States of Jersey
States Assembly

États de Jersey
Assemblée des États

CORPORATE SERVICES SCRUTINY PANEL

DRAFT BUDGET 2017

Presented to the States on 9th December 2016

SR.8/2016

Contents

1. Panel Membership, Terms of Reference and Evidence Considered

Panel Membership

1.1. The Corporate Services Scrutiny Panel comprised the following Members:

Deputy J.A.N Le Fondré, Chairman
Deputy S.M. Brée, Vice-Chairman
Senator S.C. Ferguson
Connétable C.H. Taylor
Deputy K.C. Lewis

Due to a family bereavement, Deputy Le Fondré was not able to take a full part in the report writing part of the review. This was led instead by Deputy Brée.

Terms of Reference

1.2. The following Terms of Reference were agreed for the review:

1. To consider the proposals of the Minister for Treasury and Resources in the Draft 2017 Budget Statement in respect of:

    a) Income Tax;

    b) Goods and Services Tax (GST);

    c) Impôts;

    d) Property Tax; and

    e) Other tax proposals.

2. To consider the Capital Programme for 2017 as presented in the Draft 2017 Budget Statement;

3. To consider any transfers which the Minister may propose in the Draft 2017 Budget Statement between the Consolidated Fund and other Funds and reserves and in particular the overall impact on the Strategic Reserve (taking into account all transfers to/from the Strategic Reserve since the commencement of the first MTFP in 2013);

4. To consider the updated financial forecasts and the economic implications of the Minister's proposals in the Draft 2017 Budget Statement.

Evidence considered

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

a) Draft Budget Statement 2017
b) Medium Term Financial Plan Addition 2017-2019
c) Written submissions from
   i. Jersey Chamber of Commerce
   ii. Jersey Consumer Council
   iii. Channel Island Tobacco Importers and Manufacturers Association
   iv. Jersey Motor Trades Federation
   v. Jersey Civil Service Association/Prospect
   vi. Jersey Hospitality Association
   vii. Randalls Limited

2. Findings and Recommendations

FINDING 1

Increases in Impôts duties for alcohol and tobacco are in part linked to health considerations.

FINDING 2

There is a lack of clear statistical evidence showing the impact that rises in impôts duties have on consumption of alcohol and tobacco.

RECOMMENDATION 1

Where health considerations play a part in proposed rises to impôts duties, the Minister should provide reliable evidence to show how such rises will reduce consumption.

A portion of alcohol and tobacco duties should be hypothecated to the Health Department.

FINDING 3

The purpose of fuel duty is not solely to cover road maintenance costs.

Both fuel duty and Vehicle Emissions Duty are levied for environmental reasons.

RECOMMENDATION 2

A proportion of Fuel Duty should be hypothecated for road maintenance costs. VED is levied for environmental reasons and should be hypothecated for environmental projects.

FINDING 4

A total of £103 million will be withdrawn from returns on the Strategic Reserve between 2016-2019.

FINDING 5

Capital expenditure is largely being funded from the Strategic Reserve while the States work towards returning to a budgeted surplus in 2019.

RECOMMENDATION 3

Once States' budgets have returned to surplus, the capital expenditure programme should be funded in full through annual depreciation. Further work should be carried out by the Department for Treasury and Resources to establish the best way of ring-fencing depreciation in order to achieve this.

RECOMMENDATION 4

Any further tax increases or charges considered by the Minister for Treasury and Resources in the future must take into account the considerable additional burden placed on personal tax payers in recent years and be supported by reliable evidence and impact assessments.

FINDING 6

The proposals in the Budget to introduce reporting for all companies on a 0% tax rate could lead to the introduction of some form of taxation on those companies. This could be similar to the “Tesco Tax” in the Isle of Man.

FINDING 7

There is no evidence yet of a coherent plan to fund the gap left by the rejection of the health charge; however a revised version of the health charge is not under consideration.

FINDING 8

The Panel’s advisors consider that the revised income forecasts used in the Budget are still optimistic and do not reflect current levels of uncertainty.

FINDING 9

Productivity in the economy has fallen by 20% since 2000.

RECOMMENDATION 5

The Department for Treasury and Resources should undertake work to analyse the reason for the fall in productivity in Jersey’s economy over a period when the population has grown consistently, in order to identify ways that productivity can be increased.

RECOMMENDATION 6

The treatment of capital allocations within the Consolidated Fund should be changed to better reflect the actual profile of expenditure and to provide clarity on unspent amounts and unallocated funds.

RECOMMENDATION 7

Forecasts for the consolidated fund included in future budgets and MTFPs should be accompanied by an analysis of unspent capital allocations.

RECOMMENDATION 8

Consideration should be given to requiring departments to re-apply annually for funding for capital projects which have not commenced.

FINDING 10

The actual balance on the Consolidated Fund is distorted by the up-front approval of funding for capital projects.

FINDING 11

It is not clear how the States intends to fund the payment of Parish rates on States properties.

RECOMMENDATION 9

The States should not proceed with the payment of Parish rates until a funding mechanism has been found.

3. Introduction

The Draft Budget Statement 2017 was lodged by the Minister for Treasury and Resources on 18th October 2016 as P.109/2016 and will be debated on 13th December 2016.

It contains the proposals of the Minister for Treasury and Resources in respect of taxation and capital expenditure for 2017. Similar to last year, the Draft Budget follows the Medium Term Financial Plan Addition, which was debated and approved by the States Assembly in September 2016. Many of the issues surrounding public income and expenditure were covered during the debate on the MTFP Addition and in the Panel's corresponding in-depth report. This review was therefore more concise, focusing on the key themes arising from the Budget.

Whilst the Draft Budget does not contain many surprises, the Panel received a number of submissions regarding the effect of rises in Impôts duties and also questioning the rationale for imposing such duties. The Panel considers that there might be merit in a future piece of work being undertaken to look at Impôts duties in more detail and the part they play in raising revenue and also as a tool to change behaviours.

The Panel is grateful for the work of its expert advisors from the Chartered Institute of Public Finance and Accountancy (CIPFA) and MJO Consultancy, whose reports may be read in the Appendix.

In their report, CIPFA have identified five areas for further consideration. However, they also state *"The Draft Budget Statement provides a comprehensive and transparent picture of all relevant factors involved within the 2017 Budget setting process".*

4. Impôts Duty proposals

4.1 The Draft Budget Statement 2017 proposes duty increases across the board for alcohol, tobacco and fuel, as set out in the table below[1]:

FIGURE 6 – Duty increases proposed for 2017	2016 impôts duty	Proposed increase	Proposed 2017 impôts duty
Litre bottle of whisky at 40% abv	£13.83	4.96%	£14.51
Bottle of table wine	£1.47	5.18%	£1.55
Pint of beer/cider < 4.9% abv	35p	5.44%	37p
Pint of beer/cider > 4.9% abv	6p0	4.76%	63p
20 king size cigarettes	£5.32	8.06%	£5.75
Litre of unleaded petrol	45p	4.23%	47p

Alcohol and Tobacco Duties

4.2 All of these rises are above the rate of inflation and the Panel asked the Minister for Treasury and Resources to explain this policy. In relation to the rises in alcohol duty, he told the Panel:

"…It is largely looking at broader policies that exist, and in particular I am referring here to health. It is of no surprise that alcohol is consumed in inappropriate quantities in particular, detrimental to health, and so, recognising the impact and the cost on the health services, we have, for a number of years, increased alcohol duties above inflation and that is the intention here…"

4.3 In light of this statement, the Panel asked the Minister for Treasury and Resources why these duties were not ring-fenced for the Health Department. The Minister replied:

"… We have not typically hypothecated revenue generated from budgets. That is not what happens, but if we are perfectly blunt about it, you will see that the bulk of expenditure from the States is in health and so it is of no great surprise that the revenues raised are going to find their way into that area of funding pressure…"[2]

4.4 The Panel is concerned at the impact the rises in duties will have on the tourism sector. In its submission, the Jersey Hospitality Association says:

"[The increased duties will] not only affect the Jersey Hospitality/Tourism sector, with our visitors/guests but also ordinary responsible Jersey consumers"[3].

[1] Draft Budget Statement 2017, page 25
[2] Public Hearing with Minister for Treasury and Resources, 7 Nov 2016
[3] Written submission from Jersey Hospitality Association

4.5 The submission goes on to say:

> *"As an industry, we are already contributing a significantly large amount of income via Duty and GST to the States of Jersey and in return seem to be targeted and expected to pay more with little or nothing in return, apart from more red tape and challenge"*[4]

4.6 Randalls commented that over the past two decades, Jersey has lost over 60 inns, pubs and bars and over the next two decades the same amount will probably fail or close. They went on to say:

> "…we *really do believe that current duty rates are too high and any increase will further damage what is becoming a very fragile industry…"*[5]

4.7 When questioned on the economic impact of the changes on the tourism and hospitality sectors, the Minister told the Panel:

> "…we *are conscious…of what our competitors are doing…to make sure that our offerings are reasonably comparable and, therefore, changes such as this are not going to have a disproportionate impact on that particular sector…"*[6]

4.8 A number of submissions questioned whether successive duty rises are having the intended effect of reducing alcohol and tobacco consumption. The Minister referred the Panel to the following table showing that quantities of dutiable goods imported to the Island have fallen in most categories over the last 10 years[7]:

[4] Ibid.
[5] Written submission from Randalls
[6] Public Hearing with Minister for Treasury and Resources, 7 Nov 2016
[7] Impôts Statistics, Jersey Stats Unit

Annual quantity of dutiable goods, 2005 to 2015

Year	Wine (in litres)	Cider (in litres)	Beer (in litres)	Road fuel (in litres)	Spirits (in litres of alcohol)	Tobacco (in kg)
2005	4,153,000	1,223,000	10,837,000	50,032,000	203,900	68,600
2006	4,059,000	1,310,000	10,411,000	49,033,000	202,400	68,300
2007	4,188,000	1,430,000	9,863,000	50,016,000	184,500	64,700
2008	4,007,000	1,329,000	9,876,000	52,016,000	179,400	61,100
2009	4,228,000	1,509,000	9,484,000	51,420,000	171,500	60,000
2010	4,129,000	1,481,000	9,426,000	50,960,000	172,100	58,100
2011	4,045,000	1,575,000	9,139,000	46,970,000	161,100	51,400
2012	4,149,000	1,600,000	8,699,000	48,160,000	160,700	60,800
2013	3,924,000	1,603,000	8,330,000	46,225,000	157,300	50,000
2014	4,048,000	1,526,000	8,416,000	48,064,000	152,800	42,100
2015	3,992,000	1,455,000	8,034,000	48,555,000	139,500	39,600

Source: Jersey Customs and Immigration Service (JCIS) annual reports

4.9 The Panel notes that these statistics on dutiable goods do not show actual consumption levels.

4.10 Other submissions received by the Panel suggested that evidence of actual consumption shows a different picture.

4.11 For example, the Channel Island Tobacco Importers and Manufacturers Association (CITIMA) drew attention to the Jersey Annual Social Survey which shows only a modest decline in tobacco use. CITIMA said:

> *"…while the volume of dutiable tobacco being imported has fallen by 42% since 2005, actual tobacco consumption has only declined a little, and not by anything like the same proportions"[8].*

4.12 The Jersey Chamber of Commerce in its submission said *"…consumption of spirits has continued to rise, so clearly, the government's tax and educational health strategy hasn't worked…"[9]*

4.13 Randalls' submission said: "…*We believe that the majority of drinkers do so with moderation, hence penalising all because of the few who are alcohol dependent seems to be unfair, particularly those on limited incomes who enjoy the occasional pint and the social atmosphere associated with public houses…"[10]*

[8] Written submission from Channel Islands Tobacco Importers and Manufacturers Association (CITIMA)
[9] Written submission from Jersey Chamber of Commerce
[10] Written submission from Randalls Limited

4.14 Both the Jersey Hospitality Association and Randalls raised concerns about the effect that rises in duties have on "pre-loading" and alcohol consumption at home "*where measures and consumption are neither monitored nor controlled*"[11].

4.15 CITIMA also suggested that increased duties will merely force consumers to source products from other channels where duty has not been paid.

Finding 1

Increases in Impôts duties for alcohol and tobacco are in part linked to health considerations.

Finding 2

There is a lack of clear statistical evidence showing the impact that rises in impôts duties have on consumption of alcohol and tobacco.

Recommendation 1

Where health considerations play a part in proposed rises to impôts duties, the Minister should provide reliable evidence to show how such rises will reduce consumption.

A portion of alcohol and tobacco duties should be hypothecated to the Health Department.

Fuel Duty

4.16 The Panel asked the Minister for Treasury and Resources whether fuel duty is linked to the costs of maintaining the roads and whether the above inflation increase indicates that the States is unable to keep pace with road maintenance costs.

4.17 The Minister replied that the rationale for increasing fuel duty is environmental and not just for maintaining roads but that as with all general taxation, some of the fuel duty will go to the Department for Infrastructure for road maintenance[12].

4.18 However, Vehicle Emission Duty (VED) was introduced for environmental reasons to encourage consumers to buy lower emitting cars. From the Minister's response above, it would appear that fuel is also being used for such environmental reasons, raising a question about the continued rationale for VED.

Finding 3

The purpose of fuel duty is not solely to cover road maintenance costs.

Both fuel duty and Vehicle Emissions Duty are levied for environmental reasons.

Recommendation 2

A proportion of Fuel Duty should be hypothecated for road maintenance costs. VED is levied for environmental reasons and should be hypothecated for environmental projects.

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[11] Ibid.

[12] Public Hearing with the Minister for Treasury and Resources, 7 Nov 2016

4.19 The Jersey Consumer Council told the Panel that in light of the environmental justifications for the increase, the money raised should go towards improving the natural environment and improving public transport[13].

4.20 The Minister suggested to the Panel that: the increase is not *"particularly significant or aggressive"* and:

> *"…With the significant margins that exist in Jersey in fuel, it does not necessarily mean that Islanders are going to see a 2 pence increase per litre in fuel at the pumps. It would be perfectly reasonable for that to be absorbed with the significant margins that exist and the large number of retailers that we have in the Island…"*[14]

4.21 The Minister later admitted that in reality, this was unlikely. Indeed, the submission from the Jersey Motor Trades Association points out: *"…the inevitability that any increases in costs are very likely to be passed on to consumers…"*[15]

Alternative options

4.22 The Panel has noted suggestions in some of the submissions about alternative policy options to the recent successive rises in duties.

4.23 The Jersey Hospitality Association drew attention to the decision to scrap the beer duty escalator in the UK in 2013 and instead reduce beer duty, and the positive effects that this had on the brewery industry in the UK, resulting in increased jobs and more investment in the industry.[16]

4.24 Randalls drew the Panel's attention to the anomaly in Jersey's duty bands which means that any ale or lager over 4.9% attracts a higher rate of duty. A sliding scale is used in the UK and Randalls suggested that the bands in Jersey could be adjusted to 5.2% with a sliding scale for products above 5.2%.

