# POLICY COUNCIL

FISCAL POLICY FRAMEWORK

## 1 Executive Summary

1.1 This report outlines and recommends the adoption of a formal fiscal framework (principally a set of parameters to guide all future States fiscal policy)[1] which is intended to underline the credibility of fiscal policy and provide reassurance to taxpayers about the sustainability of future States spending plans, particularly given the present outlook for States finances in the short term and the current proposals from Treasury and Resources ('T&R') to borrow to finance part of the proposed priority capital expenditure programme.

1.2 The T&R proposal in its Capital Prioritisation Report to use borrowing to finance public sector expenditure is common practice internationally. However, for the Bailiwick of Guernsey this method of financing is a clear departure from recent historical experience and will require a fundamental change in the mindset of policy makers, in particular a need for increased fiscal discipline. A **transparent formal fiscal framework** should better ensure this discipline and continued conservative fiscal policy of the States: a point strongly endorsed by the comments of Professor Geoffrey Wood[2], special advisor to the Bank of England on financial stability, who was asked to provide an external, independent opinion on the proposed framework.

> *'I am convinced that the adoption of a formal fiscal framework by the States of Guernsey is an eminently sensible course of action. I would recommend that course strongly and without any hesitation. Such a framework will provide transparency for the conduct of States fiscal policy and will entrench the discipline necessary to ensure the continuation of the cautious and prudent fiscal stance of the States. '*
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> *'Having reviewed the draft framework itself, I support the economic principles on which the framework is based and am of the opinion that the rules that the framework incorporates are both well designed and robust.'*
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> *Professor Geoffrey Wood, March 17th, 2009*

1.3 **The adoption of a framework in no manner commits the States to the use of borrowing** (be that by recourse to bank financing, bond issuance or any other

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1 See glossary for definition of economic terms.

2 Geoffrey E. Wood is Professor of Economics at Cass Business School and Professor of Monetary Economics at the University of Buckingham. He is currently a special advisor to The Bank of England on financial stability. He has been a visiting scholar at the Federal Reserve Bank of New York and has advised the New Zealand Treasury.

mechanism) but lays down a set of constraints or 'limits' to the level of borrowing that would be economically prudent *if the States subsequently chose to utilise this manner of financing at any point in the future*. As is described in the next section, presently no such limits exist and, irrespective of any future decisions regarding financing methods that may occur (including any taken in the May States debate on the T&R Capital Prioritisation Report), it is sensible to put in place a transparent framework to safeguard the continued conservative fiscal policy of the States of Guernsey.

1.4 This report outlines and discusses many issues related to government expenditure and borrowing to provide a full context to the presentation of a recommended fiscal framework based on the assumption of the following principles underlying fiscal policy:

1. stability is at the heart of sustainable economic prosperity;

2. fiscal policy needs to be focused on the medium term[3];

3. economic and fiscal policy should be stable, transparent and predictable.

1.5 The proposed framework will imply the following limits[4] on fiscal expenditure of the States:

1. **the level of gross borrowing by the States may not exceed *20%* of Guernsey gross domestic product;**

2. **the maximum annual operating deficit of the States may not exceed *3%* of gross domestic product;**

3. **the maximum additional borrowing sanctioned in any one States term may not exceed one times the level of 'permanent'[5] capital expenditure over that time period.**

## 2 Background

2.1 On February 22nd the Policy Council considered the Treasury and Resources' ('T&R'), Capital Prioritisation Report. This contained:

- the approach T&R had taken in conducting its prioritisation process;

- a recommendation of a specific capital programme to be part funded by borrowing from international capital markets:

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3 See glossary for definition of economic terms.

4 Again, this policy framework **does not** pre-commit the States to borrowing as a financing option. These are merely time invariant limits to constrain all future States fiscal policy.

5 See appendices one and two for an explanation of the concept of 'permanent'.

- a recommended amount of borrowing of £175 million pounds.

