

Medium Term Financial Plan

2017 - 2021

1. EXECUTIVE SUMMARY

- 1.1 The development of the medium term financial plan (“the Plan”) is a key component of phase 2 of the Policy & Resource Plan as it presents, for the first time, a fiscal strategy covering the medium term designed to ensure the finances of the States can support the delivery of the outcomes set out in the Policy & Resource Plan.
- 1.2 Delivery of the Plan will ensure that the States are able to achieve and maintain a balanced budget before moving into a sustainable surplus over the next four year period. This will enable the re-building of reserves and the investment in future public services in support of achieving those outcomes.
- 1.3 Predicting income and expenditure over the medium term presents a significant challenge due to the variety of inter-related social, political and economic factors and how they impact on public finances in Guernsey. This type of medium term plan is inherently uncertain and it is important to recognise that the forecasts are not precise but rather best estimates. It is for this reason that detailed sensitivity analysis has been performed in order to explore the impact of different scenarios on the income and expenditure position.
- 1.4 This Plan is unashamedly not radical or revolutionary other than in the firm commitment to delivering the reform of public services that will result in those services looking different, better meeting the needs of service users and customers, while costing less. The Plan does not seek to find a ‘silver bullet’ or materially change the fiscal approach adopted over recent years as there is no evidenced need so to do. **A realistic and medium term approach, including a balance of increased revenues, particularly from those most able to pay, and a reduction in the cost of public services can see a return to fiscal surplus without the need for unrealistic or drastic measures.**
- 1.5 The structural pressures are not something that can simply be tackled through raising taxes or cutting services. The changing demographic is increasing the ratio of those above pension age to those of working age. This means that demand for public services, in particular health and social care services, will increase; and the total cost of providing these services will increase proportionally, unless the services are redesigned to be financially sustainable.
- 1.6 In addition, the proportion of the population which is of working age is reducing, despite an assumed positive net migration of 100 per annum, which will lead to a long-term erosion of public revenues before allowing for any economic growth.
- 1.7 The Plan demonstrates that, if no actions are taken, an underlying deficit will persist throughout the period, cumulating to £70million. The ‘carry on as normal’

approach is therefore not an option. The Policy & Resources Committee believes that the burden of eliminating the structural deficit must be shared between taxpayers, particularly those most able to pay, and a reduction in the cost base through the reform of public services - which will lead to working differently, changing and improving the way services are delivered to enable savings to be made. **The Committee estimates that, over the Plan period, a total net improvement to the baseline of £40m is necessary to close the gap and is proposing that 65% of this value, £26m, is realised through public service reform initiatives and 35%, or £14m, from targeted tax measures.**

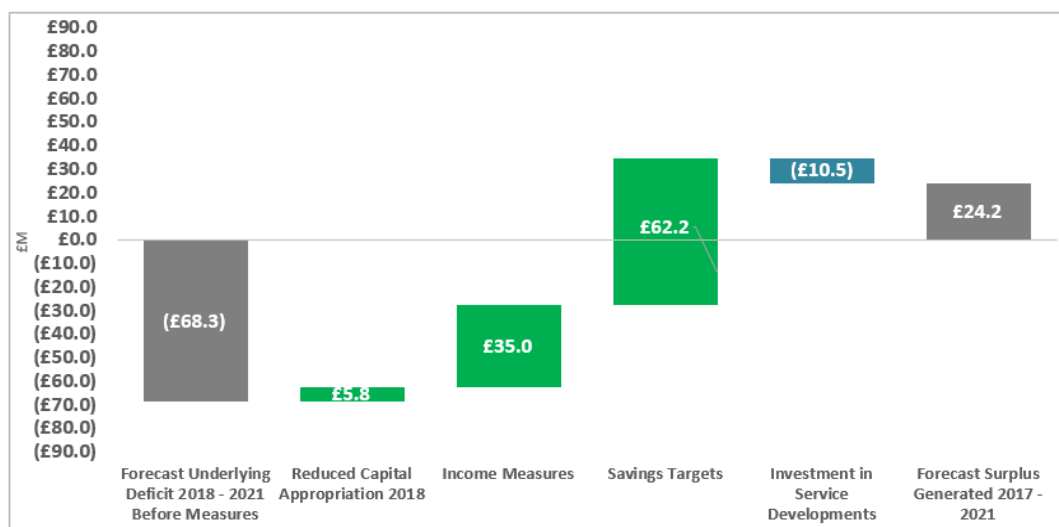
- 1.8 Taking a medium term¹ view to the eradication of the underlying deficit through targeted increases in revenues, the reform of the public service (resulting in a lower cost base) and a short-term adjustment to the amount put aside for future capital infrastructure projects should enable a fiscal position to be realised that enables additional investment in public services; our future economic development through the Future Guernsey Economic Fund; the transformation of public services through the Transformation and Transition Fund; and the replenishing of reserves.
- 1.9 In line with clear direction given by the Assembly, the Policy & Resources Committee's tax proposals over the Plan period will seek to *"raise additional revenues as far as possible from individuals and entities most able to bear the burden"*. This will involve initiatives such as further phases of the withdrawal of income tax allowances for higher earners; ongoing corporate tax reform within international constraints; and seeking an increased contribution from those businesses who receive the most commercial benefit from the island and its infrastructure, subject to the need to ensure we remain competitive.
- 1.10 However, it is important to recognise the limitations of raising revenues from such a limited tax base and it would be naïve to assume that the entire burden can rest on the shoulders of the few. There will inevitably be further increases of taxes and duties across the board but the Policy & Resources Committee will seek to ensure that any such measures are proportionate and measured. In addition, in line with its intention to seek to make the tax system more progressive, the Committee will seek to balance this with the ambition to assist those on lower and modest incomes through increasing personal allowances where affordable and implementing the welfare reform approved following the work of the Social Welfare Benefits Investigation Committee.
- 1.11 The Policy & Resources Committees believes that the States must reinforce their commitment to change the way that services are delivered as well as where they are delivered from. Through thinking differently about how public services meet