4.25 With regards to tobacco duties, CITIMA suggested that an annual duty escalator (for example RPI plus 2%) would be a positive move, which would be in line with the States' tobacco strategy but would also give the industry visibility and certainty over future duty rises[17].

4.26 The Panel did not have an opportunity prior to finalising this report to ask the Minister for his views on these specific proposals, but would be interested to receive his comments as to whether such options have been considered or might be in the future.

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[13] Written submission from Jersey Consumer Council
[14] Public Hearing with the Minister for Treasury and Resources, 7 Nov 2016
[15] Written submission from Jersey Motor Trades Federation
[16] Report: "From a bleak future to confidence and stability. The story of beer duty: 2008 to 2016"
[17] Written submission from CITIMA

5. Strategic Reserve

5.1 The Draft Budget Statement 2017 asks States Members to approve a revised proposal to withdraw £55.273 million from the Strategic Reserve and approve a transfer back to the Strategic Reserve of £5 million. The net withdrawal from the Strategic Reserve of £50.273 million was approved in the 2016 Budget, as a withdrawal of £70m and a transfer back of £20m.

5.2 The net transfer of £50 million should be set in the context of the actual and forecast transfers during the remainder of the current Medium Term Financial Plan (2016-2019), as outlined in Figure 26 of the Budget[18]:

Summary Forecast Consolidated Fund Balance (including Proposed Budget Measures)	Forecast (Oct 2016)	Draft Budget 2017 Forecast Update (October 2016)		
	2016 £'000	2017 £'000	2018 £'000	2019 £'000
Opening Balance brought forward	**64,654**	**54,638**	**27,749**	**26,399**
Forecast Operating Surplus/(Deficit)	**(43,016)**	**(12,953)**	**16,650**	**56,429**
Funding for Capital Programme	(26,691)	(65,209)	(43,233)	(32,975)
Proposed Transfers from Strategic Reserve	56,691	55,273	16,000	-
Proposed Transfers to Strategic Reserve	-	(5,000)	-	(20,000)
Currency Fund Infrastructure Investment				
Proposed Asset Disposals	3,000	1,000	1,000	1,000
Proposed Transfer from Criminal Offences Confiscation Fund			8,233	
Forecast Closing Balance carried forward	**54,638**	**27,749**	**26,399**	**30,853**

5.3 The Medium Term Financial Plan (approved in 2015) and the MTFP Addition (approved in 2016) have already set out the policy reasons for the withdrawals from the Strategic Reserve, i.e. that they are short term measures to ensure a positive balance on the Consolidated Fund while long term sustainable measures are implemented to achieve a balanced budget by 2019[19].

5.4 In line with the measures approved by the States Assembly in 2015, the withdrawals are all from the accumulated excess return of the Strategic Reserve and are not expected to utilise any of the capital value of the Reserve *(which is protected in real terms by increasing the value by RPIY each year, as approved by the Assembly in 2014)*. The respective balances of the Reserve (after the proposed transfers) are as follows[20]:

[18] Draft Budget Statement 2017, page 61
[19] See Medium Term Financial Plan Addition, page 115
[20] MTFP Addition, Fourth Addendum – Interim Update on States Income Forecasts, page 9

Strategic Reserve - MTFP Addition (September 2016)	2015 Actual £'000	2016 Forecast £'000	2017 Forecast £'000	2018 Forecast £'000	2019 Forecast £'000
Strategic Reserve - Protected Capital Value [2]	678,917	694,532	718,147	739,691	761,882
Strategic Reserve - Accumulated Excess Return [1]	92,465	87,732	47,159	47,479	85,147
Strategic Reserve - Estimated Fund balance	**771,382**	**782,265**	**765,305**	**787,170**	**847,029**

[1] *The excess return is based on the latest in-year forecast return for 2016 (July 2016), the forecast return for 2017 and an assumed return of 2% above RPIY in future years.*
[2] *the protected capital value is based on the 2012 Strategic Reserve value increased by RPIY*

5.5 The proposed withdrawal of £16 million in 2018 (from excess returns) was an additional measure proposed immediately before the debate on the MTFP Addition in September 2016 to take account of lowered income forecasts following Brexit. This withdrawal takes the net withdrawals over the life of this MTFP to £103 million.

Finding 4

A total of £103 million will be withdrawn from returns on the Strategic Reserve between 2016-2019.

5.6 Mindful that until recently, any withdrawals from the "rainy day fund" would not have been acceptable to most States Members, the Panel asked the Minister about the reasons behind the proposed withdrawals:

"Deputy J.A.N. Le Fondré:
…does the Minister accept that if we were to go back 5 or 7 years, maybe 10 years, touching the rainy day fund would have been anathema to most politicians and to the public? Would you accept that we are in different circumstances and now the rainy day fund is being dipped into relatively significantly?

The Minister for Treasury and Resources:
It is on the basis of the figures we have just discussed. I think anybody would say that a net figure of over £100 million is a significant withdrawal but it is intended to smooth the impact on Islanders in a very difficult economic climate. Has it changed? Yes, and we have to remind ourselves, of course, of the reason why: obviously the economic climate we are in but also the fact that the States have approved, as they would have to do, this particular policy. It is the decision of the States, recognising the climate that we are operating in, that it is appropriate in these circumstances to use these reserves in the way that is being proposed…"[21]

5.7 Although recognising that the proposed transfers are in line with the policy approved by the States Assembly, the Panel considered that the size of the withdrawals warranted a more detailed examination by its advisor, CIPFA, as part of this review.

[21] Public Hearing with Minister for Treasury and Resources, 11 Nov 2016

5.8 The Panel also considers that it is important that the transfers are seen in the context of previous withdrawals from the Strategic Reserve and also the possibility of additional future withdrawals as part of the financing of the Future Hospital project.

5.9 CIPFA's report included the following table outlining all strategic reserve movements (either actual or proposed) since 2013[22]:

Strategic Reserve Movements (September 2016)

Strategic Reserve movements (September 2016)	2013 Actual £'000	2014 Actual £'000	2015 Actual £'000	2016 Forecast £'000	2017 Forecast £'000	2018 Forecast £'000	2019 Forecast £'000
Less: Planned Contributions to Hospital Project	-	*(10,200)*	*(22,700)*	-	-	-	-
Less: Planned Contribution to Short-Term Measures	-	-	*(14,000)*	(56,691)	(70,273)	-	-
Plus: Planned transfer to the strategic reserve	-	-	-	-	20,000	-	20,000
Less: Proposed Contribution to Consolidated Fund					-	(16,000)	
Sub total: Net Drawings	-	(10,200)	(36,700)	(56,691)	(50,273)	(16,000)	20,000

5.10 In their report, CIPFA have compared the forecast for the strategic reserve contained in the 2017 budget to the forecast contained in the MTFP II 2015 and comment that:

> *"…there has been an element of change within the three forecasts which cannot be readily explained other than potential underspends arising from both Revenue and Capital activities…"*[23]

5.11 The proposed transfers from the Strategic Reserve in 2017 are linked to funding for the capital programme (£39m for Les Quennevais School and £16.2m for the annual capital programme).

5.12 CIPFA draw attention to the Public Finances (Jersey) Law 2005 which established the Strategic Reserve

> *"with the intention that it should be permanent and 'should not be used to defray directly expenditure of the States'"*[24]

5.13 CIPFA comment that:

> *"It could be readily argued that asset replacement and investment - sources of capital funding should be largely be provided for the substantive Capital Programme (excluding the major projects) from the Consolidated Fund without recourse to transfers from the Strategic Reserve.* [25]

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[22] CIPFA, Report December 2016
[23] Ibid.
[24] Ibid.
[25] Ibid.

5.14 However, they go on to say

> *Given the lack of clarity arising from unused capital approvals (upon the Consolidated Fund) and the prevailing advice followed by Ministers from the Fiscal Policy Panel, we can readily acknowledge the pragmatism in this approach. However, such an approach may potentially conflict with the original strategy around the utilisation of the Strategic Reserve. In terms of overall financial strategy we can fully appreciate the need to utilise reserves where cost reduction and income maximisation is not fully on track at this time."*[26]

5.15 Once the "cost reduction and income maximisation" referred to by CIPFA is fully on track, the States Financial Forecasts predict a return to budgeted surplus in 2019. By this time, Departmental Depreciation[27] will cover annual capital funding in full, without recourse to the Strategic Reserve.

Finding 5

Capital expenditure is largely being funded from the Strategic Reserve while the States work towards returning to a budgeted surplus in 2019.

Recommendation 3

Once States' budgets have returned to surplus, the capital expenditure programme should be funded in full through annual depreciation. Further work should be carried out by the Department for Treasury and Resources to establish the best way of ring-fencing depreciation in order to achieve this.

[26] Ibid.
[27] Depreciation is an estimate of the annual cost of an asset, which is typically put aside each year so that when the asset reaches the end of its useful life, a new one can be purchased. The States lists depreciation as a separate item in its accounts, but currently this is not ring fenced to fund replacement assets.

6. Tax Proposals

6.1 The Income Tax proposals contained within the Budget 2017 are broadly neutral in terms of their financial implications[28]. None of the submissions received by the Panel commented on these proposals.

6.2 The Minister is planning to increase the standard exemption thresholds in line with RPI, which the Budget confirms is "consistent with the established policy". This is lower than the rise factored into the income tax forecasts and will therefore save approximately £2.0m per year.

6.3 It appears that this saving is being used to take a step towards equalising the second earners' allowance for married people and civil partners (currently a maximum of £27,500) with the single earner allowances enjoyed by co-habiting people (£28,700). The gap between these allowances of £1,200 will be reduced by £500 through this proposal at a cost of £1.5 million per year.

6.4 Amongst the other tax proposals is a requirement for all companies on a 0% tax rate to report their profits to the Taxes Office in the future. Currently this reporting is limited to companies on a 0% rate which have a Jersey resident shareholder. In a public hearing, the Minister for Treasury and Resources told the Panel that collecting this data could lead to the introduction of a "Tesco Tax", similar to the Isle of Man.

6.5 A "Tesco Tax" could enable the Island to claim some level of tax from large UK retailers who, under the Zero/Ten tax regime do not pay tax in Jersey. The Minister explained to the Panel that collection of sufficient data on 0% companies needs to be in place before such a tax could be considered, but that it could raise around £3 million:

> *"…We know that the Isle of Man have introduced such a tax; Guernsey did at their budget before last. Once we have the necessary data we will look at considering that. That could drive revenue estimated possibly at around about £3 million per annum…"*[29]

Finding 6

The proposals in the Budget to introduce reporting for all companies on a 0% tax rate could lead to the introduction of some form of taxation on those companies. This could be similar to the "Tesco Tax" in the Isle of Man.

Health Charge

6.6 As part of the income generating measures proposed in the current MTFP 2015-2019, the Minister for Treasury and Resources had proposed a "Health Charge" of 1% of income (subject to an upper limit) to raise £15 million a year by 2019.

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[28] Draft Budget Statement 2017, page 35 (Financial and Manpower Implications)
[29] Public Hearing with the Minister for Treasury and Resources, 7 Nov 2016

6.7 This proposal was defeated during the debate on the MTFP Addition in September 2016, leaving the Minister to find alternative ways of raising the budgeted income of £15 million a year by 2019.

6.8 The Draft Budget 2017 contains reference to "future revenue raising measures" to bring in £15 million a year by 2019 and the Panel asked the Minister for Treasury and Resources whether a revised health charge was under consideration:

> *"…I think the States have made it very clear that a health charge in the way that it was proposed is not acceptable, so it is not a question of going back and trying to rehash a new health charge. No, that is not on the agenda, to be absolutely clear, so we would be looking at a number of other options…"*[30]

6.9 The Minister went on to suggest that in the short term other measures would be used to fund the gap, although the Panel has not seen evidence of a clear plan to replace the health charge.

6.10 The Chief Minister also told the Panel:

> *"…We are looking - and I cannot say any more than this - at a number of small measures that would give sustainable measures for the £15 million, which is not a rehash of the health charge. I am surprised that the Minister for Treasury and Resources used that term, because it is not normally in his vocabulary, but anyway. What we have said is that during the course of the next year, we will have to think about a long-term sustainable funding mechanism for health, which is different from what was proposed, I suspect in both shape and in timing…"*[31]

Finding 7

There is no evidence yet of a coherent plan to fund the gap left by the rejection of the health charge; however a revised version of the health charge is not under consideration.

Tax reviews

6.11 The Panel will closely monitor the progress on the various tax reviews that are either ongoing or due to start, and in particular, the review of the personal tax system will look at the impact of changes to personal income tax, social security and long term care contributions and GST since 2007.

6.12 As the Panel highlighted in its report on the MTFP Addition (S.R.5/2016), the proportion of total income tax receipts paid by personal tax payers has increased significantly over the last 10 years.

[30] Public Hearing with the Minister for Treasury and Resources, 7 Nov 2016
[31] Public Hearing with the Chief Minister, 10 Nov 2016

6.13 In light of the above, any further tax increases or charges that might be contemplated in the future by the Minister for Treasury and Resources must take into account the considerable additional burden placed on personal tax payers in recent years.

Recommendation 4

Any further tax increases or charges considered by the Minister for Treasury and Resources in the future must take into account the considerable additional burden placed on personal tax payers in recent years and be supported by reliable evidence and impact assessments.

7. Income Forecasts and the economic outlook

7.1 The Council of Ministers published an “Interim Update on States Income Forecasts” shortly before the debate on the MTFP Addition in September 2016 to take account of changes to economic conditions following the Brexit vote[32]. These forecasts have been used in the Draft Budget 2017 and show an overall reduction of £6 million in income tax in 2019, rising to a forecast £9 million reduction in 2020[33].

7.2 This is predominantly due to a worsening of personal income tax forecasts, as demonstrated by Figure 37[34]:

FIGURE 37 – Updated personal tax forecast

	Outturn	Forecast (Sep 2016)	Draft Budget 2017 (September 2016)			
	2015	2016	2017	2018	2019	2020
	£m	£m	£m	£m	£m	£m
Personal Tax						
June 2016 Forecast	361	375	395	420	441	465
New FPP economic assumptions[1]		0	-3	-6	-7	-9
Tax collectable	361	375	392	414	435	456

Some columns may not sum due to rounding

Notes:

[1]Impact of new FPP economic assumptions includes downward impact of lower earnings in 2016, lower employment and interest rate; and upward impact of slightly higher nominal earnings in 2017; and higher inflation in 2016 and 2017.

