurring cashable savings
- Accountability for performance - a cultural acceptance of the concept of "slippage" and non-achievement

Delivery of Key Assumptions – Health Charge and User Pays

- Health Charge is a tax on income rather than a charge
- Lack of linkage between consumption and liability – inconsistent with Principle 1 of Jersey's Long Term Tax Policy where "Taxation must be necessary, justifiable and sustainable
- No direct link between the Health Charge and the Health Revenue Account
- Absence of economic impact on commercial entities arising from the expected level of Commercial Waste charge
- Absence of detail on how additional User Pay income could be collected

Delivery of Key Assumptions – Capital Investment

- Lack of visibility on key new Hospital investment requirements including linked to likely recurring revenue expenditure commitments
- Hospital funding options will inevitably impact upon the overall financial strategy
- Matching and 'locking' of approved funding may impair optimal investment capability
- Position on depreciation is still not adequately informing asset investment/replacement strategy
- Pace of Capital Programme expenditure still appears to be slower than expectations

Operational Service Planning and Financial Strategy

- Some departments have used the MTFP as a ‘proxy’ for detailed service planning – the MTFP is not a substitute for ‘bottom up’ service planning
- Need to demonstrate better linkage between service outcome targets and financial performance
- MTFP II should consider impacts on service standards and quality of outcomes – especially in the context of fiscal retrenchment

Base Budgeting

- Base budgets predominately incremental in construction
- Staffing structures funded on approved structures including vacancies rather than actual need
- Focus on outcomes based budgeting would assist in the illumination of potential efficiency savings areas

Forecasting

- Undue volatility in forecasts between 2015 and 2016 submissions on key components including overall income and expenditure and the expected level of efficiency savings suggest weaknesses in overall forecasting
- Some forecasts appear to be aspirational rather than based on robust assumptions
- Lack of evidence on the application of stress testing on key assumptions
- Potential sub optimal budget behaviours in forecasting
- Significant misalignment with expectations on capital programme expenditure

Financial Performance Management

- Silo approach across departments still evident – stronger role for the Chief Executive and the Corporate Management Board of Chief Officers in tracking and managing the transformational change reform agenda
- Significant quarterly variance analysis suggests that budget managers are managing budgets rather than managing costs
- Chief Officers – more explicit accountability for financial performance required

6 Concluding comments

6.1 The MTFP II Addition submission provides a significantly stronger framework for the formulation of an effective financial strategy than that submitted in 2015. The MTFP II Addition submission provides comprehensive coverage on financial strategy and is effectively the financial planning architecture for the States. The Financial Strategy Team at Treasury and Resources together with senior Finance Officers across departments are to be commended for their professionalism and diligence in providing strategic direction in the co-ordination of the MTFP II Addition submission.

6.2 Whilst we would consider the MTFP II Addition framework used to model the medium term financial strategy to be robust, we have significant concerns relating to key assumptions principally around Income Tax estimates and the reliability of Efficiency Savings proposals. Indeed, we would be of the view that the Income Forecasts as incorporated within the submission are significantly over estimated, may impair the utility of the MTFP II itself and adversely affect confidence in what should be an exemplar of a medium term financial planning model. Income growth forecasts of 2017 – 4.2%, 2018 – 5.5%, 2019 – 4.7% and 2020 – 5% do not appear to be realistic in context (even before any uncertainty arising from the UK Brexit referendum) with prevailing and expected economic conditions over the medium term period.

6.3 As part of Income Tax assumptions we remain to be convinced that in the graduated transition in the movement towards estimating Personal Income Tax on a full current year basis (CYB) basis, that such a change in accounting treatment would produce a recurring additional Personal Income Tax additionality of some £7m per annum.

6.4 We would strongly recommend that a more prudent set of assumptions be adopted in the formulation of key income estimates including Personal and Corporate Income Tax. We are advised that the Income Forecasting Group are considering a downward revision in income forecasts/estimates as a result of the a downward revision on central economic assumptions as contained within the Fiscal Policy Panels' Annual Report August 2016. It is essential that the MTFP II Addition is revised to incorporate any resulting downward revision. Such income forecasts are critical and failure to update the model with revised assumptions based on the latest intelligence may compromise the utility of the MTFP model.

6.5 Due to better than expected financial performance within 2015 there has been a relaxation in the level of required efficiency savings - down from £90m at the point of the 2015 submission to £77.5m. Our evidence suggests that a significant number of efficiency savings proposals contained within the Addition submission are not sufficiently advanced in construction, lack granularity and are aspirational/expectational. As relevant legislative provisions of Public Finance (Jersey) Law was specifically amended to allow for the detail on efficiency savings to be fully constructed over a further period of a year, this lack of granularity is disappointing. The level of funded vacancies appears to be extremely high with vacancies at 12.9% as at June 2016. Given the overall imbalance between income and expenditure faced by the States in the period to 2019 we would recommend that within the budget setting process - funding should only be available (i.e. staffing structures and related budgets

should be completely re-appraised) to vacancies that are considered to be essential in meeting statutory obligations or services that are deemed to be absolutely critical. This would ideally be facilitated through a zero based budgeting approach.

6.6 The introduction of a Health Charge (detail to be provided within the 2017 Budget)as a levy on income may be achievable but conceptually it is difficult to create a link with usage and has clearly has the characteristics of a tax. The rationale behind the setting of the level of Health Charge and the application as a tax on income is difficult to fully understand other than to provide some phased additional income. This is reinforced by the Addition paper reducing the level of the proposed charge from an original £15m in 2018 and £35m in 2019 as a result of "*better than expected financial position in 2015 and improved income forecasts for 2016-2019, we are proposing to introduce an income-based charge which would raise £7.5 million by 2018, increasing to £15 million in 2019…*".

6.7 It is difficult not to conclude that if further efficiencies were generated throughout the States re the reform agenda, the requirement to 'plug' the Health Budget with a tax which may be disproportionately problematic but potentially avoidable if appropriate levels of efficiencies, including stripping out unrequired vacancies, are delivered.

6.8 In respect of the proposed charge for Commercial Waste estimated to raise £3m in 2018 and £11m in 2019 there is little detail on how these figures have been constructed and it been suggested that there will be some complex issues to resolve in the assimilation of charge across all 12 Parishes. Given the level of uncertainty over impacts including a potential downturn in economic growth and on-going dialogue with commercial interests further feasibility/assurance work is required before such proposals can be safely incorporated within the MTFP II Addition and be relied upon as a valid income source.

6.9 Our assessment of the MTFP II Addition against relevant components of the latest version of CIPFA Financial Management Model (V4) highlighted some scoring improvement on the 2015 position (principally related to the MTFP structure itself) although not markedly different overall from the scoring assessed on the first MTFP2012 – 2015. Whilst the overall MTFP framework is stronger (the MTFP II Addition represents a robust framework for financial strategy to be formulated) there are a number of financial management processes that require to be strengthened. We believe the States would benefit significantly from a more outcomes based focus on budget setting and significantly strengthened forecasting. What potentially links these two issues is sub-optimal budget management behaviours.

6.10 Within our September 2015 concluding comments on the MTFP II submission we commented:

"Although a key attribute of a medium term financial plan is the provision of stability, it is clear that a combination of imprudent assumptions used within MTFP1 and lack of agility in adapting to a deteriorating financial position has driven the creation of a range of measures designed to counter emerging deficits. Strategic Financial Planning

is in recovery mode rather than setting a stable financial strategy that delivers robust financial performance. At worst, using specific reserves to fund core expenditure and creating measures which are in effect short term tactical solutions without due focus being applied to causal drivers is not going to create the necessary conditions that will successfully recalibrate financial strategy for the medium and longer term.

Proposed total income of approximately £2.94 billion including some £35 million of a Health Charge is incorporated within the MTFP submission against what would be approximately £3.11 billion of total net expenditure. By any definition, there has to be a material change in the alignment of income and expenditure if there is to be a reasonable prospect of achieving a 'balanced budget' position over the four year period."[102]

6.11 The MTFP II Addition submission has attempted to address these issues, however there is still much more to do for the MTFP itself to drive the necessary behaviours that will allow delivery and convert strategy into reality. Notwithstanding the markedly improved assessment on the MTFP itself we would still see relevance in these comments one year on as the States faces the challenge of ameliorating a structural rather than a cyclical deficit. The MTFP as now constituted should provide the States with the most effective insight in tackling this challenge. Indeed, our penultimate comment in our September 2015 Report is still totally relevant – "there *may be no other time within which the MTFP will be more relevant to the decision making processes that will deliver financial sustainability for the States of Jersey."* [103]

6.12 Overall the structure and scope of MTFP II Addition still provides the capability to provide real insight into factors impacting financial strategy and should allow decision makers with the platform to create an optimal medium term financial strategy. However, this is fully predicated upon the model having robust core assumptions and transparency in the demonstration of resource provision against service needs. The MTFP II 2019-2019 has a number of real strengths however key components within the model appear to be aspirational rather than being based upon detailed and prudent assumptions, to the extent that the utility of MTFP II as currently constituted is seriously compromised. Indeed, some aspects of the MTFP appear to be more about reinforcing confidence rather than confronting some difficult realities.