¹ Throughout this plan, short-term means the next 12-18 months; medium-term is the four year period of this plan; and long-term is anything in excess of four years.

the community's needs, there is an opportunity to improve those services and, at the same time, make savings and improve value for money. There is evidence that this is already starting to happen through numerous initiatives under the banner of public service reform. This Plan sets out a strategy for delivering such savings – the reform dividend - which could, if opportunities are seized and internal barriers dismantled, deliver a £26million improvement to the financial position over the period. However, in recognition of the challenges inherent in hastily delivering such service change, and due to the improved base revenues, the Committee is now recommending that this reduction in the cost of the public service is delivered over *four* years instead of its original estimate of two.

- 1.12 The concept of the reform dividend set out in the Framework for Public Service Reform which envisaged that savings generated through the transformation of public services would be available for re-investment either in new/improved services or in meeting future service demands. Further work is required to better understand any future service demands arising from the changing demographic and the financial implications of this. In addition, although there is currently no clearly identified or costed pipeline of new or improved services, the Policy & Resources Committee has assumed that the policy work being undertaken by the Committees will ultimately lead to such proposals and has therefore made an allowance of £3.5million per annum from 2020. It is hoped that, in future iterations, the Policy & Resource Plan will facilitate longer term planning such that a good understanding is available at an early stage of the likely cost implications of policy proposals which would allow prioritisation of such developments. However, at this stage in the evolution of the Policy & Resource Plan, the Committee considered it important to make an estimated allowance.
- 1.13 In recent years, the overall financial position has been balanced through the level of appropriation to the Capital Reserve being flexed from previous policy. The Policy & Resources Committee recognises the importance of investment in our island infrastructure, the value that strategic digital investment will make to the economy and the planned transformation initiatives. That is why, through this plan, a route is mapped out to ensuring that the **full** targeted 3% of GDP (as per the Fiscal Framework) is made available for capital investment by the end of the Plan period, although this will need to continue to be managed to balance the books in the short term.
- 1.14 In summary, the Committee's Plan includes a realistic savings expectation rising to £26million per annum by the end of the period; the introduction of revenue raising measures which, by 2021, total £14million; and a short term reduction in the appropriations to the Capital Reserve – but one which does **not** impact the capital programme in the period.

Table 1: Movement from Underlying Deficit to Surplus - Medium Term



1.15 This enables:

- **3% of GDP to be invested in capital infrastructure per annum from 2019;**
- **An allowance for investment in service developments of £3.5million per annum from 2020 to reflect the commitment to re-invest the 'reform dividend' in public services;**
- **A move into structural surplus from 2019; and**
- **A cumulative surplus of some £24million to be achieved by 2021, which could be utilised to re-establish reserves or enable investment in funds such as those relating to transformation or economic development beyond the medium term.**

1.16 The Plan also sets out the proposed capital portfolio for the next period and a plan for its delivery which is affordable and realistic within the overall financial envelope. The thorough and inclusive capital prioritisation process has allowed a picture to be built not only of the capital requirements in the next four year period, but beyond that, and the Committee is also proposing a pipeline of longer term projects which extends the planning horizon for these long-term investments.

1.17 A key piece of the jigsaw for funding the capital portfolio will be returns from the States Trading Assets through the work of the States' Trading Supervisory Board ('STSB') to ensure these entities operate more commercially and are able to make appropriate annual returns which increase modestly over the period subject, of course, to the Assembly's direction that this does not place a disproportionate burden on customers, many of whom are inevitably on low incomes. In addition, better management and rationalisation of the property estate will allow receipts to accrue from the disposal, or different use, of our extensive estate.

- 1.18 Finally, in section 9, the Plan sets out the associated policy work of the Policy & Resources Committee over the period. The Committee will seek to ensure annual Budgets are proposed which are in line with this plan and deliver on the taxation policies with regard to raising additional revenues as far as possible from individuals and entities most able to bear the burden. The Committee is also seeking to make the tax system 'fairer' and will therefore be prioritising the work with the Committee *for* Employment & Social Security to redesign the way funds are raised for both the Health Service and Long Term Care Funds to apply the same principles as for income tax, with personal allowances protecting those on low incomes and those who can afford to, paying more.
- 1.19 Other prioritised work includes exploring a social investment commission to support the development of commissioning services from the third sector; an investment (as part of the States' normal asset allocation and investment management of its reserves) in an innovation and infrastructure fund to ensure there is a vehicle for the States to invest, at arms-length for a reasonable investment return, in suitable local innovative business ideas and non-States' infrastructure; and a change in the States' accounting policies to adopt International Public Sector Accounting Standards.