7.3 Shortly after the forecasts were released in September 2016, the GVA figure for 2015 was published which showed that GVA increased by 2.3% in 2015. This was better than the most recent forecast of 0.9%. The Panel asked the Minister for Treasury and Resources whether this would have any impact on future income levels. The Minister replied that it *“improved the position”* but went on to say he was conscious that *“..in doing the forecasts and assessing all levels of our forecasts, they are prudent so that we can absorb any shocks that occur…*[35]*”*

7.4 Despite the downgrade to forecasts detailed in Figure 37 of the Budget, the Panel’s advisor, MJO Consultancy, has highlighted that forecasts *“are still optimistic”* as they *“assume growth in personal tax of 4.5% in 2017, 5.5% in 2018 and 5% in 2019”.*[36]

7.5 CIPFA have also commented that the downward adjustments to income forecasts:

> *“do not suggest a significant level of change commensurate with the level of uncertainty”.*[37]

[32] MTFP Addition, Fourth Addendum – Interim Update on States Income Forecasts
[33] Draft Budget Statement 2017, Appendix 1 page 83
[34] Ibid. page 81
[35] Public Hearing with Minister for Treasury and Resources, 7 Nov 2016
[36] MJO Consultancy – Report November 2016
[37] CIPFA – Report December 2016

Finding 8

The Panel's advisors consider that the revised income forecasts used in the Budget are still optimistic and do not reflect current levels of uncertainty.

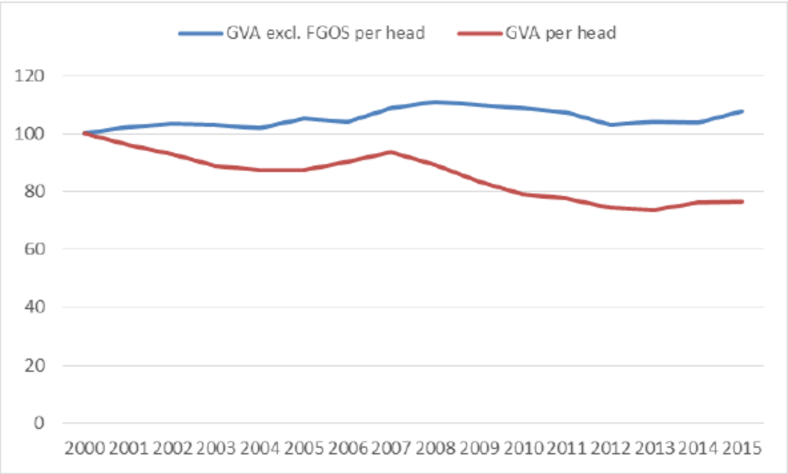
7.6 A review of the personal income tax forecasting model is due to be undertaken soon by the Economics Unit. In light of the repeated concerns raised by this Panel's advisors, this review is to be welcomed and the Panel expects to be briefed on the findings of the review in the course of 2017.

7.7 The analysis of the economic outlook contained within the budget mentions consistent concerns raised by the Fiscal Policy Panel about declining productivity levels in Jersey.

7.8 One indicator of productivity in the economy is GVA per head. As demonstrated by Figure 30, GVA per head in Jersey has fallen by around 20% since 2000, which is largely down to a fall in Financial Services profitability as a result of increased regulatory requirements requiring more back office staff[38].

FIGURE 30 – GVA per head of the population

real GVA (and GVA excluding financial services gross operating surplus) per full time equivalent employee, index 2000=100



Source: Statistics Unit and Economics Unit calculations

7.9 The Finance sector has encountered increased compliance costs in recent years to keep pace with global regulatory standards and the Panel was interested to see what the Minister felt Government could do to improve productivity. The Minister highlighted that job numbers and profits were up in 2015, Jersey Finance Limited continues to receive a grant of around £5 million a year to promote the industry and that there is investment in the Law Officers Department to ensure that the right legislation can be put in place to support the industry.

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[38] Draft Budget Statement 2017, page 67

7.10 Commenting on productivity in the wider economy, the Minister drew attention to the Economic Growth and Productivity Fund which has been established to support initiatives across the economy. The Minister also stressed the importance of investment in the technology and digital sectors.

Finding 9

Productivity in the economy has fallen by 20% since 2000.

Recommendation 5

The Department for Treasury and Resources should undertake work to analyse the reason for the fall in productivity in Jersey's economy over a period when the population has grown consistently, in order to identify ways that productivity can be increased.

7.11 Whilst the draft budget statement mentions "promoting higher productivity in all economic strategies, including the new Tourism, Retail and Rural Economy Strategies", some submissions suggested that more could be done to support the more traditional industries. For example, the Jersey Hospitality Association told the Panel:

> *"…Often the States of Jersey seem to ignore the contribution that the industry makes to the island economy both via jobs (Social Security and Tax income) plus the significant investment made in the last decade with little or no Government support to achieve/improve the customer product or experience.*
>
> *This is very noticeable when compared with other islands industries such as Finance and Digital which have had both investment and are viewed as the only way for the island to develop a sustainable economy…"*[39]

[39] Written submission from Jersey Hospitality Association

8. Public Sector Reform

8.1 There is very little mention of Public Sector Reform in the Budget (although it was set out in detail in the MTFP Addition document). However, part of the economic strategy of the Council of Ministers is to pursue efficiencies and savings from within the public sector. The Jersey Civil Service Association (JCSA) submission to the Panel focused on this particular point.

8.2 Given the ambitious targets set for savings and efficiencies within the Public Sector, it will be important that employees are motivated to deliver reform. The JCSA raised concerns regarding the difficulties being encountered with civil service pay negotiations and noted that,

> *"…Up until this 2015 pay round, the membership of the JCSA/Prospect Union have respected the economic difficulties and agreed to take the financial hits asked of them…By failing to even negotiate in relation to pay, the employer has shown a complete disrespect for its workforce and…is creating an impossible situation for its staff."*[40]

8.3 According to the JCSA, ministerial policy has:

> *"…applied severe pressure on the public sector to reduce numbers, to do more with less and to squeeze out inefficiencies wherever possible…The outsourcing of revenue earning services makes it increasingly difficult for the remaining public sector to show efficiencies. Cost cutting is not the same as efficiency..."*[41]

8.4 The Panel commented at length on the Public Sector Reform programme in its report on the MTFP Addition. The Panel will continue to monitor progress and hold Ministers to account in the delivery of reform.

[40] Written submission from Jersey Civil Service Association/Prospect
[41] Ibid.

9. Capital Programme

9.1 The Capital Programme for 2017 includes expenditure of £65 million, the majority to be spent on the Les Quennevais School rebuild (£39 million). The Public Finances Law requires all capital expenditure to be allocated at the outset but many of the projects (and corresponding expenditure) will be spread over a number of years.

9.2 The Capital programme is funded from the Consolidated Fund and the Panel's advisor has noted that due to the requirement (under the Public Finances Law) to allocate capital for projects up front, the actual balance of the Consolidated Fund is distorted and is in reality a lot higher.

9.3 The forecast balance on the Consolidated Fund in each of the years 2017 - 2019 is between £27m - £30m. However, CIPFA say that the actual balance is much higher:

> *"…. We are advised that the balance of the Consolidated Fund exceeds £100 million and the addition beyond forecast is based on allocated but unspent capital funding for specific projects …"*[42]

Finding 10

The actual balance on the Consolidated Fund is distorted by the up-front approval of funding for capital projects.

9.4 Aside from leading to a lack of clarity regarding the true balance of the consolidated fund, CIPFA comment that the approval of capital funding up front can *"impede optimal decision making".* This is a matter that CIPFA have raised in previous reports for this Panel.

9.5 CIPFA conclude by recommending that:

> *"a revised approach be adopted to the treatment of Capital Allocations within the Consolidated Fund whilst retaining a strong element of internal control"*[43]

9.6 The Panel notes that this recommendation may require an amendment to the Public Finances (Jersey) Law 2005.

9.7 The Capital Programme for 2017 included in the Budget excludes two major capital projects; the Future Hospital Project and the Office Consolidation Project. The funding proposal for the Future Hospital has now been lodged for debate as P.130/2016 and the Budget states that the outline business case for the Office Consolidation Project is due to be finalised by the end of this year.

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[42] CIPFA – Report December 2016
[43] Ibid.

Recommendation 6

The treatment of capital allocations within the consolidated fund should be changed to better reflect the actual profile of expenditure and to provide clarity on unspent amounts and unallocated funds.

Recommendation 7

Forecasts for the consolidated fund included in future budgets and MTFPs should be accompanied by an analysis of unspent capital allocations.

Recommendation 8

Consideration should be given to requiring departments to re-apply annually for funding for capital projects which have not commenced.

9.8 With both projects scheduled to be delivered over the period 2017-2024 it will be important for the economy that such a large fiscal stimulus is timed correctly and delivered according to plan, particularly with a number of other ongoing major capital projects. The Panel and its advisors have raised concerns in the past about slippage of capital projects.

10. Other Areas of Consideration

10.1 The Draft Budget Statement 2017 follows closely after the MTFP Addition, on which the Panel published a detailed report. This report is therefore restricted to key areas of note within the Budget. Other areas covered in the Budget are listed below.

Allocation of Growth Funding for 2017

10.2 Allocation of Growth Funding was dealt with through the MTFP Addition and there is therefore nothing further proposed within the Budget.

Property tax proposals

10.3 The Budget includes proposals to increase stamp duty on residential properties on any consideration in excess of £3 million from 7% to 8% and create a new 9% band for properties sold for in excess of £6 million. Fewer than 15 residential properties were sold for more than £3 million in each of the last two years, so the impact of these proposals will be relatively small.

Rates

10.4 Following a previous States decision, it is proposed in the Budget that the Rates law be amended to remove the exemption on the States paying Parish rates.

10.5 The Budget also states *"The Minister considers it equitable that the Parishes should become liable to pay the IWR (*Island Wide Rate*) on properties which are owned and/or occupied by the Parishes".* Whilst the Panel has not taken any evidence on this, it is understood that while the urban parishes will see a net gain in their income, the country parishes are likely to pay more in the IWR than they receive from the States in Parish rates.

10.6 As noted in the Panel's report on the MTFP Addition, the Minister for Treasury and Resources has not yet identified a viable income stream to fund the estimated £0.9 million cost per year of paying Parish rates. The Draft Budget contains no details on this and it remains to be seen how this will be achieved. It is not clear whether these amounts could be absorbed by States Departments (as suggested by the Comité des Connétables in evidence provided to the Panel for its review of the MTFP Addition[44]).

Finding 11

It is not clear how the States intends to fund the payment of Parish rates on States properties.

Recommendation 9

The States should not proceed with the payment of Parish rates until a funding mechanism has been found.

[44] Evidence received from the Comité des Connétables, Review of Medium Term Financial Plan Addition S.R.5/2016

Asset Disposals

10.7 Forecasted asset disposals are contained within the update on the Consolidated Fund for 2016-2019 in the Budget. These show an amount of £1 million forecast to be received in each of 2018, 2019 and 2020[45]. This differs from the forecasts in the 2016 Budget, which included receipts of £20 million in 2017 and 2019. The Panel has ascertained that the change in the forecasts relates to the sale of shares in JT which had been under consideration in early 2016, but was not subsequently taken forward.

[45] Draft Budget Statement for 2017, page 61

11. Appendix

CORPORATE SERVICES SCRUTINY SUB PANEL

BUDGET 2017

REPORT

DECEMBER 2016

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Contents

1. Introduction

1.1 In October 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 an assessment of the States of Jersey Budget Proposals 2017. This draft report outlines CIPFA's preliminary position on this work to 18 November 2016.

Our Approach

1.2 Our approach to this independent review has sought to draw together a broad range of evidence. The majority of the conclusions and recommendations contained within this draft report are based on interviews with officers within the States of Jersey and some document review including budget review work relating to the Medium Term Financial Plan II Addition relating to the period 2016-2019. This work was placed in context against prevailing best practice on budget setting and wider financial management practice as encapsulated within the latest version 4 of the CIPFA Financial Management (FM) Model.

Scope

1.3 Our scope of work included the main components of the Budget Proposition outlined within the Draft Budget Statement 2017 covering the following:-

- Budget Modelling
- Impacts on Strategic Reserve and Consolidated Fund
- Income Tax Proposals and Yield Forecasts
- Impôts and Stamp Duty land Transaction Tax Changes
- Other Income
- Base Budgets
- Capital Programme

2. Budget Deficit Modelling - 2016

2.1 As with the 2016 Budget within the MTFP II 2016-2019 period the Budget Statement 2017 reconfirms that the States are continuing to budget for annual deficits in respect of 2017 and 2018 - returning to the generation of a modest estimated surplus of £3.429 million in 2019 (all including depreciation).

Revenue Expenditure to Income

2.2 An extract from page 52 of the Draft Budget Statement 2017 illustrates an expected movements on Income impacting Total Net Revenue Expenditure with a consequential deficit for 2017 of £53.553 million being created. This position includes all proposed additional income generating budget measures within the proposed 2017 budget measures:

Outturn	Financial Forecast	Forecast (Oct 2016)	Draft Budget 2017 Forecast Update (October 2016)		
2015 £'000		2016 £'000	2017 £'000	2018 £'000	2019 £'000
	States Income				
457,583	Income Tax	471,000	481,000	508,000	532,000
85,042	Goods and Services Tax	83,334	84,120	84,924	85,747
54,147	Impôts Duty	56,787	56,390	56,366	56,267
29,032	Stamp Duty	25,394	27,563	29,066	29,664
11,928	Island Wide Rate	12,142	12,543	12,919	13,346
14,023	Other Income (Dividends)	11,149	8,703	9,017	14,937
12,506	Other Income (Non-Dividends)	9,710	10,151	9,697	10,284
27,483	Other Income (Return from Andium and Housing Trusts)	27,785	28,337	29,264	30,186
691,744	**States Income**	**697,301**	**708,807**	**739,253**	**772,431**
-	Proposed mechanism to offset States Payment of Rates	-	-	900	900
-	Future revenue raising measures	-	-	7,500	15,000
	Proposed Budget Measures		2,527	2,952	2,943
691,744	**Total States Income**	**697,301**	**711,334**	**750,605**	**791,274**
	States Expenditure (per MTFP Addition)				
697,031	Departmental Net Revenue Expenditure	697,377	700,637	697,627	686,100
	Central Contingency Allocations	42,940	23,650	25,904	28,212
	Central Growth Allocations	-	-	10,424	20,533
697,031	**Total Net Revenue Expenditure (excl: Depn)**	**740,317**	**724,287**	**733,955**	**734,845**
(5,287)	**Forecast Operating Surplus/(Deficit) for the year**	**(43,016)**	**(12,953)**	**16,650**	**56,429**
44,676	Departmental Depreciation	44,800	40,600	45,500	53,000
(49,963)	**Surplus/(Deficit) of General Revenue Expenditure over Income**	**(87,816)**	**(53,553)**	**(28,850)**	**3,429**

2.3 In context the proposed budget measures around income streams are relatively modest with £2.527m impacting in 2017 rising to £2.952m in 2018 and £2.943m in 2019.

