
STATES OF JERSEY



FISCAL FRAMEWORK FOR THE MEDIUM TERM FINANCIAL PLAN 2016 – 2019 AND BEYOND

**Presented to the States on 25th September 2015
by the Minister for Treasury and Resources**

STATES GREFFE



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Jersey's Fiscal Framework for MTFP 2016-19 and beyond

Summary

This paper follows up the report Updating Jersey's Fiscal Framework published as R102/2014, building on its recommendations and setting out the framework that will cover decisions taken over the course of MTFP 2016-19 and beyond.

It builds on the experience in Jersey in recent years, draws on international experience and sets out a clear and transparent decision making process. It will assist in making fiscal decisions that support the Island's economic objectives as set out in the Strategic Plan and underpins medium-term fiscal sustainability.

The fiscal framework is a key pillar of Jersey's macroeconomic framework but it is critical that wider policy also focuses on improving productivity and competitiveness. The supplyside of the economy is essential for aligning short-term objectives (e.g. the need for discretionary policy to support the economy) and longer-term fiscal objectives (e.g. medium-term sustainability of public finances) when interest rates cannot be used as a macroeconomic policy instrument.

In their 2015 Annual Report the FPP commented on the framework:

The Panel have been consulted on the development of this framework and see it as a further positive development, not least as it consolidates all the existing States policy and rules that cover fiscal decisions.

The key components of the fiscal framework are summarised below and set out in more detail in the main section of this report. Experience internationally with setting and maintaining fiscal rules has been mixed and for these reasons the framework uses fiscal guidelines rather than strict fiscal rules.

1. Fiscal guidelines

- i. Aim to balance the States' current budget (which excludes capital expenditure but includes depreciation) over the economic cycle.
- ii. The Social Security Funds (including the Health Insurance and Long-term Care Funds) should be kept on sustainable medium-term footing through Government Actuary Department (GAD) reviews and well planned policy changes.
- iii. Monitor the States' net asset position over the economic cycle and relative to the size of the economy.
- iv. The FPP will advise on progress in keeping to the above guidelines through their normal reporting structure and with continued focus on medium-term sustainability.

There are a number of other rules effectively in place as a result of the Public Finances Law that limit the amount the States can lend or borrow but it is not suggested they are changed or removed from the Law at this stage. However, it is key that they are kept under review to make sure they do not constrain fiscal policy decisions that are in keeping with the fiscal guidelines. In their 2015 Annual Report the FPP pointed out that:

However, a number of existing rules and legislation such as that covering the Consolidated Fund and limits on what the States can borrow and lend, still run the risk of being counterproductive in certain circumstances. For example, the conservative limits on what the States can borrow could stop, or delay, large capital projects.

If in practice these rules do lead to fiscal decisions that are inconsistent with the fiscal guidelines then it will be important to revisit whether it is necessary to keep them. However as the FPP also pointed out:

If decisions are made within the context of the fiscal guidelines and in line with the Panel's advice, these risks should be minimised. The Panel will highlight through its usual reporting structure whether these risks are materialising and if so, what further action is required.

2. Rules for the key funds

The rules for the key funds remain as already agreed by the States, although the operation of the funds will need to be consistent with the new fiscal guidelines.

a) The Strategic Reserve

The primary purpose of the Strategic Reserve remains as already agreed by the States:

The capital value (as at 31 December 2012) is only to be used in exceptional circumstances to insulate the Island's economy from severe structural decline such as the sudden collapse of a major Island industry or from major natural disaster.

In addition it can be used to provide funding for the Bank Depositors Compensation Scheme (up to £100m) and for the creation of new hospital services (in line with the proposals agreed by the States in the proposition: Health and Social Services - a new way forward).

In line with FPP advice the value of the Strategic Reserve will be monitored relative to the size of Jersey's economy and States' expenditure, not just in real terms.

b) The Stabilisation Fund

The purpose of the Stabilisation Fund (SF) remains as already agreed by the States: to make fiscal policy more countercyclical and create in the Island a more stable economic environment with low inflation.

The FPP retain oversight of the SF and advise on transfers to and from it. The FPP's role is also clarified to make it clear that their role is to advise on countercyclical fiscal policy more generally and not just use of the SF or SR. In practice it will be their advice that will ensure fiscal policy is set correctly given economic conditions and the position in the economic cycle.

c) The Housing Development Fund

The Housing Development Fund (HDF) is a special fund to fund social rented and first-time buyer housing development programmes. It allows the Minister for Treasury and Resources to borrow (up to £250m) commercially, through the fund, to finance the acquisition and development of sites. In addition it can lend the £250m bond issue to Housing Trusts/Associations/Companies to provide housing for Islanders.

d) Consolidated Fund

The Public Finances Law states that Council of Ministers cannot propose in an MTFP or Budget policies that lead to a negative balance in the Consolidated Fund (CF) at the end of any financial year. It is important that this rule is not interpreted in such a way that in certain circumstances it prevents the operation of counter cyclical fiscal policy.

Rather than change the Law, decisions under the new framework will be taken in a manner that ensures that this CF rule is retained but does not constrain the States in meeting the overarching fiscal rule.

Given the uncertainty inherent in fiscal forecasts there could be increased risks of short-term decision making if the States plans to run the CF close to zero. It would not take much divergence from expectations to require short-term measures to return the CF to balance. This could be partly mitigated if plans set out to maintain a positive balance in the CF to allow for some fluctuations relative to forecasts.

The FPP are concerned that the rules regarding the CF balance and limits on what the States can borrow/lend could be counterproductive under certain circumstances. However, if decisions are made within the context of the fiscal guidelines and in line with FPP advice these risks should be minimised. It will be important to monitor how these rules are applied and if necessary revisit their suitability as the framework continues to evolve.

3. The Fiscal Policy Panel

The role and responsibilities of the FPP are now on a statutory basis in the Public Finances Law and the FPP's Annual Report will remain the cornerstone of fiscal framework. In covering the issues set out in the Law and with respect to the fiscal guidelines set out in this framework the FPP will continue as Jersey's key fiscal institution and the lynch pin of the fiscal framework. Through independent, expert and transparent advice the FPP will be the most important check and balance to help the States set fiscal policy in keeping with the States' economic and fiscal objectives and medium-term fiscal sustainability.

With the formation of the new Income Forecasting Group the FPP have agreed to consider and assess what the appropriate economic assumptions should be for forecasting purposes and the IFG will only use economic assumptions that are endorsed by the FPP. This will help improve the transparency and credibility of that part of the forecasting process. The FPP will continue to have the opportunity to

comment on any aspect of the financial forecasts through their annual reporting structure.

The independence of the FPP is critical for its role in the fiscal framework. The Public Finances Law does make explicit mention of the Panel's independence but this could be strengthened by having a more transparent process through which the Treasury and Resources Minister appoints Panel members. The Law already requires the Minister to "seek the views of the Appointments Commission" before making an appointment. To make this process more transparent and to strengthen the independence of the Panel it will be led by the Chairman (outgoing or incoming) of the FPP, without input from the Treasury and Resources Officers or Minister. The Chair will make the recommendation to the Minister as to who is most suitable in terms of skills, experience and make-up of the Panel.