Table 2: Underlying Position after Income and Expenditure Measures for the Medium Term

	FY - 2017 £m	FY - 2018 £m	FY - 2019 £m	FY - 2020 £m	FY - 2021 £m
	MTFP	MTFP	MTFP	MTFP	MTFP
Underlying Income Position:	£408.3	£408.9	£410.4	£411.4	£412.7
Forecast Income Measures		£3.5	£7.0	£10.5	£14.0
Income Position After Measures	£408.3	£412.4	£417.4	£421.9	£426.7
2017 Cash Limits:	(£362.5)	(£362.5)	(£362.5)	(£362.5)	(£362.5)
Health Service Grant - Reinstatement:		(£4.7)	(£4.7)	(£4.7)	(£4.7)
Estimated Cost Pressures		(£3.4)	(£8.1)	(£9.4)	(£10.8)
Impact of Expenditure Savings		£5.5	£11.7	£18.8	£26.1
Underlying Expenditure Position:	(£362.5)	(£365.1)	(£363.5)	(£357.8)	(£351.9)
Service Developments				(£3.5)	(£7.0)
Capital Income - Returns from Trading Assets	£5.0	£5.5	£6.0	£6.5	£7.0
Capital Income - Property		£1.0	£1.0	£1.0	£1.0
Financial Position before Capital Appropriation:	£50.8	£53.8	£60.8	£68.1	£75.8
Capital Appropriation: Major Capital	(£29.8)	(£36.8)	(£42.4)	(£42.2)	(£42.0)
Capital Appropriation: Routine Capital	(£10.5)	(£10.5)	(£10.5)	(£10.5)	(£10.5)
Capital Appropriation: Capital Income	(£5.0)	(£6.5)	(£7.0)	(£7.5)	(£8.0)
Total Capital Appropriation	(£45.3)	(£53.8)	(£59.9)	(£60.2)	(£60.5)
Overall Surplus / (Deficit)	£5.5	£0.0	£1.0	£8.0	£15.3

2. INTRODUCTION

The Policy & Resource Plan

- 2.1 In November 2016, following consideration of a policy letter from the Policy & Resources Committee, the States approved *“The Policy & Resource Plan – Phase one” (as amended)* including an updated Fiscal Policy Framework and resolved *“To commit to achieving and maintaining a balanced budget in the short-term and surplus in the medium-term.”*
- 2.2 The Policy & Resource Plan is a vehicle for guiding the planning and coordination of the work of the States in a straightforward, clear, concise, flexible and un-bureaucratic manner. It focuses on significant policy matters and lays down a framework of overall policy assumptions in order to assist Principal Committees in the setting of their policies and priorities. Phase one of this Plan sets out the vision for the island in 20 years’ time and over the next five years the focus will be on progress towards achieving the vision. Phase Two focuses on the work that Principal Committees need to undertake over the next five years to achieve the objectives agreed during phase one.
- 2.3 As part of phase one, the States committed to pursuing a moderate, balanced and responsible approach to the fiscal position which recognises the need to restrain public expenditure and raise additional revenue. In order to achieve this the following commitments were made:

“To achieve this we will:

- *Adhere to the fiscal rules contained within the Fiscal Policy Framework*
- *Present a credible fiscal strategy as part of phase two of the Plan in June 2017 which will reflect the commitment of the States to encourage economic growth; restrain public expenditure by requiring further efficiency savings and the prudent management of financial resources, people and physical infrastructure; and raise additional revenue as far as possible from individuals and entities most able to bear the burden;*
- *Achieve and maintain a balanced budget in the short-term and surplus in the medium-term without contravening any part of the States’ Fiscal Policy Framework;*
- *Continue expenditure restraint and ensure no real terms’ growth in expenditure while the budget remains in deficit;*
- *Provide leadership of the transformation agenda and support the Public Service Reform agenda in order to manage both short and long term spending pressures;*

- *Ensure that the States' commercial and semi-commercial entities and other States' assets are maximised, making an appropriate return to the States but without placing a disproportionate burden on customers, many of whom are inevitably on low incomes;*
- *Prioritise capital investment aligned with the Plan;*
- *Ensure competitive recruitment and retention of quality, skilled professionals, balanced with appropriate scrutiny including control and review of staffing costs, grading and pay awards, and effective performance management, within the public sector"*

Medium Term Financial Planning

- 2.4 The development of this Plan is a key component of phase two of the Policy & Resource Plan as it presents, for the first time, a fiscal strategy covering the medium term outlook designed to achieve and maintain a balanced budget in the short term, surplus in the medium term and continue with expenditure restraint. Given that the States of Guernsey have finite financial resources and a demographic outlook which will place more strain on these resources, this Plan will help ensure that they are directed to the key services and projects that best support the delivery of the Policy & Resource Plan.
- 2.5 The medium term financial plan represents a further development of the approach taken in the 2016 and 2017 Budget Reports where 3-year indicative estimates for revenue income and expenditure and the appropriation to the Capital Reserve were produced. Within this plan those initial estimates, together with their key assumptions and sensitivities are further developed and analysed, supported by informed economic analysis and modelling.
- 2.6 Predicting income and expenditure over the medium term presents a significant challenge due to the variety of inter-related social, political and economic factors and how their impacts are realised in Guernsey. This type of medium term plan is inherently uncertain and it is important to recognise that the forecasts are not precise but are best estimates. It is for this reason that detailed sensitivity analysis has been performed in order to explore the impact of different scenarios on the income and expenditure position.
- 2.7 This is the first time a medium term financial plan has been put together and it will evolve with successive iterations. The aim is to develop a comprehensive financial plan that captures all States' income and expenditure (including social security), capital expenditure, the balance sheet position and cash flow forecasting.
- 2.8 The evolution of the Plan will be an iterative process, which will be subject to regular review and refinement as corporate priorities evolve in response to a changing environment. It must not be viewed as a 'rolling' process which simply extends the planning horizons of the annual budget and is constantly updated for

