# STATES OF JERSEY

# ECONOMIC STIMULUS PLAN

**Lodged au Greffe on 9th April 2009**
**by the Minister for Treasury and Resources**

**STATES GREFFE**

# PROPOSITION

**THE STATES are asked to decide whether they are of opinion −**

to refer to their Act dated 5th December 2006 in which they approved the establishment of a Stabilisation Fund, the purpose of which was to make fiscal policy more counter-cyclical and create in the Island a more stable economic environment with low inflation; and

(a) to agree to transfer the £18 million surplus funds currently available from the special fund known as the Dwelling House Loans Fund established under the Building Loans (Jersey) 1950 to the Stabilisation Fund;

(b) to agree, in accordance with Article 4A(2) of the Public Finances (Jersey) Law 2005, to transfer £44 million from the Stabilisation Fund to the Consolidated Fund to provide funding for the proposed discretionary economic stimulus package (following advice from the independent Fiscal Policy Panel) and also to earmark the balance of £112 million in the Stabilisation Fund to cover the impact of the economic downturn on States finances (where tax income is lower and expenditure on items such as income support will be higher – the so-called automatic stabilisers) forecast for 2010 and 2011;

(c) to agree, in accordance with Article 11(8) of the Public Finances (Jersey) Law 2005, to amend the expenditure approval for 2009 approved by the States on 23rd September 2008 in respect of the Treasury and Resources Department to permit the withdrawal of up to £44 million from the Consolidated Fund to be re-allocated for the net revenue expenditure of a number of departments in order to fund the proposed discretionary economic stimulus package with the funding only being made available to departments from the allocation following referral to the Corporate Services Scrutiny Panel and by public Ministerial Decision of the Minister for Treasury and Resources.

MINISTER FOR TREASURY AND RESOURCES

## REPORT

## DEALING WITH THE ECONOMIC DOWNTURN: POLICY FOR USE OF THE STABLISATION FUND AND DISCRETIONARY FISCAL STIMULUS

**Summary**

1. This report sets out proposals by the Minister for Treasury and Resources agreed by the Council of Ministers to use the Stabilisation Fund in response to the economic downturn. The Stabilisation Fund will reach £156 million (if a transfer of £18 million is made from the Dwelling House Loans Fund) and the recommendation is that £112 million is used to cover the unexpected increase in financial deficits in 2010 and 2011 due to the economic downturn and £44 million of new initiatives (discretionary policy) in 2009 and 2010.

2. The unforeseen increase in financial deficits will come about largely because of the automatic stabilisers – the loss of personal and corporate tax revenue and increase in expenditure in areas such as income support as a result of the deterioration in the economic outlook for the Island. The package of new (discretionary) initiatives will provide an extra stimulus to the economy and support employment and businesses in Jersey through the downturn.

3. The report builds on work done by Treasury and Resources in identifying the impact of the economic downturn on the States finances and the assessment of funds available for stabilisation purposes. It also complements the initial work lead by the Economic Development Department in tandem with other departments to determine what policies might be desirable and deliverable in terms of fiscal stimulus. It considers in more detail –

   - The objectives for using the Stabilisation Fund;
   - Is the time right for using the Stabilisation Fund?
   - How much fiscal stimulus is appropriate?
   - The most suitable policy options;
   - The process going forward;

4. The main conclusions under each of these headings are summarised below.

**Objectives for use of the Stabilisation Fund**

5. The overarching objective in using the Stabilisation Fund is to put additional money back into the economy (through both the automatic stabilisers and discretionary policy) that will add to demand and mean that the fall in output and extent of job losses will be less severe than would otherwise have been the case.

6. The Minister for Treasury and Resources and the Council of Ministers have agreed that the overall objective of supporting demand in the economy breaks down into 3 objectives –

   - Provide a stimulus to the Jersey economy as conditions deteriorate, to help support employment and businesses in Jersey;
   - Support employment in the Island by assisting individuals affected by the economic downturn;

- Create new opportunities for businesses in Jersey, to support them through the downturn and mitigate job losses.

**Why the time is right for using the Stabilisation Fund**

7. The Minister for Treasury and Resources has accepted the advice from the Fiscal Policy Panel (FPP) and agreed that the time is now right for use of the Stabilisation Fund. Global economic forecasts from the IMF and World Bank show that the world economy will experience the worst economic conditions since the 1930s. The Economics Unit's central estimates for economic growth in Jersey in 2009 and 2010 are -4% and -2% indicating a significant and prolonged downturn. The qualitative information from Economic Development confirms that sectors including retail, tourism and construction are likely to enter recession this year.

8. It is recognised that there is significant uncertainty surrounding the local and global economic outlook and it cannot be ruled out that the downturn in Jersey will be steeper or more shallow than currently forecast. However, the Council of Ministers agree that this is not an argument for inaction. If fiscal stimulus is designed to be effective it will not matter if the economy performs more strongly than expected. Similarly if the economy performs more weakly that actually strengthens the arguments for acting swiftly and decisively. Policy must be flexible going forward to be able to adapt to outcomes different to those currently forecast, especially given the significant uncertainties around the forecasts.

**The scale of fiscal stimulus**

9. The new Fiscal Framework agreed by the States in 2006 sets out that the Stabilisation Fund is only to be used to make fiscal policy more countercyclical. That means it should not be used to address structural deficits, which should be tackled through other means, i.e. changes in taxation or spending. Drawing on the advice from the FPP, the Council of Ministers propose that the Stabilisation Fund should only be used to address the deficits in 2010 and 2011 (not beyond) and to fund discretionary policy in 2009 and 2010.

10. The Minister for Treasury and Resources and Council of Ministers agree that given the significant uncertainties surrounding the financial forecasts going forward – both in terms of the impact of the downturn and the structural position in the medium-term – that their preference is to avoid resorting to borrowing (either from the Strategic Reserve or money markets) to fund discretionary policy at this early stage and as part of the initial response to the downturn.

11. Once the unforeseen deterioration in the deficits for 2010 and 2011 is financed from the Stabilisation Fund there will be an approximate £44 million remaining in the Stabilisation Fund. This would allow discretionary policy of just over 1% of GVA, which would meet the requirement to implement a significant discretionary stimulus above and beyond the impact of the automatic stabilisers and of similar scale to some of the packages implemented in the larger economies. Overall, the Council of Ministers see

little economic justification in not undertaking discretionary fiscal policy of this scale in Jersey.

12. The Council of Ministers believe that by acting now – quickly and decisively – to implement discretionary spending in an effective manner, this will reduce the extent of future deficits. That is, discretionary policy by its very nature (it is above and beyond the automatic stabilisers) will help to offset the downturn and if successful should reduce the fall in GVA and therefore the cost of the automatic stabilisers.

13. If discretionary policy is to be implemented within the timeframe suggested by the FPP, it is recommended that £44 million is transferred immediately from the Stabilisation Fund to the Consolidated Fund to be available for discretionary policy.

**The most suitable policy options**

14. The Council of Ministers has developed a hierarchy of 4 policy options by combining the advice of the FPP with the results of research on the effectiveness of the various policies. That is, in order of priority the Council of Ministers favoured policy options are –

**i. New programmes of maintenance/infrastructure spending**
These programmes score highly in terms of their impact on the economy and score well in the FPP's assessment, although there is a clear need to ensure that any infrastructure investment is timely. This type of spending also has the advantage that already funded projects can be brought forward from the future without a call on the Stabilisation Fund.

**ii. Supporting employment in the Island by assisting individuals affected by the economic downturn**
Policy targeted on those affected by the downturn and the less well off scores well in terms of economic impact and being timely and targeted, the real difficulty being to ensure that policy is temporary.

**iii./iv. Business support and new programmes to help individuals retrain/skills**
Both these types of policy score well in terms of being timely to implement if they are extensions of exiting programmes but carry the risk of permanent budgetary implications. If done effectively they should bring longer-term economic benefits. The Council of Ministers sees these policies as being as much about preparing the foundations for economic recovery whilst accepting that in terms of pure stimulus the initial impact could be weaker than **i**. and **ii**. above.

15. While the exact nature of the fiscal stimulus package will be developed by the Minister for Treasury and Resources, the overall focus of policy will be on maintenance and infrastructure spending that will support employment and provide opportunities for businesses in the Island. This is because it is likely to be the most effective at stimulating new business and employment, and if done effectively will focus on projects that were required anyway. Where projects can be brought forward from within the 2009 Business Plan there will

also be no call on the Stabilisation Fund. Supporting employment in the Island by assisting individuals affected by the economic downturn will also be a key priority, supported by new programmes of business support and skills training.

16. An initial assessment already undertaken by the Economic Development Department (see **Appendix 1**) in co-ordination with other departments has already identified a range of policies that appear both desirable and deliverable under the 4 headings above. The total value identified under the four headings was as follows –

- New programmes of maintenance/infrastructure spending = £15.75 million (plus a further £10 million of projects that could be brought forward);
- Supporting employment in the Island by assisting individuals affected by the economic downturn = £2.0 million;
- New programmes to help retrain/skills = £5.5 million;
- Business support = £1.5 million.

17. The total fiscal stimulus outlined above is £35 million with £25 million requiring funding from the Stabilisation Fund. With £44 million potentially available from the Stabilisation Fund for discretionary policy there is the potential to implement all the policies above and additional ones. However, this is not sufficient to progress all the policies identified in the initial assessment. A further more detailed and rigorous evaluation process is required that can ensure all policies that are implemented have maximum impact and that can identify additional policies that score well under the chosen criteria.

