P.2019/142 SMC Lett Comm

Scrutiny Management Committee

The Presiding Officer
States of Guernsey
Royal Court House
St Peter Port

13th January 2020

Dear Sir,

Scrutiny Management Committee - Commentary on the Policy & Resources Committee: The Review of the Fiscal Policy Framework and Fiscal Pressures

Introduction

This Letter of Comment from the Scrutiny Management Committee is submitted in accordance with Section 3 (19) of the Rules of Procedure. In this Letter of Comment, the Scrutiny Management Committee (the Committee) will address the case set out in the Policy Letter and supporting material.

On a general note, the Committee has long championed the need for greater clarity and transparency in many aspects related to fiscal matters including the Fiscal Policy Framework (the Framework). Whilst there continues to be significant areas where improvements could be made, the Committee is pleased to note that its recommendation to clarify the definition of borrowing within the Framework has been included within this Policy Letter.

Fiscal Policy Framework

The Committee accepts the case for the States having a Framework that sets out our government's fiscal rules. The Committee also acknowledges the need for this update to the Framework due to the rebasing of Gross Domestic Product (GDP) and the continued drive towards International Public Sector Accounting Standards (IPSAS).

However, the Committee has concerns that some of the changes put forward may go beyond the update justified by this rationale.

The Committee suggests that the Framework should in any event be brought before the next Assembly at the earliest opportunity as it is a fundamental building block that informs all subsequent policy decisions.

Review of the Framework

There has been an Independent Review of the Framework undertaken annually between 2010 and 2017. The reviews have provided an independent assessment of economic performance from a much wider macro-economic perspective as opposed to purely focussing on an analysis of compliance with the Framework.

It is suggested within the Policy Letter that an analysis of the compliance with the Framework could be undertaken internally and then published annually within the States' Accounts, whilst the comprehensive Independent Review would be undertaken every four years, timed to inform the Medium Term Financial Plan (MTFP) process. The Committee notes the potential monetary savings that would result from this change.

The Committee acknowledges that the analysis of compliance with the Framework should be possible within internal capacity and capability. As such, the Committee has no issue with this aspect of the suggested process in and of itself, although, once again, the Committee would urge the need for clear, transparent presentation of the relevant information.

However, it is very clear that the added value of increased assurance and external credibility of the annual Independent Review (and specifically an assessment of the fiscal and economic risks facing Guernsey) would not be replicated from the proposed internal process.

As a result, the Scrutiny Management Committee has serious concerns that the suggested reduction in the frequency of the external Independent Review - from annually to four-yearly - represents a reduction in valuable financial oversight. The Committee believes that the suggested change in the existing process may be more justifiable if balanced with a corresponding increase in financial accountability.

As such, the Committee strongly recommends that the suggested four-yearly external Fiscal & Economic Review should be commissioned by, or at least submitted to, the Financial Scrutiny Panel of the Scrutiny Management Committee, thus providing a further independent level of oversight. The Committee believes that the review falls within its existing mandate and moving the oversight of this process to the Financial Scrutiny Panel from the Policy & Resources Committee, would introduce additional independence.

In addition, the Committee believes an interim Independent Review should be undertaken in the middle of each political term. This would allow the economic performance of the Assembly to be assessed and held accountable during its tenure.

Principle 1 Long Term Balance: A long-term sustainable balance is a continuation of the current cautious fiscal approach. Whilst noting those indicators mentioned, the Committee seeks clarification as to what currently constitutes a balanced position. The Committee specifically notes the targets set for the Core Reserve as per the current MTFP, but questions this ongoing rationale given the already relatively healthy state of the public purse and the implied need for a sustained period of significant net revenue surpluses.

Principle 5 Aggregate Income: This Principle limits spending on the provision of public services based on the level of all forms of revenue (excluding return on investments) rebalanced from 28% to 24% of GDP, due to its value being restated. This Principle could allow for an increase in tax revenue which clearly aligns to the proposed justification of the Tax Review. The Committee is conscious that this headroom already exists within the current rules.

Principle 6 Capital Investment: The Committee notes the definition of capital spending to be limited to that funded through General Revenue (i.e. spent from the Capital Reserve). As such, any capital spend from other sources (i.e. the States Bond, Private financing) would be excluded.

The Committee would ask: what evidence is there that supports the rationale of reducing the total capital expenditure to 1.5% of GDP? It is arguable in this context that the current low level of public investment is already having an impact on our economy. Given the healthy amount of capital available to invest and the large projects already agreed, the reduction to 1.5% appears surprising. In any event, the Committee would suggest that in the absence of other evidence, the 1.5% figure is arbitrary and arbitrary goals should be treated with caution.

This target clearly lacks ambition and the Committee therefore questions what economic data and analysis there is to support this "goal", given the current absence of a permanent States' Economist. The Committee believes that thought should be given to the potential opportunities available to invest effectively in the local economy in order to stimulate growth on Island.

The Committee seeks assurance that the reduction to 1.5% is not driven primarily by the desire to balance the revenue budget in year, rather than investing prudently in what the island needs to spend to maintain, preserve and enhance its assets in the longer run.