2.2 The Policy Council agreed to the recommendations of the Fiscal and Economic Policy Group ('FEPG') that, before debating the specifics of the proposals contained in T&R's report, it would be prudent for the States first to debate and adopt a formal fiscal policy framework.

2.3 T&R's borrowing proposals are not without precedent. Its Capital Prioritisation report refers to previous occasions when recourse to borrowing has been made. The resolution of 1956 (Billet D'Etat III) gave power to the States Finance Committee to authorise States Committees temporarily borrowing from internal or external sources *'in any other manner approved by the States Finance Committee, for such periods and such periods, up to such amounts, at such rates of interest and on such periods as that Committee may approve'*.

2.4 This mandate was itself an exercise to extend the ability of States Committees to borrow for reasons other than to fund '*capital votes'* as a resolution of 1927 (Billet VIII) had precluded committees from using borrowing to fund anything other than capital expenditure. This 1927 resolution did empower the States Finance Committee to borrow to fund capital *'as well as … may be necessitated by the finances of the States'*.

2.5 The powers delegated to the States Finance Committee by the 1956 resolution are specifically transferred to T&R in point (a), (v) of the T&R's present mandate. No specific reiteration of the mandate of the 1927 resolution is made but can be assumed to be covered by point (d) referring to exercising extant powers of the obsolete States Finance Committee. The role of the Policy Council under the present constitution includes *'to provide the States advice on matters relating to the formulation and implementation of economic and fiscal policy'*.

2.6 This report is drafted under this mandate and sets out the recommendation that, especially in the absence of specific constraints contained in previous resolutions, the States adopt a Fiscal Policy Framework to provide agreed parameters for the conduct of fiscal policy and ensure a continued transparent conservative fiscal approach of the States.

## 3 Fiscal Policy

3.1 There are many aspects to fiscal policy. In its most general, layman terms it can be thought of as 'government spending and taxation'.[6] The assumption is made here that the key roles of government are: the provision of defence (clearly for Guernsey this is provided by the UK, although a contribution is made through, amongst other arrangements, the agreement to maintain Alderney breakwater); the provision of a legal framework; provision of public goods and services;

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[6] See glossary.

correcting market failure and (to a varying degree dependent on the preference of the public and political direction) wealth and/or income redistribution. In meeting these duties, the state finances its activities through (compulsory) taxation which is the preserve of fiscal policy.

3.2 Fiscal policy in Guernsey is based on the direct assumption that the private sector is the engine of growth[7] and that the Government's primary role is to provide a stable, competitive environment for the private sector to thrive. The primary objective of fiscal policy is therefore to promote long term economic growth and, given monetary policy is not under the control of the States, import leakages are high[8], and the inherent time delays for fiscal changes to take effect[9], there is only a limited role for fiscal policy to achieve macroeconomic stabilisation. **To promote long term economic growth the most beneficial approach to fiscal policy is to ensure that it is stable, secure and competitive and transparent and to achieve this that budgets are balanced over the medium to long term.**

3.3 How the state raises its finances and how the burden is shared across different members of society (and the degree, if any, of income redistribution practised through the tax and benefit system) is clearly an aspect of fiscal policy but not a focus of the proposed policy framework. **The proposed framework is to provide boundaries to the fiscal 'position' ie to ensure balance and stability of States budgets and finances in the long run.**

3.4 It is acknowledged that there is a limited role for fiscal policy in the management of demand: that at times of *extreme* economic conditions the use of government spending (or taxation) to stimulate demand may be appropriate. **However, the recommended framework assumes that in ordinary circumstances the ability of fiscal policy to achieve macroeconomic stabilisation is limited. The direct implication of the limited role for stabilisation for a fiscal framework for Guernsey is that the States needs to ensure its finances are in a healthy and flexible position over the medium term.**

## 4 International Fiscal Practice

4.1 It is common practice for large governments to borrow funds to finance public expenditures[10]: the UK has run public sector deficits in 16 out of the last 20 years; the average level of government debt for the euro area is 74.7% of GDP[11]; and one of the key responses of Western governments (in particular the US and

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7 Strategic Economic Plan, Billet XIV, 2007

8 See glossary.

9 The common assumption is that changes in fiscal policy take around 18 – 24 months to feed through into domestic demand. The recent policy practice of the UK, EU and US governments to use monetary policy has been used as a macroeconomic stabilisation measure is predicated on the view that changes in interest rates have a much more immediate effect on aggregate demand.