4. The Annual and Medium-term budgetary framework

Jersey has made significant steps forward in establishing its medium-term planning framework in recent years. Building on these positive developments the new framework follows the FPP's advice (similar recommendations have been made by the C&AG and Corporate Services Scrutiny Panel) that MTFP and Budget Reports will include:

- A financial forecast for the current and next 3 years including updated income projections taking into account the latest economic developments, expenditure forecasts and budget measures.
- Proposed movements on the Consolidated Fund, Stabilisation Fund and Strategic Reserve for the current year and next 3 years.
- Data which shows what happened to these Funds in the previous 3 years.
- A financial forecast showing the surpluses and deficits as adjusted to recognise the economic impacts of the overall position of States' finances including other funds such as the Social Security, Long-term Care and Health Insurance Funds (and in line with the advice of the Comptroller and Auditor General).

In February 2015 and in response to R102/2014 and recommendations of the Corporate Services Scrutiny Panel the Minister for Treasury and Resources approved the formation of a new Income Forecasting Group to advise on forecasts for all States income from taxation. The Minister also approved the IFG Terms of

Reference as set out in Appendix 3 and agreed that it was part of the new fiscal framework.

Further development

Fiscal frameworks should evolve over time and learn from experience and best practice elsewhere. An integral part of the previous framework and this one is that it is kept under review and that there is a continuous process of improvement. However, any changes to the framework should be explicit and transparent and in context of the existing framework and its future evolution.

Introduction

This paper follows up the report *Updating Jersey's Fiscal Framework* published as R102/2014, building on its recommendations and setting out the framework that will cover decisions taken over the course of MTFP 2016-19 and beyond. Since R102/2014 the Economics Unit has sought the views of the FPP in developing the framework further.

By setting out the fiscal framework it is anticipated that a clear and transparent decision making process will help lead to fiscal decisions that support the Island's economic objectives and underpin medium-term fiscal sustainability.

It is important to recognise the experience in recent years in Jersey. R102/2014 highlighted that the performance of the Fiscal Framework in Jersey over the previous 7 years pointed to a number of positive outcomes:

- The Stabilisation Fund (SF) and FPP were both established and in advance of the global financial crisis
- The SF was large enough to fund both automatic stabilisers and discretionary policy in the initial years following the global financial crisis.
- The value of the Strategic Reserve has been protected and grown significantly in real terms and as a share of GVA.
- The FPP have advised on key aspects of fiscal policy (including the 3Ts – timely, targeted and temporary) and collectively grown in weight, stature and credibility and are now on a statutory basis.
- The MTFP has established much greater focus on the medium-term and led the move away from annual business planning.

It was also suggested there were a number of areas where greater clarification and improvement could be provided:

- Fiscal policy had not always been countercyclical and there had at times been problems delivering capital expenditure/fiscal stimulus.
- There was some uncertainty over how the States should implement counter cyclical fiscal policy when the SF was exhausted, that is still the case as the economy recovers in 2015 and the balance in the SF is zero.
- Plans for the replenishment of the SF were not clear.
- The FPP had highlighted that the objectives of the SR needed clarification.

- The FPP had expressed concerns about Budget transparency/completeness.
- Financial forecasts on a cash basis were not appropriate for assessing the economic impact of fiscal policy.

In developing the framework it is important to take account of international experience that suggests strong and resilient Fiscal Frameworks have the following key components:

1. **Numerical fiscal rules:** provide a permanent constraint on fiscal policy in terms of a summary indicator of fiscal performance such as the government budget deficit or government debt but can also cover expenditure and revenue rules.
2. **Independent fiscal institutions:** non-partisan public bodies have contributed positively to fiscal policy making through the provision of unbiased inputs for the annual budget, independent analysis on fiscal policy issues such as budgetary developments/compliance with rules and regular assessments and recommendations.
3. **Medium-term budgetary frameworks:** where the horizon of fiscal planning is extended beyond the annual budgetary timetable and reflects the impact of past and new policy measures.
4. **Budgetary procedures:** covers all the procedural rules laid down in law covering the planning, approval and execution of the budget.

The European Commission advises that:

The reform of these elements, namely numerical rules, independent fiscal institutions, medium-term budgetary frameworks and budgetary procedures should be regarded as a single process. All these fiscal arrangements are closely interconnected, and the functioning of one of them affects the working of the remaining elements. Partial or fragmented reforms usually fall short of providing the needed improvements.

R102/2014 suggested a number of potential areas for reform under each of these headings. This report finalises the framework under which fiscal decisions during the course of MTFP 2016-19 will be made. The framework set out below gives greater clarity to the existing framework and strengthens it over the life of the next MTFP and the longer-term.

Economic and fiscal objectives

The fiscal framework needs to be consistent with the States' economic and fiscal objectives, which are set out in the Strategic Plan 2015-18. In terms of optimising economic growth the overall ambition is:

Jersey achieves sustained, productivity-led economic growth, providing rewarding job opportunities and rising living standards across society.

The Plan sets out that this requires Jersey to have sustainable public finances and low inflation.

In addition the Strategic Plan sets out one of its priorities as sustainable public finances with the ambition to:

Place Jersey on a sound path to structural fiscal balance and aim to balance States revenue and current expenditure (including depreciation) over the economic cycle, in line with the advice of the Fiscal Policy Panel.

The key areas of focus for 2015-18 set out in the Strategic Plan are included in Appendix 1. The framework set out in this paper reflects this strategic priority and is consistent with the key priorities of the States.

The components of Jersey's fiscal framework are:

1. Fiscal guidelines
2. Rules for the key funds: Strategic Reserve, Stabilisation Fund, Housing Development Fund and the Consolidated Fund.
3. The Fiscal Policy Panel
4. The Annual and Medium-term Budgetary Framework

Each component is covered in more detail in the following sections.

1. Fiscal guidelines

Experience with setting and maintaining fiscal rules internationally has been mixed and it is not clear that there are rules that could be tailored to reflect the specific nature of the Jersey economy. For these reasons the framework uses fiscal guidelines rather than strict fiscal rules. The overarching fiscal guidelines that help to set fiscal policy should be:

- i. **Aim to balance the States' current budget over the economic cycle:** The current budget excludes capital expenditure but includes depreciation. It should also exclude the revenue and expenditure of the Social Security funds

(which are covered below) but not the States' contribution to the fund (supplementation). Given that the economic cycle can be difficult to predict the FPP's advice will be critical in ensuring that fiscal policy is in keeping with this guideline.