economic and fiscal changes. However, there will be an ongoing need to refine forecasts; reallocate funding; and determine actions required to ensure forecasts are prudently balanced as well as ensuring that the strategic priorities of Government, as documented in the Policy and Resource Plan, are enabled through sound financial management and governance.

- 2.9 The rules set out in the Fiscal Policy Framework (set out in Appendix 1 to the Policy & Resource Plan) have set the parameters for this plan, informing its focus, targets and required actions. For example, the framework requires that capital expenditure should average 3% per annum in the medium term, that deficits may not exceed 3% of GDP. However, the overriding objective of the framework and for this Plan is that of long term permanent balance.

3. FINANCIAL PERFORMANCE 2012 – 2016

- 3.1 The Plan covers a five-year period, including the current year, to 2021. To help set the context for that look ahead it is helpful to begin with a look back over the financial performance for the last 5 years, 2012 – 2016.

Table 3: General Revenue Position 2012 - 2016

	FY - 2017	FY - 2018	FY - 2019	FY - 2020	FY - 2021
	£m	£m	£m	£m	£m
	MTFP	MTFP	MTFP	MTFP	MTFP
Income Tax - Individuals (incl Distributions)	£241	£237	£247	£249	£256
Company Income Tax	£40	£44	£51	£41	£47
Misc Income	£4	£4	£8	£11	£19
Indirect Taxes (incl Company Fees)	£77	£76	£77	£79	£85
Total Income:	£362	£361	£383	£380	£407
Net Committee Expenditure	(£342)	(£346)	(£350)	(£365)	(£363)
Capital Income	£1	£10	£1	£0	£11
Financial Position before Capital Appropriation:	£21	£25	£34	£15	£55
Capital Appropriation: Major Capital	(£25)	(£35)	(£36)	(£36)	(£23)
Routine Capital Expenditure	(£16)	(£13)	(£8)	(£8)	(£8)
Other Transfers		(£3)		£4	£1
Total Capital & Other Transfers	(£41)	(£50)	(£44)	(£40)	(£30)
Overall Surplus / (Deficit)	(£20)	(£25)	(£10)	(£25)	£25

Income 2012 – 2016

- 3.2 Income increased overall across the period, but not in a consistent manner, which presented challenges. For example, income taxes declined in real-terms between 2012 and 2013, again between 2014 and 2015, yet increased in real-terms by 3.7% between 2013 and 2014. Inconsistent income patterns present immediate challenges for any in-year positions as revenue budgets are approved and plans in place which can make it difficult to influence significantly in the short term so as to respond to income shortfalls. It is therefore important for sufficient reserves to be accumulated that can then be used to manage such cyclical variations.
- 3.3 In 2016, revenue income showed positive overall growth in particular across all income taxes, following disappointing performance in 2015. There were also a number of exceptional receipts that boosted the income total, including strong investment returns that were £3.5million higher than in 2015 and an un-planned transfer from the States' unincorporated trading assets that totalled £2million.

Revenue Expenditure 2012 – 2016

- 3.4 Expenditure over the period was significantly and positively influenced by the savings delivered through the Financial Transformation Programme which, by 2015, had reached approximately £30million on an annually recurring basis. Critically, the programme was successful in developing a greater understanding of cost management and mitigation across the States, empowering decision-makers and budget-holders.
- 3.5 During 2016, measures of expenditure restraint were introduced so as to deliver savings against the approved expenditure budgets in-year following signs at the beginning of the year of both shortfalls on income and overspending on health and social care services. This generated £2million of in-year savings from vacancy controls and through proactive operational controls across service areas. Of particular note was the controls introduced across health and social care services which turned a forecast overspend in the order of £4million into a year-end underspend of less than £1million. The Committee *for* Education, Sport & Culture also contributed £1.6million of their Routine Capital Allocation which helped to support the overall position. Several of the measures taken by service managers in 2016 have informed the identification of savings initiatives in 2017 and are recurrent. However, a number of the actions taken were one-off in nature and therefore this outturn cannot be seen as a baseline position.

Overall Surplus / Deficit

- 3.6 As illustrated in table 3 above, the overall deficit for the last five years totalled £55million and was funded by States reserves – in particular the Contingency Reserve and the General Revenue Account Reserve - which were depleted by that value. In addition, in 2016 the appropriation to the Capital Reserve was limited in order to avoid a deficit position, a further contribution to supporting the structural deficit.
- 3.7 The 2016 financial outturn was an overall surplus of £25million² which appears in the table above to have sharply reversed the previous trend. Although the 2016 outturn was positive and has led to adjustments to the baseline starting position for revenue income, a significant proportion of the surplus was one-off in nature. The windfall investment returns due to an exceptional year do not impact on the baseline position; neither does the additional return from States Trading Assets. In addition, the expenditure position was artificially constrained in order to try and balance in year. Finally the appropriation to the Capital Reserve was reduced by

² This overall surplus is £10million higher than the provisional position reported in March 2017. This is due to net year-end adjustments of £5million including a £2.2million increase in the general revenue share of the investment returns; and the application of the additional reduction in the appropriation to the Capital Reserve of £5.4million.