6.13 With continuing service delivery and investment pressures including the affordability/funding decisions related to the new Hospital Project, all in the context of a potentially uncertain economic outlook, the value of an effective MTFP cannot be understated.

6.14 An effective MTFP can be readily achieved if MTFP II is recalibrated to reflect a more realistic position on specific key assumptions underpinning Income, Efficiency Savings

[102] CIPFA – Corporate Services Scrutiny Panel – MTFP – 2016-2019 – Page 22
[103] CIPFA – Corporate Services Scrutiny Panel – MTFP – 2016-2019 – Page 23

and Charges. In doing so potentially unpalatable decisions on tax, spend and the level of reserves will not go away and the forecasted trajectory on deficits may indeed appear to be even larger and more prolonged, however the States will be able to base its decisions on a more robust financial strategy that can only lead to better outcomes.

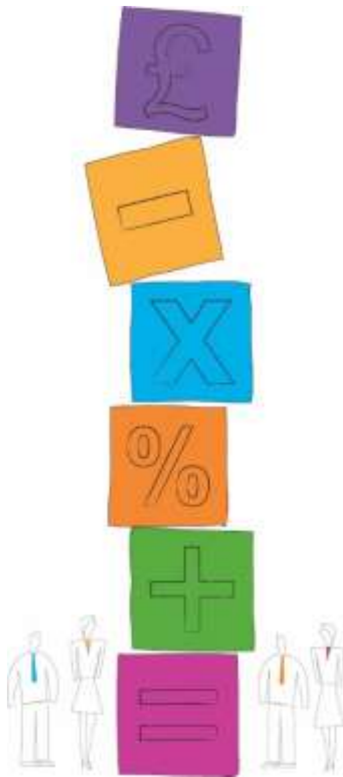
6.15 Finally we would wish to take this opportunity to record our sincere gratitude to Members of the States Assembly, Management and Staff at the States of Jersey for the provision of extremely valuable support in the course of our work.

7 Recommendations

7.1 In terms of strengthening the effectiveness of arrangements associated with MTFP II Addition we would propose 23 recommendations (in no specific order of priority):-

	Delivery of Key Assumptions – Tax Yields
1	That consideration be given to adopting income forecasts at a point between the lower and central scenarios outlined by the Income Forecasting Group (IFG) within its latest income forecasts produced as informed by the Fiscal Policy Panel's Annual Report – August 2016.
2	The detailed workings behind establishing Income Tax base estimates (not just specific adjustments on base) covering both Personal and Corporate should be highlighted and tracked to actual yields.
	Delivery of Key Assumptions – Efficiency Savings and Measures
3	The MTFP should only incorporate measures that are defined, have significant prospectivity of being implemented and have relative precision around the financial impacts that are going to be achieved. Such measures should not be conceptual but be formulated within existing business case methodology and backed by appropriate evidence.
4	Savings need to be definable as recurring and 'cashable' – not counterfactual.
5	Whilst recognising that virement controls may conflict with cash limit budgeting – Chief Officers should be accountable for using budgetary resources for unintended purposes.
6	Unused resources arising from the current level of vacancies should not be recycled as efficiency savings if service outcomes are not impaired by not filling such vacancies.
7	People savings related to staff down-sizing - it is recommended that appropriate impact studies should be used to inform the forecasted metrics foundational to the formulation of personal Income Tax estimates and assess relevant implications for Pension Funds.
	Delivery of Key Assumptions – Capital Investment
8	Performance management on the Capital Programme should include for more realistic cost profiles.
9	Consideration should be given to modifying the current controls over locking/securing/committing capital funding to allow for more flexibility and improved utilisation of funding sources.
10	Improved visibility required on Investment Appraisal and Business Case methodology used on Projects incorporated with the Capital Programme. This should demonstrate full incorporation of life cycle costing with complete visibility on how the full current and future Revenue Consequences of Capital Projects is being provided.
11	There should be a link between the application of depreciation and asset investment/replacement strategy.
12	Funding options for the New Hospital Project should be identified and assessed as soon as possible to allow an early evaluation of affordability and the likely impact on overall financial strategy.
	Operational Service Planning and Financial Strategy
13	The MTFP II Addition should have stronger linkage between service outcome targets and forecasted financial performance.
14	The MTFP process should not be a 'proxy' for service planning. Operational service planning requires to be fully linked/fused to service financial strategy. Service Business Plans should have financial strategy at their core.
15	Service Planning should illuminate outcomes and service objectives and allow outcomes to

	be fully costed. Consideration should be given to modifying the current controls over locking/securing/committing capital funding to allow for more flexibility and improved utilisation of funding sources.
	Base Budgeting
16	Outcome based budgeting and additional zero based budgeting should be used to complement the prevailing incremental approach.
17	Staffing budgets should only reflect basic service requirements and not carried vacancies – funding to the extent of 12.9% should be eliminated - we would recommend that within the budget setting process - funding should only be available (i.e. staffing structures and related budgets should be completely re-appraised) to vacancies that are considered to be essential in meeting statutory obligations or services that are deemed to be absolutely critical. This could be readily facilitated through a zero based budgeting approach.
	Forecasting
18	Key assumptions used within forecasting should be stress tested for reliability/risk assessed. This could readily be achieved with some external scrutiny or a structure pro-forma checklist that could be submitted to colleagues within a validation approach.
19	Forecasting budget managers should be made to formalise projections on at least a 4 weekly period.
20	That a carefully controlled and tracked mechanism be devised to allow critical assumptions within the MTFP to be recalibrated/adjusted in the face of emerging conditions that cannot be corrected/influenced/ameliorated. This would incorporate a reforecasting facility and a required rebalancing or resources.
	Financial Performance Management
21	Managers should be encouraged to manage costs rather than budget utilisation. A form of incentivisation/reward should be introduced to allow managers to offer up unrequired budget.
22	Accountability – Chief Officers require to be held to account for the performance on achievement of agreed savings targets - there should be effective responsibility and accountability specifically relating to the performance management of the achievement of expected savings targets.
23	The Corporate Management Board should be the crucible for driving the transformational change programme and be the core communicators on actions/progress.



Registered office:
77 Mansell Street, E1 8AN
T: 020 7543 5600
www.cipfa.org

APPENDIX 2 – MICHAEL OLIVER REPORT

MEDIUM TERM FINANCIAL PLAN ADDITION, 2017–19[1]

MICHAEL J. OLIVER

[1] The adviser would like to acknowledge all the help he has received from the Treasury, the Economic Adviser, the Comptroller and Auditor General and the States Statistician for their patience and hard work in clarifying and supplying various figures and issues.

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2. Income forecasts

3. Expenditure in the Medium Term Financial Plan

4. By 2019?

5. Conclusions, observation and summary of recommendations

INTRODUCTION

The Medium Term Financial Plan Addition (the Addition) was lodged on 30 June 2016 and is due to be debated by the States of Jersey on 27 September 2016. The Addition is the second part of the Medium Term Financial Plan 2016–19 (MTFP 2). The draft of MTFP 2 was lodged in July 2015 and debated and amended in October 2015. In July 2015, the draft MTFP proposed that between 2016 and 2019:

- Total states net expenditure would rise from £761 million to £768 million;
- Total net revenue expenditure would increase by £400,000 from £734.4 million to £734.8 million.
- Total states income would rise from £665 million to £757 million with proposals to raise an additional £36 million annually from 2019.
- Aggregate capital expenditure would be £168 million.

In July 2015 Department expenditure was only given for 2016 but Departmental expenditure limits were imposed for 2017–19.

Following the debate on the draft by the States Assembly, the MTFP 2 was amended so that between 2016 and 2019:

- Total states net expenditure would rise from £767 million to £768 million;
- Total net revenue expenditure would decrease from £740.3 million to £734.8 million.

Detailed indicative States Net Revenue Expenditure forecasts for 2016-2019 are included in the Addition and it is proposed that between 2017 and 2019:

- Total states net expenditure will fall from £790 million to £768 million.
- Total net revenue expenditure will increase from £724 million to £735 million.
- Total states income will rise from £715 million to £773 million (excluding the health charge).

- An income-based health charge will be introduced in 2018 to raise £7.5 million in that year and £15 million in 2019 (details of the charging mechanism will be contained in Budget 2017).
- £73 million will be achieved in staff and non-staff savings and efficiencies.
- £4 million of user-pays charges will be introduced.
- Charges for the disposal of commercial refuse and liquid waste will raise £11 million per year by 2019.

The adviser has assisted the Corporate Services Scrutiny Panel during the process of their review into the Addition. This report focuses on the income forecasts; the expenditure and considers what the MTFP hopes to achieve by 2019. Conclusions and a summary of recommendations follow.

2. INCOME FORECASTS

2.1 Income forecasts and final outturns from MTFP 1

Table 1 shows total States income (which includes revenues from income tax, GST impôts duty, stamp duty, other income and the island rate) for the period of the first MTFP and the differences to forecast.