- ii. **The Social Security Funds (including the Health Insurance and Long-term Care Funds) should be kept on a sustainable medium-term footing through Government Actuary Department (GAD) reviews and well planned policy changes.** However, the yearly fiscal position of funds (revenue less expenditure) should be considered in assessing the States' overall fiscal stance during the cycle and in particular the economic impact of fiscal policy.
- iii. **Monitor the States' net asset position over the economic cycle and relative to size of economy.** The States' net asset position is now published in the annual accounts and how this varies from year to year should also be considered relative to the size of the economy (GVA). Given the strength of the net assets position there may be circumstances where it is justifiable that the net assets position deteriorates e.g. using the Social Security Reserve to manage the impact on the fund of the ageing society or using the real return from the Strategic Reserve when economic and fiscal conditions merit such an approach. However, the advice of the FPP will be critical in determining whether such approaches are consistent with the medium-term sustainability of States' finances.

In addition, given the existing rules (covered below) for funds such as the Stabilisation Fund and Strategic Reserve it is important to consider their value relative to the size of the economy and States' expenditure/revenue.

- iv. **The FPP will advise on progress in keeping to the above guidelines through their normal reporting structure and with continued focus on medium-term sustainability.** The above are guidelines not fixed rules for the reason that it is very difficult to have rules that are flexible enough to apply in all economic circumstances. This makes the judgement of the FPP extremely important in assessing progress. Information should be included in all Budget and MTFP reports on past and expected future performance relative to the above guidelines which would facilitate wider understanding of progress and relative to FPP advice.

The States' net asset position

The States' balance sheet from the States' Accounts is shown in Chart 1. It shows a snapshot of the States' financial position at the end of 2014. This includes the assets – what the States owns and what is owed to the States, and the liabilities – what the States owes at that the end of the year.

The assets on the balance sheet include:

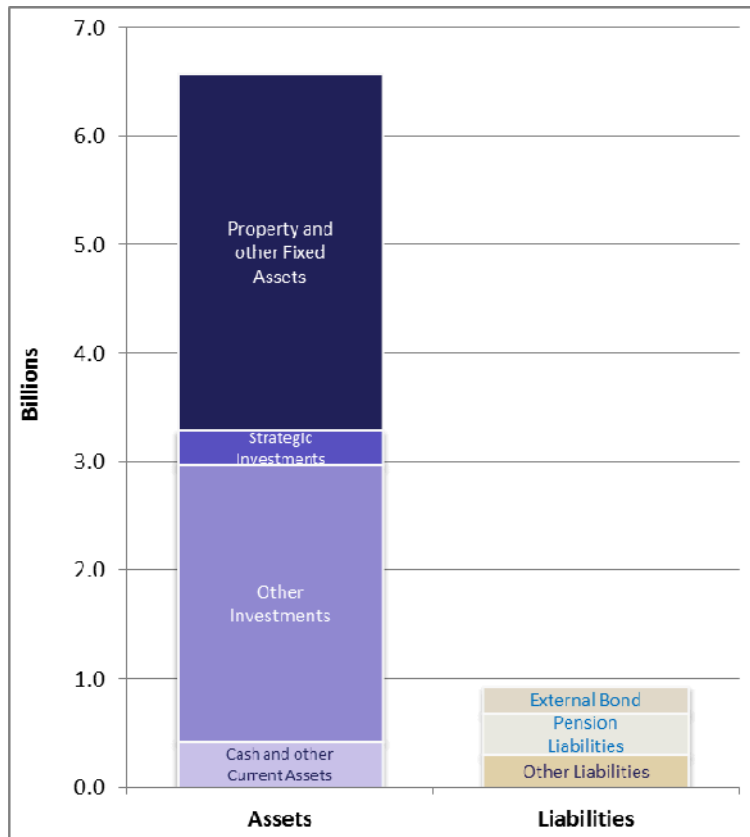
- Property and other fixed assets, £3,324m - such as land, buildings, social housing and various networks including the road network, the foul and surface water network and sea defence network.
- Strategic investments, £318m - The States owns controlling investments in the following utility companies: Jersey Electricity plc, Jersey New Waterworks Company Limited, JT Group Limited and Jersey Post International Limited.
- Other investments, £2,546m - for example in the Strategic Reserve (£787m) and Social Security Funds (£1,446m).
- Cash and other current assets, £417m.

The liabilities on the balance sheet include:

- Public sector pension liabilities (£386m) of the employer (including past service liabilities but not those that do not fall to the employer)
- Other liabilities (£290m), including the value of currency in circulation and amounts owed to other people and businesses.
- The external bond taken out in 2014 (£243m) although this will be balanced by additional assets in terms of social housing and non-strategic investments (acquired by investing the remaining capital from the bond issue).

Chart 1: States' assets and liabilities 2014

£ billions



Source: States of Jersey 2014 Accounts

Chart 2 shows a snapshot of the States' financial position at the end of each year between 2008 and 2014. This includes the assets and liabilities of all the States' funds, including the Strategic Reserve and Social Security Funds.

It shows that the States' net asset position has improved from £4.7bn to £5.7bn (in real terms) over this period.

However, care is required in interpreting what this measure shows about fiscal sustainability, as there are significant limits. It does not include the present value of future spending that the States will wish to undertake, for example on health, education and pension provision. This measure also excludes the States' most valuable financial asset – its ability to raise taxes in the future.

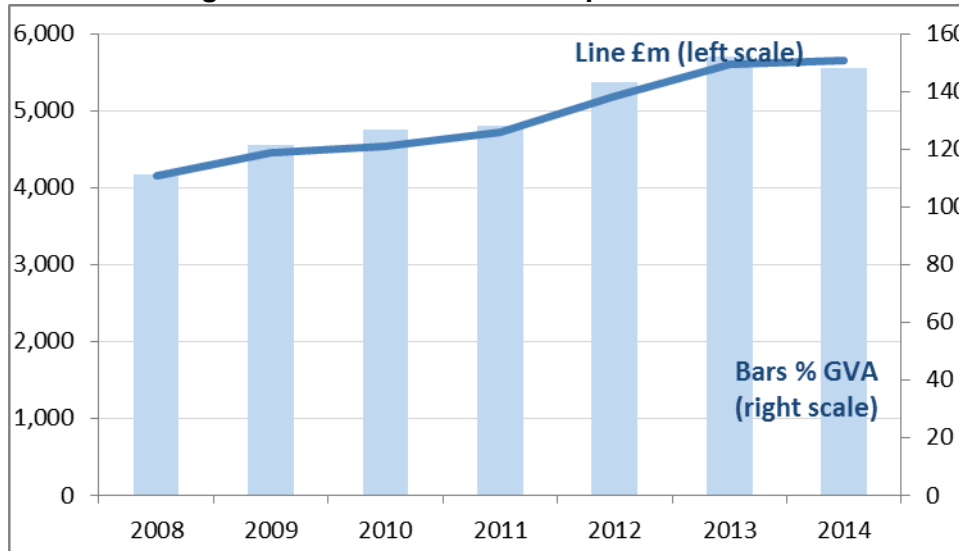
Two main factors explain this increase:

- An increase in the value of investments, most of which are held in the Strategic Reserve and Social Security Funds.
- An increase in the value of fixed assets. This is mainly due to revaluations of the existing stock (for example, reflecting higher replacement costs) rather than adding to, or improving the fixed assets stock.