£24million³ from the agreed policy in order to ensure no deficit and resulting call on depleted reserves in 2016.

Capital Appropriations

- 3.8 In order to achieve our stated fiscal strategies, the requirement to fund the Capital Reserve to meet the fiscal target of 3% of Gross Domestic Product (GDP) annually without creating a deficit needs to form an intrinsic part of the plan. In both the 2016 and 2017 Budgets this appropriation had to be reduced so as to achieve a balanced budget. The implications of this adjustment are clear; that the financial challenges presented today are effectively limiting our ability to invest in our longer term future, through major capital projects that are critical to the development of island infrastructure and public sector service provision.
- 3.9 As table 4a sets out, total capital expenditure (i.e. from the Capital Reserve and Routine Capital) only achieved the 3% value of GDP in 2012.

Table 4a: States' Capital Expenditure

Actual Capital Expenditure - Capital Reserve & Routine Capital	2012 (£m)	2013 (£m)	2014 (£m)	2015 (£m)	2016 (£m)
Actual Capital Expenditure - Capital Reserve	£62	£49	£18	£32	£32
Actual Capital Expenditure - Routine Capital	£16	£13	£8	£8	£8
Total Actual Expenditure	£78	£63	£26	£40	£40

- 3.10 In table 4b the appropriations and other transfers to the Capital Reserve, combined with Routine Capital Allocations were also below the 3% GDP target for all years 2012 – 2016. The last 2 years (2015 – 2016) were boosted by transfers from other reserves / funds, capital income and investment returns, but these sources should work alongside a reliable and affordable appropriation from General Revenue.

³ A reduction of £18.5million was agreed at the time the 2016 budget was set. A further reduction of £5.4million was approved as part of the 2017 Budget Report in November 2016.

Table 4b: States' Capital Appropriations

	Actual					Budget
GDP	2012 (£m)	2013 (£m)	2014 (£m)	2015 (£m)	2016 (£m)	2017 (£m)
Re-flated Guernsey GDP (2016 Statistics)	£2,335	£2,344	£2,345	£2,355	£2,365	£2,375
3% of GDP = Target Capital Expenditure Per Annum	£70	£70	£70	£71	£71	£71
Transfers to the Capital Reserve:	2012 (£m)	2013 (£m)	2014 (£m)	2015 (£m)	2016 (£m)	2017 (£m)
General Revenue Appropriations	£24	£25	£35	£36	£13	£30
Routine Capital Allocations	£16	£13	£7	£8	£8	£11
Capital Income	£6	£10	£1		£10	£5
Total General Revenue Transfers	£46	£48	£44	£44	£30	£45
Investment Returns	£5	£6	£3	£2	£10	£7
Other Reserve / Fund Transfers		£2	£5	£22	£18	£26
Total Other Transfers	£5	£8	£8	£24	£28	£33
Total Capital Reserve Investments	£50	£56	£52	£68	£59	£78

Baseline Position

- 3.11 Table 5 below sets out our underlying financial position, adjusting for factors highlighted above, one-off measures that enabled a balanced budget in 2017 and inclusive of known and committed cost pressures.
- 3.12 The income position of £408.3million is the latest 2017 forecast income which is based on financial performance in 2016 and the first quarter of 2017 and the starting position for the medium term forecast.
- 3.13 The 2017 cash limits total represents the net expenditure budget in 2017, and is inclusive of operating income and the 3% reduction. Throughout this Plan it has been assumed that the 3% reductions are met on a recurrent basis. At the time of writing, a total of £1.5m remains un-identified on a recurrent basis although measures are expected to be put in place throughout the remainder of 2017.
- 3.14 The grant to the Health Service Fund was suspended in 2017 for one year. This has therefore been added back to the underlying cost base ahead of any future decisions about health service funding over the medium term which may arise from the project being undertaken to review this particular source of revenue.
- 3.15 Capital appropriations shown represent the expected annual requirements from General Revenue to achieve the 3% of GDP target, comprising the routine capital allocation of £10.5million per annum and £44million to support major capital projects. Capital income is excluded from any baseline as the assumption is that

all capital income is appropriated to the Capital Reserve and so has no net effect on the underlying position.

- 3.16 The table suggests that when these factors are combined there is an underlying annual structural deficit of approximately £13million. Although limiting the appropriation to the Capital Reserve is a measure that has been taken tactically in recent years in order to balance the budget, this is not sustainable in the medium to long term without limiting essential investment in capital infrastructure.