**The process**

18. To ensure that any discretionary expenditure is based on a fully developed business case a further prioritisation process, that is independent of all Departments who have submitted proposals, will be completed. This process will result in funds being allocated to Departments by the Minister for Treasury and Resources to fund delivery of the highest priority discretionary stimulus activity. The input of the Corporate Services Panel will be required at key stages of the process.

19. Departments will be required to submit detailed business cases for all proposals that should be signed off by the Chief Officer and the Finance Director. These business cases, that should include full justification of costs and benefits of the discretionary expenditure, will be submitted to the Treasury and Resources Department for independent validation.

20. Validated business plans will then be considered by an independent Evaluation Team (ET) of key Officers whose departments do not benefit from the spend. Plans and the ET recommendations will be shared with the Corporate Services Panel. The ET will assess all proposals and make recommendations to the Minister for Treasury and Resources who will make the final decision on allocation of funds from the Stabilisation Fund for discretionary purposes.

21. This process will ensure that the policies identified have the maximum impact and that additional policies can be identified under the four headings. In addition, it will enable that policies will be implemented in a timely fashion, in keeping with the FPP's advice that they should happen in the next 6 to 9 months. Failure to implement policies in this timeframe will put Islanders' jobs at risk.

22. The process with key dates is summarised in the table below.

**Summary of the process for developing the fiscal stimulus package and involvement of Council of Ministers and Corporate Services Panel**

| **Date** | **Process** | **Council of Ministers** | **Corporate Services Panel** |
|---|---|---|---|
| **3 April** | | R&P agreed by CoM | CSP receives R&P and supporting papers |
| **7 April** | Pro-formas for bids sent to departments | | |
| **9 April** | R&P lodged by TRM | | CSP Scrutiny process for R&P continues |
| **1 May** | Closing date for Pro-formas and detailed business plans | | |
| **1 -25 May** | Independent evaluation process by Evaluation Team (ET) | | |
| **19 May** | States debate R&P | | |
| **25 May** | TRM receives recommendations from ET | CoM receives recommendations from ET | CSP receives recommendations from ET |
| **1 June** | TRM finalises initial proposals following advice from CSP | CoM receives TRM initial proposals | CSP receives TRM initial proposals for comment |
| **10 June** | | | from CSP on TRM proposals |
| **11 June** | | CoM agrees proposals | |
| **12 June onwards** | Implementation of stimulus package begins | | |
| **12 June onwards** | Further advice from ET to TRM on stimulus proposals | CoM to agree additional proposals | CSP to comment on any additional recommendations |

| | |
|---|---|
| Monitoring of implementation by ET on monthly basis | from ET |

**POLICY FOR USE OF THE STABILISATION FUND AND DISCRETIONARY FISCAL STIMULUS**

**Introduction**

23. The Fiscal Policy Panel (FPP) recommended in their November update that the States should draw up contingency plans as to when and how the Stabilisation Fund should be used. Since the FPP's subsequent briefings to States members and the Council of Ministers in January it has become apparent that the economic climate has deteriorated at a faster rate than previously expected.

24. As a result, the Minister for Treasury and Resources wrote to the FPP on 13th March 2009 asking them to update their previous advice and explicitly answer several key questions –

- Whether economic conditions now justify use of the Stabilisation Fund to support the local economy?
- Should the States be doing more than just allowing the automatic stabilisers to work and implementing discretionary policy to support the economy this year?
- Further guidance on how the key options comply with the 3Ts criteria (that policy should be Temporary, Targeted and Timely) and advice on their general advantages and disadvantages.

25. The FPP responded to the Minister for Treasury and Resources on 26th March 2009. Their advice has been integral to the formulation of what will be Jersey's first fiscal stimulus package. This paper sets out the approach taken by the Minister for Treasury and Resources and Council of Ministers in developing the policy proposals.

26. This paper sets out a strategy for use of the Stabilisation Fund for fiscal stimulus in 2009. It considers in more detail –

- The objectives for using the stabilisation fund;
- Is the time right for using the stabilisation fund?
- How much fiscal stimulus is appropriate?
- The most suitable policy options;
- The process going forward.

**The objectives for using the Stabilisation Fund**

27. The downturn in Jersey will be precipitated by falling demand across the economy. It will result from lower demand from outside the Island for Jersey goods and services such as tourism and financial services as the large economies including the UK go through a severe recession. Businesses in the Island are likely to cut back on expenditure and investment in the Island in

uncertain economic times. Consumers are also likely to spend less as confidence falls with a faltering economy. The end product is that jobs in Jersey will be at risk.

28. The overarching objective in using the Stabilisation Fund is to put additional money back into the economy (through both the automatic stabilisers and discretionary policy) that will add to demand and mean that the fall in output and extent of job losses will be less severe than would otherwise have been the case. The Stabilisation Fund can be used to put extra demand back into the economy to compensate for some of the factors outlined above.

29. Additional government spending adds directly to demand in the economy and can compensate for weaker demand from consumers, businesses and/or customers abroad. It can be targeted at those people most likely to spend any benefit they receive and therefore encourage them to spend and add to demand in the economy. The additional demand created will mean that businesses in Jersey will employ more people than would have been the case if demand had fallen further.

30. The nature of the proposed interventions should also be determined by the specific objectives of the stabilisation policy. For example, the nature of the intervention would be different if the intention is to support demand in general across the economy or to help particular individuals or businesses.

31. The Minister for Treasury and Resources and the Council of Ministers have agreed that the overall objective of supporting demand in the economy breaks down into three objectives –

- Provide a stimulus to the Jersey economy as conditions deteriorate, to help support employment and businesses in Jersey;
- Support employment in the Island by assisting individuals affected by the economic downturn;
- Create new opportunities for businesses in Jersey, to support them through the downturn and mitigate job losses.

32. These objectives suggest that the fiscal stimulus will need to be delivered in a timely manner and when the economy is deteriorating, i.e. in 2009. The FPP said in their letter to the Minister in March that *"Action should start immediately to have an impact as quickly as possible" and ideally within the next 6 to 9 months*. Failure to get the timing right will mean that more jobs could be lost in the downturn or that spending takes places when it is not needed and the economy is recovering, with a risk that it will feed through into higher inflation.

33. Policy will need to target the people that are most likely to spend what they receive and in particular those on low incomes and those affected by the economic downturn through loss of their jobs or by the downturn in the housing market. Finally, to support Jersey businesses it will be important that stimulus feeds directly into the demand for their output and services and does not leak out the economy.

**Is the time right for use of the Stabilisation Fund?**

34. An objective assessment of current and future economic conditions has been undertaken by the States Economic Adviser and included –

    i. Qualitative assessment of how businesses and the different sectors are performing, using evidence provided from the Economic Development Department through their range of contacts with the business community and additional information from meetings with local businesses.

    ii. Quantitative macro forecasts – work has been underway since last year in the Economics Unit looking at how to better forecast the likely direction of GVA in both the current year and the following year. It explores statistical relationships between GVA and a host of economic variables – Jersey and external – to give more confidence in predicting the direction of the economy.

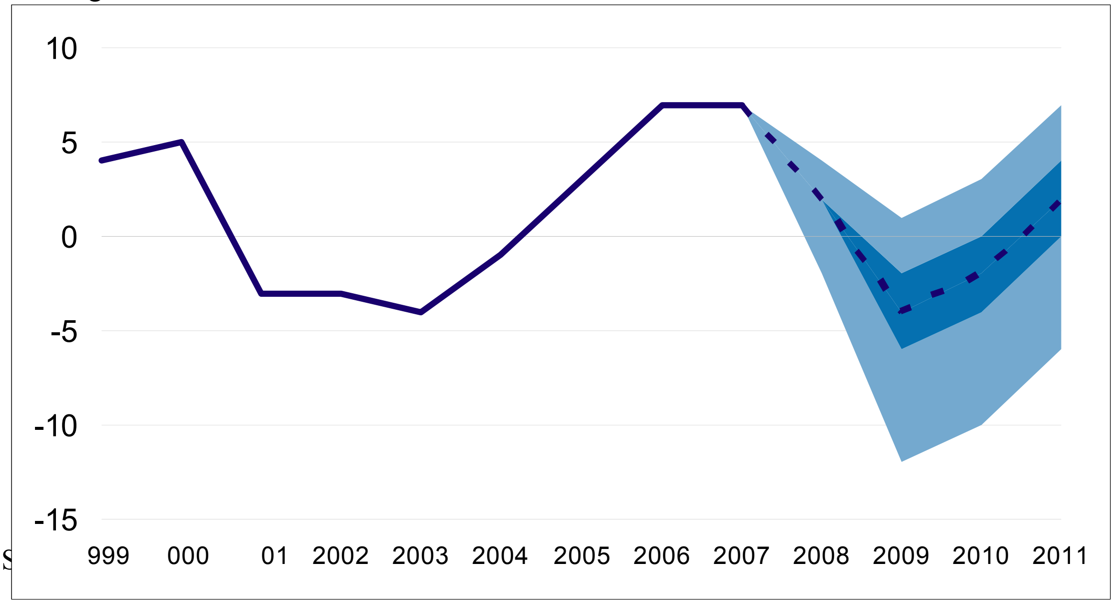
35. In future it is hoped that this analysis will be complemented by a Statistics Unit quarterly business survey that will give further information on how the various sectors are performing and expect to perform in coming months. Work is already underway as to what form this will take.

36. The conclusions from this analysis are that –

    - Global economic forecasts from the IMF and World Bank show that the world economy will shrink this year and experience the worst economic conditions since the 1930s.
    - The Economics Units central estimates for economic growth in 2009 and 2010 are -4% and -2% indicating a significant and prolonged downturn. There is significant uncertainty around these forecasts given the lack of detailed data on the Jersey economy and the unusually uncertain economic times (see **Chart 1** below).
    - The qualitative information from Economic Development confirms that sectors including retail, tourism and construction will enter recession this year.