The value of the States’ other assets and liabilities has remained fairly stable over the period.

In 2014 the rate of growth in the net assets position has slowed as a result of lower returns on the CIF and other investments and some large impairments.

Chart 2: Changes in the States’ net asset position



Source: States of Jersey Treasury Department/Economics Unit calculations

Other rules

There are a number of other rules in the Public Finances Law that have potential implications for fiscal policy decisions. It set outs that the States may not borrow money except in accordance with a decision of the States made on a proposition lodged by the Minister. Also that the total amount of borrowing by the States should not exceed an amount equal to the estimated income of the States derived from taxation (including duties) during the previous financial year. In 2014 total income tax and duty revenue was nearly £600m or about 15% of GVA. It is not clear why this is deemed to be the appropriate limit for total borrowing, provides quite a lot of latitude given the starting point and does not have any reference to accumulated savings such as the Strategic Reserve.

Following Budget 2014 the total lending permitted was increased from 15% to 60% of the estimated income derived from taxation during the previous financial year.

It is not suggested that these rules are changed or removed from the Law at this stage. However, they should be kept under review to make sure they do not constrain fiscal policy decisions that are in keeping with the fiscal guidelines and FPP advice. If in practice these rules do lead to fiscal decisions that are inconsistent with

the fiscal guidelines then it will be important to revisit whether it is necessary to keep them.

2. Rules for the key funds

The rules for the key funds remain as already agreed by the States, although the operation of the funds will need to be consistent with the new fiscal guidelines.

a) The Strategic Reserve

R102/2014 highlighted that there was a lack of clarity around the definition of the 'capital value' for the SR in the original framework in 2006. This was addressed in Budget 2015 when the States agreed:

“to note the future operation of the Strategic Reserve Fund (“The Fund”), as set out in Appendix D of the Budget Statement and to agree that the Strategic Reserve balance of £651,216,000 as at 31st December 2012 should be defined as the capital value of the Strategic Reserve and that, for future years, the capital value be maintained in real terms by increasing the capital value in line with increases in Jersey RPI(Y)”.

The previous agreed uses of the Strategic Reserve remain the same and in particular as set out in P.133/2006 that it:

“...should be a permanent reserve, where the capital value is only to be used in exceptional circumstances to insulate the Island’s economy from severe structural decline such as the sudden collapse of a major Island industry or from major natural disaster”.

The States subsequently approved P.84/2009, in which they agreed to vary the policy approved in 2006:

“...to enable the Strategic Reserve Fund to also be used, if necessary, for the purposes of providing funding for the Bank Depositors Compensation Scheme to be established under the Banking Business (Depositors Compensation) (Jersey) Regulations 200-; and to agree that monies from the Strategic Reserve Fund, up to a maximum combined total not exceeding £100 million, should be made available if required to meet the States contribution to the Bank Depositors Compensation Scheme and/or to meet any temporary cash flow funding requirements of the Scheme”.

Under P.84/2009, if the Fund makes a loan to the Bank Depositors Compensation Scheme "...it is envisaged that the loan will be repaid with interest and terms and conditions agreed by the Minister for Treasury and Resources".

A fourth use of the Fund was approved by the States under P.122/2013, which agreed that:

"...the Fund could be used...in order to enable the creation of new hospital services as part of the proposals agreed by the States on 23rd October 2012 in adopting the proposition 'Health and Social Services: a new way forward' (P.82/2012) – to agree, as an exception to the approved policy for the use of the Fund, that the Fund may be used for the planning and creation of new hospital services in the Island, and to approve the transfer of an initial sum of £10.2 million from the Strategic Reserve Fund to the Consolidated Fund in 2014 so as to provide for these purposes, in accordance with the provisions of Article 4(3) and 10(3)(f) of the Public Finances (Jersey) Law 2005".

Appendix D to Budget 2015 which was not explicitly agreed by the States also stated

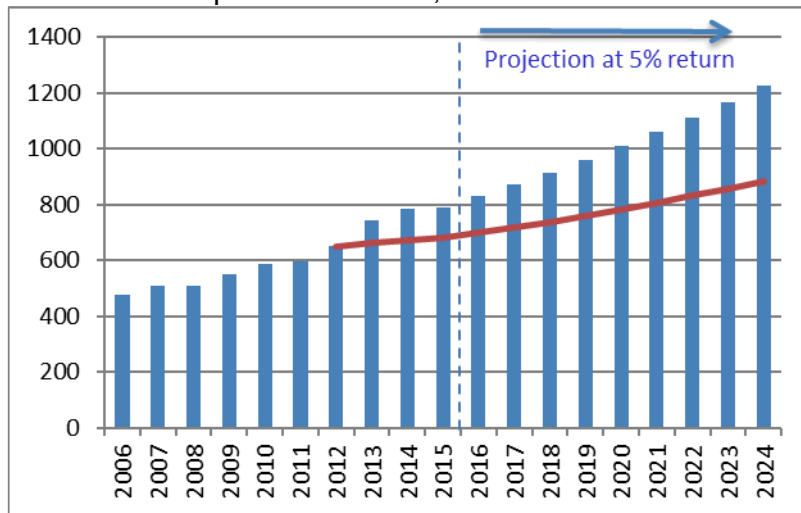
"Any future Real Investment Returns of the Strategic Reserve Fund from the 1 January 2013 onwards will be used to fund the costs of the new hospital services. The States have agreed to the draw down up to £297 million from the Strategic Reserve Fund for this purpose.

For calculation purposes, all Real Investment Returns will be accumulated from 1 January 2013 going forward, for future years. The Total Fund Value as at 31 December 2012 of £651 million will be used as the start position for the calculation of forecast Real Investment Returns for future years. The Real Investment Returns will then be available to be drawdown to meet the total costs of the project up to £297 million. Cash-flows will be drawn down in line with the project cash-flow requirements."

At the end of 2014 the Strategic Reserve was valued at £786.5m (following the £10.2m drawdown for the hospital) and at the end of August in 2015 it had reached £791m. The chart below shows that if the value at the end of 2012 is updated in line with RPIY then the current value is significantly in excess of the real value (£115m at end of 2014). If it is assumed that the Strategic Reserve continues to grow at 5% a year (for illustrative purposes) from 2016 onwards and RPIY moves in line with inflation then by 2024 the value of the fund would be £1,225m relative to a 2012 constant real value of £882m.