Principle 7 Limiting Borrowing: The Committee is pleased to see that its review of the States Bond (the Bond) has been acknowledged and one of the recommendations of the KPMG Report has been implemented. The definition of what constitutes "debt" has been strengthened with the inclusion of a broader inclusion of long-term States' liabilities.

However, the Committee is concerned that the Policy Letter does not acknowledge the increase in headroom proposed by this Principle for additional borrowing. This figure may also increase in real terms over a period of time as the long-term liability of the Bond potentially reduces relative to GDP.

Financial Planning Process

The Committee has serious reservations with regard to the timescales for the various products leading to the next Future Guernsey Plan (previously known as the P&R Plan). The Committee would seek reassurance that the proposed sequencing provides the opportunity for the MTFP to be informed by the next Independent Fiscal & Economic Review.

Tax Base Review

This proposed review is predicated on significant future cost pressures that require an increase in overall tax revenue. It is not unreasonable for government to conduct such reviews in appropriate circumstances.

Nevertheless, the Committee is of the strong opinion that there remains a number of options available for the Assembly to consider to address the potential cost pressures before considering higher or new taxes or levies. These include significant public sector reform, continued transformation of public services and the potential reprioritisation of spending on specific services. The Committee also wonders if now is the time for an external, objective review of the current levels of efficiency of existing public spending before we go any further in expanding the size of the States.

The whole premise of the tax review seems to assume that the only choice for policymakers in the future is for Guernsey taxpayers to bear the burden of more and more demands for new or better public services et al and therefore that there must be new or higher taxes to meet these future demands; but, in all honesty, that is not the only policy choice on offer. Other policy choices do exist, even if they might be considered unpalatable; e.g. not extending public services; not funding NICE drug treatments. For the future shape of States' policy to be determined effectively, the Assembly needs to have a full and frank debate about why future demand areas are so critical and whether Guernsey should seek to endorse all, some, or none of those future growth areas. Moreover, there is nothing genuinely inevitable about the States funding all of the future areas of demand that have been flagged up in the Policy Letter. The States must be ready to make an active choice.

In addition, the Committee is especially disappointed by the limited consideration that appears to have been given to the option of growing the economy to address the concerns regarding future tax revenue. It is also apparent that adjustments to population levers currently are not being considered as a potential solution to long term spending pressures.

The Committee is also disappointed that the Report does not include further detail relating to the perceived cost pressures outlined in the Report which are cited to justify the need for a review.

Whilst noting that a full report will be submitted in due course, the Committee is particularly concerned by the absence of detail with regard to the £35-£40m figure relating to Public Sector Terms and Conditions. This represents around half of the cost pressures and this Committee believes that further details need to be provided to the Assembly at this stage, so that Members are able to make a fully informed decision.

The Committee remains concerned with the lack of reported progress on the planned £26m programme of public sector reform and would wish to be assured that any significant increase in taxation would only be countenanced after substantial progress and delivery has been demonstrated on the full programme of public sector reform and transformation of services.

The Committee would also like to be assured that any decisions to increase taxes would only be taken following a full social, economic and environmental impact assessment of the proposed new tax implications for all Islanders, but particularly those who come within the 'In-Work Poverty' category.

Terms of Reference

The Committee is conscious that any potential recommendations of this review should align with the high level-principles within the Future Guernsey Plan together with the recommendations of the Committee's In-Work Poverty Report.

The Committee also notes that the Report appears to have largely written-off corporate taxation as an avenue for increasing substantial revenue income. It could be argued that Guernsey needs people as much as it needs the companies who employ them, but the implication seems to be that the burden associated with the collection of additional tax revenue will fall largely on individuals. Further justification for this stance is required from the Policy & Resources Committee.

Generally, the Scrutiny Management Committee has strong reservations that the benefits of a low tax jurisdiction may not be reflected across the whole community given the high cost of living experienced by many individuals and families. This should be a factor that the reviewers have uppermost in their minds during the review itself.

It could be argued that the Terms of Reference have been tailored somewhat towards implementing a Guernsey goods and services tax and on the taxing of individuals, rather than corporate organisations. The Committee believes that, in the final analysis, the States should examine the adoption of potentially regressive tax solutions very carefully indeed before political agreement and any chosen approach should be brought before the next Assembly for formal ratification.

Conclusion

In conclusion, the Scrutiny Management Committee believes that the idea of four yearly independent reviews of the Fiscal Framework and the States of Guernsey's compliance with it, represents a potentially significant diminution of level of financial scrutiny and accountability of political representatives vis-à-vis the Fiscal Policy Framework and its implementation.

In terms of the proposed Tax Review, the Committee would urge that any review considers all the options available and is not limited by the views of the current Policy & Resources Committee.

The Committee would also wish to be assured that any significant increase in taxation would only be countenanced after completion of the full programme of public sector reform and ongoing transformation of services, plus a full economic impact assessment of the proposed new tax implications for all Islanders have been completed.

Yours sincerely,

Deputy Christopher Green
President of the Scrutiny Management Committee