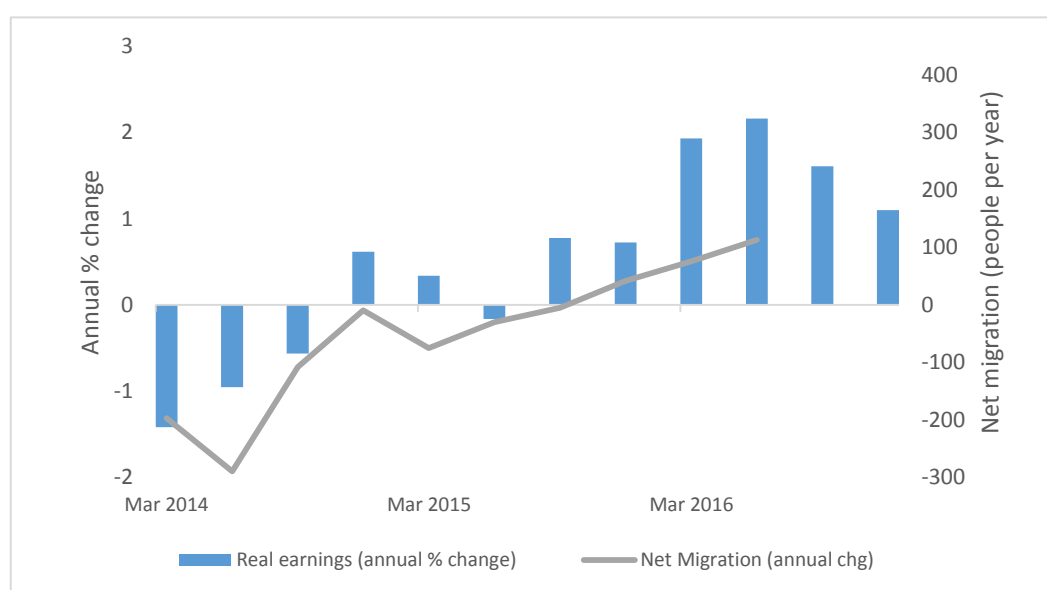
Table 5: Underlying Income & Expenditure Position

	FY - 2017 £m
Underlying Income Position:	£408.3
2017 Cash Limits:	(£362.5)
Health Service Grant - 2017 suspension:	(£4.7)
Underlying Expenditure Position:	(£367.2)
Capital Income - Returns from Trading Assets	£5.0
Financial Position before Capital Appropriation:	£46.1
Capital Appropriation: Major Capital	(£43.8)
Capital Appropriation: Routine Capital	(£10.5)
Capital Appropriation: Capital Income	(£5.0)
Total Capital Appropriation	(£59.3)
Overall Deficit	(£13.2)

4. ECONOMIC FACTORS

- 4.1 Guernsey enters this medium term plan period in an improving but still vulnerable position. After three years of weak growth, Guernsey saw strong earnings and employment growth in early 2016 and a return to net immigration. Government revenues, and personal income tax receipts in particular, showed strong growth over the second half of 2016. While the rate of growth in earnings and employment had slowed to more sustainable levels by early 2016, 2017 however began in a relatively good position supported by real growth in ETI receipts in the first quarter.

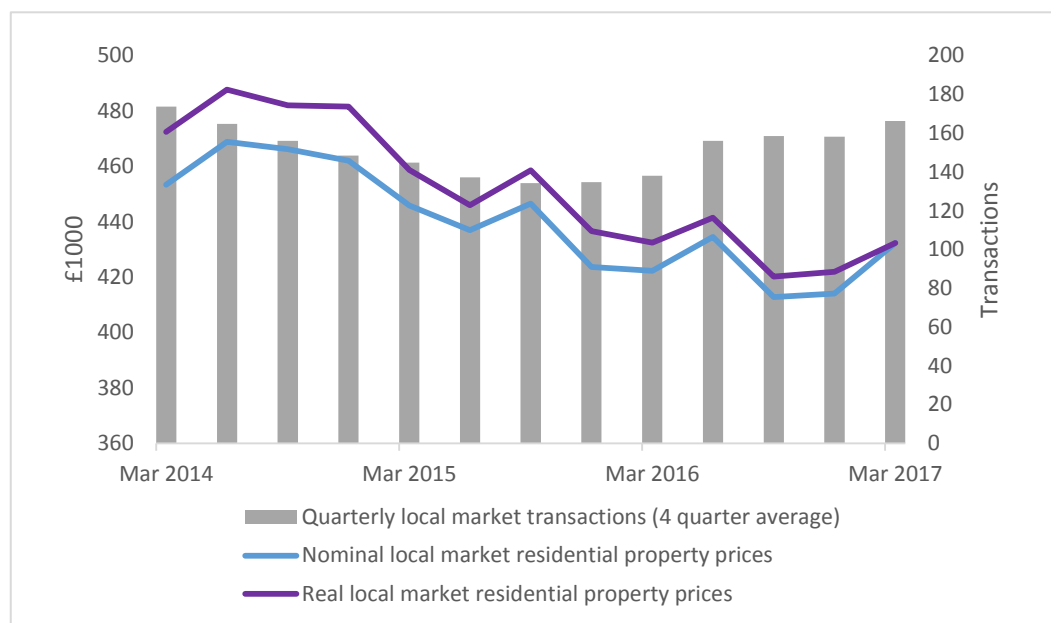
Table 6: Earnings and Net Migration



- 4.2 At the close of 2016 the strong growth in employment in professional, business scientific and technical activities (which include accounting, legal and consultancy activities) continued to underpin the labour market. The strong consistent growth in this sector is gradually diversifying the activity and skill base of the economy. By the end of the 4th quarter of 2016 the finance sector had shown a modest level of year on year growth in employment for six successive quarters supported by strong growth in the fiduciaries subsector. The finance sector remains both the largest employer in the island, comprising 21% of the workforce, and the sector with the highest median earnings.
- 4.3 There are areas where the economy is still vulnerable. Transactions in the residential property market appear to have recovered a little by the first quarter of 2017 and prices were higher in nominal terms than a year earlier. However, once adjusted for inflation, prices were 12% lower in real-terms than at their peak in 2013. When combined with the real growth in median earnings this has