Chart 3: Strategic Reserve in nominal and real terms

Red line = 2012 value uprated with RPIY, blue bar = nominal values at 5% return

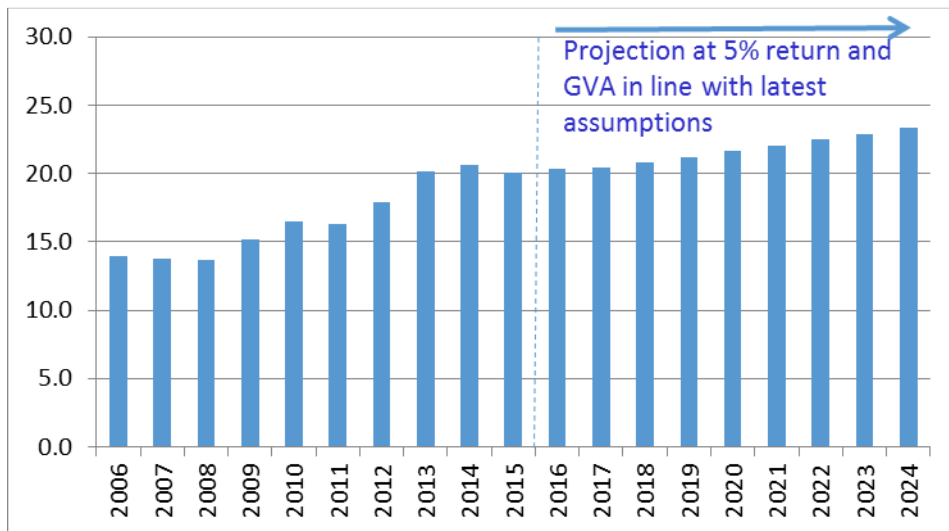


Source: Economics Unit calculations

Under this scenario the value of the SR would also rise from about 20% of GVA in 2014 to about 23% of GVA (assuming GVA grows in line with the latest economic assumptions).

Chart 4: Strategic Reserve as a proportion of GVA

% GVA (assuming 5% investment return and GVA moves in line with latest economic assumptions)



Source: Economics Unit calculations

The Budget 2015 definition above ensures that the value of the SR in 2012 is maintained in real terms, including the growth that was secured under the 2006 Fiscal Framework until that date.

However, the original purposes of the SR – severe structural decline and natural disaster – and their associated costs may not change in relation to Jersey RPI.

These costs may be more associated with the size of the economy or the level of government expenditure both of which may increase in real terms and therefore at a sharper rate than RPI.

It is therefore important that the value of the Strategic Reserve is not just monitored in real terms but also relative to the size of the economy. The FPP have previously advised that:

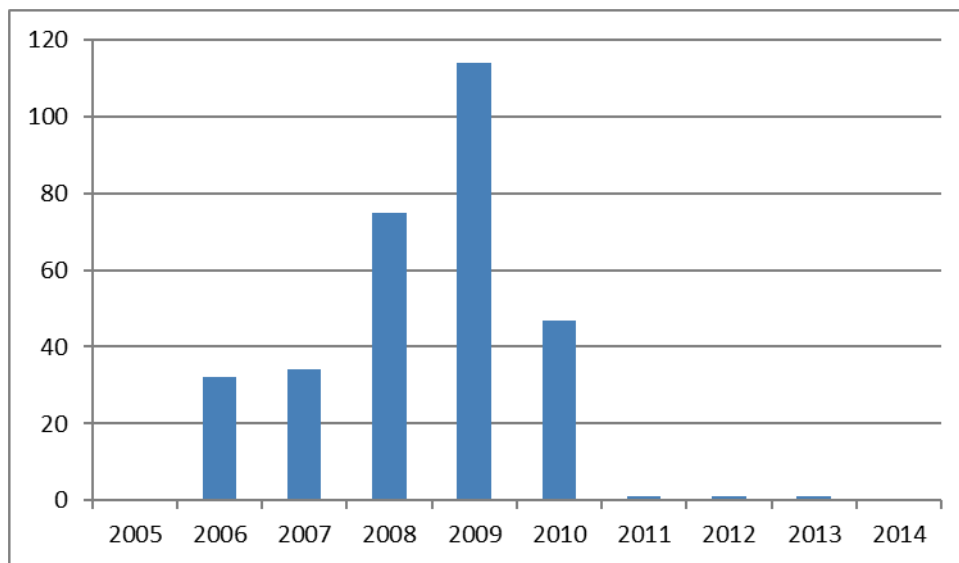
“The States should monitor the value of the Strategic Reserve relative to the size of Jersey’s economy and States’ expenditure.”

b) Stabilisation Fund

The Stabilisation Fund was established in 2006 as part of the new fiscal framework and significant resources built up in advance of the global financial crisis and with oversight from the independent FPP (see chart below).

Chart 5: The Stabilisation Fund

Closing balances £m



Source: States of Jersey Treasury and Resources

SF was large enough to fund both automatic stabilisers and discretionary policy and offer significant support to the local economy in the initial years following the global financial crisis. Significant withdrawals from the SF totalling over £150m were made in the period 2009 -11.

R102/2014 set out that there was a need to update and clarify the role of the Stabilisation Fund. In Budget 2015 the States agreed:

“to refer to their Act dated 5th December 2006, in which they approved the establishment of a Stabilisation Fund and agreed that the purpose of the Fund was to make fiscal policy more countercyclical and create in the Island a more stable economic environment with low inflation, and to approve the rules for the future operation of the Stabilisation Fund as set out in Appendix E of the Budget Statement”

The establishment of the Stabilisation Fund was approved by the States in P.133/2006, which stated that “a special fund, to be known as the Stabilisation Fund, be established, with (a) the purpose of the Fund being to make fiscal policy more countercyclical and create in the Island a more stable economic environment with low inflation. (b) the Minister for Treasury and Resources to be responsible for proposing to the States the transfers between the Consolidated Fund and the Stabilisation Fund having regard to the advice of a new independent Fiscal Policy Panel appointed by the States...(c) the fund to be set up with the transfer of £32 million surplus funds currently available from the Dwelling House Loans Fund.”

Since the establishment of the Fund, it has continued to operate in line with the purpose as defined under P.133/2006. With States approval granted for fund flows into and out of the Fund. P.179/2009 is an example of the States approving, a budget transfer from the Stabilisation Fund of £37 million to replace the States fall in States Revenues in 2010 and to enable a working balance of £20 million to be maintained in the Consolidated Fund in 2010.

In accordance with Article 4A(1) and (2) of the Law, transfers to or from the Fund must be via the Consolidated Fund and must be approved by the States through a proposition lodged by the Minister for Treasury and Resources.

Under Article 56C of the Law, the Fiscal Policy Panel (FPP) is required to prepare and publish an annual report upon the state of the economy in Jersey and the States’ finances. The Article 56C(2) Law states that the matters commented upon in the report must include

- a) the strength of the economy in Jersey;
- b) the outlook for the economy in Jersey and, generally, world economies and financial markets;
- c) the economic cycle in Jersey;
- d) the medium and long-term sustainability of the States finances, having regard to the foregoing matters; and

- e) transfers to or from, the Strategic Reserve Fund and Stabilisation Fund, having regard to the foregoing matters.

It is clear that the FPP retain oversight and significant influence over the use of the SF which will continue to ensure it is used for the purposes intended. In addition, the Comptroller and Auditor General (C&AG) has a duty under the Law (Article 11(i)) to provide the States with independent assurance that money withdrawn from the Fund has been used for the purpose for which it was authorised to be withdrawn.

