STATES OF JERSEY

EXPENDITURE PROPOSALS FOR 2012 AND 2013 AND DRAFT BUDGET STATEMENT 2011 (P.157/2010) – SIXTH AMENDMENT (P.157/2010 Amd.(6)) – COMMENTS

Presented to the States on 6th December 2010
by the Council of Ministers

STATES GREFFE

COMMENTS

The Council of Ministers opposes this amendment.

This amendment would lead to deficits increasing from £55 million to £63 million in 2011 and from £18 million to £32 million in 2012 and an overcommitted balance on the Consolidated Fund of £29 million by 2012.

Members are recommended to reject this proposition for the following reasons –

- It is an unfunded Budget amendment which takes real risk with States finances, increasing the deficit by £8 million in 2011 and £14 million in 2012 and every future year.

- The Fiscal Policy Panel (FPP) has produced a report strongly advising against unfunded Budget amendments.

- The recommendation by Senator Le Gresley that the introduction of 2% Social Security contributions above the ceiling be introduced from July 2011 does not recognise that the change is a complex project with many different strands. There would be enormous risks in trying to bring in an earlier implementation date, with a high probability of failure. Changes to the Social Security IT system and employers' payroll systems will take time to implement.

- In the Council's view, the amendment has not identified any solutions which can be implemented in the timescales required.

- The amendment suggests that savings targets could be increased further, however the Council's view is that whilst more savings can be achieved in the longer term, it is unrealistic to target more cuts while still protecting essential services.

Supporting analysis

Effect on public finances

Given how tight the financial situation is, the main concern is that this amendment is unfunded.

If this amendment is accepted, it will reduce tax revenues by a net £7 million in 2011 and £14 million in 2012. Put simply, this is an unfunded Budget amended which is taking real risks with States finances. In its 2010 Annual Report, the Fiscal Policy Panel (FPP) stated quite clearly –

> *"Propositions or amendments to the Budget that reduce revenues or increase expenditure without offsetting savings or revenue increases will worsen the fiscal position and should be avoided as they will undermine the credibility of the fiscal consolidation and make it more difficult to implement."*

This amendment would reduce the revenue from GST relative to the draft Budget by £8 million in 2011 and £15 million every year thereafter. As it is proposed to reduce the GST compensation, there is a small reduction in expenditure of around £1 million.

Therefore, without an off-setting reduction in other expenditure or an increase in other revenue, this amendment would increase the deficit by £7 million in 2011 and by £14 million in each of the following years. This would have a substantial negative impact on the annual deficit and the Consolidated Fund balance, as shown in Figure 1.

Figure 1: Financial forecasts based on central scenario

2010		2011	2012	2013
£m		£m	£m	£m
53	Opening Consolidated Fund balance as in draft Budget	20	11	-7
-101	Surplus/Deficit as in draft Budget	-55	-18	8
68	Transfer from Stabilisation Fund	46		
20	**Closing Consolidated Fund balance as in draft Budget**	**11**	**-7**	**1**
	Amendment 6:			
	GST lower proposed rate to 4%	-8	-15	-15
	Income support savings	1	1	1
53	Opening Consolidated Fund balance if amendment approved	20	4	-29
-101	Surplus/Deficit if amendment approved	-63	-32	-6
68	Transfer from Stabilisation Fund	46		
20	**Closing Consolidated Fund balance if amendment approved**	**4**	**-29**	**-35**

Figure 1 illustrates the central forecast. However, the forecast has a range of uncertainty above and below.

One of the main justifications for this amendment is "the range of uncertainty in the forecast of income tax receipts for the next 3 years". However, this fails to recognise that these forecasts have downside, as well as upside, risks. There is a real risk that tax revenue could turn out lower than expected, and if we reduce the rate of GST this could seriously undermine States finances. If we only increase GST by 1%, and the financial forecasts turn out more like the pessimistic scenario in the draft Budget 2011, we could be left facing deficits of £86 million next year, £62 million in 2012 and £50 million in 2013, even after all other CSR and FSR measures are in place. Perhaps even more striking is the trend in the Consolidated Fund, which, if unchecked, could have a negative balance to the tune of £143 million by 2013. However, the Minister for Treasury and Resources would not be allowed to propose a Budget with a negative balance on the Consolidated Fund, so the reality would be the requirement to deliver £93 million of fiscal tightening in Budget 2012.

The Council of Ministers does not favour GST because it is an easy option, but because all the evidence suggests it is judged as the most equitable option for Jersey. Consumption taxes like GST are among the taxes that are the least harmful to competitiveness and economic growth. Further, the Council of Ministers have worked hard to come up with a balanced, 3 part plan to deal with the fiscal challenges, which involves savings, taxes and economic growth. GST is an important element of this, but far from the only one. Were it simply the easy option, the balance may have been different.

Practicalities of increasing the social security ceiling sooner

Senator Le Gresley recommends that the introduction of the 2% Social Security contributions above the ceiling be introduced from July 2011. However this is not realistic given the practical considerations that are involved.

His rationale for proposing this change in date is based solely on the time likely to be taken to receive Privy Council approval for P.163/2010 (Draft Social Security (Amendment No. 19) (Jersey) Law 201- lodged *au Greffe* on 26th October 2010).

P.163/2010 does not itself provide for contributions above the earnings ceiling. It gives the States the authority to approve Regulations to make changes of that nature to the Social Security Law. Following Privy Council approval, Regulations will then need to be lodged and debated.

Creating contributions above the earnings ceiling has a significant impact on several aspects of the Social Security Law, including –

- The treatment of self-employed individuals
- The treatment of non-employed individuals
- The awarding of credits when individuals are unable to work.

Regulations will need to be drafted to address these areas, as well as the creation of new contribution rates above the earnings ceiling. These Regulations will require significant Law Drafting effort. In addition to the Regulations, there will also be substantive changes to administrative Orders, all of which must be in place before the new contributions can be collected.

Changes to legislation must then be implemented through the Social Security IT system. The calculation of contribution liability and the individual's contribution record is at the very heart of the Social Security system, and changes to contributions affect every area of Social Security operation. All contributory benefits (old-age pension, short- and long-term incapacity allowances, etc.) rely on the assessment of an individual's contributory record.

Changes to the calculation of contributions must be introduced into the departmental IT system, while at the same time ensuring that all pensions and benefits continue to be paid on time. For this reason, all changes to the main business system of Social Security are thoroughly tested before they are introduced into the live system.

In addition to IT and operational changes for Social Security, all employers will also need to make changes to their payroll systems to allow for differential rates above and below a ceiling. Support and guidance for employers will need to be arranged, and new software distributed and tested, before contributions can be levied at the new rate.

This is a complex project with many separate strands. The Social Security Department has made a commitment to have completed all the preparatory work by December 2011 to allow for implementation of the new rates in January 2012. This is a challenging timetable, and other planned work within the Department will need to be deferred to enable this deadline to be met.

There would be enormous risks in seeking to achieve an earlier implementation date, with a high probability of failure.