Consolidated Fund and Strategic Reserve

2.4 Whereas the budget proposals are designed to assist with bringing the general revenue expenditure over income back into surplus by 2019 there are planned impacts/transfers relating to the Consolidated Fund and Strategic Reserve. Forecasted Consolidated Fund Balances are as follows:

Forecast Consolidated Fund Balance (including Proposed Budget Measures)	Forecast (Oct 2016) 2016 £'000	Forecast Update for Draft Budget 2017 (October 2016) 2017 £'000	2018 £'000	2019 £'000
Opening Balance brought forward	**64,654**	**54,638**	**27,749**	**26,399**
Forecast Operating Surplus/(Deficit)	**(43,016)**	**(12,953)**	**16,650**	**56,429**
Funding for Capital Programme				
Apply Funding for Annual Capital Programme	(25,691)	(26,209)	(35,000)	(32,975)
Other Funding proposals				
- Les Quennevais School	(1,000)	(39,000)	-	-
- Prison Improvement Phase 6	-	-	(8,233)	-
Proposed Transfers from Strategic Reserve				
- Proposed Funding for Committee of Inquiry (CoI)	4,000	-	-	-
- Funding for Annual Capital Programme	25,691	16,273	-	-
- Funding for Les Quennevais School	1,000	39,000	-	-
- Funding for Economic and Productivity Growth Provision	5,000	-	-	-
- Funding for Redundancy Provision	16,000	-	-	-
- Funding for Working Balance on Consolidated Fund	5,000	-	16,000	-
Proposed Transfers to Strategic Reserve	-	-	-	-
- Repayment for Economic and Productivity Growth Provision	-	(5,000)	-	-
- Repayment for Redundancy Provision	-	-	-	(20,000)
Proposed Asset Disposals	3,000	1,000	1,000	1,000
Proposed Transfer from Criminal Offences Confiscation Fund	-	-	8,233	-
Forecast Closing Balance carried forward	**54,638**	**27,749**	**26,399**	**30,853**

2.5 Transfer funding from the Strategic Reserve of £55.273 million (net £50.273 million) is required in addition to the forecasted £56.691 million to be transferred in 2016. Funding sources for the substantive 2017 Capital Programme are some £26.209 million relating to the substantive Capital Programme and £39.000 million in relation to the Les Quennevais School. The proposition contained within the Draft Budget Statement specifically outlines the above movements:

d) to refer to their Act dated 8th October, 2015 in which they agreed that in 2017 a net transfer of up to £50.273 million from the Strategic Reserve Fund made up of a transfer up to £70.273 million from the Strategic Reserve Fund to the Consolidated Fund for measures identified in replacement table 2 of page 6 of P76/2015 as amended and a £20 million transfer from the Consolidated Fund to the Strategic Reserve Fund as detailed in the same table; and *to agree that this approval can be varied and to agree for 2017:*

(i) the transfer, in accordance with the provisions of Article 4(3) of the Public Finances (Jersey) Law 2005, of £55.273 million from the Strategic Reserve Fund to the Consolidated Fund to meet the measures as identified in Summary table E; and

(ii) the transfer, in accordance with the provisions of Article 4(2) of the Public Finances (Jersey) Law 2005, of £5 million from the Consolidated Fund to the Strategic Reserve Fund

with the resultant net drawdown from the Strategic Reserve Fund in 2017 remaining at

£50.273 million the same as approved by the Assembly in the aforementioned Act.[46]

2.6 As with the 2016 Budget setting position transfers from the Strategic Reserve to the Consolidated Fund do not meet the direct funding of general revenue expenditure. The Strategic Reserve was created in 1986 under Article 4 of the Public Finances (Jersey) Law 2005 where it is stated that the fund is a permanent reserve and should not be used "*to defray directly expenditure of the States*." Article 4 allows transfers from the Consolidated Fund to the Strategic Reserve as proposed by the Minister for Treasury and Resources and agreed by the States Assembly. However funds cannot be withdrawn from the Strategic Reserve unless proposed by the Minister and agreed to by the Assembly. As a consequence, transfers between the Consolidated Fund and the Strategic Reserve may be proposed within the Medium Term Financial Planning process (MTFP) or the Draft Budget Statement (as is proposed annually) in accordance with Articles 8 and 10 of the Public Finances (Jersey) Law. In terms of the 2017 Budget Statement:

"The MTFP 2016-2019 proposed the use of the Strategic Reserve as one of the short-term funding measures and the drawdowns and repayments were approved in P76/2015 (as amended) in October 2015.

The MTFP Addition 2017-2019 proposed the same net drawdown from the Strategic Reserve in 2017 of £50.273 million but varied the breakdown between withdrawals and repayments to reflect the latest financial position."[47]

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[46] Draft Budget Statement 2017 – P2

[47] P.109 – 2016 – Budget Statement 2017 - Page 6

2.7 The corresponding 2016 Budget analysis showed an increased movement in the funding of the Capital Programme from the Strategic Reserve of £26.273m and some £20 million of Asset Disposals delivered in both 2017 and 2019:[48]

Intended Transfers to/(from) Strategic Reserve	Forecast Movements 2015 £'000	Forecast Movements 2016 £'000	Forecast Movements 2017 £'000	Forecast Movements 2018 £'000	Forecast Movements 2019 £'000
Funding requirement for Committee of Inquiry	(10,000)	(4,000)	-	-	-
Funding requirement for Economic and Productivity Growth Provision	-	(5,000)	(5,000)	-	-
Transfer from Consolidated Fund	-	-	-	-	10,000
Funding requirement for Redundancy Provision	(4,000)	(16,000)	-		
Transfer from Consolidated Fund	-	-	-	-	20,000
Funding for Consolidated Fund working balance	-	(5,000)	-	-	
Les Quennevais School	-	(1,000)	(39,000)	-	-
Funding requirement for Annual Capital Programme		(25,691)	(26,273)	-	-
Transfer from Consolidated Fund - Asset Disposals	-	-	20,000	-	20,000
Total Intended Transfers to/(from) Strategic Reserve	**(14,000)**	**(56,691)**	**(50,273)**	**-**	**50,000**

2.8 The 2017 Budget positions the funding of the Capital Programme from the Strategic Reserve down from this previous 2016 forecasted position for 2017 of £26.273 million to £16.273 million (outwith the £39 million direct funding of Les Quennevais School) and the Asset Disposals down from the 2016 forecasted position for 2017 of £40 million covering the period 2017 – 2019 to £3 million. We understand that an improved 2015 actual outturn on the Consolidated Fund position has allowed this reduced transfer requirement of £10 million from the Strategic Reserve. In respect of the net downward movement of some £37 million on asset disposals we also understand that the original planning incorporated a potential sale of part of JT Global which had not yet materialised and is now the subject of a detailed review. Overall capital investment has not decreased but the sources of funding have changed.

2.9 The de minimis balance on the Consolidated Fund for budget setting purposes appears to be consistently greater than £20 million. We understand that a minimum balance was originally raised as a component of P179/2009, restated in the Fiscal Framework R107/2015 and is used as a contingency for unforeseen movements in income forecasts. This concept is eminently sensible, however the actual balance on the Consolidated Fund is, in reality, significantly higher. We are advised that the balance of the Consolidated Fund exceeds £100 million and the addition beyond forecast is based on allocated but unspent capital funding for specific projects.

2.10 For the financial year 2015 the non-trading components of the States spent some £45.6 million on capital expenditure. The 2015 Budget included a capital allocation of some £74.8 million from the Consolidated Fund with an additional £97.3 million of unspent approvals brought forward from previous years. As at 31 December 2015,

[48] Table 2 on page 6 of P.76/2015

whilst £45.6 million was spent there was some £121.6 million of unspent allocation. As at 30 June 2015 only 20.8 million of capital expenditure was incurred.[49]

2.11 Within our MTFP II Addition Report - September 2016 we reiterated previous comments:

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

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

[49] Quarterly Corporate Capital Reporting June 2015 – P1

2.12 Our 9th recommendation within the MTFP II report highlighted the following :

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

2.13 The current budget setting process which positions the Consolidated Fund balance within a £20 - £30 million pound bandwidth is significantly different from the consistent level of actual balances being over £100 million pounds. Obviously this is an extremely prudent approach and highly influenced/driven by Jersey Public Finances Law. Article 10(8) of the Public Finances (Jersey) Law 2005 states:

"The Minister must not lodge a draft budget that includes a report that shows a deficit in the consolidated fund at the end of the financial year to which the budget relates."

2.14 Article 10(8) of the Public Finances (Jersey) Law 2005 requires the Minister to take steps to ensure that decisions and related financial impacts will not create a deficit in the Consolidated Fund to be established at the point in time of the end of the financial year. The Public Finance (Jersey) Law 2005 also provide that once Capital Project approval has been obtained and that Capital Expenditure has been incorporated within the Capital Planning vote – that Article 16 :

"..*authorises a States funded body (other than a States trading operation) to withdraw from the consolidated fund, in one or more financial years, commencing with the financial year for which the approval is given, to make payments due for a capital project, amounts not exceeding, in total, the amount approved for the project, net of any capital receipts that are intended to be used for the project."*

2.15 Whilst the Public Finances Law allows for transfer to be made to the Consolidated Fund to negate deficit balances arising, the actual in-year cash position is heavily distorted by the high level of unused capital funds routed through the Consolidated Fund[50]. By definition this requires such approvals to be 'ring fenced' within the Consolidated Fund. Given the restrictions/controls on transfers to the Strategic Reserve and investment of 'surplus' funds, it is clear that the additionality of unused

[50] Article 10(8) of the Public Finances (Jersey) Law 2005 states: - "The Minister must not lodge a draft budget that includes a report that shows a deficit in the consolidated fund at the end of the financial year to which the budget relates."

capital funds does not lend for absolute clarity around the precise balance of the Consolidated Fund. This becomes highly relevant when there are significant variances between capital project estimates and actual cost requirements - which can naturally arise through slippage and the passage of time. We have previously raised this issue in our work around Budgets 2016 and 2015:

"On the Capital Programme we believe that the States face challenges in improving the precision of key assumptions as well as capacity including performance management capability and ultimately, affordability. The appropriate legislative allocation approval process has created a dysfunctional impact upon Financial Performance and Strategy as it is driven largely by aspirational/expectation rather than reality. Continuation of the existing position will act as a significant impediment to the formulation of a robust financial strategy that informs both the annual Budget Setting process and the MTFP." [51]

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

Capital Programme Performance – it is recommended that the legislative framework around the Capital Allocation process and incorporation within the Budget process be reviewed to allow for the realistic delivery of the Capital Programme and that appropriate performance management arrangements are put in place to ensure delivery."[52]

[51] States of Jersey – Corporate Services Scrutiny Panel – Budget 2015 - CIPFA – Page 35 – Para 11.9
[52] States of Jersey – Corporate Scrutiny Panel – MTFP 2016 – 2019 Section 6 Page 24

2.16 The Draft 2017 Budget Statement does not contain details of the Strategic Reserve forecast balances other than expected movements:

Strategic Reserve Movements (September 2016)

Strategic Reserve movements (September 2016)	2013 Actual £'000	2014 Actual £'000	2015 Actual £'000	2016 Forecast £'000	2017 Forecast £'000	2018 Forecast £'000	2019 Forecast £'000
Less: Planned Contributions to Hospital Project	-	*(10,200)*	*(22,700)*	-	-	-	-
Less: Planned Contribution to Short-Term Measures	-	-	*(14,000)*	(56,691)	(70,273)	-	-
Plus: Planned transfer to the strategic reserve	-	-	-	-	20,000	-	20,000
Less: Proposed Contribution to Consolidated Fund					-	(16,000)	
Sub total: Net Drawings	-	(10,200)	(36,700)	(56,691)	(50,273)	(16,000)	20,000

2.17 However the relevant table of forecasts has been obtained dated - September 2016 and is highlighted below together with the June 2016 position and the June 2015 as embedded within the original MTFP II submission:

Strategic Reserve balance and estimated returns (September 2016)

Strategic Reserve - Budget 2017	**2013 Actual £'000**	**2014 Actual £'000**	**2015 Actual £'000**	**2016 Forecast £'000**	**2017 Forecast £'000**	**2018 Forecast £'000**	**2019 Forecast £'000**
Strategic Reserve - Protected Capital Value	***664,240***	***674,868***	***678,917***	**694,532**	**718,147**	**739,691**	**761,882**
Strategic Reserve - Accumulated Excess Return	***78,888***	***111,654***	***92,465***	**87,732**	**47,159**	**47,479**	**85,147**
Strategic Reserve - Estimated Fund balance	**743,128**	**786,522**	**771,382**	**782,265**	**765,305**	**787,170**	**847,029**

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**

Figure 37 – Estimated balances on the Strategic Reserve 2013 – 2019 - MTFP 2 - [53]

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**

2.18 As can be seen there has been an element of change within the three forecasts which cannot be readily explained other than potential underspends arising from both Revenue and Capital activities based on the 2015 annual outturn(including improved income positions) and 2016 forecasted outturns.

3. Income Tax Proposals and Yield Forecasts

[53] P92 – MTFP II 2015

3.1 The proposed Budget 2017 income measures apply only a modest £2.527 million of additional income growth. Whilst Income Tax proposals will inevitably affect the 2017 year of assessment, the consequential revenue implications substantially fall within 2018 onwards. This is illustrated within the following table:-

Outturn	States Income	Forecast (Oct 2016)	Forecast Update for Draft Budget 2017 (October 2016)			
2015 £'000		2016 £'000	2017 £'000	2018 £'000	2019 £'000	2020 £'000
	Income Tax					
370,806	Personal Income Tax	382,000	399,000	421,000	442,000	463,000
89,437	Companies	91,000	84,000	90,000	93,000	96,000
(2,660)	Provision for Bad Debt	(2,000)	(2,000)	(3,000)	(3,000)	(3,000)
	Proposed Budget Measures			430	430	430
457,583		471,000	481,000	508,430	532,430	556,430
	Goods and Services Tax (GST)					
71,687	Goods and Services Tax (GST)	70,647	71,212	71,782	72,356	72,935
4,154	Import GST	3,687	3,908	4,142	4,391	4,654
9,201	ISE Fees	9,000	9,000	9,000	9,000	9,000
85,042		83,334	84,120	84,924	85,747	86,589
	Impôts Duties					
4,529	Impôts Duties Spirits	4,899	4,807	4,767	4,714	4,638
7,638	Impôts Duties Wine	7,876	8,050	8,317	8,565	8,779
1,003	Impôts Duties Cider	1,082	1,126	1,187	1,247	1,304
5,078	Impôts Duties Beer	5,376	5,330	5,340	5,335	5,305
13,606	Impôts Duties Tobacco	13,915	13,511	13,259	12,974	12,633
21,406	Impôts Duties Fuel	22,045	22,045	22,045	22,045	22,045
144	Impôts Duties Goods (Customs)	145	145	145	145	145
743	Vehicle Emissions Duty (VED)	1,449	1,376	1,306	1,242	1,242
	Proposed Budget Measures		2,307	2,302	2,293	2,276
54,147		56,787	58,697	58,668	58,560	58,367
	Stamp Duty					
25,821	Stamp Duty	21,818	23,740	25,119	25,667	26,233
1,883	Probate	2,168	2,300	2,300	2,300	2,300
1,328	Stamp Duty on Share Transfer (LTT)	1,408	1,523	1,647	1,697	1,748
	Proposed Budget Measures		220	220	220	220
29,032		25,394	27,783	29,286	29,884	30,501
625,804	**Total Taxation Revenue**	636,515	651,600	681,308	706,621	731,887
11,928	**Island Rate Income from Parishes**	12,142	12,543	12,919	13,346	13,786
14,023	**Other States Income - Dividends**	11,149	8,703	9,017	14,937	9,872
12,506	**Other States Income - Non Dividends**	9,710	10,151	9,697	10,284	11,330
27,483	**Other States Income - return from Andium Homes**	27,785	28,337	29,264	30,186	31,215
65,940	**Total Other States Income**	60,786	59,734	60,897	68,753	66,203
691,744	**Total States Income - including Budget measures**	697,301	711,334	742,205	775,374	798,090
	% increase on previous year	*0.8%*	*2.0%*	*4.3%*	*4.5%*	*2.9%*
-	Proposed Mechanism to offset States Payment of Rates	-	-	900	900	900
-	Future revenue raising measures	-	-	7,500	15,000	15,000
691,744	**Total States Income - including additional proposals**	697,301	711,334	750,605	791,274	813,990