The advantages of such a fund are that it facilitates counter cyclical fiscal policy which tries to delink revenues and expenditure (in Jersey terms this means trends in corporate/personal tax from immediate spending decisions) and the ability of fiscal policy to support the economy during downturns. In addition, by ensuring that deficits are not run year in and year out or that balanced budgets is the maximum achieved it supports long-term fiscal sustainability.

As mentioned above, the experience in Jersey has been positive in that the accumulation of the SF allowed the States to run significant deficits in the aftermath of the global financial crisis, preventing the need to make painful adjustments at a time when the economy was weak. It allowed swifter action in that the States did not have to agree/arrange borrowing.

However, experience in Jersey also highlights a number of issues (as highlighted earlier) where the framework has worked less well and that needs further consideration and/or addressing directly:

- Fiscal policy has not always been countercyclical in Jersey since the financial crisis.
- The FPP's remit focuses particularly on use of the Stabilisation Fund which may mean its mandate is unclear when the SF is extinguished.
- Future plans for rebuilding the SF are not clear.

An independent Fiscal Commission Working Group of economic experts for the Scottish Government advised in advance of the 2014 referendum that if Scotland achieved independence the Scottish Government should establish a short-term stabilisation fund to manage year on year changes in oil and gas tax revenue immediately following independence and that its operation should be embedded into the wider management of the public finances.

However, as the experience in Jersey shows a Stabilisation Fund is not sufficient by itself to run counter cyclical fiscal policy, not least as governments can use the non-

fund fiscal position in other ways that counteract the impact of the SF. The FPP have advised that “the extent of fiscal stimulus should not be limited by the balance on the Consolidated or Stabilisation Funds”.

It is for these reasons that this paper makes it more explicit that the role of the FPP is to advise on countercyclical fiscal policy not just use of the SF or SR. This means that if the SF has no funds and there is a need to run countercyclical fiscal policy (as advised by the FPP) i.e. deficits to support the economy when conditions are weak then other solutions will have to be considered such as:

- One-off payments into the Consolidated Fund from sales of assets/unexpected dividends etc
- Borrowing/transfers from the SR (with consideration of repayments)
- Borrow/transfers from other funds (with consideration of repayments)
- Borrow externally/from the market

The FPP’s advice would be important in determining which option is most cost effective for the States, whether it is consistent with medium-term sustainability and whether there is a viable policy approach where repayment is required.

If the SF is the valve that facilitates counter cyclical policy then its rebuilding after it has been exhausted during an economic downturn must be dependent on running budget surpluses when the economy is operating above capacity in subsequent years. Given that the SF has been extinguished over the global financial crisis and subsequent period there will be a need to rebuild it in future years. If the States can follow the FPP’s advice in ensuring that the current budget is balanced over the economic cycle and by 2018/19 then this will be the most effective way to prepare to rebuild the SF. Without any structural deficit the current budget would run a surplus when the economy is above capacity.

There is clearly a risk that as economic cycles are not uniform, the SF may not be rebuilt sufficiently in advance of the next downturn. If that is the case the FPP’s advice will be critical in determining the right policy approach and in particular the nature of the downturn and what fiscal policy response is appropriate. If that requires discretionary fiscal stimulus then the FPP’s advice would be critical in determining how this could best be achieved.

c) The Housing Development Fund

A copy of the original terms of operation of the Housing Development Fund (HDF) from P.84/1999: *Establishment of Housing Development Fund* is attached as Appendix 2 with the key points being that.

The HDF would extend the Housing Development Scheme to include funding for the development of social rented housing as well as for first-time buyer properties.

The HDF would provide a mechanism for funding housing developments undertaken by the States, as well as providing subsidies (where necessary) for developments undertaken by other providers of social rented housing (such as Housing Associations) and, if necessary, for certain private sector "first-time buyer schemes".

In accordance with Article 3(3)(a) of the Public Finances (Jersey) Law 2005, the Housing Development Fund was established as a special fund for specific purposes. The States acting through the Minister for Treasury and Resources fully administers the Housing Development Fund. As a special fund, only the States may, on a proposition lodged by the Minister of Treasury and Resources, vary the purposes of a fund so established.

These terms were formally extended by the States in Budget 2014 to enable the £250 million borrowed to be lent to Housing Trusts/Associations/Companies or bodies with the same purpose registered in Jersey in order that they can provide housing for islanders, on terms and conditions to be agreed, after consultation with the Minister for Housing, between the Minister for Treasury and Resources, and the aforementioned Housing Trusts/Associations/Companies. In the case of Andium Homes Ltd it also allows for the redevelopment and refurbishment of existing sites and properties. These revisions were incorporated into the operation of the Housing Development Fund.

R102/2014 advised that it was necessary to make the purpose of the Housing Development Fund (HDF) more explicit. In Budget 2015 the States agreed that:

"to refer to their Act dated 5th December 2013 in which they approved the Draft Budget Statement 2014 (P.122/2014) and, inter alia, agreed to vary the purpose of the Housing Development Fund in accordance with Article 3(3)(b) of the Public Finances (Jersey) Law 2005 to include the lending of monies to enable the further provision and development of housing in Jersey;

and to approve, in accordance with Article 3(3)(b), the revised rules for the operation of the Housing Development Fund as set out in Appendix C of the Budget Statement, with these rules giving further instruction and guidance on the use of funds and the purpose and the operation of the Fund”

It is clear that the purpose of the Housing Development Fund is to fund social rented and first-time buyer housing development programmes. It allows the Minister for Treasury and Resources to borrow (up to £250m) commercially, through the Fund, to finance the acquisition and development of sites. The original terms set out in P.84/1999 will continue.

d) Consolidated Fund

The Public Finances Law states that Council of Ministers cannot propose in an MTFP or Budget, income and expenditure that leads to a negative balance in the Consolidated Fund (CF) at the end of any financial year. From a cash management perspective this rule may be relevant to ensure that in any year the States can meet its commitments. However, in terms of wider fiscal policy it is less relevant and should be secondary to the overarching fiscal guidelines. For example, this rule does not prevent the States from operating a significant – and potentially unsustainable – economic deficit in any one year (for example by transferring money into the CF from other funds or through one-off receipts).

It is also important that this legislative rule is not interpreted in such a way that in certain circumstances it prevents the operation of counter cyclical fiscal policy. If there is a need to run deficits to a greater extent than the CF will allow then the policy issue is how to ensure there is sufficient money that can be transferred into the CF (for example through borrowing or transfers from reserves or externally) to be in keeping with the fiscal guidelines and FPP advice.

Rather than change the Law, decisions under the new framework will be taken in a manner that ensures that this CF rule is retained but does not constrain the States in meeting the overarching fiscal guidelines.

Given the uncertainty inherent in fiscal forecasts there could be increased risks of short-term decision making if the States plans to run the CF close to zero. It would not take much divergence from expectations to require short-term measures to return the CF to balance. This could be partly mitigated if plans set out to maintain a positive balance in the CF to allow for fluctuations relative to forecasts.

The FPP are concerned that the rules regarding the CF balance and limits on what the States can borrow/lend could be counterproductive under certain circumstances.