37. The FPP have also commented in their letter to the Minister on whether the economic situation merits use of the Stabilisation Fund: *"If our assessment of the economic outlook is correct, such conditions merit offsetting policy action, which the Stabilisation Fund, as part of the new Fiscal Framework, is designed to facilitate"*.

**Chart 1: Jersey economic forecasts**
% change in real GVA




38. The Council of Ministers has accepted the advice of the FPP and in particular that *"It is important to get the timing and content of any discretionary policy right. Although the cyclical impact of the downturn on the States finances will fall mainly in 2010 and 2011, the time to act is now"*.

39. The central forecasts for Jersey are for a downturn that lasts 2 years (2009 and 2010) with a recovery starting in 2011. If the Stabilisation Fund is to be used for the purposes agreed in 2006 as part of the new Fiscal Framework, then the Council of Ministers believes that on the basis of the current economic forecasts it should only be used in those 2 years (or to address the financial implications for the States that arise from those years, i.e. 2010 and 2011).

40. Given the significant uncertainty around economic forecasts in general in Jersey and specifically in the current global climate, it cannot be ruled out that the downturn in Jersey will last more than 2 years. However, the Council of Ministers does not see this as a reason not to put significant discretionary policy in place now.

41. If economic conditions turn out worse than expected, the Council of Ministers believes that it would actually suggest more stimulus is required rather than less. On the other hand, should economic conditions turn out better than expected if policy has been implemented effectively, it will help support conditions for future economic growth. Policy must be flexible going forward to be able to adapt to outcomes different to those currently forecast, especially given the significant uncertainties around these forecasts.

**The scale of fiscal stimulus**

42. The scale of the fiscal stimulus should be determined by a number of factors, not least the overall policy objectives. A stimulus put in place to *prevent* a fall in GVA and rise in unemployment will need to much larger than one that tries to mitigate the fall in activity. From the objectives set out by the Council of Ministers (see paragraph 29) it is clear that the policy objectives fall more into the latter category than the former.

43. The scale of the fiscal stimulus will be made up of 2 elements – that from the automatic stabilisers (the loss of personal and corporate tax revenue and increase in expenditure in areas such as income support as a result of the deterioration in the economic outlook for the Island) and that from discretionary policy (new initiatives implemented to put extra demand back into the economy).

44. The relative size of automatic stabilisers and discretionary policy are inter-related. For example, a larger element of automatic stabilisers may mean that there is a lesser need for discretionary policy. Also, the larger discretionary policy is the smaller the impact of the automatic stabilisers (because discretionary policy should mitigate the deterioration in the economy and therefore reduce the automatic stabilisers).

45. There are a number of factors that should help determine what size of overall fiscal stimulus is appropriate –

- **Length of recession:** basically how long the downturn lasts.
- **Depth of recession:** the size of the expected fall in GVA (and ultimately the amount of spare capacity it creates).
- **Medium-term public finances:** if government finances are not on a sustainable path the response from businesses and consumers to the stimulus could be muted.
- **Size/openness:** in small open economies like Jersey the impact of any given size of fiscal stimulus will be more muted than in larger economies simply because some of the impact will leak out the economy through spending (by consumers and businesses) on imports.

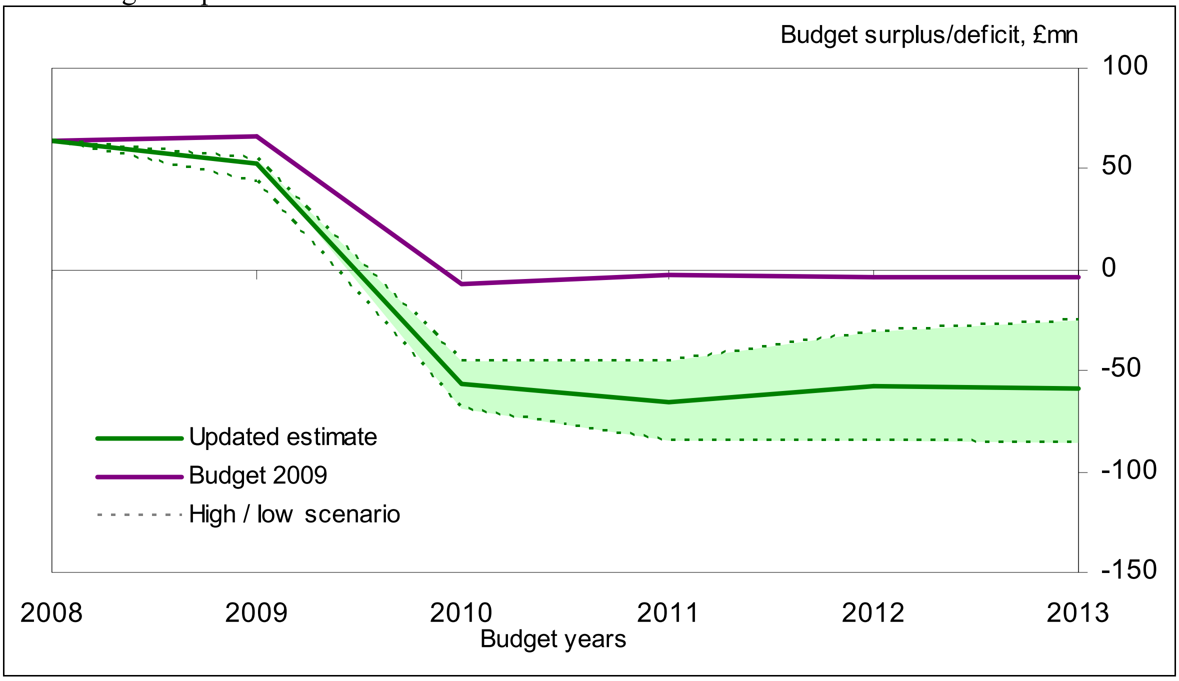
46. In considering the overall scale of fiscal stimulus appropriate in Jersey it is necessary to first examine the scale of the automatic stabilisers (which is considered in detail in **Appendix 2**). **Chart 2** (below) shows that the latest estimates for the States' financial position from that analysis, which still contain significant uncertainty. They predict a deficit of £57 million in 2010 and £67 million in 2011 (or about 1.5% of GVA in each year or 3% in total), with a deficit in subsequent years of around £60 million (although there is even greater uncertainty around this).

47. This actually means that the extent to which the financial forecasts have deteriorated in 2009 and 2010 (a proxy for the automatic stabilisers) as result of the more pessimistic economic forecasts is £13 million in 2009, £50 million in 2010 and £62 million in 2011. The deficits in 2010 and 2011 (the £13 million in 2009 is simply a smaller surplus) are effectively those which

are unfunded and would therefore need to be financed by the Stabilisation Fund.

48. It is hard to distinguish what is a cyclical and what is a structural deterioration in the deficit in 2010 and 2011. However beyond that period a deficit is forecast which could be largely structural, although that will depend to some extent on whether the world economy and financial markets return to previous levels or grow in line with trend from the current low base.

**Chart 2: Latest financial forecasts**
budget surplus/deficit £ million

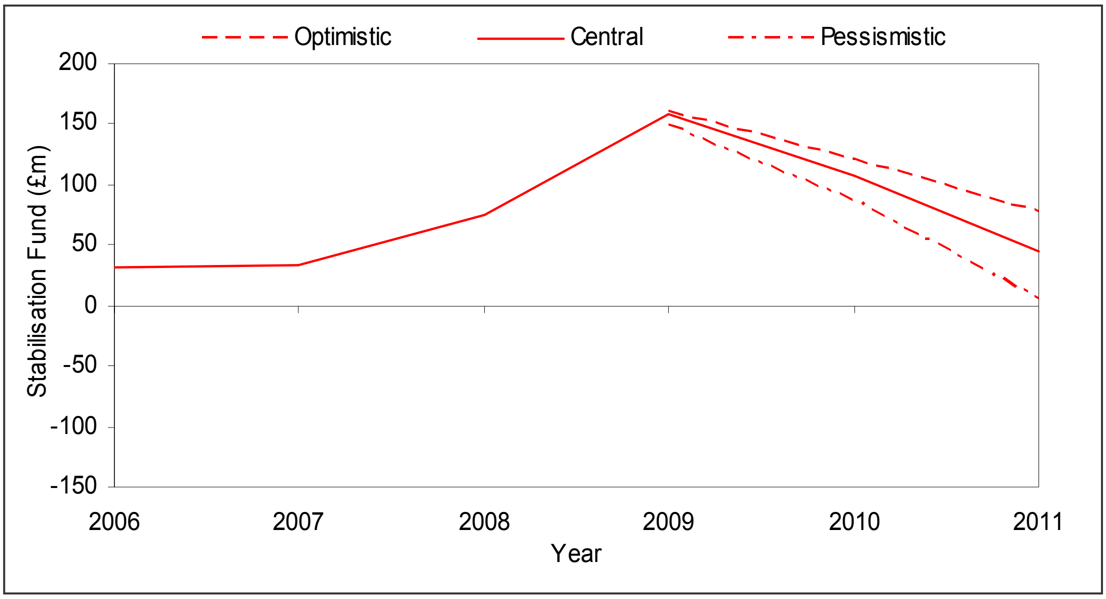



Source: Treasury and Resources/Economics Unit

49. The new Fiscal Framework agreed by the States in 2006 sets out that the Stabilisation Fund is only to be used to make fiscal policy more countercyclical. That means it should not be used to address structural deficits, which should be tackled through other means, i.e. changes in taxation or spending. The expected balance of the Stabilisation Fund this year is £156 million (see **Appendix 2**).