3.2 The impacts of previous year proposals have fed through and impact the baselines on all future years. The £2.527 million of income changes do not impact Income Tax for 2017 but have an effect on future years as highlighted below from the table extract:

Proposed Measures	Estimated impact on 2018 revenue (£'000)	Estimated impact on 2019 revenue (£'000)	Estimated impact on 2020 revenue (£'000)
Income Tax:			
- Increase standard income tax exemption thresholds by	2,000	2,000	2,000
- Increase second earner's allowance by £500	(1,500)	(1,500)	(1,500)
- Increase maximum child care tax relief by £2,000	(70)	(70)	(70)
Income Tax sub-total	**430**	**430**	**430**
Impôt Duties:			
- Alcohol duty increases	567	575	579
- Tobacco duty increases	784	767	746
- Fuel duty increases	921	921	921
- VED increases	30	30	30
Impôt Duties sub-total	**2,302**	**2,293**	**2,276**
Stamp Duty/Land Transactions Tax	**220**	**220**	**220**
Total Financial Implications	**2,952**	**2,943**	**2,926**

3.3 The 2016 Budget approved decisions incorporated ten Income Tax proposals – nine impacting personal income tax and one relating to a corporate income tax measure. These were incrementally improve the base positions for future years and included:-

- Increase standard exemption thresholds by 0.9% and freeze age enhanced exemption thresholds (raises revenue because income forecasts)
- Phase-out standard child allowance and additional person allowance from standard rate taxpayers
- Modernise wife's earned income allowance (WEIA)
- Modernise child care tax relief (CCTR)
- Increase tax relief for child care costs
- Phasing out of mortgage interest tax relief (MITR)
- Removal of non-residents relief
- Reducing the benefits in kind (BIK) exemption
- Removal of remaining pension relief
- Corporate – non-payment of tax credits to companies taxable at 0%

3.4 The financial impact on 2017 - 2019 tax bases were as follows:

Measure	Estimated impact on 2017 taxation	Estimated impact on 2018 taxation	Estimated impact on 2019 taxation
Income Tax	(£)	(£)	(£)
- Increase standard income tax exemption thresholds by 0.9% (June 2015 RPI) and maintain age enhanced exemption thresholds	2,200,000	2,200,000	2,200,000
- Grandfather entitlement to age enhanced exemption thresholds	-	-	300,000
- Phasing out standard child allowance and APA from standard rate taxpayers	645,000	1,290,000	1,935,000
- Modernise WEIA and CCTR	100,000	100,000	100,000
- Phase out mortgage interest tax relief	-	100,000	200,000
- Removal of non-residents relief	500,000	500,000	500,000
- Reduction of benefit in kind exemption	360,000	360,000	360,000
- Removal of remaining pension relief	-	350,000	350,000
- Additional Child Care Tax Relief	(100,000)	(100,000)	(100,000)
Income Tax sub-total	3,705,000	4,800,000	5,845,000
Impôts Duty:			
- Alcohol duty increases	249,000	248,000	251,000
- Tobacco duty increases	627,000	608,000	593,000
- Fuel duty increases	452,000	452,000	452,000
- VED duty increases	648,000	577,000	510,000
Duty sub-total			1,976,000
Stamp Duty/Land Transactions Tax	**(220,000)**	**(220,000)**	**(220,000)**
Total Financial Implications	5,461,000	6,465,000	7,431,000

3.5 Although the 2017 Tax proposals are largely incremental the overall modelling is reliant upon robust forecasting on 2016 outturn tax yield and the impact of emerging factors that will influence both Personal and Corporate Tax yields in 2017.

3.6 Latest (October 2016) forecasts highlight a marginally improved position from June 2016 but also highlight a deterioration in 2017 positions through to 2020 (excluding any impact of proposed 2017 Budget Income changes:

Central Forecast from Range (October 2016)	Forecast (Oct 2016)	Draft Budget 2017 Forecast Update (October 2016)			
	2016 £'000	2017 £'000	2018 £'000	2019 £'000	2020 £'000
States Income					
Income Tax	471,000	481,000	508,000	532,000	556,000
Goods and Services Tax	83,334	84,120	84,924	85,747	86,589
Impôts Duty	56,787	56,390	56,366	56,267	56,091
Stamp Duty	25,394	27,563	29,066	29,664	30,281
Income from Taxation and Duty	**636,515**	**649,073**	**678,356**	**703,678**	**728,961**
Other Income	60,786	59,734	60,897	68,753	66,203
Proposed mechanism to offset States Payment of Rates	-	-	900	900	900
Future revenue raising measures	-	-	7,500	15,000	15,000
Total States Income - Central Scenario (excl: Budget measures)	**697,301**	**708,807**	**747,653**	**788,331**	**811,064**
June 2016 Forecast	**693,774**	**715,203**	**759,240**	**789,360**	**820,506**
Variation to June 2016 Forecast (excl: Budget measures)	***3,527***	***(6,396)***	***(11,587)***	***(1,029)***	***(9,442)***

3.7 On Personal and Corporate Income Tax the following positions are highlighted:

Income Tax	Outturn	Forecast (Sep 2016)	Draft Budget 2017 (September 2016)			
	2015	2016	2017	2018	2019	2020
	£m	£m	£m	£m	£m	£m
Personal tax						
June 2016 Forecast	361	375	395	420	441	465
New FPP economic assumptions		0	-3	-6	-7	-9
Tax collectable	***361***	***375***	***392***	***414***	***435***	***456***
Corporate Tax						
June 2016 Forecast	91	87	87	90	93	96
New FPP economic assumptions			0	-1	-1	-1
In Year Taxes Office information		4	-3	1	1	1
Tax collectable[2]	***91***	***91***	***84***	***90***	***93***	***96***
Bad Debts	-1	-2	-2	-3	-3	-3
Provisional updated income tax forecast	***451***	***464***	***474***	***501***	***525***	***549***
CYB adjustment (unchanged from June 2016 Forecast)	+7	+7	+7	+7	+7	+7
Total Provisional updated income tax forecast	***458***	***471***	***481***	***508***	***532***	***556***
June 2016 Forecast - including CYB adjustment	458	467	487	514	538	565
Overall difference to June 2016 Forecast		+4	-6	-6	-6	-9

Some columns may not sum due to rounding

3.8 The Minister's (Treasury and Resources) foreword to the Draft Budget Statement 2017 described Jersey's approach to personal Income Tax as follows:

"Jersey's personal tax system is progressive. Those on the lowest incomes – more than 15,000 households – pay no income tax at all. Of the 45,000 households that do pay income tax, 15% pay tax at the 20% standard rate. The remaining 85% benefit from Marginal Relief, giving most of them effective rates of tax nearer 10%. The top 10% of earners pay more than half of the personal income tax that funds public services for everyone. Our tax allowances result in around 40% of lowest-earning households contributing approximately 3% of the personal income tax revenues that fund Jersey's public services.[54]"

3.9 The Income Forecasting Group have used the August 2017 economic data endorsed by the Fiscal Policy Panel (FPP) in the formulation of forecasts. The main movements in forecast are extracted from page 54 of the Draft Budget Statement 2017:

This updated forecast follows the detailed forecasts prepared in June 2016 to inform the original MTFP Addition submission. Since that time further information has been received and the forecast update is based on:

- Updated FPP endorsed economic assumptions for 2016-2018 from the Panel's Annual Report for 2016, 30 August 2016, which show a slight reduction in the assumptions over the forecast period largely reflecting the uncertainty and implications arising from the outcome of the UK referendum.
- The latest in-year forecasts for 2016 for all States income and further information from the Taxes Office. The in-year data for 2016 shows that in most cases the June 2016 forecasts are robust, in particular corporate tax is expected to exceed forecast. There are slight variations in impôts and stamp duty.
- The income tax forecasting model has been updated to reflect the latest FPP endorsed economic assumptions and IFG discussions regarding trends from the in-year Taxes Office data.
- All other areas of income have been remodelled with new economic assumptions and appropriate in-year 2016 data.

The forecast update for the draft Budget 2017 show a number of variations compared to the June 2016 forecast. The main variations which are described in more detail in the individual appendices to the main Budget report can be summarised as follows:

Income Tax

- The new forecast suggests that income in 2016 will be £4m higher than previously expected, due to improvements in the in-year corporate tax data from the Taxes Office.
- Lower earnings growth forecast for 2016, based on the FPP endorsed economic assumptions, will result in £3m lower personal tax in 2017, while data from the Taxes Office suggests that corporate tax may also be £3m lower in 2017 than previously forecast.
- Reduced economic assumptions mean that personal tax is expected to be £6m lower in 2018, rising to a £9m downgrade by 2020. Corporate tax is relatively unchanged over 2017-2019 as the lower economic assumption is offset by in-year data from the Taxes Office. The net impact is that the income tax forecast in 2019 is now expected to be £6m lower than the June 2016 forecast.

GST, ISE Fees and Import GST

[54] P.109 – 2016 – Budget Statement 2017 - Page 6

- The current in-year data shows the income from all these areas is in line with the June 2016 forecast and in respect of ISE fees these are now largely complete for 2016.
- The reduction in the FPP's real GVA forecast in 2017 causes a small downward adjustment to the level of increase in future GST revenues based on forecast trends agreed by IFG.

Impôts Duties

- The current in-year data suggests a small increase in duty revenues for 2016 and coupled with the increased FPP inflation assumptions for 2016 and 2017 provide a small increase in the expected revenues for future years.

Stamp Duty

- The FPP have revised downward the forecast for house price inflation in 2017 and when this is applied in the stamp duty model to all transactions below £2 million it results in a small decrease in income in each forecast year.
- The volume of activity in the first half of 2016 is slightly down on forecast and as a result the 2016 forecast is reduced slightly. Due to the volatility of the property market this reduction is not yet carried forward in the base until the final 2016 position is clearer and will be reviewed in March 2017.

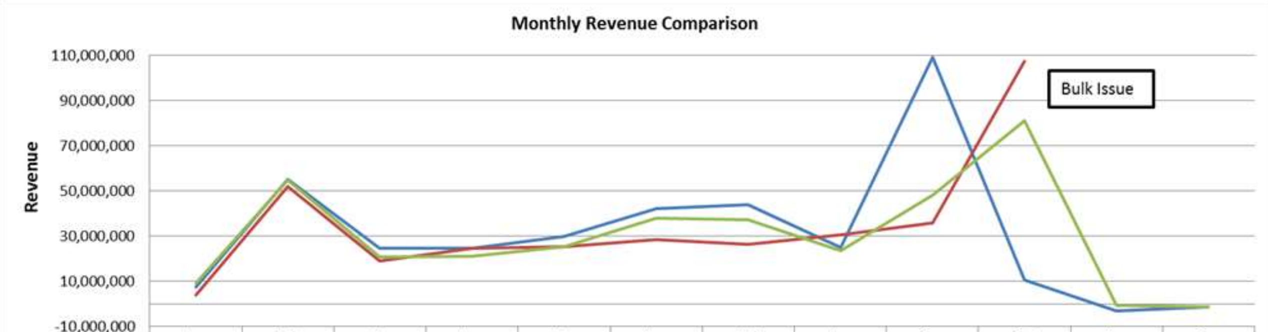
Other Income

- The other income forecasts show that, with the exception of the delay in receipt of the anticipated SoJDC dividend, compared to the June 2016 forecasts there is a slight reduction in income which broadly reflects the prudent approach to investment income and the small changes due to revised RPI assumptions.

3.10 As at 30 June 2016 Personal Income Tax yield was behind profile. The graph below highlights the June 2016 actual income for Personal Tax against 2016 budget and the average 2012 – 2015:

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Budget 2016	7,558,930	55,225,086	24,769,078	24,523,131	30,020,876	42,004,657	43,760,045	24,862,830	109,238,283	10,519,830	-3,246,922	-1,235,824
Actual 2016	3,839,499	52,102,562	18,938,598	24,533,421	25,430,215	28,536,940						
4 Year Actual Avg 2012 - 2015	9,336,614	54,887,376	20,854,256	20,965,072	25,428,535	37,915,951	37,391,721	23,442,673	47,956,337	81,053,622	-803,967	-1,180,080

3.11 The latest position to October continues to show a lack of consistency in processing assessments:



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Budget 2016	7,558,930	55,225,086	24,769,078	24,523,131	30,020,876	42,004,657	43,760,045	24,862,830	109,238,283	10,519,830	-3,246,922	-1,235,824
Actual 2016	3,839,499	52,102,562	18,938,598	24,533,421	25,430,215	28,536,940	26,520,606	30,544,606	35,881,405	107,170,278		
4 Year Actual Avg 2012 - 2015	9,336,614	54,887,376	20,854,256	20,965,072	25,428,535	37,915,951	37,391,721	23,442,673	47,956,337	81,053,622	-803,967	-1,180,080

3.12 The differentials have been attributed to gaps in staffing resource dedicated to the assessment process – turnover in experienced staff and ongoing ITAX system issues. Advice received from the Tax Office on the Forecast Position 2016 – 2019 includes the following statement:

"There is no direct correlation between the rate of which assessments are completed and the in year forecast or the Medium Term Financial Plan IFG forecast.

The in year forecast is based on a standalone model which takes assessments completed to date and where there is not an assessment yet completed adds corresponding prior year assessments uplifted for any increase in actual trend. The 2016 forecast remains at £382 million, made up of £375 PYB basis and £7m CYB adjustment, which matches that of the IFG used in the MTFP Addition update (September 2016) and the draft Budget 2017 (October 2016).

The IFG medium term forecast for 2017 and future years is steered by the FPP review and a number of other economic factors and assumptions using the last full year of final tax data as the basis. The latest IFG forecast in September 2016 reduced the medium term income tax estimates in 2020 by £9 million based on the impact of the latest FPP economic assumptions."