However, if decisions are made within the context of the fiscal guidelines and in line with FPP advice these risks should be minimised. It will be important to monitor how these rules are applied and if necessary revisit their suitability as the framework continues to evolve.

3. The Fiscal Policy Panel (Jersey's Independent Fiscal Institution))

The FPP have been very influential, successfully advising on a number of key aspects of fiscal policy (including the need for fiscal stimulus, the application of the 3Ts and advising on how to assess the structural position of States' finances). The emphasis given to their advice by the Treasury, Council of Ministers, States members and wider stakeholders shows how they have collectively grown in weight, stature and credibility. The Panel have published 6 annual reports, 5 update/interim reports and exchanged public letters with the Treasury and Resources Minister on additional fiscal stimulus for social housing in 2012. In addition, the FPP are now appointed on a statutory basis.

The role and responsibilities of the FPP are set out in the Public Finances Law some of the key elements being:

There must be a Panel with at least 3 members, The Minister shall appoint the members of the Panel.

Before appointing a member of the Panel, the Minister must seek the views of the Appointments Commission

The Panel may not be directed on the advice given by it, and the comments and recommendations made by it, in any report prepared by it in the discharge of its functions

The Panel must prepare an annual report upon the state of the economy in Jersey and States' finances. The matters commented upon in the report must include –

- (a) the strength of the economy in Jersey;
- (b) the outlook for the economy in Jersey and, generally, world economies and financial markets;
- (c) the economic cycle in Jersey;
- (d) the medium and long-term sustainability of the States' finances, having regard to the foregoing matters; and

- (e) transfers to or from, the strategic reserve fund and stabilisation fund, having regard to the foregoing matters.

The timing of the report varies depending on whether it is a budget year or an MTFP year and in an MTFP year an additional report is required ahead of the preparation of the MTFP.

The FPP's Annual Report will remain the cornerstone of the fiscal framework. In covering the issues set out in the Law and with respect to the fiscal guidelines set out in this framework the FPP will continue as Jersey's key fiscal institution. Through independent, expert and transparent advice the FPP will be the most important check and balance to help the States set fiscal policy in keeping with the States' economic and fiscal objectives and medium-term fiscal sustainability.

R102/2014 highlighted that the fiscal framework could be improved if the FPP could contribute to the financial forecasting process in a way that was consistent with their other responsibilities. With the formation of the new Income Forecasting Group (see Appendix 3) the FPP have agreed to consider and assess what the appropriate economic assumptions should be for forecasting purposes and the IFG will only use economic assumptions that are endorsed by the FPP. This will help improve the transparency and credibility of that part of the forecasting process. The FPP will continue to have the opportunity to comment on any other aspect of the financial forecasts through their annual reporting structure.

The Public Finances Law does make explicit mention of the Panel's independence but this could be strengthened by having a more transparent process through which the Treasury and Resources Minister appoints Panel members. The Law already requires the Minister to "seek the views of the Appointments Commission" before making an appointment. To make this process more transparent and to strengthen the independence of the Panel it will be led by the Chairman (outgoing or incoming) of the FPP, without input from the Treasury and Resources Officers or Minister. The Chair will make the recommendation to the Minister as to who is most suitable in terms of skills, experience and make-up of the Panel.

4. The Annual and Medium-term budgetary framework

Jersey has made significant steps forward in establishing its medium-term planning framework in recent years. It already has a number of underlying resource principles and the updated fiscal rules described above should be fully embedded in the MTFP and a framework in place for how compliance is monitored and evaluated.

Jersey's budgetary framework is set out in the Public Finances Law and already has many of the characteristics of the robust frameworks. Overall there is a clear process outlined in law and a requirement to provide some key budgetary data for the financial year covered by the Budget. The Budget is done on a centralised basis through Treasury and Resources and the budgetary impact of policies is set out for the financial year. The framework includes a Stabilisation Fund and contingency funds, allowing significant flexibility for changing economic circumstances and unforeseen contingencies.

However, Budget 2014 was published in line with the Law and the FPP concluded it "lacks a lot of basic and important information that is required to understand the overall impacts of proposed fiscal policy". In addition in its 2012 Annual Report the FPP said the Panel had to make significant adjustments to the financial forecast in the MTFP to assess the underlying economic impact and that the future presentations of States' finances would be more informative, leading to a better informed policy debate if these adjustments were already included in the MTFP and Budget.

Given these views the FPP recommended in their 2013 Annual Report that:

Budgets should be clear and concise, and the Panel recommends that every Budget should include:

- *A financial forecast for the current and next 3 years including updated income projections taking into account the latest economic developments, expenditure forecasts and budget measures.*
- *Proposed movements on the Consolidated Fund, Stabilisation Fund and Strategic Reserve for the current year and next 3 years.*
- *Data which shows what happened to these Funds in the previous 3 years.*
- *A financial forecast showing the surpluses and deficits as adjusted to recognise the economic impacts.*

On this last point it should include the overall position of States' finances including other funds such as the Social Security, Long-term Care and Health Insurance Funds.

Similar recommendations have been made by the C&AG and Corporate Services Scrutiny Panel and are already largely being implemented by the Treasury and Resources department. The new framework builds on this and makes it a

requirement that the above recommendations are complied with and that the information be provided as part of every MTFP and Budget report.

R102/2014 pointed out that the current framework is not explicit as to how and when financial forecasts are undertaken (beyond the requirements in the MTFP) and updated. The role and membership of the previous Income Tax Forecasting Group was not clearly set out there was lack of transparency about its role. It concluded that:

Jersey's Fiscal Framework could be enhanced by clearly defining frequency, role and responsibilities around income forecasting and having a more explicit way of assessing alternative scenarios.

In February 2015 and in response to R102/2014 and recommendations of the Corporate Services Scrutiny Panel the Minister for Treasury and Resources approved the formation of a new Income Forecasting Group to advise on the forecasts of all States income from taxation. The Minister also approved the IFG Terms of Reference as set out in Appendix 3 and agreed that it was part of the new fiscal framework.

R102/2014 also recommended that further consideration should also be given to the way government accounts are calculated and presented in the MTFP and Budget documents. In particular the benefits, practicalities and resource implications of the Chief Statistician producing government finance data to an internationally recognised standard for economic accounts. Given the additional information required as part of the new framework it is not clear that any benefits from such a development would justify the costs at this point in time. However, this matter should be kept under review and the views of the FPP sought on an ongoing basis as to whether any further changes are necessary.

Fiscal frameworks should evolve over time and learn from experience and best practice elsewhere. An integral part of the previous framework and this one is that it is kept under review and that there is a continuous process of improvement. However, any changes to the framework should be explicit and transparent and in context of the existing framework and its future evolution.