50. The chart below shows the balance in the Stabilisation Fund in terms of how it has been built up and looking forward as to what would happen to it if it was used to cover the unfunded proportion of the deficits in 2010 and 2011. The remaining balance would be £44 million in 2011.

**Chart 3: The balance in the Stabilisation Fund**
£ million




Source: Treasury and Resources/Economics Unit

51. The fact that the Stabilisation Fund may not be exhausted covering the deficits in 2010 and 2011 leaves the possibility of funding discretionary spending of up to £44 million directly from the Stabilisation Fund. This does beg the question as to what level of discretionary spending is appropriate in Jersey? The money in the Stabilisation Fund is a somewhat arbitrary number as it only reflects the funds that have been saved in recent years since the onset of the new Fiscal Framework and since money has been specifically earmarked for stabilisation purposes.

52. If discretionary policy is to exceed the residual in the Stabilisation Fund after financing the deficits in 2010 and 2011 then the only real source of funds will be borrowing (either from the Strategic Reserve or directly from the money markets). The Minister for Treasury and Resources and Council of Ministers agree that given the significant uncertainties surrounding the financial forecasts going forward – both in terms of the impact of the downturn and the structural position in the medium-term – that their preference is to avoid resorting to borrowing of this type at this early stage and as part of the initial response to the downturn.

53. The Council of Ministers accepts that should the economic conditions turn out worse than forecast and/or the deficits in 2010 and 2011 larger than expected there may be a need to revisit their position on borrowing to support the economy through the downturn. Any change in position would need to be on the basis of new and updated information not currently available and would be brought to the States for agreement.

54. The Council of Ministers believe that by acting quickly and decisively to implement discretionary spending in an effective manner this will reduce the extent of future deficits. That is, discretionary policy by its very nature (it is above and beyond the automatic stabilisers) will help to offset the downturn

and if successful should reduce the fall in GVA and therefore the impact of the automatic stabilisers.

55. The table below looks at what other larger economies are planning in terms of discretionary policy in response to the economic turmoil. The range is between 0.2-2% of GDP in 2009 or 0.3-4.8% over 2009 and 2010.

**Table 1: Discretionary fiscal stimulus packages in large economies**
% of GDP

| | 2008 | 2009 | 2010 | Total |
|---|---|---|---|---|
| **Canada** | 0.0 | 1.5 | 1.3 | 2.7 |
| **China** | 0.4 | 2.0 | 2.0 | 4.4 |
| **France** | 0.0 | 0.7 | 0.7 | 1.3 |
| **Germany** | 0.0 | 1.5 | 2.0 | 3.4 |
| **India** | 0.0 | 0.5 | …. | 0.5 |
| **Italy** | 0.0 | 0.2 | 0.1 | 0.3 |
| **Japan** | 0.4 | 1.4 | 0.4 | 2.2 |
| **UK** | 0.2 | 1.4 | -0.1 | 1.5 |
| **US** | 1.1 | 2.0 | 1.8 | 4.8 |
| **Average** | 0.5 | 1.6 | 1.3 | 3.4 |

Source: IMF

56. The IMF attributes the differences in the scale of the packages across the larger economies to a number of different factors –

- **Automatic stabilisers:** countries in which the automatic stabilisers are larger will need smaller discretionary stimulus.
- **Economic conditions:** the sharper the expected fall in output and the greater the extent of spare capacity, the larger the required stimulus.
- **Fiscal conditions:** more favourable trends in deficits and public debt will leave more room for overall fiscal and discretionary stimulus.
- **Other factors:** the fiscal expansion will be larger if fiscal multipliers (i.e. the way policy feeds through into the economy) are lower.

57. How does Jersey score on these different factors? Firstly the automatic stabilisers will tend to be weaker in Jersey. Government spending and taxation are generally lower as a proportion of GVA than in the larger economies and the initial calculations above suggest that the automatic stabilisers are weaker and delayed in their impact. Secondly, the deterioration in economic conditions is expected to be as large (if not larger) than in the larger economies. Thirdly, with no borrowing and public debt Jersey has a better fiscal backdrop than the larger economies, although there are clearly significant uncertainties about the medium-term fiscal outlook. Finally, in small open economies the fiscal multipliers will tend to be smaller than in the larger economies.

58. Jersey could take the option that as a small open economy it could free ride on the benefits from fiscal stimulus elsewhere. However, the Council of Ministers view is that such inaction in Jersey would not help mitigate the impacts of the downturn in the Island and that it is necessary to act independently now.

59. Overall, the Council of Ministers believe there is little economic justification for not undertaking discretionary fiscal policy in Jersey. The £44m remaining balance in the Stabilisation Fund would allow discretionary policy of just over 1% of GVA and be in the region of packages implemented in the UK and France, although significantly below the larger packages of US, China and Germany.

60. If discretionary policy is to be implemented within the timeframe suggested by the FPP it is recommended that £44m is transferred immediately from the Stabilisation Fund to the Consolidated Fund to be available for discretionary policy. The Council of Ministers believe that the extent of the economic downturn in Jersey and the wider global economy suggests that this size of discretionary policy is both appropriate and required urgently. Discretionary policy needs to be timely and economic forecasts suggest that time is in 2009 and early 2010.

61. There is a significant risk that if the economic downturn turns out to be more severe than forecast, longer in duration or have a greater impact on States finances that the Stabilisation Fund will be exhausted just addressing the deficits that result before the end of 2011. This will mean that further discretionary policy could only be financed by other means i.e. borrowing (from the Strategic Reserve or money markets). The Council of Ministers does not see this as an argument for less discretionary policy now but rather that the need for discretionary policy would be even greater than currently assessed.

62. The next section goes on to consider what the most suitable options for discretionary policy are.

**The most suitable policy options**

63. The FPP have recommended that when considering the alternative uses of the Stabilisation Fund it is important to bear in mind the 3Ts. That is policy should be –

- **Timely.** Action should start immediately to have an impact as quickly as possible and ideally within the next 6 to 9 months.
- **Targeted.** Policy should hit the intended target whether it is to support activity and employment in the Island, support those most adversely affected by the downturn or implement projects which have intrinsic benefit.
- **Temporary.** There should be no negative long term implications for the public finances, i.e. no long term damage to the tax base and no long term spending commitments.

64. Whatever the type of policy that is used in Jersey, there will always be a significant risk of leakage as money spent by businesses or consumers can be directed on imports. This means that in small open economies the impact of any change in fiscal policy can be more muted than in larger economies. It is also important to recognise that stabilisation policy is not intended to completely offset recessionary forces but rather to work in the opposite direction to those forces and cushion the impact.

65. The Minister for Treasury and Resources asked the FPP to comment publicly on six broad options for discretionary policy. The FPP in their response to the Minister for Treasury and Resources highlight how they feel the policy options score relative to the 3Ts and set out their general advantages and disadvantages. Their response is repeated in full below.

***1. Supporting people on low incomes***

*This type of policy can be timely, provided that the income support system can be altered quickly. It is by definition targeted on the least well off and therefore those who are most likely to spend. However, it is difficult to see how such a measure would be temporary as it would be hard to reverse such a decision unless it was directed only to the newly unemployed.*

***2. Direct tax cuts***

*Given the lags in the Jersey tax system it is hard to see how such a policy could be timely and impact in 2009, without being complex. It may also be harder to target the less well off or those worst affected by the downturn because quite simply they may not pay tax. It would then be less effective at holding up demand in the economy than direct support for the less well off. A pre-announced commitment to reverse the cut would be essential to meet the temporary criterion, but this is unlikely to be credible, and without a credible commitment, this proposal carries a serious risk of aggravating medium term budget problems.*

***3. Indirect tax cuts***

*This type of tax change could be timelier than a direct tax change. But such a tax change would not be well targeted as it would benefit everybody, rather than those most likely to spend on the Island. It would be less effective at holding up demand in the economy than direct support for the less well off. Furthermore a pre-announced commitment to reverse the cut would be essential to meet the temporary criterion, but is unlikely to be credible.*

*Like direct tax cuts, this option carries a serious risk of aggravating medium term budget problems and a real risk of undermining the tax base. Changes to GST so soon after introduction should be avoided.*

***4. Spending on skills/training***

*This option may be timely, especially if it only requires changes to existing policies. Spending on the programme itself has immediate benefits. It can be targeted on Jersey residents, those losing their jobs or low income groups. If measures also included support payments to participants, these could be targeted towards those most likely to spend. Care would have to be exercised to ensure that those elements of such schemes that do not bring lasting benefits could be made credibly temporary.*

*Investment in skills – if done effectively – should bring lasting economic benefits beyond the life of this downturn. Improving the skills base is important for supporting future productivity and economic growth. However, there will be permanent budgetary implications.*

***5. Additional infrastructure/maintenance expenditure***

*If these options are to meet the timely criteria, then it is vital that projects are identified that are ready to go in the next few months i.e. are 'shovel ready'.*

*The most likely projects to meet this requirement are maintenance expenditure. Such measures should also meet the targeting criterion since maintenance projects are likely to utilise local labour. The scale is dependent on the amount of spare capacity in the local construction sector. It is important to avoid excess demand pushing up prices.*

*Making sure maintenance of the infrastructure (including public housing stock, schools, and hospitals) is up to date and bringing forward maintenance scheduled for the near future does not increase the overall cost to public finances, and so meets the temporary criterion.*

*Large infrastructure projects may struggle to be timely. They score better on the targeting criterion as it should be possible to target such spending on supporting local employment in the Island and the scale of the intervention should consider the amount of spare capacity in the local construction sector. Any such interventions should be designed to be temporary, and each policy should be assessed for any future expenditure commitments such as ongoing maintenance or further investment.*

*As maintenance and infrastructure investment leads to improvements in the stock of States assets, it can be considered as an investment in the supply-side of the economy that will bring returns beyond the life of this downturn. The basic question to address is do the projects have intrinsic merit?*

***6. Small business support***
*This option may be timely especially if it only requires changes to existing policies. Policy could be targeted on businesses particularly affected by this downturn for example by focusing on those that are not able to obtain or maintain credit solely as a result of problems in the financial sector. Policy would have to be designed carefully to be temporary and not stand in the way of inevitable structural change.*

66. As well as the advice of the FPP it is important to bear in mind what research and experience from elsewhere tell us about the various options for discretionary policy.