3.13 As outlined within our 2016 Budget work the strength of overall modelling includes dependencies on delivering on what was the 2015 outturns. For 2016 actuals we have not had access to the latest in-year positions but have been advised that overall Income Tax – both Personal and Corporate are 'on track'. Overall dependencies would include:

- Generating Income Tax yields to latest forecast
- Departmental Net Expenditure Budgets – delivering to the latest 2016 forecast
- Achieving Other Income forecasts

Underlying Assumptions on Yield

3.14 Personal Income Tax, in terms of proportionality is the largest component of Income Tax coming in at an approximately 80.5% of overall yield and is significantly influenced by employment related indices. Revised economic metrics (central trend scenario) used by the Income Forecasting Group as at August 2016 were as follows:

	2014	2015	2016	2017	2018	Return to trend 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

3.15 Changes from the March 2016 were as follows:

	2014	2015	2016	2017	2018	Return to trend 2019	2020
Real GVA	0.0	-1.4	-1.0	-1.4	0.0	0.0	0.0
RPI	-0.0	0.0	0.4	0.7	-0.3	0.0	0.0
RPIY	-0.0	0.0	0.5	1.0	0.0	0.0	0.0
Nominal GVA	0.0	-1.4	-0.5	-0.4	0.0	0.0	0.0
Company profits	1.8	-5.2	-0.3	-0.5	0.0	0.0	0.0
Financial services profits	0.0	-9.6	-0.5	-0.5	0.0	0.0	0.0
Compensation of employees(a)	-2.8	2.0	-0.7	-0.3	0.0	0.0	0.0
Employment	0.0	0.4	0.0	-0.5	0.0	0.0	0.0
Average Earnings	0.0	0.0	-0.7	0.2	0.0	0.0	0.0
Interest rates (%)	0.0	0.0	-0.1	-0.6	-0.8	-1.3	-1.1
House prices	-0.0	-0.2	0.0	-2.0	0.0	0.0	0.0

3.16 In using these revised economic indicators (and a central rather than an upper or lower range forecast) a revised set of Income Tax forecasts have been produced based on economic indicators which incorporate rates of growth in average earnings in 2018 of 3.8% and 2019 of 3.0%:

Year	2015	2016	2017	2018	2019
Income Tax £'000	£457,583	£471,000	£481,000	£508,430	£532,430
Growth £'000		£13,417	£10,000	£27,430	£24,000
% change		2.9%	2.1%	5.7%	4.7%

3.17 A noticeable trend within the UK is the relative stability on employment albeit with a large volume of employees working in low paid employment generating consequential low tax yields. Were this trend to growth within Jersey the States may struggle to improve relative tax yields.

3.18 It is also noticeable that personal tax estimates require the estimated adjustment on the movement to a current year basis of £7 million. We have previously indicated our concern over the validity of such an adjustment over time.

3.19 In respect of Personal Income Tax it is noted that the 2016 Outturn is set to bring in £375 million which is 3.9% higher than the 2015 outturn of £361 million.

	Outturn	Forecast (Sep 2016)	Draft Budget 2017 (September 2016)			
	2015	2016	2017	2018	2019	2020
	£m	£m	£m	£m	£m	£m
Personal Tax						
June 2016 Forecast	361	375	395	420	441	465
New FPP economic assumptions[1]		0	-3	-6	-7	-9
Tax collectable	361	375	392	414	435	456

Some columns may not sum due to rounding

Notes:

[1]Impact of new FPP economic assumptions includes downward impact of lower earnings in 2016, lower employment and interest rate; and upward impact of slightly higher nominal earnings in 2017; and higher inflation in 2016 and 2017.

3.20 There has been a downward revision arising from the latest economic indicators (see above) although these adjustments do not suggest a significant level of change commensurate with the level of uncertainty. We would consider that the level of average nominal earnings estimate used of 3.8% in 2017 to be overly optimistic especially in the context of acknowledged downside risks. We would reiterate a quote which we have previously identified:

"Good forecasting helps managers identify risks, but they need to take into account that data and assumptions can themselves be part of that risk."[55]

[55] NAO – Forecasting in Government to achieve Value for Money – January 2014 - Para 3.11 – Page 29

3.21 On Corporate Tax - growth is expected to be slower in 2017 and there is an element of uncertainty and potential volatility arising from Brexit and matters arising in the United States particularly with the potential for the UK and the US to significantly reduce their Corporate/Corporation Tax Rates. Forecast profiles used in the budget process for Corporate Tax is as follows:

	Outturn	Forecast (Sep 2016)	Draft Budget 2017 (September 2016)			
	2015	2016	2017	2018	2019	2020
	£m	£m	£m	£m	£m	£m
Corporate Tax						
June 2016 Forecast	**91**	**87**	**87**	**90**	**93**	**96**
New FPP economic assumptions[2]			**0**	**-1**	**-1**	**-1**
Updated information from Taxes Office		+4	-3	+1	+1	+1
Tax collectable	**91**	**91**	**84**	**90**	**93**	**96**

Some columns may not sum due to rounding

Notes:

[2]Includes £3m downward adjustment for significant changes for individual corporate tax payers from 2016.

3.22 We understand that there are approximately 200 corporate tax payers of significance and that the Tax Office carefully monitors corporate performance accordingly. On overall monitoring we are advised that the Tax Office has improved its tracking on performance. However there are acknowledged ITAX system issues which has undoubtedly impaired overall processing performance. We understand that a comprehensive replacement system is being currently procured.

3.23 There is no doubt that Tax forecasts have improved and enhanced levels of assurance have been provided although there is still an element of accrued tax income based on an estimation of outstanding assessments as well as the movement from prior year basis to current year basis. It will be critical that such adjustments are founded upon sound assumptions.

3.24 Whilst there is a consistent acknowledgement through the Fiscal Policy Panel (FPP) and the Income Forecasting Group (IFG) that risks are on the downside, the forecasting used in estimating tax yields favours a central scenario. If we now have more assurance on the accuracy of tracking, sectoral intelligence and the formulation of base estimates it may be more prudent to consider a mid-way point between a lower and central scenario forecasts given the level of uncertainty within the economic outlook and the acceptance of an extended level of deficit financing. We understand that the Council of Ministers has commissioned an independent detailed review into Personal Tax. Given the complexity of issues impacting personal tax yields we would fully welcome this approach.

3.25 Within our 2016 Budget work we commented:

> *"Given the extended deficit financing now required through to 2019 and the minimal likelihood to generate additional income generation capability in 2016, the primary focus, in terms of financial management capability, will necessarily turn to further cost reduction. "*

3.26 We would regard this to be even more relevant within 2017 Budget setting and beyond.

4. Other Income Proposals

4.1 The 2017 Budget proposals cover two main categories of activities totalling net additional revenue for 2017 of £2.527 million. This is split between the following components:-

- Impôts Duty Increases – additional £2.307 million in revenue for 2017
- Stamp Duty/Land Transaction Tax – an additional revenue of £220,000 for 2017

4.2 A detailed split for 2017 is outlined below:

Proposed Measures	Estimated impact on 2017 taxation revenue (£'000)
Impôt Duties:	
- Alcohol duty increases	558
- Tobacco duty increases	798
- Fuel duty increases	921
- VED increases	30
Impôt Duties sub-total	**2,307**
Stamp Duty/Land Transactions Tax	**220**
Total Financial Implications	**2,527**

4.3 The Draft Budget Statement envisages the extended impacts to follow for future years:

Proposed Measures	Estimated impact on 2018 taxation (£'000)	Estimated impact on 2019 taxation (£'000)	Estimated impact on 2020 taxation (£'000)
Impôt Duties:			
- Alcohol duty increases	567	575	579
- Tobacco duty increases	784	767	746
- Fuel duty increases	921	921	921
- VED increases	30	30	30
Impôt Duties sub-total	**2,302**	**2,293**	**2,276**
Stamp Duty/Land Transactions Tax	**220**	**220**	**220**

Total Financial Implications	**2,952**	**2,943**	**2,926**

Impôts

4.4 Proposals aimed at generating additional revenue of approximately £2.277 million on Alcohol, Tobacco and Fuel duties have specific base duty increases. For Alcohol an approximate real average increase of 5.2% is applied. This is significantly greater than RPI and it is assumed that the overall estimate of £19.871 million is driven by a consistent level of demand re purchasing/consumption.

4.5 In respect of Tobacco products the Minister proposed an increase in duty of 8.1% which equates to a rise of £0.45 on a packet of 20 cigarettes. This change is expected to help bring in some £14.309 million in 2017 from this source.

4.6 Petroleum based fuel is scheduled to rise by £0.02 per litre (unleaded petrol). Such a change is expected to help realise a total fuel tax yield of some £22.966 million in 2017.

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

4.8 On Vehicle Emissions Duty (VED) incentives are given to encourage vehicle owners to switch to vehicles with low emissions. Revised VED rates will be applied to increase income by some £30,000 based on revising rates upwards to £1,839.60 for the highest polluting vehicles.

4.9 As with other Impôts, the level of precision on the additional income will depend on expected volumes being realised and anticipated purchasing/falling predicted trends.

Stamp Duty and Land Transaction Tax on borrowing to £400,000

4.10 Previous Budget changes were designed to reduced Stamp duty/LTT payable on mortgages secured on Jersey property, the 2016 Budget proposed a further reduction on the stamp duty/LTT payable on the registration of mortgage debt. The aim was to reduce/equalise the stamp duty/LTT differential between cash buyers and those requiring a mortgage to buy property – based on the average property price on Jersey. The proposed reduction only applied to properties worth not more than £450,000. In practice, on the first £350,000 of mortgage debt there was no stamp duty/LTT however on the next £100,000 of mortgage debt stamp duty/LTT was payable at the reduce rate of 0.25%. The reduction was expected to reduce tax revenues by £220,000 per annum on current "housing trends".

4.11 The 2017 proposal reverses this position on tax revenues by raising £220,000 and neutralising the impact of the previous budget measure. This is achieved through increasing the rate of stamp duty on residential properties valued over £3 million to 8% and creating a new band on properties valued in excess of £6 million where the stamp duty rate will be 9%.

4.12 Overall, the proposals are based on robust underlying data and appear to be consistent with prevailing policy.

5. Base Budgets

5.1 The MTFP Addition 2016-19 substantially provides the detailed base budgets that are reflected within the Draft Budget Statement 2017 albeit with a few changes agreed within the latest MTFP debate .The Base Total Net Expenditure by Departments and Non Ministerial Bodies excluding depreciation is £789,560 million for 2017 (up from £767.008 million set for 2016)and the detail relative to departments and other bodies is highlighted[56]:

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

[56] Draft 2017 Budget Statement – Page 60

This movement represents a 2.94% increase on the 2016 equivalent States Net Expenditure position including net capital and contingency allocations.

Base Budgets and Efficiency Savings

5.2 The MTFP 2016-19 Addition II as compiled by Treasury and Resources provides significant detail behind base estimate movements including expected savings, transfers and additional funding. There is strong tracking on movements and there is granularity behind reconciliations – with budget detail is provided in both subjective and objective analysis. We previously concluded *"the key base budget information format substantially accords with good practice and allows a high level of transparency on key budget lines within a subjective analysis format*."[57] Indeed, the MTFP II Addition process has provided the line by line detail for 2017, 2018 and 2019 as illustrated above.

5.3 We also concluded that the MTFP II Addition submission provided "*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."*[58] Whilst we considered that the framework used to model the medium financial strategy to be robust we did have "have *significant concerns relating to key assumptions principally around Income Tax estimates and the reliability of Efficiency Savings proposals….a significant number of efficiency savings proposals contained within the Addition submission are not sufficiently advanced in construction, lack granularity and are aspirational/expectational…. 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."*[59]

5.4 In respect of the base budget positions on staffing we would reiterate our position that the incremental budget setting based process on providing full funding for agreed and adjusted staffing structures do not provide the appropriate level of rigour or behaviours needed to encourage a shaping staffing resources to critical need. Whilst vacancy levels within public sector can be high - typical budget setting processes used include :

[57] CIPFA - MTFP II 2016 – 2019 Addition – Corporate Scrutiny Panel – 16.9.16 – page 45
[58] CIPFA - MTFP II 2016 – 2019 Addition – Corporate Scrutiny Panel – 16.9.16 – page 45
[59] CIPFA - MTFP II 2016 – 2019 Addition – Corporate Scrutiny Panel – 16.9.16 – page 45

- Removing a significant allowance for turnover - typically this across UK public bodies is between 3% - 5%

- Removing budgetary provision for all vacancies to a corporate central contingency with departments required to 'bid' for 'critical' staffing resource

5.5 We have seen a combination of the above work well, indeed we have noted that a large UK local authority has successfully removed 75% of funded vacancies – with only critical Health/Social Services/Education being funded with such posts being recognised interim/locum/critical cover posts through a bidding process.

5.6 The MTFP II Addition submission reshaped the overall level of savings, efficiencies and user pays - moving from an original £145 million 'structural deficit' including some £90 million on Staff and Non Staff efficiency savings. A revised £77.5 million target to 2019 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**

5.7 The MTFP II Addition has now provided the basic level of detail and the 2017 Base Budget position has been created around this. However, our scrutiny work highlighted a lack of consistent detail on departmental base budget lines on how the expected level of savings, efficiencies and user pay charges is going to be achieved. Indeed, whilst our focus is on the 2017 Budget construction our previous comments still apply:

"..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."

"We have previously made repeated comments on the weaknesses of using predominately
……………… 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 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."

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."[60]

5.8 Although we can trace the expected savings and efficiencies arising from the MTFP II Addition 2016 – 2019 work within base budget lines, the general level of background work provided across the departments did not provide an appropriate level of confidence to illustrate that departmental management can actually deliver such plans.

Growth – additional Funding

5.9 Within the MTFP II Addition process the proposed Health and Social Services Department net expenditure positions across 2017, 2018 and 2019 were dependent in part on the approval of transfers from the Health Insurance Fund and an approval of a proposed Health Charge. With the States rejecting the Health Charge within the MTFP II Addition debate the base budgets for 2017 – 2019 were subsequently reduced by £5 million per annum across these three years. However for the 2017 Budget submission the Council of Ministers "*is proposing that £5 million for 2017 be earmarked as a first call on 2016 underspends to be carried forward and applied to Health and Social Services. The Council of Ministers will explore sustainable expenditure measures with departments ahead of the Budget 2018 when proposals for the allocation of Central Growth for 2018 and 2019 would be considered which currently include £9.7 million in and £17.5 million of Health growth in 2018 and 2019 respectively."*[61]

[60] CIPFA - MTFP II 2016 – 2019 Addition – Corporate Scrutiny Panel – 16.9.16 – page 45
[61] Draft Budget 2017 Statement – page 59

5.10 Whilst this is not regarded as a real growth item there is an acknowledgment that there is a substantive need for additional resources although it does assume that matching underspends will arise. In terms of the overall MTFP II process Health and Education have been afforded a degree of protection in accordance with the acute nature of sustained and emerging pressures associated with such service delivery areas. Both services have a strong track record of managing down cost pressures and we retain an element of assurance that service financial management capabilities will ensure the delivery of the 2017 departmental estimates positions.