Appendix 1: Strategic Plan Priority Sustainable Public Finances

Desired Outcome	Key Areas of Focus 2015 – 2018
<p>1.1 Sound and sustainable public finances</p>	<p>Allocate resources at a corporate level in light of strategic priorities and in line with the following principles:</p> <p>Spending</p> <ul style="list-style-type: none"> • Be prudent, taking account of the uncertain economic and financial outlook and build flexibility into future plans. • Identify and implement all possible savings and efficiencies. • Challenge existing expenditure in the context of strategic objectives. • Optimise service delivery, to improve service delivery and value for money. • No additional spend unless matched by savings or income. • Support the economy in line with the advice of the Fiscal Policy Panel. • Undertake a comprehensive programme of zero-based budget reviews including consideration of whether there is an obligation to provide a service. • Maintain balanced budgets over the economic cycle. • Actively manage our assets by maximising investment returns within agreed levels of risk. • Plan expenditure on capital and infrastructure over the long term and consider carefully the appropriate sources of funding for major projects, including borrowing. <p>Taxation</p> <ul style="list-style-type: none"> • Taxation must be necessary, justifiable and sustainable. • Taxes should be low, broad, simple <i>and fair</i>. • Everyone should make an appropriate contribution to the cost of providing services, while those on the lowest incomes are protected. • Taxes must be internationally competitive. • Taxation should support <i>economic, environmental and social policy</i>. • We shall develop a new Fiscal Policy Framework and look at ways to promote financial stability.

Desired Outcome		Key Areas of Focus 2015 – 2018
1.2	Improved systems of financial management	<p>Evaluate and where applicable implement the recommendations of Comptroller and Auditor General as detailed in her report dated 2nd April 2015, "Review of Financial Management" (R.38/2015).</p> <p>Improve organizational culture including performance management.</p> <p>Improve balance between departmental responsibility and in favour of greater collective strategic responsibility.</p>
1.3	Improved, more productive, and sustainable public services	<p>Deliver e-government <i>to a level and timescale that will be set out in the Corporate Delivery Plan</i>, workforce modernisation, and re-designed Lean services.</p> <p>Restructure departments and rationalise office accommodation.</p> <p>Reduce demand on services by investing in early interventions, such as promoting healthier lifestyles and the 1001 Days initiative.</p> <p>Develop partnerships across the public, private, voluntary and community sectors to improve services for communities and families.</p> <p>Support the voluntary and community sector to build capacity to deliver vital services through the Charities Law and associated initiatives.</p> <p>Ensure that all agencies and government departments delivering public services have clear direction, and deliver value for money.</p>

Appendix 2: Operation of the Housing Development Fund (HDF) (From P.84/1999)

The current Housing Development Scheme is an ongoing fund set up to provide the Housing Committee with bridging finance to develop properties for onward sale. The Scheme bears the cost of land acquisition and development, which is then recovered on the disposal of completed sites.

The HDF would extend the Housing Development Scheme to include funding for the development of social rented housing as well as for first-time buyer properties.

The HDF would provide a mechanism for funding housing developments undertaken by the States, as well as providing subsidies (where necessary) for developments undertaken by other providers of social rented housing (such as Housing Associations) and, if necessary, for certain private sector “first-time buyer schemes”.

The nature of the HDF’s operation is such that funds would flow out of the account in the early years to be repaid over the longer term, leaving the Fund initially in a deficit position. This deficit would require financing and it is proposed that this is achieved through –

- refinancing the Dwelling Houses Loans Fund (DHLF), to release cash of some £22m (based on the DHLF’s 1998 balance), which could be used in the short-term;
- direct external borrowing (the extent of this would depend upon the level of involvement from Housing Associations in the development programme).

The existing agreement with Housing Trusts provides an interest subsidy that caps the repayment rate for Trust borrowing at four per cent per annum. Capital development subsidies are also made where rental levels are too low to sustain the scheduled repayment.

For this reason funding, in addition to that raised from rental income gained on the new housing units, will be required to ensure the fund is fully repaid. It is proposed that these subsidy arrangements are extended to include developments undertaken by the Housing Committee as well as those undertaken by Housing Trusts.

The forward financial forecast presented to States’ Committees on 20th May 1999 includes a preliminary allocation of £10m per annum to be added to the amount available for capital expenditure. This amount, or such other amount as the Finance and Economics Committee considers appropriate, is to be earmarked for transfer to the HDF.

The borrowing liability of the HDF would then need to be repaid. The funding to meet the repayments would be realised from a number of sources -

- allocations from the Capital Fund as earmarked and referred to in paragraph 6 above;
- an annual transfer from the Housing Committee Revenue Budget, based on a proportion of the rental income gained from the new units to be developed and added to that Committee's stock;
- any 'surpluses' from first-time buyer sales. Where a first-time buyer development is undertaken on land already in States' ownership, the sale price for those properties may exceed the cost of development. It is proposed that, in such cases, the net 'surplus' be allocated to the HDF to offset schemes where a development subsidy is required;
- the HDF develops, the Finance and Economics Committee would consider such alternative means of funding as may be considered appropriate.

Appendix 3: Terms of Reference for the Income Forecasting Group

Purpose

The group is established as an advisory function on the forecasts of all States income from taxation and social security contributions which will be informed by economic assumptions produced by the Fiscal Policy Panel.

Objectives

To produce an absolute minimum of two forecasts each year:

- A full review of states tax, social security contributions and duty revenue forecasts will take place following the provisional outturn and no later than March of each year.
- A further forecast to inform the Budget debate, no later than September, including any revised economic assumptions and experience from the current year actual revenues.
- In an MTFP year, a further update will be considered between the full review in March and the actual lodging of the MTFP.

To produce reports on the forecasts of States' income from taxation and social security contributions, including:

- Forecasts for income tax revenues
- Forecasts for goods and services tax and ISE Fees
- Forecasts for impôts duties
- Forecasts for stamp duties
- Forecasts for social security contributions
- Economic assumptions used; and
- Factors and risks that should be considered

The forecasts will cover a period of at least four years and include a range within which a central forecast can be applied

Reporting

The reports will be presented to the Treasury and Resources Minister in advance of the Council of Ministers consideration.

Once a report is approved by the Treasury and Resources Minister it will be published alongside the Medium Term Financial Plan and the Budget.

Other reports can be prepared on the request of the Treasury and Resources Minister.

Administration

All meetings will be minuted with agreed actions.

Quarterly review meetings will also be held.

Quorum – at least six of the nine members be present for the meetings to be considered quorate.

Any variations to the group membership once established to be agreed by the Treasury and Resources Minister or Chief Minister.

It will be the responsibility of the Chief Executive and Treasurer of the States to ensure that the group has sufficient resources to fulfil its responsibilities.

Group Membership

The members of the group are:

- Treasurer of the States of Jersey (Chair)
- Comptroller of Taxes
- Director of Financial Services
- Chief Officer, Economic Development
- Chief Officer, Social Security
- Adviser, International Affairs
- Deputy Director of Tax Policy
- States Economic Adviser
- An external person appointed by the Treasury and Resources Minister

The meetings of the group will be attended by the following officers in a supporting role:

- Head of financial planning (secretary)
- Finance director, Income Tax
- Economist

The group will invite other officers and external advisers to attend as appropriate which will be documented.

The group will operate independent of any political influence.