10 See appendix four.

11 Source OECD, defined as gross financial liabilities of the public sector as a proportion of GDP.

the UK) to the economic slowdown induced by the credit crunch has been to use public sector borrowing to finance banking sector bailouts and a plethora of fiscal stimuli.

4.2 Whilst also it is eminently possible for large countries such as the US to run deficits for protracted periods of time[12], the sustainability of public sector finances is of continual concern to international investors and taxpayers alike as large current deficits will require either less spending or increased taxation in future years. Borrowing is a perfectly orthodox method of financing but in economic terms is merely an exchange of taxes over time[13]: any spending over and above today's present revenues will require additional taxation in the future and there is an inherent cost to borrowing, namely the payment of interest on the capital borrowed.

4.3 Whilst it is rare for countries to default[14] fiscal prolificacy imposes its own burden on governments in higher future interest payments demanded by lenders and increased taxation levels to service and pay off high levels of debt. There is also much public scepticism worldwide as to the ability of politicians to maintain strict long term fiscal discipline in the face of popularity that public spending may bring in the short term[15]. For these reasons during the 90s in particular attention was directed at imposing formal fiscal frameworks on governments to ensure restraint in public sector borrowing.

4.4 The most well known of these are the Maastricht criteria and the UK's Golden Rules and the concept of fiscal rules has been somewhat undermined by the UK's lack of adherence to its own rules.[16] However, the rationale underpinning fiscal rules remains and is to provide reassurance to the private sector (and by implications financial markets) of the credibility of fiscal policy and ensure that public sector deficits are neither excessive nor unsustainable[17] in the long run. In the words of HM Treasury *'Fiscal policy is now directed firmly towards maintaining sound public finances over the medium term, based on strict rules'*.

4.5 The objective of the Maastricht criteria was to bind together separate sovereign states in a common fiscal policy to ensure stability of a common currency. The objective of the UK rules were more orthodox: namely to maintain market

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[12] There are numerous reasons for this which will not be explored here but it should be noted that it is much easier for the US having the dollar as a 'reserve' currency (ie international investors like to hold their assets in key stable currencies) to borrow large sums.

[13] This is known as Ricardian Equivalence, named after the 19th century English economist, David Ricardo who first postulated this 'law'.

[14] The French State had a tendency to default during the 17th and 18th centuries and its poor reputation as a borrower meant it found it harder than England to finance the Napoleonic Wars. In more recent years, the Russian State effectively defaulted during the devaluation of the Rouble in 1998.

[15] This is a recognised phenomenon in academic circles and was first and best encapsulated by Nordhaus (1975) The Political Business Cycle.

[16] Whilst clearly the current and projected level of UK borrowing exceeds self imposed limits, the regular changing of the date and position of the UK business cycle led many commentators to question the UK's commitment to its rules.

[17] Note there is a technical distinction between excessive and unsustainable.

confidence in UK fiscal policy and hence the strength of Sterling and keep the costs of future UK Government borrowing within reasonable bounds.

4.6 The fiscal policy framework of Jersey is somewhat broader than either the EU or UK frameworks referred to above and is more interventionist in nature, reflecting the lack of control Jersey has over monetary policy (as indeed is the case for Guernsey) which has over the last 20 years or so been used as the primary demand management tool in the EU and UK. Rather than assume a neutral framework for fiscal policy, Jersey's framework assumes a much greater role for active management of demand in the economy. The Jersey framework overtly incorporates policies aimed at reducing inflation and managing aggregate demand through release of funds to and from its Strategic Reserve.