Other Income

5.11 Other income is comprised of four lines of income which do not contain specific budget proposals - however such income streams are regarded as significant. These are highlighted within an extract below[62]:

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

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

5.13 Other Income (Dividends) is significantly more volatile and is expected to move down significantly from the forecasted 2016 position from £11.149 million to a 2017 baseline of £8.703 million due to ‘challenging’ trading conditions of the entities that return a share of profits to the States.

5.14 The main contributors are entities in which the States have a shareholding and are as follows:

[62] Draft Budget 2017 Statement – Figure 47 - page 96

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

5.15 Changes from the June 2016 position incorporated within the MTFP II Addition 2016-2019 are noted as follows:

The only significant change since the June 2016 forecast is in relation to the delay in the receipt of an anticipated £5.5m dividend from SoJDC on the completion of the College Gardens development from 2018 to 2019. There are also some minor changes to the Jersey Post dividend.

Other income – Dividends would now include any financial return forecast from the Ports of Jersey, following their incorporation in October 2015. However, in the early years of their trading the strategic business model indicates no net return for the MTFP period 2016-2019 as a result of forecast investment in commercial projects post incorporation and reduced taxation returns as the loss relating to the payment of the PECRS pre-1987 debt is offset against tax.[63]

5.16 The Other Income (Non Dividend) component contains a range of income streams including investment returns from the Consolidated Fund and Currency Fund pooled through the Common Investment Fund (CIF) Investments. There is a level of uncertainty around this source of income :

Larger streams of income arise from:

- *Investment returns from the Consolidated Fund*
- *Investment returns from the Currency Fund*
- *Returns from the JFSC*
- *Returns from Jersey Car Parking Trading Account*

The investment returns from the Consolidated Fund and Currency Fund benefit from the pooled investments in the Common Investment Fund ("CIF"). The returns are

[63] Draft Budget Statement 2017 – Page 94

based on the investment strategies of the two funds and the holding balance available to be invested. The forecast returns can be quite volatile to the extent they are invested in equities, but a proportion of the balances need to be held in cash on which returns are generally lower but more stable. Return on cash with interest rates at all-time lows will remain fairly small for some time and there are no significant changes in interest rates predicted in the near future. There is likely to be some improvement in the investment returns in 2016, since the June 2016 forecast, based on the recorded in-year gains to August 2016. However, with much uncertainty in the outlook the forecasts have not been adjusted as part of this interim update until the outlook for investments becomes clearer. The June 2016 forecasts were prudent and these are being maintained for the draft Budget 2017. The States investment advisers continue to recommend that future returns should be based on long term trends rather than the higher returns achieved in recent years.[64]

Andium Homes and Housing Trust

5.17 We are unsighted on the potential for the £28.3 million to be achieved in 2017 and the 2016 outturn of £27.8 million. However, we have received no contra indicators that such income streams will not outturn. As with the 2016 position we are assuming that there is an appropriate governance and performance management framework in place to ensure that assurance on these income streams is obtained.

[64] Draft Budget Statement 2017 – Pages 94/95

6. Capital Programme

6.1 The Ministerial Foreword to the Draft Budget Statement 2017 outlines a high level narrative on 2017 capital investment as follows:

> *"The £65 million capital investment programme proposed for 2017 focuses on vital public infrastructure. The largest expenditure is £39 million for Les Quennevais School, with smaller amounts going on the redevelopment of Grainville School, a new computer system for the Taxes Office which will enable islanders to file their personal tax returns online, and a new sewage treatment system.*
>
> *A proposal for where to site the new hospital is due to be lodged with the States Assembly shortly. I will lodge the proposal for funding the hospital before the Budget debate."*[65]

6.2 We understand that the original MTFP Capital allocation of £65.273 million has been refined within the 2017 process to £65.209 million. The overall Capital Programme includes two categories - Major Projects and 'all other projects'. Major Projects (excluding Les Quennevais School) are not included within the overall 2017 provision of £65.209 million and are:

- Sewerage Treatment Works – Upgrade
- Future Hospital
- Office Consolidation Project
- Prison Improvement Works Phase 6

6.3 In respect of the Sewerage Treatment upgrade part of its proposed funding relates to a call on the Department for Infrastructure's (DfI) rolling vote allocation. However from page 37 of the Draft Budget Statement we understand that:

> *"Department for Infrastructure have allocated £1,400,000 to a new project, a Commercial Recycling Facility, from their existing Infrastructure Rolling Vote allocation. This new requirement is aimed to assist with handling inappropriate materials currently entering the Energy from Waste Plant and causing unnecessary increased running costs to the plant. They are looking to supplement their Rolling Vote allocation from 2016 revenue underspends, subject to necessary approval and*

[65] Draft Budget Statement 2017 – Page 10

consideration of spend against budgets, as this allocation has already provided funding for the Sewage Treatment Works replacement project."

6.4 It is unclear how this addition source is reflected within the 2017 Budget Proposals.

6.5 The full programme is highlighted by department heading below:

	Proposed Programme 2017
Corporate Web Platform Refresh	300
Hardware Refresh	200
Taxes Office System Renewal	8,400
Chief Minister's Total	**8,900**
Minor Capital	381
Fire and Rescue HQ/Ambulance Co-location *	500
Community and Constitutional Affairs Total	**881**
Grainville Phase 5 (Inclusive of provision for Music Service) *	3,264
Replacement Assets and Minor Capital works	200
Les Quennevais School Rebuild *	39,000
Education Total	**42,464**
Equipment, Maintenance and Minor Capital	12
Department of the Environment Total	**12**
Replacement Assets (Various)	3,100
Health & Social Services Total	**3,100**
Replacement Assets	1,637
Infrastructure Rolling Vote	6,765
Commercial Recycling Facility	1,400
Department for Infrastructure Total	**9,802**
Replacement Assets - Non Mins	50

Non Ministerial Total	**50**
TOTAL PROJECTS	**65,209**

	Proposed Programme 2017 £'000
Car Park Maintenance and Refurbishment	2,334
Sustainable Transport and Road Safety Schemes	1,250
Jersey Car Parking	**3,584**
Vehicle and Plant Replacement	1,285
Jersey Fleet Management	**1,285**

Funding Sources

6.6 As highlighted in Section 2, funding sources for this proposed programme totalling some £65.209 million is as follows:

- Consolidated Fund - £26.209 million after transfer from the Strategic Reserve of £16.273 million;
- Strategic Reserve – direct £39.000 million Les Quennevais School)

	Proposed Funding 2017 £'000	Indicative Funding 2018	Indicative Funding 2019
Departmental Capital Programme	**65,209**	**43,233**	**32,975**
Funding Sources			
Consolidated Fund	(26,209)	(35,000)	(32,975)
Criminal Offences Confiscation Fund (Prison Phase 6 only)		(8,233)	
Strategic Reserve - Les Quennevais School	(39,000)	-	-
Funding Available	**(65,209)**	**(43,233)**	**(32,975)**
TOTAL FUNDING	**65,209**	**43,233**	**32,975**

6.7 Overall funding from the Strategic Reserve in 2017 of £55.273 million to capital investment is significant. As outlined in Section 2 of this report the Strategic Reserve was established under Article 4 of the Public Finances (Jersey) Law 2005 with the intention that it should be permanent and "should not be used to defray directly expenditure of the States."[66]

6.8 In our MTFP II Addition 2016 – 2019 and Budget 2016 work we highlighted a disconnect between the calculation of depreciation and the utilisation of depreciation in asset replacement/investment decision strategy. It could be readily argued that asset replacement and investment - sources of capital funding should be largely be provided for the substantive Capital Programme (excluding the major projects) from the Consolidated Fund without recourse to transfers from the Strategic Reserve. Given the lack of clarity arising from unused capital approvals (upon the Consolidated Fund) and the prevailing advice followed by Ministers from the Fiscal Policy Panel, we can readily acknowledge the pragmatism in this approach. However, such an approach may potentially conflict with the original strategy around the utilisation of the Strategic Reserve. In terms of overall financial strategy we can fully appreciate the need to utilise reserves where cost reduction and income maximisation is not fully on track at this time.

[66] Corporate Services Scrutiny Panel – paper on Reserve – Budget 2014 – Page 1

7. Concluding Comments and Recommendations

7.1 The Draft Budget Statement builds substantially upon the previous work involved in the MTFP II and MTFP II Addition submissions. The Draft Budget Statement provides a comprehensive and transparent picture of all relevant factors involved within the 2017 Budget setting process. The MTFP 2016-19 Addition II provides significant detail behind base estimate movements including expected savings, transfers and additional funding. There is strong tracking on movements between budget headings and a strong balance of narrative and analysis. In this respect we would commend the work of the Financial Planning Team at Treasury and Resources in the compilation of both MTFP II Addition 2016 – 2019 and the Budget 2017.

2017 Budget Proposals

7.2 Consistent with the prevailing economic conditions the 2016 Income Tax proposals are relatively modest with additional income of £2.527m impacting in 2017 rising to £2.952m in 2018 and £2.943m in 2019. On tax there is full alignment with long term tax policy and along with previous year budget proposals will incrementally have appositive impact on the overall income baseline. The proposals for Impôts and Stamp Duty Land Transactions appear to match prevailing public policy considerations and along with some modest Vehicle Emission Duty changes will provide valuable additional net revenues.

Risks - 2017

7.3 The principal identified risks around the 2017 Budget relate to the following five areas:

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

7.4 Our recommendations made within our assessment of the MTFP II Addition 2016-2019 substantially cover these specific risks[67]. Further clarity is provided in five areas:-

[67] CIPFA Corporate Services Scrutiny Panel – MTFP II Addition 2016 – 2019 - Pages 48 and 49

Income Tax Growth Assumptions – clarity on the precise extent to which the economic indicators are applied to the formulation of both Corporate and Personal Income Tax base estimates – particularly the assumed 3.8% growth in earnings in 2017 and how this fits into an overall 2.1% uplift in overall tax yield in 2017. On Personal Income Tax it is noted that the 2016 Outturn is set to bring in £375 million which is 3.9% higher than the 2015 outturn of £361 million – this is set against a downward revision arising from the latest economic indicators

Base Budgets – funding vacancies – the prevailing incremental budget setting based process on providing full funding for agreed and adjusted staffing structures do not provide the appropriate level of rigour or behaviours needed to encourage a shaping of staffing resources to critical need

Efficiency Savings/Public Sector Reform Agenda - departmental capabilities in delivering efficiency savings –whilst we can trace the expected savings and efficiencies arising from the MTFP II Addition 2016 – 2019 work within base budget lines the general level of background work provided across the departments did not provide an appropriate level of confidence that departmental management can actually deliver such plans – the Draft Budget Statement 2017 does not provide any further assurance on progress on the pace of the Public Sector Reform Agenda e.g. Office Accommodation project and eDigital initiatives

Capital Programme Performance – the overall scope of the Capital Programme is ambitious (this analysis does not cover Major Projects as they do not feature within the Draft Budget Statement 2017) yet we did not acquire any further evidence to suggest that enhanced performance management arrangements were going to be in place to ensure such critical projects are delivered – this is not substantially covered within the Draft Budget Statement 2017. There is a critical need to improve on the precision of key assumptions as well as capacity including performance management capability and ultimately, affordability. The appropriate legislative allocation approval process has created a dysfunctional impact upon Financial Performance and Strategy as it is driven largely by aspirational/expectation rather than reality. This has led to a lack of clarity on the prevailing balance on the Consolidated Fund where unused capital approvals obscure and can potential impede optimal decision making. It is recommended that a revised approach be adopted to the treatment of Capital Allocations within the Consolidated Fund whilst retaining a strong element of internal control

Strategic Reserve – in respect of asset replacement and investment - sources of capital funding should be largely be provided for the substantive Capital Programme (excluding the major projects) from the Consolidated Fund without recourse to transfers from the Strategic Reserve – arising from the correct application of depreciation for asset replacement

Direction of Travel on Budget Setting

7.5 Whilst the budget setting processes used by the States are relatively sound, more clarity is needed on key assumptions including the approach used within the formulation of Personal Income Tax. Budget setting processes would also benefit from moving away from largely incremental practices towards an outcomes based approach incorporating some zero basing. There appears to be an inordinate gap in the time required to produce financial performance information - our work was not informed by the latest quarterly financial performance and our assessment on 2016 outturn and the 2017 baselines estimates are based in part of the accuracy of the latest forecasts which were based upon the second quarter.

7.6 Overall the modelling of financial strategy is extremely robust but there is a clearer need to drive improvement in the use of resources and budget setting has a clear role to play. However, actual delivery will require full ownership and accountability of operational and financial performance across the departments – an issue which is much wider than the annual budget setting process.

7.7 As highlighted within our corresponding scrutiny work for the 2016 Budget the 'big issue' will be improving the cost effectiveness of core of service delivery. Our concluding comment in our 2016 Budget work was :

Whilst this prediction on a further deterioration on financial performance has been realised we would have confidence that the States are now on track to turn around this position and are within a critical phase of recovery. Full recovery and stability will, of course be predicated upon the extent that the States can substantially deliver significant service change. Realistically this is likely to take place post 2016. The 2016 Budget sets a clear initial position on recovery although the formulation of detailed realisable estimates across 2017 to 2019 must provide further evidence that the structural deficit can be eliminated and that the States can fund current spending from current income.

7.8 One year on this comment is still resonates although there is some tangible evidence of real progress being made and there is real improvement in the formulation of realisable estimates from 2017. In summary the Draft Budget Statement 2017, represents a measured approach to the annual budget setting process within highly uncertain economic conditions. The Statement sets out the annual budget setting strategy consistent in the context of the MTFP II Addition 2016 – 2019, the prevailing public policy in Jersey and the advice from the Fiscal Policy Panel (FPP). It is likely that some 'headroom' will be required to enable the financing of the New Hospital Project as well as the other major projects not incorporated within the substantive capital programme. In this respect difficult decisions are going to have to be made around the optimal level of reserves together with a renewed approach to Public Sector Reform/service cost reduction and modifications to tax strategy if expected yields underperform.

7.9 In context the overall challenge - the budget States Net Expenditure position is set for 2017 at £789,560 million. This movement represents a 2.94% increase on the 2016 equivalent States Net Expenditure position of £767.008 million set for 2016. Part of this movement will be the £39 million investment in Les Quennevais School. Whilst there may underspends being delivered there will be continuing latent service cost pressures, investment requirements and the challenges in covering such additional pressures through revenues. A consequence is the planned utilisation of reserves. A foundation has been set within the MTFP Addition II 2016 – 2019 process and the Budget Statement 2017 is an integral component of this. Returning to surplus by 2019 will not be easy but the prevailing financial strategy outlines a clear way ahead.

7.10 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.

Income forecasts in the 2017 Budget – a brief note

MJO Consultancy

This short report for the Corporate Services Scrutiny Panel is divided into three: (1) a brief narrative on the evolution of the forecasting process from March 2016 to August 2016; (2) a summary of developments during September and October 2016; (3) comments on the income tax forecasts in Budget 2017.