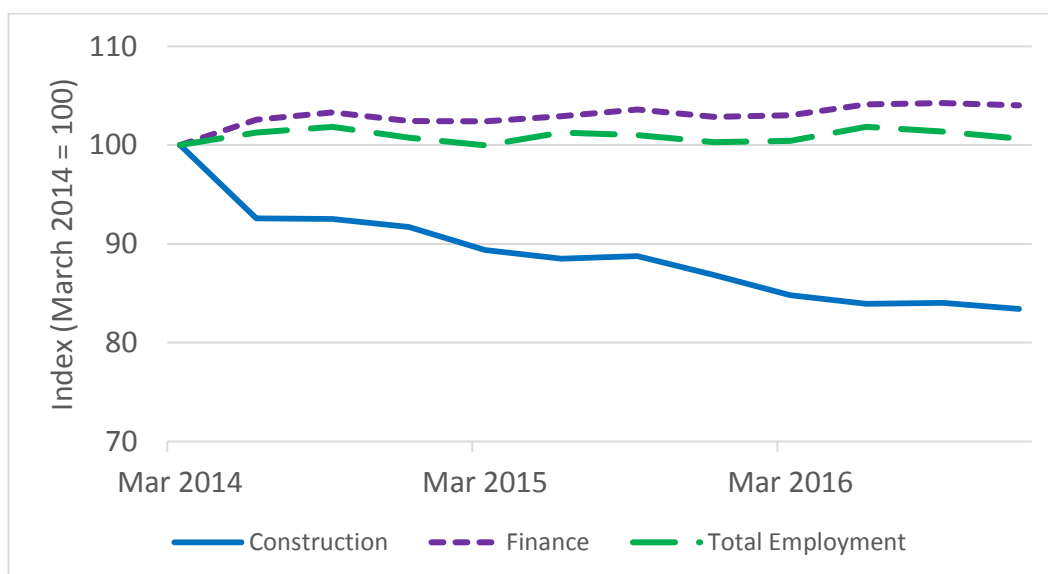
improved the overall affordability of the housing market and the adjustment will be welcomed in some quarters. However the loss of value of real assets is likely to negatively impact levels of confidence in the economy and the drop in prices along with the low number of sales compared to historic averages continues to have a

Table 7: Local Housing Market



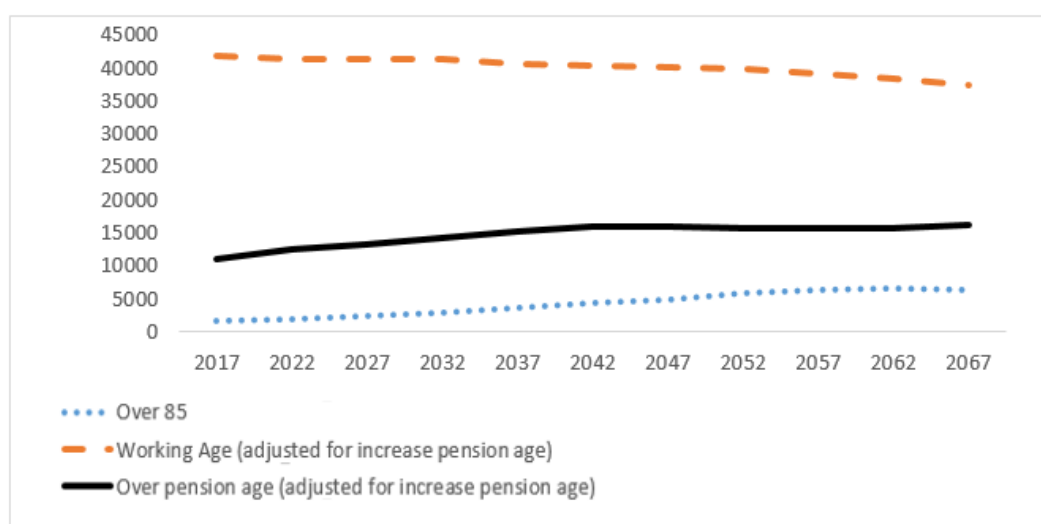
- 4.4 The construction sector also continues to face difficult conditions, with a lack of large scale construction projects resulting in an ongoing downward trend in employment in the sector. Should this trend continue it may erode the capacity and skills of the industry on-island and this will need to be addressed.

Table 8: Employment Index: Total Employment, Finance and Construction



- 4.5 In the medium term, there are both threats and opportunities. While the initial reaction from the UK's vote to leave the European Union in both Guernsey and the UK has been less negative than had been anticipated before the vote, it is likely to take several years before the real impact of the decision can be clearly understood. The international movements towards ever greater transparency also create challenges for Guernsey, which will need to continue to work hard to maintain and defend its reputation and value in international finance markets.
- 4.6 Longer term Guernsey, like most developed nations, has an ageing population. The generation now leaving the workforce are larger in number than the generation now entering it and this has wide reaching long-term implications for our society. Over time the number of people in need of assistance and support is likely to increase. At the same time the workforce available to provide this support, both in terms of the payment of taxes to pay for the provision of public services and in filling both formal and informal social care roles, will decrease.