4.7 Fiscal Policy frameworks are common (those of the EU, UK and Jersey have been referred to above but they are incorporated in countries as diverse as Singapore and Nigeria[18]) and especially in the light of the outlook for the States budget position in the short term and the proposals from T&R to borrow to finance capital expenditure, it is appropriate for Guernsey to adopt a framework of its own to reflect its own individual conservative fiscal tradition.

4.8 **The Policy Council does not believe that the main role of a fiscal policy framework should be as an active demand management tool** as is the case in Jersey. Rather the objective of a fiscal policy framework for Guernsey would be to provide transparency for the conduct of all future fiscal policy and promote stability in fiscal policy and ensure that levels of present and future borrowing, if agreed by the States, remain within sustainable and prudent limits.

4.9 The proposed Fiscal Framework, as recommended by the Policy Council, is outlined in section eight of this report. Prior to that, to first provide context, a discussion of issues related to public sector investment, fiscal frameworks and an explanation of the rationale of the recommendations of the proposed framework is provided.

## 5 Public Investment and capital expenditure

5.1 As the proposals presently put forward by T&R are to fund various capital expenditures through borrowing, it is salient to first review certain of the economic issues surrounding public sector capital expenditure.

> *'Public investment in basic infrastructure is an essential pre-condition for capital accumulation in the private sector. Public investment in*

[18] Indeed it is becoming more common for smaller jurisdictions to also adopt fiscal frameworks. The Bermudan Government recently (Feb 09) published a medium term fiscal framework which is designed to help set parameters for borrowing. Whilst is covers a range of budgetary requirements, in particular spending plans, it also includes a statutory debt ceiling which is set in the medium term at $250m and in the long-term at a ceiling of $1billion (about 17% of GDP). Although now a member of the EU, Malta has had a fiscal policy framework for a number of years.

*education and health facilities improves human capital formation. However, public investment is also an area where grossly unproductive white elephants can be found.'*

International Monetary Fund, Policy Pamphlet, #48 ('IMF')

5.2 This IMF quote succinctly encapsulates the core rationale for public sector investment. Whilst public investment in infrastructure[19], education and health services as a necessary duty of the public sector in pursuit of the policy objective of sustainable and equitable economic growth is accepted as an economic fact, there is no consensus on the direct relationship between the scale of public sector investment in general (and spending in particular) and economic growth. Indeed, there have been many, many academic studies on the matter and the empirical evidence is not equivocal[20] although there is an argument to suggest that there is a consensus that public capital has a positive effect on the level of output[21].

5.3 There is also no clear cut consensus on the 'correct' level of public sector investment and aside from the issue of crowding out[22], the issue of the productivity or effectiveness of public sector investment is also a matter of debate. This is a particularly contentious issue, often debate being coloured by conjecture and political opinion but given the assumption that the IMF argument in favour of the principle of public sector investment is accepted, there is clearly a need to maintain, renew and improve public capital stock. Clearly ensuring appropriate accounting allowances are made for depreciation in order to facilitate the maintenance of the public sector capital stock is in order. Further than that there is little else but international and historical experience and norms to provide guidance as to possible appropriate levels of public sector investment spending for Guernsey.

5.4 During the nineteen nineties the average EU level of public sector investment was around 2.9% of GDP and the UK average was somewhat less at around 1.9%[23]. Both of these figures are low when compared to the post WWII average to the mid 1980s: for instance in the 1970s the UK averaged more than three times this level. Taking the historic measure of Guernsey national output would

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[19] The World Bank defines infrastructure as public services (electric energy, water facilities), public works (roads) and other transportation (harbours and airports).