Table 1. Income forecasts and outcomes in the first MTFP, 2013-15 (budget years)

	2013	**2014**	**2015**
	£m	£m	£m
States Income	647	674	711
Outcome	637	649	692
Difference to forecast	–10	–25	–19

Source: MTFP 1 and States Accounts, various years

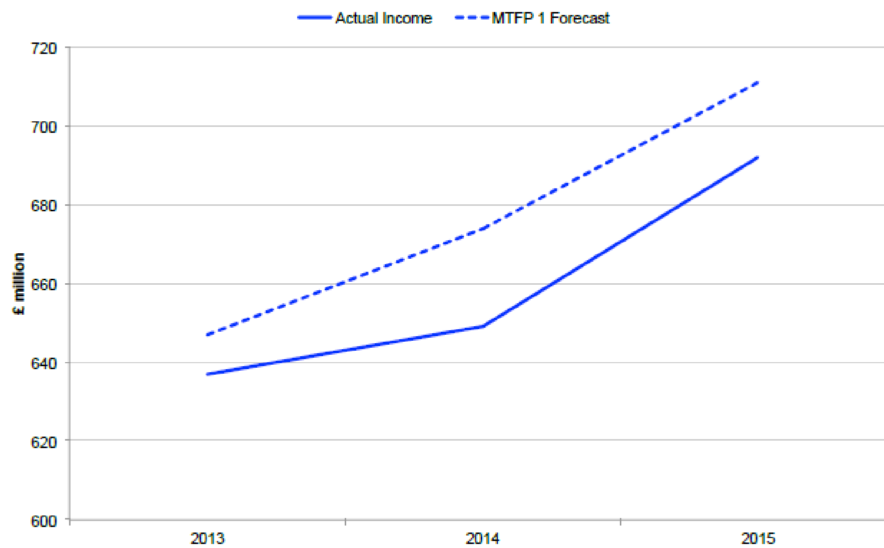
The differences between outcome and forecast were primarily because of the lower income tax receipts (Table 2). Figure 1 plots the growth of States income to the forecasts made at the time of MTFP 1.

Table 2. Income tax forecasts and outcomes in the first MTFP, 2013-15 (budget years)

	2013	**2014**	**2015**
	£m	£m	£m
Upper	470	495	525
Central	**450**	**470**	**500**
Lower	425	450	475
Outcome	452	437	458
Difference to central forecast	+2	–33	–42

Source: MTFP 1 and States Accounts, various years

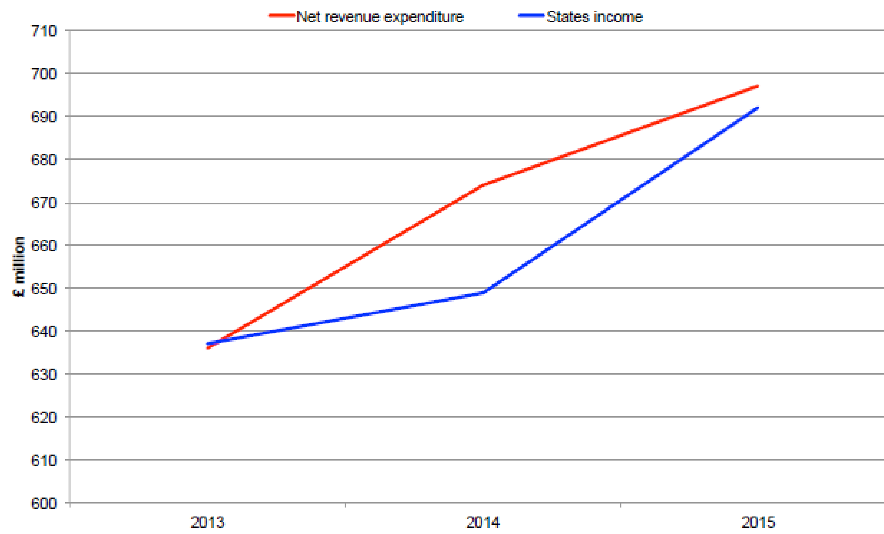
Figure 1. Forecast States income and outturn, 2013–2015 (£ million)



Source: States Accounts and MTFP 1

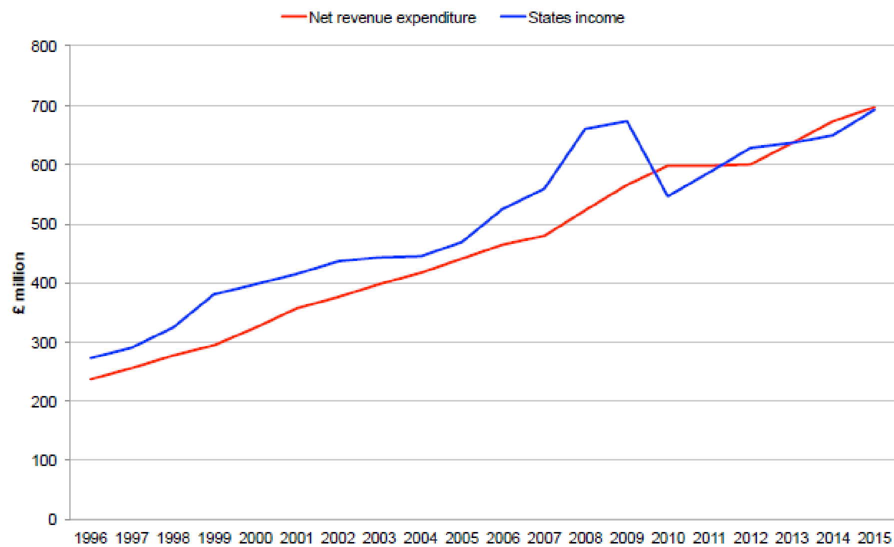
Figure 2 illustrates the growth of income and net revenue expenditure over the first MTFP. As can be seen, net revenue expenditure was significantly above income for this period and marked an important change to the pre-2010 pattern where expenditure was below income (Figure 3).

Figure 2. Actual net revenue expenditure and income, 2013–15 (£, million)



Source: States of Jersey Accounts, various years

Figure 3. Growth of actual net revenue expenditure allocation and income, 1996–2015 (£ million)

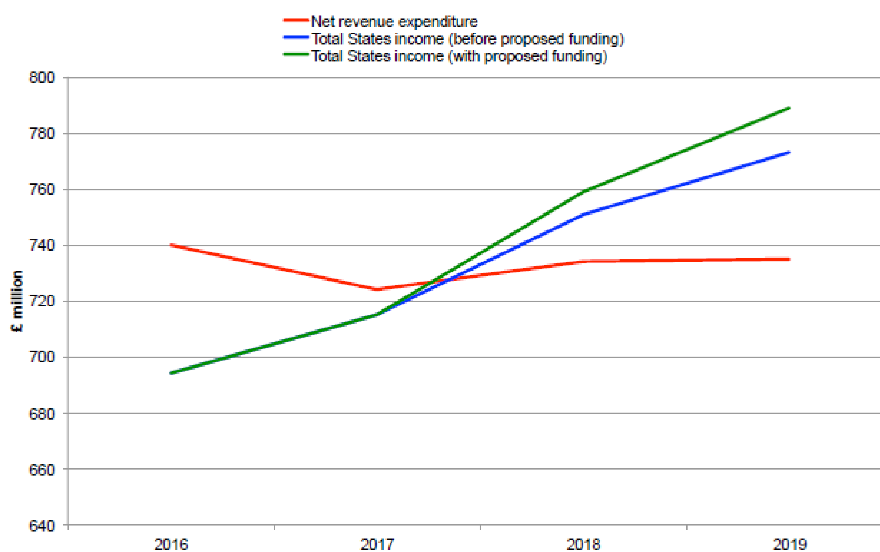


Source: States of Jersey Accounts, various years

2.2 Income forecasts for the period of the second Medium Term Financial Plan

Figure 4 plots the income forecasts published in June 2016 for the lifetime of the second Medium Term Financial Plan against expenditure. Unlike the first MTFP, the forecast in the Addition suggests that a positive gap will open up between income and expenditure over the lifetime of the second MTFP. According to the forecasts in the Addition, income will rise by more than expenditure from 2018 (and considerably more if the additional proposed funding mechanism of £24.3 million is included by 2019).

Figure 4. Proposed growth of income and net revenue expenditure, 2016–19 (£m)



The bulk of Jersey's income derives from income tax and it is instructive to see how the income tax forecasts have evolved since the publication of MTFP 2 in June 2015. These are shown in Table 3. The first thing to note is that a year after the publication of MTFP 2, the income tax forecasts have improved significantly (comparisons are shown in rows 11-14). The central income tax forecast in the Addition compared to the central income tax forecast in MTFP 2 a year ago suggests an aggregate improvement of £55 million between 2016 and 2019.