*Experience elsewhere*

67. The policy choice should also reflect the expected economic impact of the various measures. A key consideration is what is the fiscal multiplier associated with the various types of policy. The IMF considered these issues in a recent paper "The case for global fiscal stimulus". There is not enough information on the Jersey economy to estimate the likely fiscal multipliers of different policy options. That means it is important to look at the conclusions from elsewhere, always bearing in mind the different nature of the Jersey economy.

68. Empirical estimates of fiscal multipliers are dispersed over a broad range. The IMF believes there are several factors which cause such diverse estimates –

- ➢ The extent of leakages into savings;
- ➢ The extent of leakages into imports;

- The monetary policy response;
- The ability of countries to finance stimulative fiscal policy and keep medium-term finances on a sound footing.

69. So for a closed economy with few or no financing constraints the fiscal multiplier may be large, while for small open economies more susceptible to financial constraints it would be smaller.

70. Multiplier effects differ with the fiscal instruments adopted. Expenditure measures tend to have the larger effects than others, followed by targeted transfers. Government investment expenditures have a direct effect on aggregate demand as well as secondary multiplier effects on household spending as incomes increase as a result of the initial investment spending and due to the higher productivity of the economy. The downside with such policies is the ease and speed with which they can be put in place.

71. Transfers in general are less effective because if they are temporary they will have only a limited effect on household behavior. Untargeted transfers are less effective than targeted transfers because if the consumers are on low incomes they will be more likely to spend what they receive. Targeted transfers have the advantage of ease and speed of implementation although they carry the risk that they may be difficult to reverse. Reductions in personal tax rates appear to be only slightly more effective than general transfers but less so than for targeted transfers, as they do not focus on those most likely to spend the benefit they receive.

72. The IMF highlight that one of the key risks to the large scale fiscal packages being considered is that they create a perception of lack of fiscal discipline. They explain that such packages must be complemented by credible medium-term frameworks if they are to be successful.

*The options for Jersey*

73. Work lead by the Economic Development Department has identified the areas that are practical for policy development in Jersey and has drawn up a list of options under each heading. They fall into the following four key categories of fiscal policy (with a fifth relating to non-fiscal measures) –

  i. Supporting employment in the Island by assisting individuals affected by the economic downturn;
  ii. New programmes of maintenance/infrastructure spending;
  iii. New programmes to help individuals through retraining and skills development;
  iv. Increased business support, particularly for small businesses.

74. When the advice of the FPP is combined with the analysis of the effectiveness of the various policy options by the IMF it is possible to develop a hierarchy from the four options above. That is, in order of priority the Council of Ministers have identified the following policy options –

i. **New programmes of maintenance/infrastructure spending**
These programmes score highly in terms of their impact on the economy and score well in the FPP's assessment, although there is a clear need to ensure that any infrastructure investment is timely. This type of spending also has the advantage that already funded projects can be brought forward from the future without a call on the Stabilisation Fund.

ii. **Supporting employment in the Island by assisting individuals affected by the economic downturn**
Policy targeted on those affected by the downturn and the less well off scores well in terms of economic impact and being timely and targeted, the real difficulty being to ensure that policy is temporary.

iii./iv. **Business support and new programmes to help individuals retrain/skills**
Both these types of policy score well in terms of being timely to implement if they are extensions of exiting programmes but carry the risk of permanent budgetary implications. If done effectively they should bring longer-term economic benefits. The Council of Ministers sees these policies as being as much about preparing the foundations for economic recovery whilst accepting that in terms of pure stimulus the initial impact could be weaker than **i**. and **ii**. above.

75. Work lead by EDD in coordination with other departments has identified policies that were initially considered both desirable and deliverable under the four headings above (see **Appendix 1**). The total value under the four headings was as follows –

- New programmes of maintenance/infrastructure spending = **£15.75 million** (plus £10 million of already funded projects that can be brought forward from the 2009 Business Plan);
- Supporting employment in the Island by assisting individuals affected by the economic downturn = **£2.0 million**
- Increased business support, particularly for small businesses = **£1.5 million**
- New programmes to help individuals through retraining and skills development = **£5.5 million.**

76. The total fiscal stimulus which would require funding from the Stabilisation Fund is £25 million (with a further £10 million of already funded projects from the 2009 Business Plan that could be potentially brought forward). With £44 million potentially available from the Stabilisation Fund for discretionary policy there is the potential to implement all the policies above and additional ones. However, the initial assessment of desirability and deliverability does not mean that the Minister for Treasury and Resources and Council of Ministers are recommending them for implementation.

77. A further more detailed process needs to be developed to ensure that the projects meet the 3Ts, a more detailed cost/benefit analysis is undertaken, the business case is made and the options represent efficient use of states funds and are value for money. The next section sets out a rigorous evaluation

process that will identify which of the above projects are suitable and any other projects or policies that need to be considered.

**The process**

78. The work by EDD summarised in **Appendix 1** represents a first stage in developing a discretionary policy package. However, to ensure that any discretionary expenditure is based on a fully developed business case and relative priorities that maximise the impact and comply with the "Three Ts" a further prioritisation process, that is independent of all Departments who have submitted proposals, will be completed.

79. This process will result in funds being allocated to Departments by the Minister for Treasury and Resources to fund delivery of the highest priority discretionary stimulus activity. The input of the Corporate Services Panel will be required at key stages of the process.

80. Departments will set out a business case for proposed expenditure that will be signed off by their Chief Executive and Finance Director. The business case will set out in as much detail as possible –

- What the money will be spent on (and what will be on- and off-Island);
- The costs and benefits of the proposal;
- When the activity and/or spending will start;
- The length of time the activity and spending will last;
- When the final payments will be made and/or activity finishes;
- What the manpower implications are for the States.

81. The Treasury Department will prioritise all the expenditure proposals received to obtain value for money. In addition, the submissions and reporting requirements will be to follow best practice defined in Financial Direction 5.4 that is normally used to define conditions for grants issued to States funded bodies.

82. Proposals will also be assessed in terms of their overall economic impact. In order to do this the proposals will be validated with reference to the FPP's 3Ts (Timely, Targeted and Temporary). In addition proposals will be assessed in terms of the scale of the economic impact. That is, how much the proposal costs and the likely impact it will have on employment and business activity in the Island. Proposals will score lowly if they are not shown to support jobs (in a cost effective manner) in the Island and/or the benefits are likely to leak quickly out of the economy.

83. Validated business plans will then be considered by an independent executive group (Evaluation Team – ET) which will be chaired by the Chief Executive of the States and comprised of the States Treasurer and the States Economic Adviser who will base their judgements on advice from the Fiscal Policy Panel. Plans and the ET recommendations will be shared with the Corporate Services Panel.

84. The ET will assess all proposals and make recommendations to the Minister for Treasury and Resources who will make the final decision on allocation of funds from the Stabilisation Fund. Funds for approved projects will then be transferred to Departments who will be responsible for delivery and reporting outputs and outcomes in a timely manner. Department Chief Officers and Finance Directors will be accountable for delivery within their departments and reporting to the Minister for Treasury and Resources.

85. The process with key dates is summarised in the table below.

**Summary of the process for developing the fiscal stimulus package and involvement of Council of Ministers and Corporate Services Panel**

| Date | Process | Council of Ministers | Corporate Services Panel |
|---|---|---|---|
| **3 April** | | R&P agreed by CoM | CSP receives R&P and supporting papers |
| **7 April** | Pro-formas for bids sent to departments | | |
| **9 April** | R&P Lodged by TRM | | CSP Scrutiny process for R&P continues |
| **1 May** | Closing date for Pro-formas and detailed business plans | | |
| **1 -25 May** | Independent evaluation process by Evaluation Team (ET) | | |
| **19 May** | States debate R&P | | |
| **25 May** | TRM receives recommendations from ET | CoM receives recommendations from ET | CSP receives recommendations from ET |
| **1 June** | TRM finalises initial proposals following advice from CSP | CoM receives TRM initial proposals | CSP receives TRM initial proposals for comment |
| **10 June** | | | CSP on TRM proposals |
| **11 June** | | CoM agrees proposals | |
| **12 June onwards** | Implementation of stimulus package begins | | |
| **12 June onwards** | Further advice from ET to TRM on stimulus proposals<br><br>Monitoring of implementation by ET on monthly basis | CoM to agree additional proposals | CSP to comment on any additional recommendations from ET |

**Financial and manpower implications**

There are no manpower implications involved with the initial transfer of £44 million from the Stabilisation Fund to the Consolidated Fund. However, once the stimulus package is finalised by the Minister for Treasury and Resources, there may well be manpower implications for both the public and private sectors, but at this stage it is not possible to identify them. Any manpower implications for the public sector will be made clear when the stimulus proposals are evaluated.