[20] Two of the seminal academic papers on the issue cited conflicting evidence. Barro, Robert J. (1991), "Economic Growth in a Cross Section of Countries," Quarterly Journal of Economics, Vol. 106, in a cross country study found no statistically significant evidence; Diamond, Jack (1989), "Government Expenditures and Economic Growth: An Empirical Investigation," IMF Working Paper, WP/89/45 found that capital spending on education, health and housing had a positive effect on growth.

[21] Sanchez-Robles, Blanca, (1998). "Infrastructure Investment and Growth: Some Empirical Evidence," Contemporary Economic Policy, Oxford University Press, vol. 16(1), pages 98-108.

[22] The concept of crowding out is whereby public sector expenditure comes at a cost of private sector expenditure. In an economy such as Guernsey which during non recessionary times operates at full or maximum employment clearly additional public sector expenditure may come at a cost of directing resources (eg labour) that otherwise might be directed to private sector activity.

[23] Source, Eurostat

equate to a range of annual capital spending of between £31 to £48 million per annum[24].

## 6 Fiscal Frameworks

6.1 The Institute of Fiscal Studies states that *'borrowing without strict limits in order to finance investments can lower the attention paid when evaluating the costs and benefits of each project'*[25]. This provides an explanation of the rationale of why fiscal policy frameworks are often stipulated in terms of numerical limits to budget deficits and borrowing. In short they are often easier (and hence more transparent) to understand.

6.2 The Maastricht Criteria, qualifications for aspirant member states in the run up to the introduction of the Euro were indeed framed in this manner: outstanding debt was to be no higher than 60% of GDP and annual deficits to be less than 3%. These numerical values are, economically speaking at least, quite arbitrary[26].

6.3 The issue of appropriate fiscal frameworks has led to much debate in academic circles over an economically sound set of principles or rules to guide fiscal policy. There is strong intellectual support for the **permanent balance rule** as proposed by Buiter and Grafe[27]. This rule states that the level of present net debt needs to be smaller than the present values of all future (non-interest) budget surpluses or less technically put that **all government expenditure (capital and revenue) should be in balance with income in the long run.**

6.4 As referred to earlier, the UK Government in 1997 also introduced its own fiscal rules: that borrowing to fund current expenditure should be zero over the business cycle and any net borrowing should only be used to fund public investment[28]. Whilst these rules can be seen to be very close in spirit to the permanent balance rule they are not strictly identical as the distinction between types of expenditure is made by the UK in determining the overall balance.

6.5 Ex UK monetary policy committee member, Willem Buiter, states that fiscal rules should be *'transparent, easy to monitor, ensure government solvency,* ***make good economic sense*** *even in the long run and properly accommodate initial conditions.'*

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24 See figures 2 and 3, appendix two.

25 Bloom, N, Bond, S, (2001) 'UK investment: high, low, rising, falling?' Institute of Fiscal Studies

26 Whilst the numerical values may be somewhat arbitrary the concept and rationale of having them in place clearly is not.

27 Buiter, W, Grafe, C, (2004) 'Patching up the pact. Suggestions for enhancing fiscal sustainability and macroeconomic stability in an enlarged European Union', Economics of Transition, Vol 12 (1), 67-102.

28 Clearly with the credit crunch and subsequent actions to remediate its negative effects these rules have been temporarily (if not permanently) suspended.

6.6 The mathematical exposition of the borrowing rule associated with the permanent balance rule is somewhat involved. However, in short it can be presented as follows:

> *'the share of government spending as a proportion of GDP plus the growth and inflation adjusted costs of public debt (as a proportion of GDP) can be no more than the share of taxes in GDP'.*

6.7 **Practically speaking this requires all expenditure to be classified similarly and asserting that, over time, expenditure should not exceed income. This sets public expenditure at effectively a 'normal', 'steady state' or 'anchor' level in terms of share of national output.** Deviations (and hence borrowing) from this level are allowed in the short run to fund times of exceptional need for expenditure or in times of reduced income. This satisfies Keynesian views of the need for the use of fiscal policy as a demand management tool and also the 'classical' view that the most efficient level of taxation is one that is constant over time[29]. This is consistent with the view of the Policy Council that there is little role for fiscal policy as a demand management tool in ordinary times and that the primary role of fiscal policy is to support stability in the medium term (as outlined in section 4.8).