Table 3 The evolution of the income tax forecasts from MTFP 2

	2016	2017	2018	2019	2020	
	£m	£m	£m	£m	£m	
(1) MTFP 2 Upper	476	499	535	568		
(2) MTFP 2 Central	**458**	**475**	**499**	**519**		
(3) MTFP 2 Lower	440	451	462	471		
(4) September 2015 forecast	**455**	**475**	**499**	**519**		
(5) Revised forecast Budget 2016	**455**	**479**	**504**	**525**		
(6) May 2016 forecast	**460**	**480**	**507**	**531**	**558**	
(7) CYB Proposed adjustment	**7**	**7**	**7**	**7**	**7**	
(8) MTFP 2 Addition Upper	476	506	540	576	616	
(9) MTFP 2 Addition Central	**467**	**487**	**514**	**538**	**565**	
(10) MTFP 2 Addition Lower	458	468	488	500	514	
						Total (£m)
(11) Difference between (9) and (2)	9	12	15	19		55
(12) Difference between (9) and (4)	12	12	15	19		58
(13) Difference between (9) and (5)	12	8	10	13		43
(14) Difference between (6) and (2)	2	5	8	12		27

The cumulative difference between the forecasts for Budget 2016 and the MTFP Addition is an extra £43 million (row 13). The main reason for this additional income, shown in row 7, is the move to a current year basis for income tax (as explained in Appendix 5 of the Addition). This accounting policy change adds an extra £28 million in income tax revenue for 2016–19. As row 14 reveals, had it not been for this change, the cumulative additional income tax forecast for the MTFP 2 period would have been £27 million (i.e. that assumed in the May 2016 forecast).

The underlying economic assumptions and the income forecasts used in the Addition were prepared in the absence of the UK's decision to leave the EU in June 2016 (Brexit). Initial stock market volatility after Brexit was short-lived but sterling's weakness and surveys of business activity, confidence and optimism suggested that the UK was likely to see little growth in GDP during H2 2016. These concerns led the Bank of England to reduce Bank Rate to 0.25% and introduce a new Term Funding Scheme and further quantitative easing.

The MTFP Addition was also published before the release of Jersey's Survey of Financial Institutions for 2015 which showed a significant call in profits (8 per cent in real terms) for the sector and a 5 per cent fall in GVA of the banking sector. A fall in financial services profits was built into the forecasts by the Income Forecast Group (IFG) which captured some, but not all of this fall.

In July 2016, the Fiscal Policy Panel (2016a) did not recommend changing any of the economic assumptions although it stressed that the balance of risks were on the downside. At the end of August 2016, the FPP's Annual Report downgraded several economic assumptions for the post 2015 period (FPP 2016b). Table 4 shows the differences between the FPP's central assumptions contained in the MTFP Addition and their 2016 Annual Report.

Table 4. Differences between economic assumptions in MTFP Addition and FPP's 2016 Annual Report

	2015	2016	2017	2018	2019
Real GVA	-1.4	-1.0	-1.4	0.0	0.0
RPI	0.0	0.4	0.7	-0.3	0.0
RPIY	0.0	0.5	1.0	0.0	0.0
Nominal GVA	-1.4	-0.5	-0.4	0.0	0.0
Company profits	-5.2	-0.3	-0.5	0.0	0.0
Financial services profits	-9.6	-0.5	-0.5	0.0	0.0
Compensation of employees	2.0	-0.7	-0.3	0.0	0.0
Employment	0.4	0.0	-0.5	0.0	0.0
Average earnings	0.0	-0.7	0.2	0.0	0.0
Interest rates (%)	0.0	-0.1	-0.6	-0.8	-1.3
House prices	-0.2	0.0	-2.0	0.0	0.0

At the time of writing, the IFG had not re-calibrated its income forecasts but intends to do so by 7 September. It is impossible for the advisor to pass any comment on the new income forecasts at this stage other than to say that the new central income forecasts will most likely be downgraded.

The full income forecasts from the MTFP Addition are shown in Table 5. The strong growth in the central income tax forecasts is worthy of note. It would have been surprising even in the event of Brexit whether they could have been achieved. In May 2016 the IFG suggested that corporate tax forecast would fall slightly over the

period compared to September 2015 but at the same time they upgraded the personal income tax forecasts and made further upward adjustments because of the accounting change to the current year basis, as shown in row 7 of Table 3. This has bolstered the profile of the central income tax forecasts. The total income forecasts do not include the proposed mechanism to offset States payment of rates or a sustainable funding mechanism for health.

The advisor's first recommendation in the report on the first Medium Term Financial Plan in 2012 was 'In future, the MTFP should incorporate up to date economic forecasts. This might mean that economic forecasts need to be made more regularly but it would align the MTFP closer to recent economic circumstances'. In light of the Survey of Financial Institutions, Brexit, the subsequent actions by the Bank of England and the FPP's Annual Report, the advisor warmly welcomes the decision by the IFG to revise the income forecast for the MTFP Addition.

Table 5. Income forecasts in MTFP 2 Addition, 2015–2020

		2015	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m
Income Tax							
- Central		**457,583**	**467,000**	**487,000**	**514,000**	**538,000**	**565,000**
- Higher			476,000	506,000	540,000	576,000	616,000
- Lower			458,000	468,000	488,000	500,000	514,000
	% growth		2.1%	4.3%	5.5%	4.7%	5.0%
	Range		4%	8%	10%	14%	18%
GST							
- Central		**85,042**	**83,334**	**84,968**	**85,779**	**86,609**	**87,458**
- Higher			84,911	87,379	88,897	90,460	92,269
- Lower			81,818	82,652	82,800	82,953	83,783
	% growth		-2.0%	2.0%	1.0%	1.0%	1.0%
	Range		4%	6%	7%	9%	10%
Impots							
- Central		**54,147**	**56,106**	**55,584**	**55,338**	**55,332**	**55,159**
- Higher			56,666	57,176	57,976	59,045	59,440
- Lower			55,554	54,030	52,815	51,846	51,179
	% growth		3.6%	-0.9%	-0.4%	0.0%	-0.3%
	Range		2%	6%	9%	13%	15%
Stamp Duty							
- Central		**29,032**	**26,216**	**27,968**	**29,504**	**30,115**	**30,745**
- Higher			26,929	29,286	31,539	32,871	34,282
- Lower			25,943	27,122	28,011	28,011	28,011
	% growth		-9.7%	6.7%	5.5%	2.1%	2.1%
	Range		4%	8%	12%	16%	20%
Other Income							
- Central		**65,940**	**61,118**	**59,682**	**66,220**	**63,403**	**66,244**
- Higher			61,578	61,074	68,459	66,606	70,141
- Lower			60,017	57,784	63,501	59,765	61,965
	% growth		-7.3%	-2.3%	11.0%	-4.3%	4.5%
	Range		3%	6%	7%	11%	12%
Total							
- Central		**691,744**	**693,774**	**715,203**	**750,840**	**773,460**	**804,606**
- Higher			706,084	740,914	786,871	824,981	872,133
- Lower			681,333	689,588	715,126	722,575	738,937
	% growth		0.3%	3.1%	5.0%	3.0%	4.0%
	Range		4%	7%	10%	13%	17%

2.3 New charges in the MTFP Addition

There are several new charges for the taxpayer included in the MTFP Addition. It is suggested that a Waste Charge should be introduced to raise £11 million; the Proposition in the Addition asks for an in principle approval for the introduction of a Health Change to raise £7.5 million in 2018 and £15 million in 2019; and finally, there are £4 million of new user pays charges over the next three years. In MTFP 2, the Health Charge was mooted as potentially £35 million from 2019 but this has been adjusted 'in light of the potential need to raise further revenue to fund a new hospital' (MTFP 2 Addition, p. 46) and because of an improvement in the financial situation.

The introduction of new charging mechanisms (which includes the recent introduction of the long term care charge) is a departure for the States of Jersey, which has traditionally raised money through taxation and social security contributions. The introduction of charges has become more widespread in other parts of the world and as the *Economist* (2015) notes in what it describes as 'pay-as-you-go government':

> …the recent spread of fees has less to do with economics than with political expediency. Politicians have seized on charges as an easy way of raising money, and have inflated some fees until they bear little relation to the cost of the service supposedly being purchased. Too often the result is a regressive, economically distorting swindle. It is no wonder charges are popular with governments. Rather than being flagged up in finance bills, as new taxes are, they can be slipped into legislation that attracts less scrutiny. And they can be aimed at politically unorganised groups, rather than the public at large, meaning they are less loudly opposed than tax increases or welfare cuts.

As the *Economist* (2015) commented:

> The root of the problem is an inability to raise money by more transparent means—that is to say, taxation…This newspaper shares their desire for small government. But advocating low taxes while backing bogus, revenue-raising "charges" is a phoney sort of fiscal responsibility.

The widespread discontent in Jersey following the introduction of GST at 3% in May 2008 and the increase to 5% in June 2011, suggest there are difficulties in introducing new taxes.[2]

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[2] Even though the argument was made at the time, including by members of the FPP, that the social security system protects the most vulnerable and the broad base of GST was very

The distributional analysis paper produced to inform the debate surrounding the proposal considered by the Council of Ministers had some 'wider options' which included a graph showing increasing the marginal rate of income tax from 26% to 28% but there was a negligible discussion about this. The opportunity to explore and consider further income tax raising measures seems to have been precluded from the parameters of the paper. It is unusual that fundamental expenditure on healthcare is not being paid for through the income tax system, but this might suggest a radical new departure for the way the States of Jersey intends to raise money in the future.

Recommendation 1: There should be an investigation into the current structure of the tax system to assess its appropriateness for the sustainability of expenditure beyond 2019.