Evolution of the forecasting process: March 2016 to August 2016

Jersey's draft MTFP Addition was lodged in June 2016. The draft drew on economic assumptions from March 2016 and income forecasts which were produced in May 2016. However, seven days before the draft MTFP Addition was lodged, the UK electorate voted to leave the European Union. The Minister for Treasury and Resources asked Jersey's Fiscal Policy Panel to provide an economic update in July 2016, ahead of the Panel's annual report in August 2016. The FPP concluded that there was not sufficient information to make 'a coherent set of revisions, although it is clear that the referendum result has the potential to have an impact on growth, inflation and monetary policy assumptions'. A month later the FPP published its Annual Report. Drawing on developments since March (which included new outturn data for the Jersey economy), it revised several of its economic assumptions (see Table 1).

Table 1. Differences between economic assumptions from the draft MTFP Addition and FPP's 2016 Annual Report in August 2016

	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

When this adviser produced his report on the MTFP Addition for the Panel, the Income Forecasting Group (IFG) had not revised income forecasts based on the new economic assumption. It was clear from the new economic assumptions, however, that the central income tax forecasts would have to be downgraded.

Revised forecasts: September 2016 to October 2016

The IFG's revision to its May forecast was presented during the first week of September 2016. The September forecast was based on the revised economic assumptions produced in August 2016 and the latest 'in year' 2016 information from each of the States income areas. The main changes compared to the March 2016 economic assumptions are summarised in Box 1.

BOX 1:

Revised economic assumptions and outturn data, September 2016

1. On outturn data:
    a. Financial services profits for 2015 were lower than forecast.
    b. FTE Employment growth in 2015 was higher than forecast.
    c. Finance sector compensation of employees grew by 9 per cent (nominal) in 2015; leading to a higher expectation for compensation of employees overall.
    d. Average earnings growth for 2015 was 0.7 percentage points lower than forecast.
2. Financial services profit growth – growth expected to be slower in 2016 and 2017.
3. Non-finance profit growth expected to be slower in 2017.
4. Inflation – expectations for 2016-2017 are higher than previously.
5. Average earnings – 2017 expected to be slightly higher (in nominal terms, due to higher inflation).
6. Employment growth – is now expected to be slower in 2017.
7. UK policy interest rates – are now expected to be lower throughout the forecast period.

A summary of the changes to income tax forecasts, which follows from the outturn data and revised economic assumptions, is shown in Box 2.

BOX 2:
Impact of the revisions on income tax receipts

- Income in 2016 will be £4m higher than previously expected (due to improvements in the in-year corporate tax data from the Taxes Office).

- Lower earnings growth forecast for 2016 will result in £3m lower personal tax in 2017 and will be built into the base for subsequent years.

- Data from the Taxes Office suggests that corporate tax may also be £3m lower in 2017 than previously forecast.

- Personal tax is expected to be £6m lower in 2018, rising to a £9m downgrade by 2020.

- Corporate tax is relatively unchanged over 2017-2019.

- The net impact is that the income tax forecast in 2019 is now expected to be £6m lower than the June 2016 forecast.

The income forecasts in Budget 2017

Table 2 shows the evolution of the income tax forecast since the publication of MTFP 2 through to Budget 2017. The changes to the economic assumptions since August 2016 resulted in a calculation that income tax receipts would fall by £18 million between 2017 and 2019 and fall a further £9 million in 2020 (row 15). Current income tax forecasts have reverted to May 2016 levels before the adjustment to the current year basis (rows 6 and 7). Nevertheless, excluding the predicted £9 million deterioration in income tax receipts for 2020, current forecasts assume that total income tax receipts will be £41 million higher over the 2016–19 period than those assumed in MTFP 2 (row 16).

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

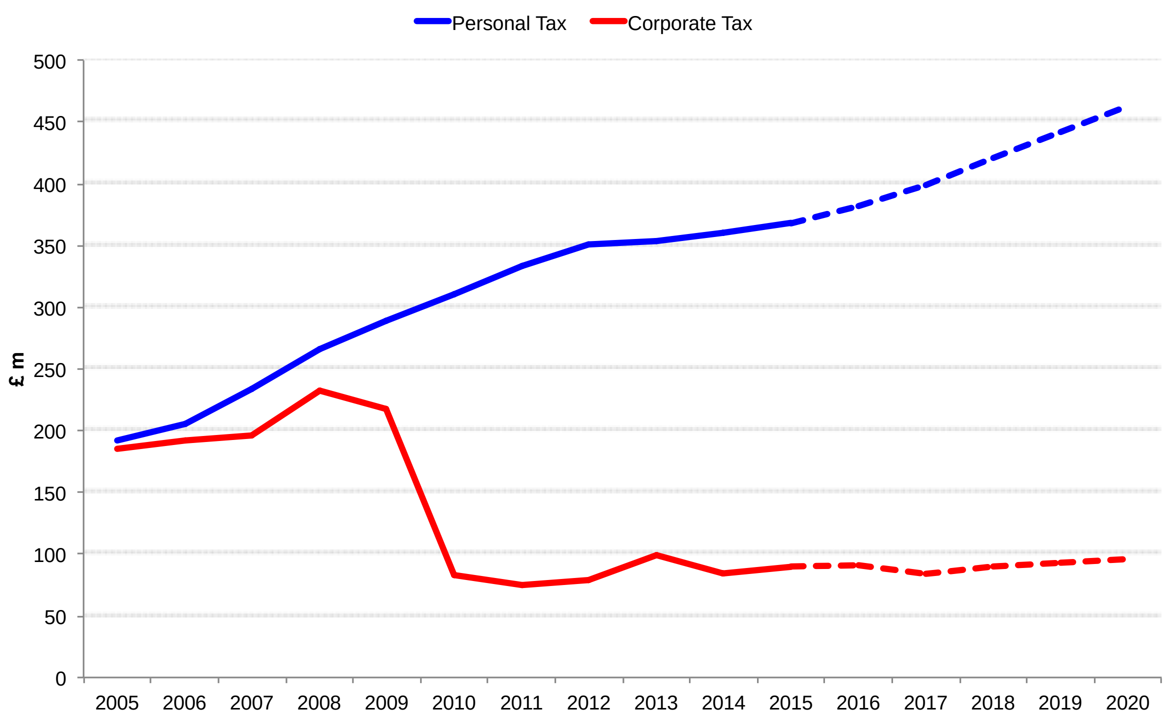
	2016	2017	2018	2019	2020	
	£m	£m	£m	£m	£m	
(1) MTFP 2 Upper	476	499	535	568		
(2) MTFP 2 Central	**458**	**475**	**499**	**519**		
(3) MTFP 2 Lower	440	451	462	471		
(4) September 2015 forecast	**455**	**475**	**499**	**519**		
(5) Revised forecast Budget 2016	**455**	**479**	**504**	**525**		
(6) May 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	
(11) Forecast for Budget 2017[1]	**471**	**481**	**508**	**532**	**556**	
						Total (£m)
(12) Difference between (9) and (2)	9	12	15	19		55
(13) Difference between (9) and (4)	12	12	15	19		58
(14) Difference between (9) and (5)	12	8	10	13		43
(15) Difference between (11) and (9)	4	-6	-6	-6	-9	-27
(16) Difference between (11) and (2)	13	6	9	13		41

Note 1: The income tax forecasts for Budget 2017 in row 11 are identical to the IFG forecasts produced in September 2016 (see P68/2016 (Add)(4)) so this has not been

included in the table.

Box 2 indicates that most of the predicted deterioration in income tax receipts stem from slower growth in personal tax receipts. This is not captured in Table 2, but Figure 1 illustrates the growth of actual and forecast income tax receipts between 2005 and 2020, bifurcated between personal tax and corporate tax. The big fall in corporate tax receipts from 2010 was due to the move to 'zero/ten' and subsequent fluctuations are largely the result of volatility in the financial services industry. Over the last decade, personal tax has accounted for a larger share of income tax receipts: in 2009, personal tax accounted for 57 per cent of total income tax and by 2015 this figure has risen to 80 per cent. By 2020, personal tax will account for 83 per cent of all income tax receipts.

Figure 1. Growth of personal tax and corporate tax, 2005–2020 (actual and forecast)



Source:
http://www.gov.je/Government/JerseyInFigures/GovernmentAccounts/Pages/TaxReceipts.aspx and Budget 2017.

Since the revision of the economic assumptions and income tax forecasts in September there have been two pieces of economic news in the local economy. First, the growth of real GVA in 2015 was 2.2 per cent, which was twice as large as the FPP had forecast. Unfortunately, GVA is a measurement of past economic performance and despite the positive growth, there is significant downside uncertainty for sustained growth in GVA in future years because of Brexit, *inter alia*. While acknowledging the relative buoyancy of the Jersey economy in the first half of 2016, in August 2016 the FPP downgraded their forecast for GVA in 2016 and 2017 (see Table 1). It is clear that there are formidable difficulties associated with forecasting the impact of Brexit and even short-term effects take time to work through to the Jersey economy (e.g. inflation is likely to pick up in 2017 as a result of the depreciation of the pound since June 2016).

The second piece of economic news was the release in October of the June labour market report, which showed that employment data for June 2016 grew to 60,320, which was an increase of 2.1 per cent on June 2015. In terms of future personal tax receipts this appears to be positive news. However, the composition of the increase in private sector employment was made up of 740 full-time employees; 690 on zero hour contracts and 280 part-time positions. It would be interesting to know how many of the 970 non-full time employees are exempt from personal tax or receive payments from social security to make ends meet. Employment in banking, the traditional bulwark which has generated high personal tax receipts, recorded a fall of 330 employees on an annual basis and is 1,800 lower than in 2007 and 2008. Growth in the finance sector was driven by the trust and company administration sub-sector (an additional 420). Anecdotal evidence suggests the salaries in this sub-sector might well be lower than the lost banking salaries (there is also considerable scope to automate many of the these positions in future years with so-called robotic process automation).[68] The lower employment growth forecast by the FPP already suggests that the gains for income tax growth will be limited going forward and this will be magnified if average earnings are weaker than forecast and productivity growth remains sluggish.

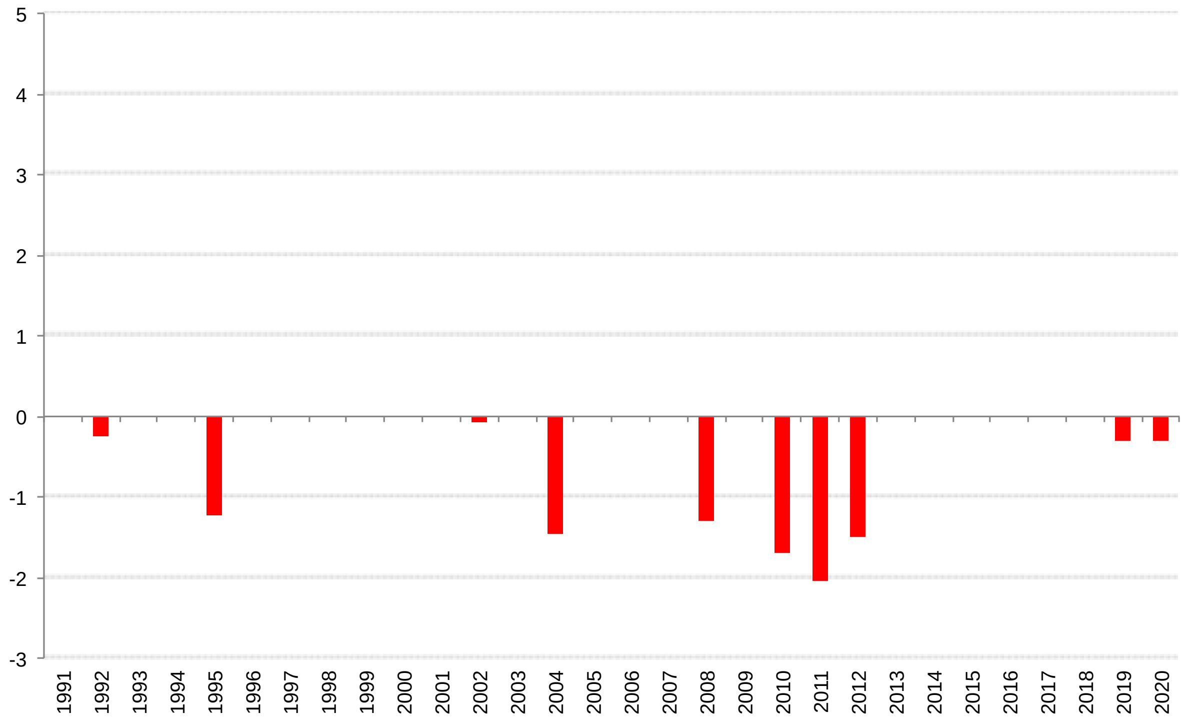
The growth in average earnings for the year to June 2016 was 2.1 per cent (the forecast had been for growth of 2.8 per cent) and as shown in Box 2 above, will result in £3 million lower personal taxation in 2017. As the commentary in Budget 2017 notes, the long-term trend in average earnings growth has been 4.3 per cent over the 1991–2016 period. Over the 2008-2016 period the average has been 2.3 per cent. It is unclear why the economic assumptions suggest growth of average earnings at 3.8 per cent and 3.0 per cent in 2017 and 2018 respectively, and then 3.0 per cent in 2019 and 2020, especially when there has been a structural change in Jersey's economy.

Figure 2 illustrates the real-term annual percentage changes in average earnings from 1991

[68] http://www.forbes.com/sites/steveculp/2016/04/20/robotics-the-next-frontier-for-automation-in-finance-and-risk-management/#32df51f2422c

to 2016 and forecast changes from 2017–2020. There have been real-term annual decreases in earnings in eight out of the last twenty-six years; using recent forecasts for RPI and the growth of average earnings for 2017–2020 suggests that from 2018, inflation will again increase faster than average earnings. In the UK, the Office for Budget Responsibility has noted in its update for the November 2016 Autumn Statement that real wage growth will falter in 2017 and by 2021, average earnings will be below their 2008 levels. The OBR's conclusion was that Brexit will harm productivity and wage growth and the fall in sterling will push up inflation. A similar squeeze on real wages is likely in Jersey which will reverse the short-lived gains made during the last four years.

Figure 2. Real term annual percentage change in the Index of Average Earnings, 1991 to 2020 (actual and forecast)



Source: Statistics Unit and FPP forecasts

In short, the discussion above suggests that despite the downgrade to the income tax forecast in September 2016 the assumptions about the rate of growth of income tax in Budget 2017 are still optimistic (the dashed blue line in Figure 1 assumes growth in personal tax of 4.5 per cent in 2017; 5.5 per cent in 2018; 5 per cent in 2019 and 4.8 per cent in 2020). Whilst the current reviews on personal income tax and company taxation are welcome and will probably be used to raise additional revenue in due course, the significant headwinds that the Jersey economy is facing will not be addressed by changes to fiscal policy alone.