**APPENDIX 1**

## PAPER BY THE ECONOMIC DEVELOPMENT DEPARTMENT

**Economic Stimulus – Responding to an economic downturn in Jersey**

**Determining the nature of economic stimulus**

An Officer Group lead by the Economic Development Department has identified what might be deliverable and achievable under the priority areas identified below:

- ***Supporting people most affected by the downturn.*** When Income Support was introduced, a system of transitional protection was established which protected the benefit levels (in cash terms) of those whose benefit entitlement was greater under the systems replaced by Income Support. The first of the phased reductions in that protection is due to occur in October 2009. Taking the decision to delay this by at least a year (to October 2010) could postpone the reduction in incomes of these lower middle income families. Other measures could also, if required, include ensuring adequate support for those losing their jobs or even those facing mortgage arrears/repossession should house prices fall significantly.

- ***New programme of maintenance/infrastructure spending.*** Maintenance and small capital projects can be identified capable of being brought forward to 2009 thus timely, be targeted as projects that would have happened anyway, have a lasting economic benefit and create local employment whilst of a fixed duration therefore temporary in nature.

- ***New programmes to help support those coming to the employment market for the first time, retrain those made unemployed, improve the skills base of the island.*** If policy can be implemented quickly will be timely, can be directed on those people affected by downturn, and can be temporary as long as the programme is designed in that manner.

- ***Increased business support including small business advisors, Small Firms Loan Guarantee Scheme, marketing support for finance and tourism.*** Can be timely because largely extending or enhancing existing services, can be directed at businesses most affected/where spending most effective and can be designed to be temporary.

- ***Non-fiscal measures.*** The States must be quick to act, adopt a leadership role and be more responsive in difficult times in such areas as RUDL, early invoice payments, planning procedures, adopting a pro-active stance to training placements and monitoring the need to support the housing market through changes to housing policy. As examples, Planning could be streamlined and speeded up to allow activity of an appropriate nature to take place now rather than in future.

- ***Communications with respective audiences and the making information available regarding the types of support freely and easily available.*** There will be a clear need to develop a full communication strategy at political, consumer or business levels, clearly highlighting the types, nature and scope of the various elements of the stimulus package, and how these differ from, but add value to, the ongoing States agenda and priorities outlined within the 2009 Business Plan.

In terms of preparing the list of policy options, Economic Development has taken the Priorities outlined above, briefed Chief Officers from the most appropriate States Departments, plus the Skills Jersey Board and in turn commissioned from them, 'bids' outlining the types of activity that could be brought forward to provide an appropriate stimulus effect.

Full proposals were subsequently received from each of the Departments and a long-list of potential stimulus actions drawn up. A prioritisation exercise was undertaken by EDD and the States Economic Advisor to ascertain the 'fit' of proposals in terms of both 'Desirability' and 'Deliverability'.

This gave a much clearer indication of the type of projects that were possible and evaluated in much greater detail in follow up meetings with appropriate Departments. The output of these consultations has been the drawing up of a consolidated list of potential stimulus investments.

**Overview of potential proposals**

Within the prioritised stimulus actions, the following investments by Departments are identified –

***Supporting people most affected by the downturn:***

**Social Security: Maintaining Transitional Relief for Income Support**
The rate of transitional relief for people receiving income support is due to be decreased in October 2009. One way of best supporting those most in need would be to maintain transitional relief at its current level for another year.
**Investment: £2,008,000**

***Supporting those coming to the employment market for the first time, retraining those made unemployed, improve the skills base of the Island***

**Skills Jersey: Supporting those seeking to gain access to employment**
A full package of measures has been put forward by the Skills Jersey Board designed to assist those seeking to find work, help young people & graduates and those seeking to upskill or change career.
**Investment: £2,016,240**

**Health Department: Nursing Apprenticeship scheme**
Introduction of a nursing apprenticeship scheme that would upskill current health workers and provide guaranteed employment for new entrants.
**Investment: £3,500,000**

***Increasing business support and access to finance.***

**Jersey Enterprise: Providing a package of measures to support Jersey companies**
Enhancing and introducing new initiatives that will provide local companies with the appropriate levels of support and opportunity that they will require to help them survive the effects of the downturn.
**Investment: £1,530,000**

***Bringing forward a programme of States maintenance/infrastructure spending***

**Housing Department: Maintenance**
The department has a current backlog of works that could be brought forward that would provide valuable future workload for a variety of tradesmen, primarily within smaller companies.
**Investment: £1,700,000**

**Housing Department: Bringing forward Housing Stock refurbishment**
Three extensive refurbishment schemes could be brought forward by the department that would provide for large contractors and sub-contractors.
**Investment: £9,000,000**

**Property Holdings: Bringing forward capital works**
The department has up to eight medium to large projects that could be brought forward giving a range of work an opportunities for large and medium construction companies, plus sub-contractors.
**Investment: £1,750,000**

**Property Holdings: Maintenance**
States buildings have an extensive backlog of works required in order to make them compliant in terms of the most basic standards. Funding here would only allow an element of this to be tackled, however would create a significant amount of work for smaller tradesmen on the Island.
**Investment: £3,300,000**

**Total additional investment:** **£24,796,240,** split

**Total value of economic stimulus:** **£35,931,240** including
Business Plan Funds Derived £10,000,000

**APPENDIX 2**

**PAPER FROM TREASURY AND RESOURCES DEPARTMENT**

**Estimating the cost of "automatic stabilisers" and identifying funding for discretionary fiscal stimulus**

**Executive Summary**

The FPP have advised that in the face of a significant economic slowdown there are two types of fiscal stimulus. Firstly automatic stabilisers, in the form of reduced tax receipts and revenues and also increased expenditure, for example on social benefits. Secondly, discretionary fiscal stimulus in terms of planned injections into the economy to stimulate activity.

An updated estimate of the automatic stabilisers has now been produced, including an improved method of forecasting income tax revenues.

The central range of the updated estimate predicts **a reduced surplus by just over £10 million in 2009, compared to the Budget 2009, and deficits increasing by around £50 million in 2010 and over £60 million in 2011.**

At this central range of the updated estimates and assumptions **the cost of the automatic stabilisers would require a significant proportion of the Stabilisation Fund balance of £138 million to be earmarked by 2011.** This would leave some scope for additional discretionary fiscal stimulus (i.e. above and beyond that delivered by the automatic stabilisers) before any other sources of funding are considered.

The Minister for Treasury and Resources has, with officers, considered other sources of funding for the discretionary fiscal stimulus and at this stage is able to identify a further £18 million which can be transferred into the Stabilisation Fund. **This balance is available from the Dwelling Houses Loans Fund and the Minister is proposing that £18 million is transferred to the Stabilisation Fund bringing the balance available to £156 million.**

The States is therefore asked in the proposition to consider whether this **sum of £156 million is earmarked firstly for the estimated cost of the automatic stabilisers, with the balance transferred to the Consolidated Fund to allow a discretionary fiscal stimulus package** as advised by the Fiscal Policy Panel and the States Economic Adviser.

What is clear from the scale of the likely costs of automatic stabilisers is that **every opportunity must be taken to reprioritise existing expenditure allocations** as an initial means of providing for any discretionary fiscal stimulus.

## 1. Purpose

The FPP have advised that in the face of a significant economic slowdown there are two types of fiscal stimulus. Firstly automatic stabilisers, in the form of reduced tax receipts and revenues and also increased expenditure, for example on social benefits. Secondly, discretionary fiscal stimulus in terms of planned injections into the economy to stimulate activity.

This paper provides an indication of the scale of the automatic stabilisers and identifies any balance of funding in the Stabilisation Fund that might be available for discretionary fiscal stimulus. A separate Appendix identifies the likely scale and make up of the options for a discretionary fiscal stimulus package if funding were available.

## 2. Background

Initial work was carried out in late January and early February to provide an initial estimate of what the cost of the automatic stabilisers might be in 2009 and future years. This was presented in outline to the Council of Ministers and all States Members at briefings in early February.

Significant further work has now been completed, particularly in respect of forecasting income tax revenues. An updated estimate of the automatic stabilisers, incorporating the improved assessment of income tax revenues, has now been developed.

Notwithstanding the comprehensive analysis of income tax revenues, it should be stated at the outset that these estimates must still be presented with a "health warning". The current set of circumstances and uncertainties facing the Island and the global economy are unprecedented, such that past trends may not prove to be reliable, and so a range of assumptions have had to be made to produce a best estimate from the information available.

In addition, the outcomes for income tax have been vetted by the Income Tax Forecasting Group (ITFG), a group of officers who are currently responsible for income tax forecasts including; Comptroller of Income Tax, Chief Adviser – International Affairs, Director of International Finance and the Treasurer of the States. Work will continue to improve and refine the estimates, but at this stage, and with the caveats above, the range of the improved estimates is the best information on which these proposals can be based.

## 3. Economic Assumptions

A significant piece of work has also been carried out by the States Economics Unit to forecast potential movements in the Island's economy over the next few years. The central range of forecasts of GVA has been used for the purpose of the estimates for automatic stabilisers, however it should be recognised that there is a much wider range of possible outcomes as referred to in the main body of the report.

In addition to forecasts of Real and Nominal GVA, the Economics Unit, now informed by the relationships identified with income tax revenues, has also provided a further set of assumptions which cover:

- future RPI (x)
- compensation of employees
- company profits
- movement in house prices
- forecasts of interest rates
- forecasts of FTSE 100 – equity prices.

Advice has also been taken from the States Investment Advisers (Hewitts) on potential returns from types of investment income which, together with the economic assumptions, have been used where appropriate in these estimates.