2.4 Hypothecation

Hypothecation, or earmarking, is a term used to assign tax revenues to a specific end. Earmarking of revenues is common practice throughout the world, for example national pension systems (where contributions are used to pay out to beneficiaries); National Lottery funding in the UK being used for specific arts and sports projects; the licence fund to finance the BBC, and so on. There are numerous variations on hypothecation, which are illustrated in Table 6. It is argued by some that hypothecation allows voters to see how the taxes they are paying relate directly to particular expenditure; however, others are more sceptical and argue that the advantages of transparency and public awareness can be offset by misuse and misunderstanding. A summary of the key advantages and disadvantages is presented in Table 7.

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different from the discriminatory nature of the UK's Value Added Tax, Jersey politicians have remained nervous about increasing indirect taxation further.

Table 6. Varieties of earmarking

Varieties (examples)	**Degree of specificity of the expenditures involved**	**Strength of linkage between the earmarked revenues and the expenditure**	**An identifiable benefit rationale for the linkage**
Self-financing public enterprise such as a water supply company	Specific	Tight	Benefit
Fuel and road finance	Specific	Loose	Benefit
Social security (e.g. pensions, maternity benefits, sick pay)	Broad	Tight	Benefit
Tobacco tax and health finance	Broad	Loose	Benefit
Environmental taxes and clean-up programmes	Specific	Tight	None
Payroll tax and health finance	Specific	Loose	None
Revenue sharing of national tax revenue to sub-national governments	Broad	Tight	None
Lottery revenues to health	Broad	Loose	None

Source: Fjeldstad and Heggstad (2012, p. 26)

Table 7. Advantages and disadvantages of earmarking

Advantages	Disadvantages
When hypothecated revenue is closely linked to the nature of the expenditure, it can apply the 'benefit principle' of taxation (i.e. that broadly consumers should pay, in a tax, for the services they benefit from)	It reduces budgetary flexibility since certain revenues and expenditures are already determined before the allocation of resources begins.
Where the hypothecation relationship on the revenue and expenditure side is very close (e.g. utility bills) it can function like a price mechanism and provide appropriate signals for the efficient allocation of resources for service providers.	It can often be essentially presentational – the fungibility of revenues and expenditure means that new hypothecated funds can simply be offset by shifting funding to other areas, leaving the overall pattern of expenditure unchanged.
Linking taxation with certain expenditures can reduce resistance to new or higher taxes and encourage compliance through higher tax morale.	There are risks to accountability in using hypothecation. A certain amount of expenditure and revenue is effectively pre-determined and it can reduce the role of democratic legislatures in amending and approving the overall budget.
Can ensure minimum levels of funding for certain expenditures.	Can encourage rent-seeking behaviour from special interests in order to entrench a particular advantage through the revenue and expenditure system.
Where budget allocations are uncertain or subject to erratic bureaucratic decisions, direct hypothecation for certain expenditures might be able to by-pass the internal discussions that go into resource allocation	Can inadvertently weaken the fiscal contract between the state and taxpayers. Certain expenditures may be insulated from negative political reaction through hypothecation, but that may simply open the question about the remainder of all expenditure, which does not have a particular 'justification' through hypothecation.
Can encourage behavioural change (e.g. new 'green taxes' linked to environmental objectives)	There can be distributional impacts. Hypothecated user charges may be regressive, and weigh most heavily on the poor in society.

Source: adapted from Welham, Hedger and Krause (2015)

In recent years, Jersey seems to have moved closer to hypothecation in some areas (e.g. Long Term Care fund) and there are examples in the Addition with earmarked funds for Child Protection and Child Policy improvement; from under spending on

Social Security benefits and uncommitted redundancy funding. It is not obvious how this links to the States of Jersey rules and fiscal framework and whether earmarking will be extended to include the financing of the new hospital.

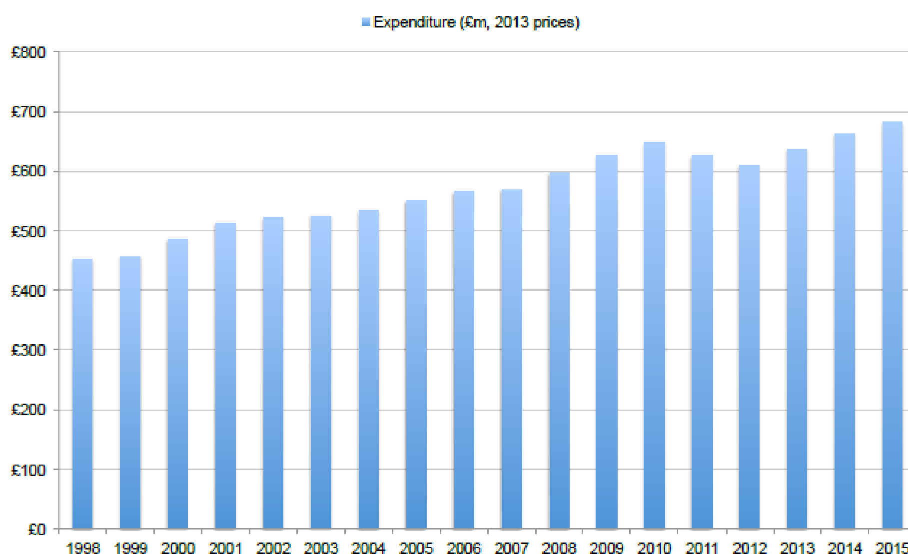
Recommendation 2: The Treasury should consider the advantages and disadvantages for Jersey of hypothecation.

3. EXPENDITURE IN THE MEDIUM TERM FINANCIAL PLAN

3.1 Expenditure patterns in Jersey

Figure 5 shows the growth of net revenue expenditure in Jersey since 1998 in real terms. Between 1998 and 2015, net revenue expenditure grew by 51 per cent. As can be seen on the graph, the years of significant real term cuts for department occurred in 2011 and 2012 but were followed by three years of growth at over 4 per cent each year.

Figure 5. Growth of net revenue expenditure, 1998–2015 (2013 prices)



Source: States Accounts, various years

3.2 Growth of expenditure over MTFP 1 compared to proposed growth of expenditure over MTFP 2.

Table 8 shows the growth of net revenue expenditure (near cash) for the first MTFP, 2013–15 in nominal terms. The amendments made to MTFP 1 after the States Assembly debate in 2012 reduced net revenue expenditure but subsequent updates, contingency expenditure and additional funding led to a higher final approved budget figure. Actual expenditure is given in the penultimate column. Underspend is the

difference between the final approved budget and the actual expenditure for each year.

Table 9 shows proposed total net expenditure for 2016–19 in nominal terms. The significant increase in expenditure during 2016 is followed by a reduction of over £16 million in 2017 an increase of £10 million in 2018 followed by a slight increase in 2019.

Figures 6 and 7 place the growth of net revenue expenditure in real terms for the period of the two MTFPs. Figure 6 is actual net revenue expenditure and shows the big increases over the period. Figure 7 is planned expenditure for 2016–19. The significant growth of net revenue expenditure in 2016 is more than reversed in 2017 and is followed by further cuts in 2018 and 2019. In real terms, net revenue expenditure is going to be cut by almost 9 per cent between 2017 and 2019. Since 1998, the only time that total net revenue expenditure has been cut in real terms was in 2011 and 2012 (although this was quickly reversed under MTFP 1).

Table 10 shows a breakdown of net revenue expenditure for Ministerial Departments and States funded bodies between 2016 and 2019 in nominal and real terms. The contraction in funding for States Departments in real terms is clear. Much has been made of the additional money available for strategic priority areas, particularly in health and education. In the absence of the additional funding from central growth allocation for health and education there are real terms cuts to expenditure in health and education, albeit that they are the most protected Departments (for example, Infrastructure's funding is cut by a third between 2018 and 2019).

Table 8. Net Revenue Expenditure (near cash), 2013–15 (£ million)

Period	Draft MTFP 2013-15, as lodged	MTFP 2013-16, as amended[1]	MTFP Annex Update 2014 and 2016					Original approved budget	Carry forward	Contingency	Additional funding	Revenue/ Capital transfers	Final approved budget	Actual	Underspend
			Pay Awards 2013/2014	Budget Measures 2015	Procurement Savings	Housing Incorporation	Central Growth 2014								
2013	626,224	626,224						626,224	22,126	16,804	217	-6,363	659,008	636,186	-22,822
2014	643,510	641,300	18,458				2,210	661,968	19,873	4,594	19,167	-3,143	702,459	674,163	-28,296
2015	654,738	653,278	18,458	-12,069	-3,451	29,472	1,460	687,148	13,009	24,910	-5,455	2,360	721,972	697,031	-24,941

Notes: 1. Summary Table B, page 145, from Medium Term Financial Plan, 2013-15, as amended.
2. Medium Term Financial Plan Approval (Near-Cash)

Sources: States of Jersey Accounts; MTFP 1 and annual updates

Table 9. Net Revenue Expenditure (near cash), 2016–19 (£ million)

Period	Draft MTFP 2016–19, as lodged	MTFP 2016–19, as amended[1]	Department Total	Proposed Central Contingency Allocation	Proposed Central Growth Allocation	Proposed total net revenue expenditure	Original approved budget
2016	734,417	740,317	697,377	42,940		740,317	740,317
2017	734,387	724,287	700,637	23,650		724,287	
2018	733,997	733,955	697,627	25,904	10,424	733,955	
2019	734,845	734,845	686,100	28,212	20,533	734,845	

Note: 1. Summary Table B, page 149, from Medium Term Financial Plan, 2016–19, as amended.