## 7 Explaining the specific rationales behind the proposed framework

7.1 The key rationale behind adoption of a fiscal policy framework, as has been stated elsewhere in this report is to ensure transparency in the conduct of fiscal policy, maintain strict fiscal discipline and continued conservative fiscal policy of the States. Enshrined within the framework outlined in the next section is the assumption that fiscal stability is a key requisite to macroeconomic success for an economy and together with an internationally competitive tax regime provides the best fiscal platform for future economic growth.

7.2 The rationale also is that the States should follow sound economic practice and that it should adopt the permanent balance approach as advocated specifically by Buiter and Grafe. This rule has the benefit of economic soundness, transparency and is consistent with a continued conservative fiscal approach of the States. This approach does allow for temporary mismatches between spending and income ie deficits. As was stated earlier there is nothing inherently unorthodox in governments using borrowing to finance public sector expenditures. This is a reasonable approach during times of *extreme* volatility in the business cycle or in the instances of temporary mismatches between desired and/or necessary public capital expenditures and income. Prudency of the past in building up of reserve funds to accommodate times of exceptional need or extraordinary items should

[29] All taxes create distortions or inefficiencies. A full textbook explanation would not be appropriate or indeed possible here but the 'classical' view is that a constant ie unchanging rate of taxation reduces such inefficiencies to a minimum.

continue and therefore the States should commit to maintenance of the contingency reserve at its post zero ten level in the long run[30].

7.3 Numerical limits to borrowing and deficits have been defined by using the mathematics behind the permanent balance rule. These numerical limits are somewhat lower than those enshrined by the EU and the UK in terms of absolute levels of borrowing. This reflects the lower size of the public sector (and hence tax take) in Guernsey and in any event it is harder and less advisable for smaller, vulnerable states to commit to large liabilities.

7.4 Whilst the spirit of the UK approach of only allowing debt to be accumulated to fund capital expenditure is incorporated, the proposed framework is more stringent in that there is no distinction between expenditures for the debt position and limits are set in reference to the permanent position of the States and not by a reference to (an arbitrary) positioning of an economic cycle. As an additional stringency strict time limits to both agreeing and instigating remedial measures to address forecasts of fiscal positions outside of the framework both from the time of their identification and their occurrence.

7.5 Following the **permanent balance rule** means the States will need to have robust forecasts of all future expenditure and income and an accurate picture of the position of the Guernsey economic cycle and also defined levels of 'normal' level of public spending (which has been defined in terms of the long run historic average for Guernsey) and the appropriate long run level of public sector investment (which has been calculated by reference to both historic EU, UK and Guernsey norms). It would be naïve to presume that these forecasts will provide anything more than a reasonable steer to future fiscal outcomes but it is in the spirit 'that it is better to be approximately right rather than precisely wrong'[31].

7.6 One of the features lacking for Guernsey is a series of independent forecasts of the economy and the States budgetary outturns. In larger countries such as the UK there is a mini industry of economists analysing and producing independent forecasts of such issues. **It would greatly assist public credibility for Guernsey's fiscal policies if a route was found for such forecasts to be published in an independent or 'quasi' independent manner.** It is also intended that the Policy Council (in addition to the steps outlined in 7.7 below) will shortly begin to produce a series of objective econometric forecasts for the Guernsey economy.