4. **Estimating the cost of "automatic stabilisers"**

The potential effects on States income are summarised as follows:

- ➢ **The effects on Income tax receipts** show falls in tax on investment income and company profits but with tax on earnings remaining more robust. With the retrospective income tax regime there will be a time lag before these factors translate into reduced revenues for 2010, 2011 and beyond.
- ➢ There are a number of additional factors in this downturn, as opposed to that experienced in the early 1990's and 2000-2004, not least the major uncertainty of the nature of any recovery in the global economy but also the additional impact of extraordinarily low interest rates. As a result these forecasts have to be treated with caution and with the caveat that they are best estimates based on the information available.
- ➢ The updated forecasts draw on past relationships and trends between income tax revenues and economic factors and identify the most positive correlations. Where these correlations are economically sound and pass the vetting of the ITFG then these have been used as the basis for future forecasts.
- ➢ But, because of the uncertainty in the global economy it may prove that past relationships are not an accurate guide to future performance so a combination of assumptions from the data analysed and then the views of the ITFG have been used.
- ➢ What is apparent is that there will be a significant reduction in income tax revenues, in addition to the effects already forecast for the move to a 0/10 corporate tax structure. The reduction is estimated in the central range at between £30 million and £45 million in 2010 and 2011 with only a slow recovery in future years.
- ➢ The effect of a recession on **GST** and **Impôts duties** is less direct than with income tax, as both are based on consumer demand and many of these commodities will still be required. A broad estimate would be that these revenues will remain static with any nominal growth (RPI) being offset by the downturn (GVA). While past trends in GST are not available, this assumption is supported by an analysis of UK VAT receipts which have remained fairly constant during times of past economic downturn.
- ➢ An analysis of the trend of Impôts duty revenues over a twelve year period, including the last downturn in 2000-2004, was also carried out which showed no significant effect on the trend of revenues for this period.

- **Stamp duty** revenues are likely to fall as a result of the weaker housing market. A fall in volume was already evident in the second half of 2008 and this was reflected in a significant reduction of some £10 million – £12 million in the forward forecasts included in the 2009 Budget.
- Latest assumptions are for a further fall-off in demand and perhaps a slower recovery during 2010. The December 2008 quarter's house price index showed the first quarterly fall in prices for two years and the most significant in a quarter since 2003. It has been assumed that there will be a further fall in house prices over the next two years reducing stamp duty revenues over the forecast period.
- The States will also see a significantly reduced return from its **cash balances** in 2009 and 2010 as a result of the impact of forecast deficits and the current projections for interest rate levels over the next two years. The assumptions provided by the States investment advisers have been used to improve the immediate forecasts and in the medium term the Bank of England forecasts are used.
- Any effects on **other States income** may be seen in a reduced demand for certain of the services provided by the States, such as sport and leisure, planning, harbours and airport. However, discussions with these departments suggest that this is unlikely to be significant.

In terms of the effects on States expenditure these are perhaps more difficult to forecast. In particular, it is difficult to predict the extent to which small changes in demand could be managed within the capacity of existing budgets.

- Undoubtedly the major impacts are likely to be seen in increased social benefits and social housing as people's incomes and employment are affected. This will translate to pressures on **income support** which now includes the allowances for social housing benefit. While the average cost of support is in the order of £6k p.a. per household, the department estimates that the cost of support to working families likely to be most affected by the downturn would have a much higher average cost of support of £13.5k per annum.
- Conversely, the employment situation may serve to reduce the cost of the **supplementation** budget (broadly £2k per capita) which may partly offset some of the benefit costs anticipated. The challenge is not only to estimate the impact of the downturn on employment, but also what proportion of those forecast to be unemployed would qualify for income support or currently generate a supplementation charge. At this stage it has not been possible to adjust the calculation for the implications of any change in the relationship between the increase in the ceiling and the growth of earnings.
- Increased demand is also likely in relation to **higher education** due to higher staying on rates and on grants funding from more applications and the effect of reduced family incomes. However, at present this area of the service is underspent and may be able to absorb some of this effect. Similarly, education may see increases in demand for **adult and further education** and general activity at Highlands College related to increased unemployment and individuals pursuing retraining and re-skilling. Consideration of these effects and an analysis of trends has been carried out which also considers existing

capacity. This is more likely to be an area where additional demand could initially be prioritised within existing capacity or if funds are provided could be addressed through any discretionary and targeted stimulus.

- The effects on household incomes may also be seen in reduced demand for **fee paying schools** and a consequent increase in places at **States schools.** The effect of this will depend on the levels of waiting lists at the private schools and capacity at States schools.
- At this stage it is assumed that the area most likely to see additional demand and funding pressure within education would be at Highlands College, but in the first instance this would be managed within existing funding.
- The various arms of **economic development** in relation to the Skills Executive, support for small businesses, and training and workforce development are likely to come under pressure for funding. Separately, these areas are likely to provide a number of new initiatives that will be launched as part of the discretionary economic stimulus package.
- Other areas of spending may receive increased demand but depending on the scale of these pressures departments may be able to adapt to accommodate and absorb these changes in the short-term. However, it is important to note that if a more significant or extended recession is experienced then these pressures are likely to need more funding.

## 6. Summary of estimates of the automatic stabilisers

The latest estimates of the cost of automatic stabilisers will result in significant deficits in all the forecast years.

The graph at **Annex A** compares the updated range of forecast deficits with the financial position in the Budget 2009. The graph and table at **Annex B** shows, as an illustration, the impact of the various components of the automatic stabilisers on the forecast deficits for 2010.

**The central range of the updated estimate predicts a reduction to the surplus in 2009 by just over £10 million and increases to the deficits by around £50 million in 2010 and by over £60 million in 2011.**

The potential impact on the Stabilisation Fund of funding the range of forecasts of the updated estimates of automatic stabilisers is shown at **Annex C**.

Work will continue to improve the forecasts and assumptions and further information will also become available directly from the performance of businesses, employment and other key indicators as the year progresses.

At this stage it is reasonable to assume that at the central range of the updated forecasts and assumptions **the likely cost of the automatic stabilisers would require a significant proportion of the Stabilisation Fund balance of £138 million to be earmarked by 2011.**

This would leave some scope for additional discretionary fiscal stimulus (i.e. above and beyond that delivered by the automatic stabilisers), but will also require further discretionary stimulus to be achieved by reprioritising existing expenditure allocations or for other sources of funding to be explored.

It is more evident in these updated estimates that the budget deficit appears to be persistent. This suggests that the deficit is at least partially structural, rather than purely cyclical. This might suggest focussing the use of the Stabilisation Fund during the recession in 2009-2010 and considering other ways to re-balance the budget for 2011 onwards, such as reducing expenditure or increasing taxation.

## 7. Funding for Discretionary Fiscal Stimulus

The Minister for Treasury and Resources has with officers considered other sources of funding for the discretionary stimulus and at this stage is able to identify **a further £18m which can be transferred into the Stabilisation Fund. This balance is available from the Dwelling Houses Loans Fund and the transfer is proposed in the attached proposition.**

Together with the transfer of £63 million agreed in the 2009 Budget the balance on the Fund would then stand at £156 million.

The States is therefore able to consider the proposal that **this sum of £156 million is firstly earmarked to provide funding for the automatic stabilisers in 2010 and 2011, with the balance available for any discretionary fiscal stimulus** as advised by the Fiscal Policy Panel and the States Economic Adviser.

What is clear from the scale of the likely costs of automatic stabilisers is that **every opportunity must be taken to reprioritise existing expenditure allocations** as an initial means of providing for any discretionary fiscal stimulus.