Sources: MTFP 2; MTFP 2 Addition

Figure 6. Net revenue expenditure, 2013–15 (2013 prices)

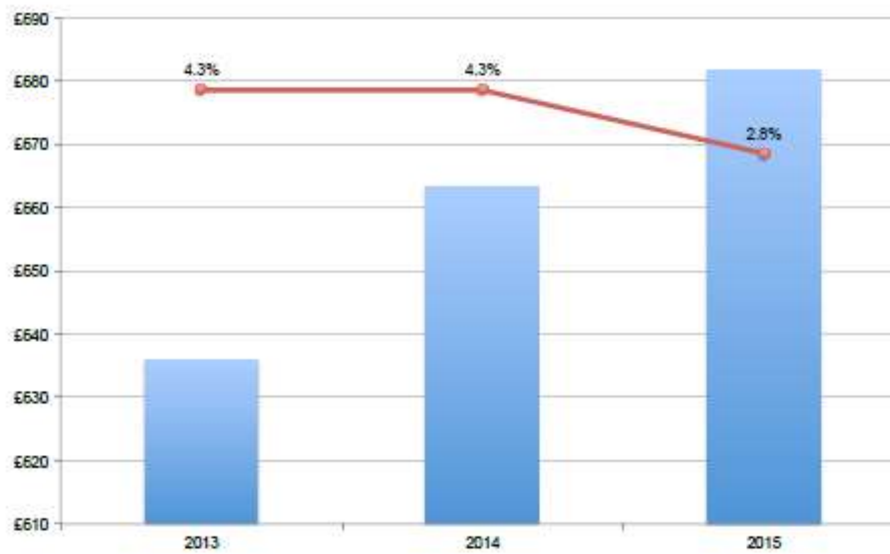
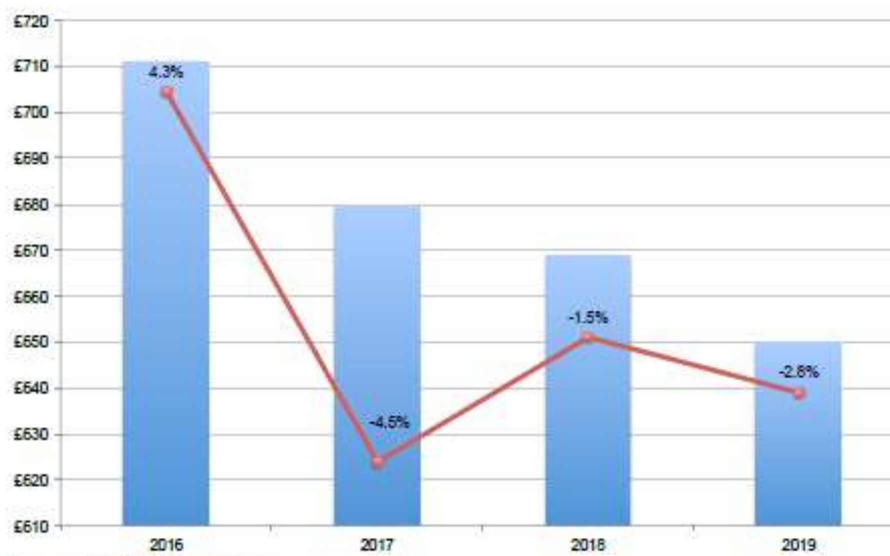


Figure 7. Projected net revenue expenditure, 2016–19 (2013 prices)



Source: MTFP 2 Addition

Table 10. Total states net expenditure for 2016-17, nominal and real (2013) in £ millions

	2016		2017		2018		2019	
	nominal	real	nominal	real	nominal	real	nominal	real
Ministerial Departments								
Chief Minister	26,860,100	25,812,556	26,482,100	24,840,210	26,210,100	23,877,401	25,473,100	22,518,220
External Relations	1,740,700	1,672,813	1,746,300	1,638,029	1,746,300	1,590,879	1,746,300	1,543,729
Economic Development	19,144,400	18,397,768	19,152,600	17,965,139	18,309,000	16,679,499	17,765,900	15,705,056
Education, Sport & Culture	103,660,100	99,617,356	105,974,000	99,403,612	106,246,900	96,790,926	106,346,900	94,010,660
Planning and Environment	5,205,400	5,002,389	5,856,100	5,493,022	5,393,400	4,913,387	4,675,900	4,133,496
Health & Social Services	203,776,800	195,829,505	207,908,300	195,017,985	210,787,000	192,026,957	210,481,100	186,065,292
Home Affairs	49,270,500	47,348,951	48,782,700	45,758,173	48,241,900	43,948,371	47,095,200	41,632,157
Social Security	189,479,200	182,089,511	186,225,700	174,679,707	187,551,300	170,859,234	189,331,400	167,368,958
Infastructure	40,137,100	38,571,753	39,981,100	37,502,272	35,367,400	32,219,701	26,449,200	23,381,093
Treasury & Resources	20,976,700	20,158,609	21,447,400	20,117,661	20,973,500	19,106,859	20,267,400	17,916,382
Total Ministerial Departments	660,251,000	634,501,211	663,556,300	622,415,809	660,826,800	602,013,215	649,632,400	574,275,042
Non Ministerial Departments & States Assembly								
Bailiff's Chambers	1,563,900	1,502,908	1,687,700	1,583,063	1,699,700	1,548,427	1,711,800	1,513,231
Law Officers' Department	7,797,800	7,493,686	7,555,900	7,087,434	7,323,800	6,671,982	7,087,100	6,264,996
Judicial Greffe	6,616,100	6,358,072	6,558,100	6,151,498	6,497,100	5,918,858	6,429,800	5,683,943
Viscount's Department	1,320,600	1,269,097	1,341,200	1,258,046	1,349,900	1,229,759	1,345,500	1,189,422
Official Analyst	604,800	581,213	600,200	562,988	601,300	547,784	571,500	505,206
Office of the Lieutenant Governor	738,400	709,602	734,500	688,961	724,900	660,384	714,700	631,795
Office of the Dean of Jersey	25,800	24,794	27,000	25,326	27,200	24,779	27,500	24,310
Data Protection Commission	267,400	256,971	374,300	351,093	439,700	400,567	505,900	447,216
Probation Department	1,990,500	1,912,871	2,013,800	1,888,944	2,017,600	1,838,034	2,021,700	1,787,183
Comptroller and Auditor General	777,200	746,889	804,400	754,527	817,400	744,651	831,200	734,781
Court and Case Costs								
Total Non Ministerial Departments & States Assembly	21,702,500	20,856,103	21,697,100	20,351,880	21,498,600	19,585,225	21,246,700	18,782,083
States Assembly and its services	5,086,200	4,974,304	5,045,400	4,732,585	4,963,400	4,521,657	4,882,400	4,316,042
Grant to the Overseas Aid Commission	10,337,700	9,934,530	10,338,500	9,697,513	10,338,500	9,418,374	10,338,500	9,139,234
Total Non Ministerial Departments & States Assembly	£37,126,400	£35,764,936	£37,081,000	£34,781,978	£36,800,500	£33,525,256	£36,467,600	£32,237,358
Central Contingency Allocations								
Central Allocation - AME Contingency	2,000,000	1,922,000						
Central Allocation - DEL Contingency	4,736,800	4,552,065	5,000,000	4,690,000	5,000,000	4,555,000	5,000,000	4,420,000
Central Allocation - Pay and Workforce Modernisation	4,203,100	4,039,179	5,643,700	5,293,791	12,293,700	11,199,561	17,606,700	15,564,323
Central Allocation - Restructuring and Redudancy	23,000,000	22,103,000	7,000,000	6,566,000	3,164,000	2,882,404	1,955,400	1,728,574
Central Allocation - Committee of Enquiry	4,000,000	3,844,000						
Central Allocation - EPGDP	5,000,000	4,805,000	4,356,000	4,085,928	3,796,000	3,458,156	2,000,000	1,768,000
tion - Earmkared Child Protection/Policy Improvement			1,650,000	1,547,700	1,650,000	1,503,150	1,650,000	1,458,600
Central Allocation - Growth Provision					10,424,000	9,496,264	20,533,000	18,151,172
Total Central Contingency Allocation	42,939,900	41,265,244	23,649,700	22,183,419	36,327,700	33,094,535	48,745,100	43,090,668
Total Department Net Revenue Expenditure	£697,377,400	£670,266,147	£700,637,300	£657,197,787	£697,627,300	£635,538,470	£686,100,000	£606,512,400
Total Net Revenue Expenditure	£740,317,300	£711,531,391	£724,287,000	679,381,206	£733,955,000	668,633,005	£734,845,100	£649,603,068
Net Capital Expenditure Annual Programme			26,273,000	24,644,074	35,000,000	31,885,000	32,975,000	29,149,900
Net Capital Expenditure Allocation - Other Projects			39,000,000	36,582,000	8,233,000	7,500,263		
Total States Net Expenditure Allocations			£789,560,000	740,607,280	£777,188,000	708,018,268	£767,820,100	£678,752,968

One question that arises is what determined the allocation of a particular level of expenditure for any of the key priority areas in the Addition. For instance, health spend in Jersey is currently 7 percentage of GDP which is low compared to other jurisdictions. The release of additional funding is contingent on the savings targets and/or projected income being achieved. However, there is looseness to the discussion surrounding this in the MTFP Addition with the suggestion that 'if either savings or income forecasts fail to reach the proposed targets the level of additional funding will need to be revisited'. This could be interpreted that if the income is available the expenditure will take place, regardless of whether the savings will be made or not. Although it has been made clear that the total spending limits for the period of MTFP 2 cannot be exceeded, there is also the proviso that this does not apply in 'exceptional economic or environmental circumstances'.