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[30] In June 2006 the States resolved that up to half of the Contingency Reserve (interest and capital) may be used to fund the shortfall in public sector expenditure during the first phase of the implementation of the Economic and Taxation strategy (ie Zero Ten). Point 7.5 above, recommends that the residual balance be maintained (as a proportion of Guernsey GDP) as a long run (ie 'permanent') level to continue to provide a similar 'reserve' for future contingencies. The implication is that any subsequent use of the reserve as a temporary financing option would therefore require replenishment back to that level in subsequent years.

[31] Warren Buffet. *Attrib*

7.7 It is therefore proposed that in this spirit the Policy Council will produce an annual report (either internally or commissioned externally) to be published in tandem with T&R budgetary forecasts. The most credible route would be to appoint a small independent panel of experts in a similar manner to Jersey who would provide outside expert opinion that would be published and on the record on the subject of whether policy was being conducted within the framework. The rationale being that this will provide transparency and independence of mind to the view of whether or not long run permanent balance is being maintained.

## 8 The proposed fiscal policy framework

### Principles

The principles underlying fiscal policy in Guernsey are that:

- stability is at the heart of sustainable economic prosperity;
- fiscal policy needs to be focused on the medium term;
- economic and fiscal policy should be stable, transparent and predictable.

### Objective

Consistent to these underlying principles the overarching objective of the fiscal framework is that fiscal policy should achieve the economic position of **'long run permanent balance'** ie that income and expenditure should match over the medium term to ensure continued conservative fiscal policies of the States of Guernsey.

### Framework

1. Assuming a long run **permanent balance** position implies the acceptance of long run 'permanent', ie normal, levels for taxation and public spending including public sector capital investment: these long run levels provide 'norms' for future plans and are calculated with reference to historic or international empirical experience.

2. Deviations, and hence any fiscal deficits, from these long run norms are only acceptable if they are of a temporary nature, ie in the instances of a mistiming of income and increased capital expenditure requirements or those caused by severe swings of the economic cycle.

3. To ensure that balance is achieved in the medium term forecasts of all future revenue and expenditures will be continually generated to ensure that any revenue shortfalls are matched by future surpluses.

4. Any borrowing to fund temporary mismatches between expenditure requirements and revenue income will be restricted by strict conservative limits to ensure the sustainability of Guernsey's long term finances and the international credit rating of the States. **Gross debt can only be accumulated to fund capital investment.**

5. Any use of the contingency reserve as an alternative to borrowing will require the replenishment of the reserve in subsequent years to maintain reserves to an agreed level[32].

The above framework implies the following **limits to fiscal expenditure** of the States[33]:

1. that the level of gross borrowing by the States may not exceed *20%* of Guernsey gross domestic product;

2. that the maximum annual operating deficit of the States may not exceed *3%* of gross domestic product;

3. that the maximum additional borrowing sanctioned in any one States term may not exceed one times the level of 'permanent' capital expenditure over that time period;

   *and that the assumed 'norms' for permanent capital expenditure and taxation to be 3.0% and 21% of gross domestic product respectively.*[34]

- **To ensure adherence to this framework the undertaking is made to ensure that identified deficits will be addressed within 5 years of their appearance, economic conditions permitting, and that measures to counter identified structural deficits are agreed within two years of their identification.**

- **To provide credibility to this framework, and a degree of objectivity to the likely path of States finances, each year the Policy Council will publish a report to the States, separate to Treasury and Resources annual budgetary process, to provide an objective analysis on the conduct of fiscal policy.**

**9 Resource Implications**

9.1 If adopted there may well be a likely requirement for additional staff time (less than one full time equivalent) to implement the framework. The additional tasks would be provision of secretariat facilities to the independent panel, support for analytical and forecasting activities, and assistance in drafting of reports. Clearly appointing an independent panel of experts to support the conduct of this policy would also require a dedicated budget allocation in the region of £50,000.

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[32] See 7.2
[33] See appendix three.
[34] See appendix two.

## 10 Recommendations

10.1 That the States endorse and adopt the Fiscal Policy Framework as described by section 8 of this Report.

L S Trott
Chief Minister

23rd March 2009