**Annex A**

**Comparison of Updated Estimates (March 09) and financial forecast from Budget 2009 (Oct 08)**

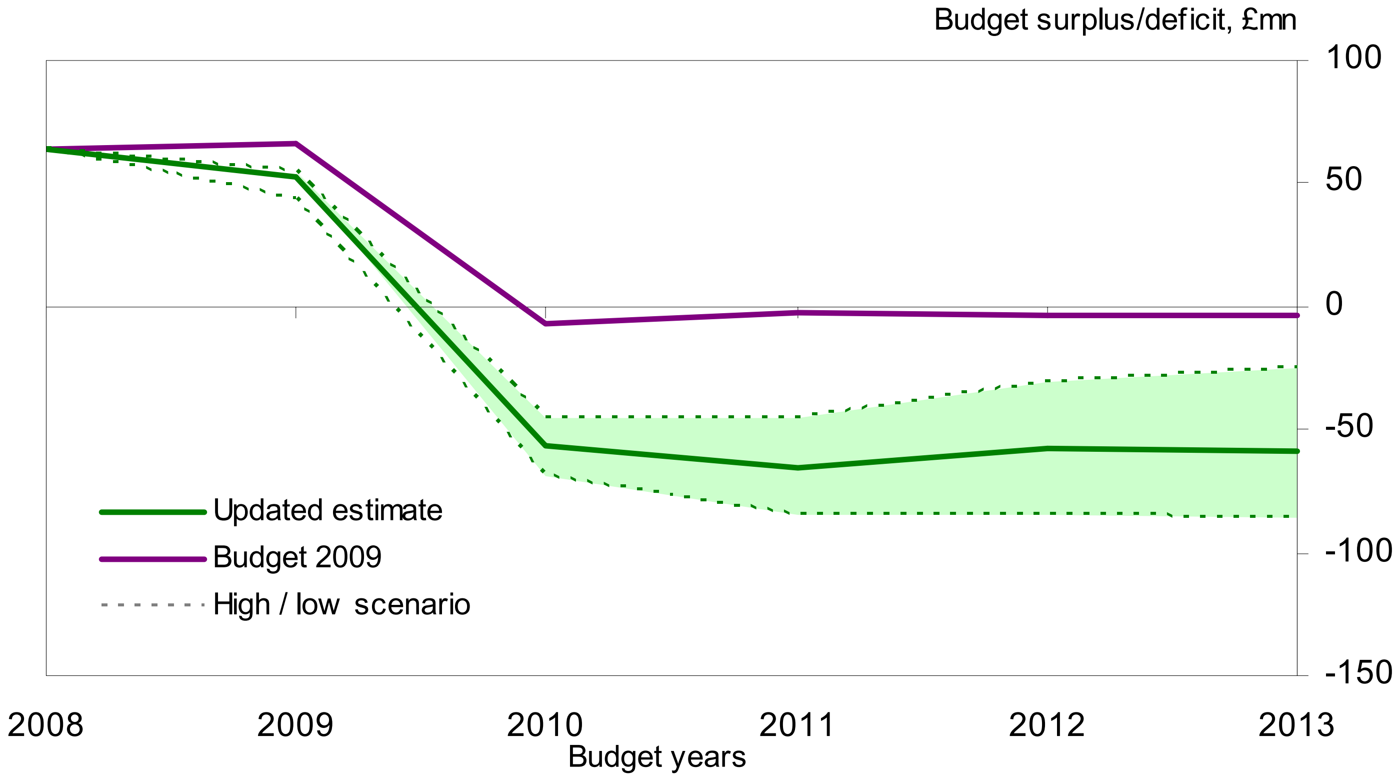
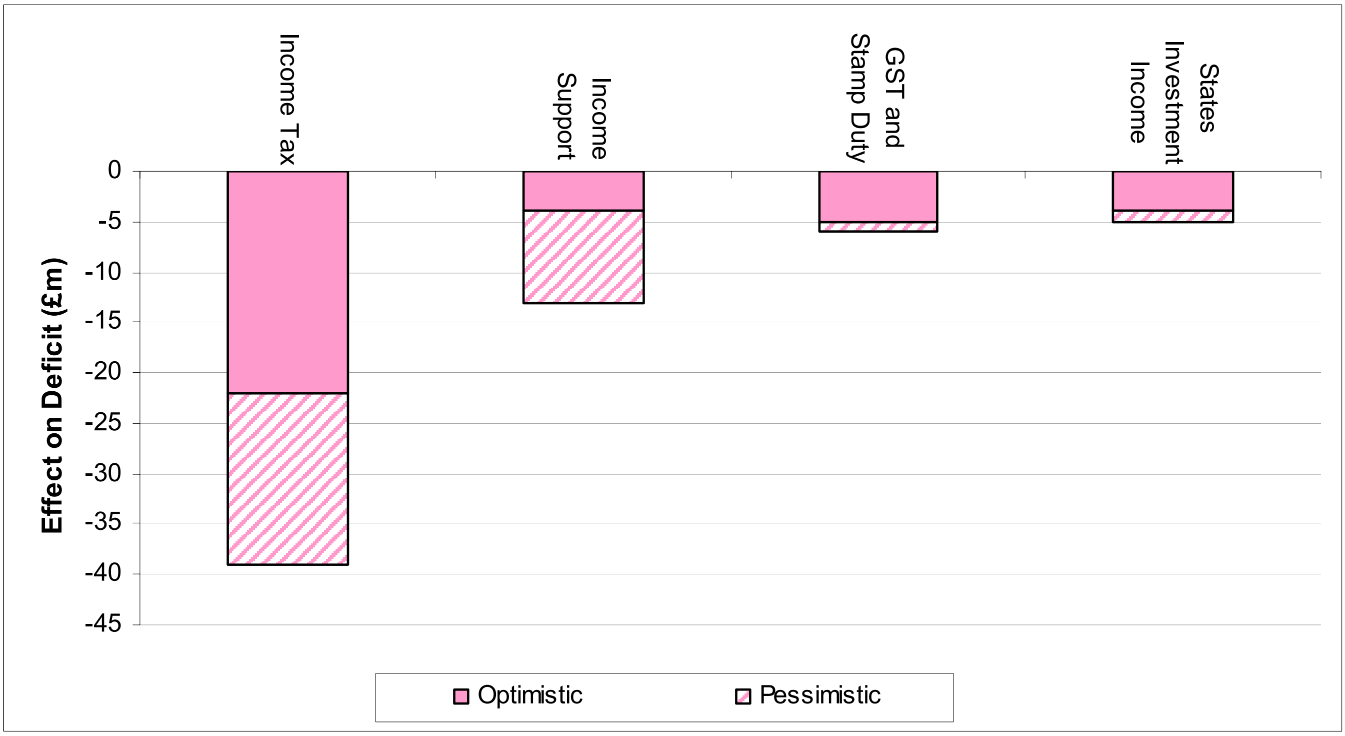


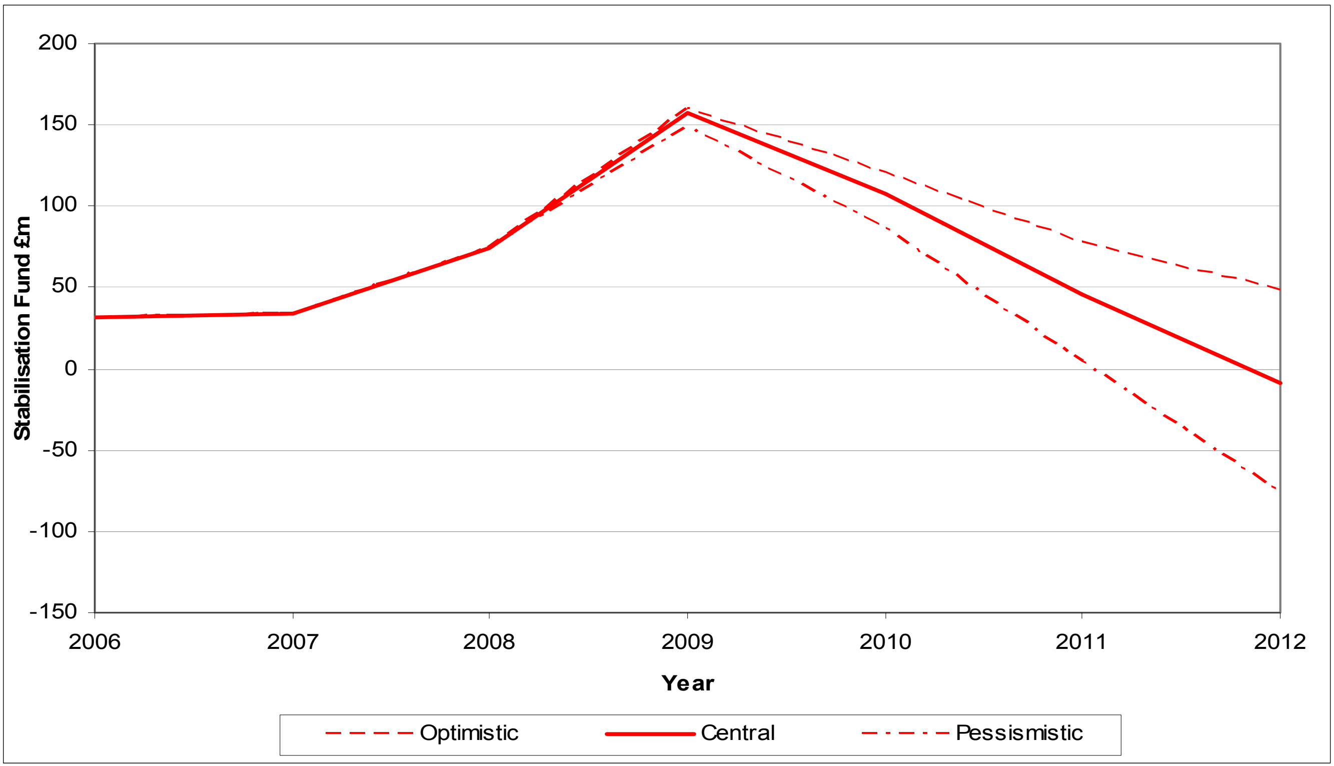
**Illustration of the Impact of individual Automatic Stabilisers on the Range of Forecast deficits in 2010**



**Impact of individual Automatic Stabilisers on the Range of Forecast deficits**

| **Impact on States Forecast** Updated estimates | **2009** £m | **2010** £m | **2011** £m | **2012** £m |
|---|---|---|---|---|
| **States Revenues** | | | | |
| Income Tax | | | | |
| Low range effect | (3) | (22) | (32) | (21) |
| Mid range effect | (3) | (30) | (44) | (39) |
| High range effect | (7) | (39) | (56) | (57) |
| States Investment Income | | | | |
| Low range effect | (3) | (4) | (3) | (3) |
| Mid range effect | (4) | (5) | (3) | (3) |
| High range effect | (5) | (5) | (3) | (3) |
| Stamp Duty and GST | (3) | (6) | (7) | (6) |
| **States Expenditure** | | | | |
| Income Support and Supplementation | | | | |
| Low range effect | (2) | (4) | (2) | 3 |
| Mid range effect | (3) | (9) | (9) | (6) |
| High range effect | (7) | (13) | (16) | (16) |
| | **2009** £m | **2010** £m | **2011** £m | **2012** £m |
| **Summary of Total Impact** | | | | |
| Low range effect | **(11)** | **(36)** | **(44)** | **(27)** |
| Mid range effect | **(13)** | **(50)** | **(63)** | **(54)** |
| High range effect | **(22)** | **(63)** | **(82)** | **(82)** |
| **Budget 2009 Forecast** | **66** | **(7)** | **(4)** | **(3)** |
| **Total Revised Forecasts** | | | | |
| Mid range effect | **53** | **(57)** | **(67)** | **(57)** |

**Impact on Stabilisation Fund of Range of Forecasts for Automatic Stabilisers**




**Note:** Balance of Stabilisation Fund at £156 million in 2009 includes £63 million transfer agreed in Budget 2009 and proposed transfer of £18 million from the Dwelling Houses Loans Fund.