3.3 Efficiencies and savings

In the MTFP 2 published in 2016, the Council of Ministers announced that they wished to make £90 million of savings and efficiencies by 2019 from 'people savings' (£70 million) and 'non-staff savings' (£20 million). A year later, they reached the conclusion that this figure:

> …was not achievable without an unacceptable impact on the level of public services and therefore Islanders. Ministers are committed to achieving this target but they recognise that embedding substantial change requires time. They have therefore decided on a longer timescale to meet the target – taking it into the next MTFP period 2020-2023.
> (Source: http://www.futurefocused.gov.je/latest/savings-efficiencies-and-user-pays-775m)

It is not clear what the 'unacceptable impact' would have been if the full £90 million had been planned for in the Addition. In any case, the new savings and efficiencies in the Addition are shown in Table 11. These total £73 million by 2019. If the user pays charges are also included (not shown in the table), the proposed department savings by 2019 total £77.5 million.

Table 11. Summary of savings and efficiencies from the MTFP Addition (£million)

	2016	2017	2018	2019
Savings	525	1,087	1,487	1,817
Efficiencies	21,793	29,244	38,020	46,317
Efficiencies – Pay restraint	10,894	16,725	20,701	24,826
Total	33,212	47,056	60,208	72,960

One of the best definitions of efficiency savings are can be found in a Devon County Council report in 2005:

> Efficiency savings are those savings which can be squeezed from budgets through better organisation of operations; greater use of information and communication technologies; better utilisation of assets; more economical procurement practices; partnership arrangements with other authorities and the private sector; and from the automation of clerical and administrative procedures. Efficiency savings do not affect the standard or level of service to the population at large or for particular client groups.
>
> (Mills 2005)

Departments were meant to have undertaken a comprehensive and detailed re-appraisal of their expenditure and thought through new ways of working as part of CSR 1 and CRS 2 in the late 2000s and early 2010s but this doesn't appear to have been the case. The executive summary from Kevin Keene's report on States activities entitled 'Stop, Reduce, Outsource' stresses that the States could save money by focussing on what they really need to do and stopping, reducing or outsourcing the rest.[3] Nowhere in the MTFP Addition does if feel as if this has been taken on board and this represents yet another missed opportunity for real reform.

The Public Accounts Committee (2016) have recently re-emphasised the views of the C&AG (Comptroller and Auditor General 2015) that the only way to really gauge Department budgets is to introduce zero-based budgeting. Given the contraction in Department expenditure over the period of the MTFP 2 it would have been thought that this would have been the natural starting point for expenditure allocation.

Recommendation 3: Zero-based budgeting to be introduced across all States Departments in time for the next Medium Term Financial Plan.

[3] http://www.gov.je/Government/Pages/StatesReports.aspx?ReportID=1750

How Departments in the States of Jersey intend to achieve their efficiency savings post-2016 is not entirely clear. The Annex to the Addition provides a little more detail than Appendix 2 of the Addition but many of the efficiencies appear to be aspirational at this stage. From a purely accounting perspective this matters not: the Treasurer has made it clear that Departments will only be given their (reduced) allocated cash limits over the period of MTFP 2. In short, they will have to live within their means. Given the recurrent underspends during the lifetime of MTFP 1 (which totalled £76 million), it would seem that £70 million could be found *in toto* from Departments through modest belt-tightening alone without having to change working practices, as outlined in the above definition.

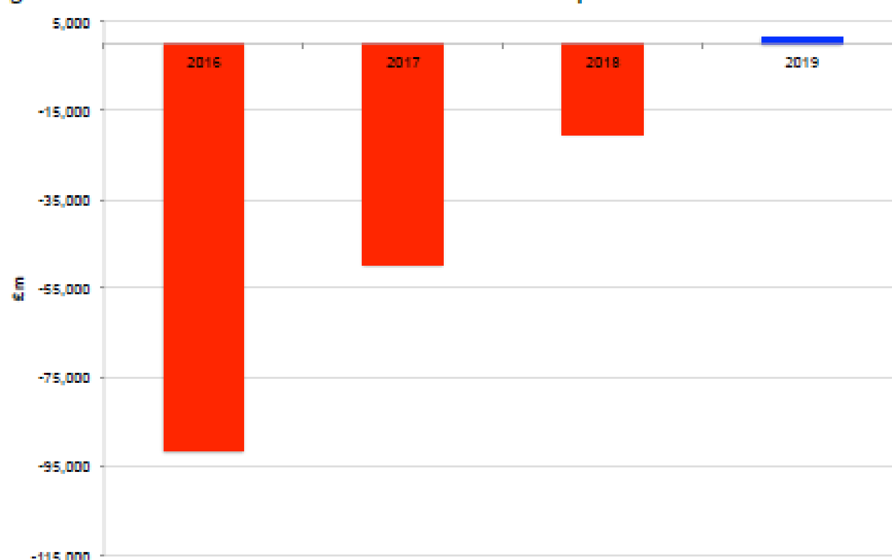
Recommendation 4: An Efficiency and Reform Group should be set up immediately to actively monitor and gauge the level of efficiencies in Departments during MTFP 2.

4. BY 2019?

The move from producing annual business plans to medium term financial planning was warmly welcomed at the time by a number of commentators, although a number of criticisms were raised about the first MTFP (Corporate Services Scrutiny Panel 2012; Comptroller and Auditor General 2015). It is recognised that producing a medium term financial plan is a more difficult exercise than an annual business plan as the two-pronged approach of the second Medium Term Financial Plan has shown. The adviser wonders whether in part some of the difficulties with MTFP 2 have arisen because medium term planning is still a relatively new concept and in part that it is driven predominately by processes designed to balance the books which employ uber accounting spreadsheets.

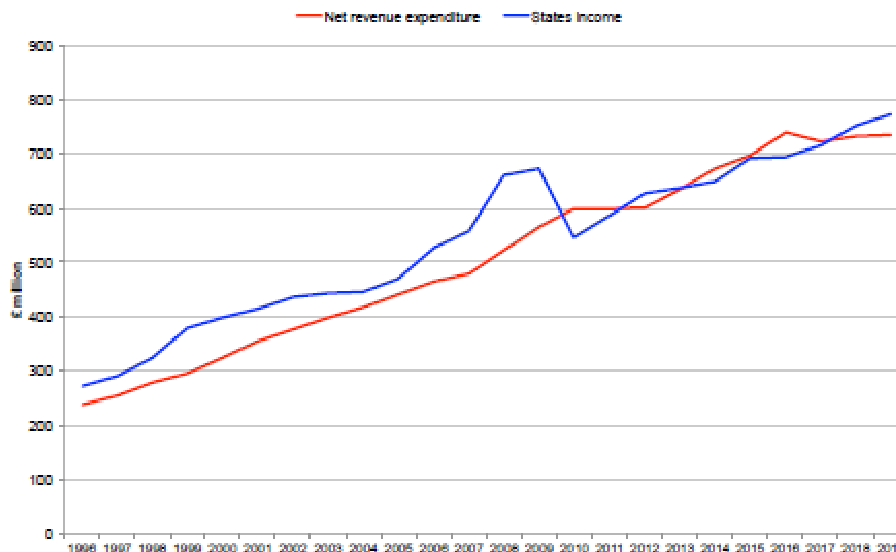
By 2019 policymakers have indicated that due to the measures introduced in the MTFP 2 there will be a small surplus of £1.5 million (Figure 8) and the States will have balanced their budget. Moreover, after eight years of expenditure growing faster than income, it is predicted that from 2018, income will begin its post-2010 trajectory by growing above expenditure (Figure 9).

Figure 8. Financial forecast of structural financial position 2016-2019



Source: MTFP 2 Addition, p. 184

Figure 9 Growth of net revenue expenditure (actual and planned) and income, 1996–2019 (£, million)



Note: The States income line does not include the proposed mechanism to offset States payment of rates or a sustainable funding mechanism for health.

Source: States of Jersey Accounts, various years and MTFP 2 Addition

The profile of income and expenditure post-2018 suggests that the 2010-16 period was an aberration and Jersey will return to the pre-2010 pattern captured in Figure 9. The advisor would caution against such optimism. The scale of the change required for a real and sustained step-change in reducing public expenditure is not to be found in the MTFP 2 Addition. Moreover, despite the recent progress made on limiting the growth of earnings in the public sector, the incredibly high cost base of the public sector will take time to be reduced due to a combination of socio-politico-economic reasons. Achieving real and sustained efficiencies in the workforce requires a transformation driven by strong leadership, which espouses a shared common vision/goal/purpose/objectives with all employees. There is scant evidence that reform is being delivered at the pace and depth required to achieve this by 2019.

On the income side, the IFG and the FPP have recognised the risks to achieve the central income forecasts for the MTFP 2 period. The Survey of Financial Institutions issued after the publication of the MTFP was a further warning that growth in GVA is

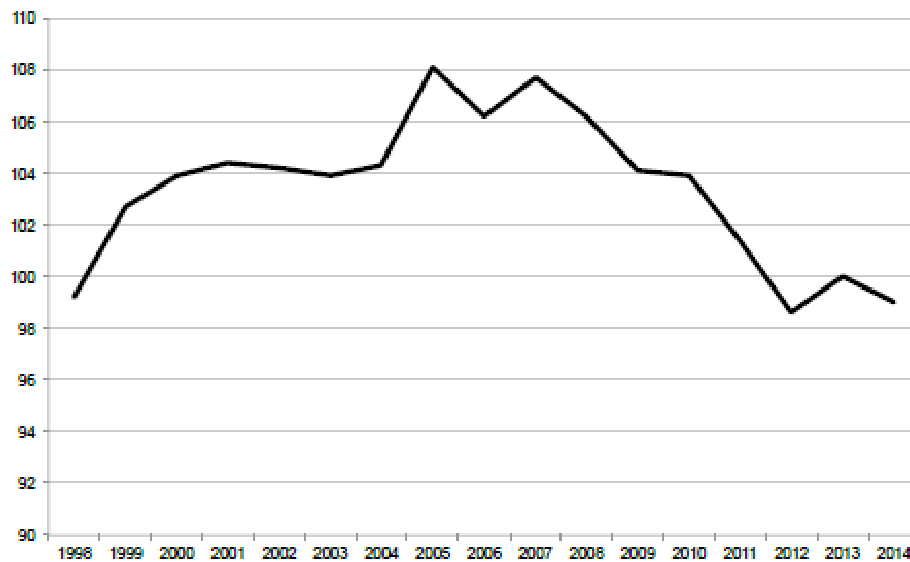
probably going to be lower than assumed in May 2016 economic forecasts. Brexit also carries significant risks for Jersey in the medium term. The central economic assumptions in the FPP's Annual Report for 2016 indicates hardly any growth in real GVA for 2016 and flat growth in 2017 and 2018. Nevertheless, it is clear that even if income fails to reach the central income forecast in the MTFP Addition (or if it is reduced further if the IFG re-do the income forecasts), on the basis of past experience policymakers will find ways of spending money to match income under the guise of cyclical difficulties with Jersey's economy. The FPP also advises that changing the broad approach of the MTFP would not be appropriate at this stage.

More fundamentally, as the advisor has warned in recent reports (and echoed what the FPP have said, albeit in a slightly different way), there are significant challenges for Jersey's economy. The average economic standard of living in Jersey, as measured by GVA per head, has declined by 20 per cent in real terms since 2001. Faster population growth and slower rates of GVA will only lead to a further deterioration. The most important challenge – raising productivity – can be clearly illustrated in Figures 10 and 11. Figure 10 shows that GVA per FTE for the finance sector has declined significantly since 2001 and Figure 11 shows how it has been essentially flat for the rest of the economy.

Figure 10. GVA per FTE of Finance sector in real terms, 1998-2015, index numbers (2013=100)

Source: Statistics Unit, States of Jersey

Figure 11. GVA per FTE of non-Finance sector in real terms, 1998-2014, index numbers (2013=100)



Source: Statistics Unit, States of Jersey

As the FPP (Fiscal Policy Panel 2016b, p. 11) note in relation to the finance sector, 'the longer-term trend remains one of falling productivity in banking and in the (relatively small) fund management and accountancy sectors, with largely flat productivity in trust, company administration and legal'.

With a slim budget surplus predicted for 2019; enormous challenges to reform the public sector within three years and in the absence of a reversal in the fortunes finance sector, policymakers now find themselves in a challenging position. As a former member of the FPP remarked, over the last few years the weight of evidence implies that it is now raining. The advisor would suggest that the forecast is for the rain to come down more heavily with any sunshine some way off. This would suggest that rather than waiting for a cataclysmic event to engulf Jersey, the Rainy Day Fund (the Strategic Reserve) might now be used. How the Strategic Reserve might be spent strategically rather than drip-feeding falls in income has not been articulated and policymakers should give urgent consideration to this.

Recommendation 5: The Treasury should set up a working group to plan on how it might use the Strategic Reserve by 2019.

5. CONCLUSIONS, OBSERVATION AND SUMMARY OF RECOMMENDATIONS

5.1 Conclusions

5.1.1 The central income forecasts in the MTFP Addition are optimistic.

5.1.2 It is unclear why charges have been introduced in the MTFP Addition rather than using the tax system to raise revenue.

5.1.3 The link between hypothecation and Jersey's fiscal framework is not clear.

5.1.4 The reduction in total net revenue expenditure in real terms over the 2017–19 period are significant.

5.1.5 An opportunity for 'stop, reduce, outsource' in the Addition has been missed.

5.1.6 Many of the efficiencies proposed by Departments lack granular detail which makes them appear aspirational.

5.1.7 There are significant challenges ahead for Jersey's economy, particularly surrounding raising productivity growth in the near term.

5.2 Observation: the Fiscal Policy Panel

The advisor believes that the FPP has played an important role in the macroeconomic policy debates in Jersey since its inception in 2008. During the course of this MTFP, the FPP will have been constituted for ten years and this provides an appropriate opportunity to review the role and operation of the FPP. Such a review could consider how the FPP has functioned since its inception; whether its role could be strengthened e.g. could it have similar responsibilities as the UK's Office for Budgetary Responsibility; and its working relationship between the Income Forecasting Group, the Economics Unit and the Treasury.

Recommendation 6: By the summer of 2018, there should be a review of the operation, role and responsibilities of the Fiscal Policy Panel.

5.2 Summary of Recommendations

Recommendation 1: There should be an investigation into the current structure of the tax system to assess its appropriateness for the sustainability of expenditure beyond 2019.

Recommendation 2: The Treasury should consider the advantages and disadvantages for Jersey of hypothecation.

Recommendation 3: Zero-based budgeting to be introduced across all States Departments in time for the next Medium Term Financial Plan.

Recommendation 4: An Efficiency and Reform Group should be set up immediately to actively monitor and gauge the level of efficiencies in Departments during MTFP 2.

Recommendation 5: The Treasury should set up a working group to plan on how it might use the Strategic Reserve by 2019.

Recommendation 6: By the summer of 2018, there should be a review of the operation, role and responsibilities of the Fiscal Policy Panel.

References

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APPENDIX 3: PANEL MEMBERSHIP, TERMS OF REFERENCE AND EVIDENCE CONSIDERED

Panel Membership and Terms of Reference

The Corporate Services Scrutiny Panel comprised the following Members:

Deputy J.A.N. Le Fondré, Chairman

Deputy S.J. Brée, Vice-Chairman

Connétable C.H. Taylor

Deputy K.C. Lewis

The following Terms of Reference were agreed for the review:

1. The overall appropriateness of savings to be delivered during the period 2017-2019 and any material risks to service delivery
2. To look at how spending will be funded
3. To assess progress and the deliverability of capital projects
4. To examine the conditions on which any growth expenditure for 2017 – 2019 is released
5. To consider what impact the MTFP will have with regards to
    a) Revenue expenditure changes
    b) Benefit changes
    c) Capital expenditure
    d) General revenue raising measures
    e) User pays
6. To consider the timescale for implementation of the impact assessments
7. To consider the status of the accepted recommendations from the previous Scrutiny Report S.R. 6/2015 on the MTFP 2016 – 2019
8. To consider the economic context of the MTFP to include
    a) Examination of the assumptions made for the economic forecasts
    b) Consideration of the latest information on financial and operational performance e.g. tax yields, savings and delivery
    c) Contingencies; their use, and how they are allocated
    d) To examine how income is forecast and the levels of income against expenditure
9. To clarify how States expenditure has materially evolved

10. To consider what allowance is made for the possible structural deficit in 2018 and beyond the period of the MTFP

Evidence Gathered

The following documents were considered by the Panel during its review:

a) Draft Medium Term Financial Plan Addition for 2017-2019

b) Medium Term Financial Plan 2016 – 2019

c) Draft Annex to the Medium Term Financial Plan Addition for 2017 – 2019

d) Distributional analysis of the MTFP proposals

e) IFG Update report on draft forecasts of States income from taxation and duty for the preparation of MTFP Addition 2017-2019

f) Corporate Services Scrutiny Panel Review of the MTFP 2016-2019 S.R.6/2015

g) UK Business Confidence Monitor – Q3 2016

h) States of Jersey Statistics Unit, Jersey Business Tendency Survey March 2016

i) States of Jersey Statistics Unit, Survey of Financial Institutions – GVA and productivity 2015

j) States of Jersey Statistics Unit, Index of Average Earnings, June 2016

k) Jersey's Fiscal Policy Panel Annual Report August 2016

l) Jersey Chamber of Commerce Submission

m) Letter from Comité des Connétables

The Panel held the following public hearings, transcripts of which are available on the Scrutiny website (www.scrutiny.gov.je):

Minister for Treasury and Resources – 15/07/16 and 02/09/16

Chief Minister – 08/07/16