Table 9: Population Projections⁴



- 4.7 Based on central assumptions, this combination of factors means Guernsey's dependency ratio (which measures the proportion of people not of working age who typically make greater use of public services, relative to the size of the working age population) which is already relatively high at 0.54, may increase to 0.68 by 2067. In short, we face a long term challenge as our primary tax base and labour force may shrink at the same time as the demand for public services is increasing.

⁴ Projections made in line with standard central assumptions of net immigration averaging 100 people per year and fertility rate of 1.6 and mortality as per UK Government actuary projections.

- 4.8 The demographic challenge is one of the most pervasive issues we face, not only in the provision of health and care services, but in almost all areas of public policy. Issues range from the provision of a suitable profile of housing for the changing needs of an older population, to ensuring that we have access to the skills and manpower to ensure the ongoing economic and social success of our community; from the appropriate provision of education services to the management of our social security funds to ensure there are sufficient funds available to meet the entitlement of the community.
- 4.9 This requires a change in approach to the way we use our resources. The decline in the available labour force places a premium on the use of human capital and a requirement for personnel to be used effectively in both the public and the private sector. The increasing demand for health and social care services will require these services to be efficient and effective if they are to be both socially and financially sustainable in the long term. This makes it very important that we invest in the transformation of our model for the delivery of health and social care services.
- 4.10 There is a need for greater use of technology to transform our service provision, stream lining and automating process wherever possible to enable staff to be reallocated to areas where they are most needed.
- 4.11 There is a need to adapt to external developments as well. As markets have become increasingly global, international authorities have moved to ensure that the tax treatment of cross border trade is both fair and transparent. Guernsey is very well-placed in respect of these developments, given the long-standing commitment to implement international standards. However we will need to continue to adapt to the changing environment in order to retain our reputation as a transparent and co-operative jurisdiction alongside our competitive position in the market for international financial services. This means, for example, continuing to progress work on the Organisation for Economic Cooperation and Development (OECD)'s anti-base erosion and profit shifting (BEPS) agenda (Guernsey is a member of the OECD BEPS Forum and a signatory to the Multilateral Instrument), as well as building on the very strong 2016 Council of Europe MoneyVal evaluation.

5. INCOME AND EXPENDITURE FORECASTS 2017 – 2021

Introduction

- 5.1 Building on the fiscal performance, fiscal challenges and the economic factors highlighted in the earlier sections, this section sets out forecasts for income and expenditure, including capital expenditure, to reveal the scope of the fiscal challenge over the medium term.
- 5.2 In 2016 an investment was made in a comprehensive forecasting tool (the Guernsey Economic Modelling (GEM) system) to better inform medium term projections relating to demographics, economic growth and States' income and expenditure. Understanding our income and expenditure base is critical to an informed understanding of the ability to deliver public services in a sustainable, affordable and prioritised way. The model has been used as part of developing this Plan with a particular focus on the modelling of income.

Core Assumptions

- 5.3 **Net Migration:** The projections have been calculated from a central assumption of +100 net migration per year. For income forecasts in particular the impact at different net migration estimates is calculated and summarised separately as part of 'Sensitivity Analysis' section.
- 5.4 **Inflation:** Inflation is not included in the forecast so that the real-terms' changes, representing both potential growth and challenges, can be clearly highlighted. Inflation is a factor that could present a significant challenge or opportunity over the medium term, for example to expenditure for the provision of services, if inflationary impacts on the services we deliver are not managed. It is therefore critical that our procurement strategies are focused on securing contractual terms that manage and mitigate price increases so that expenditure cost pressures are limited wherever possible. In addition, pressures on pay mount as inflation increases. Inflation could also present opportunities should it lead to impacts on income receipts that are greater than the corresponding impact on our expenditure base. Inflation is further considered as part of the 'Sensitivity Analysis' section.
- 5.5 **Budget Measures:** The approach taken with all income and expenditure forecasts is to illustrate the accurate underlying position, influenced by the inclusion of forecast economic and demographic factors, but separate from the application of any annual budget measures, excepting those already agreed that relate to TRP and Tobacco. All budget measures approved in the 2017 and earlier Budget Reports are reflected in the starting 2017 forecast position or adjusted in the annual modelling.

- 5.6 **Economic Climate:** The core assumption that informs the forecast is that while there is positive underlying growth within the economy this has been tempered to make allowance for wider economic risk factors to be adequately reflected. The economy has demonstrated continual resilience with regards to responding to international economic challenges and this is reflected in the 'stable' rating assigned by Standard & Poors in late 2016. However, it is a prudent to ensure that our financial planning incorporates risk and the potential impacts of economic turbulence.

It has been difficult to make any assumptions at all regarding the impact of BREXIT on our economic performance. To date, there has been little impact. However, once the final proposals for the changes are understood, it is possible that they might have a serious and structural impact on the Guernsey economy. No allowance has been made for this within the Plan at this stage.

Within the 'Sensitivity Analysis' section the impact of alternate economic scenarios where growth is stronger and weaker over the medium term are modelled.

INCOME FORECASTS

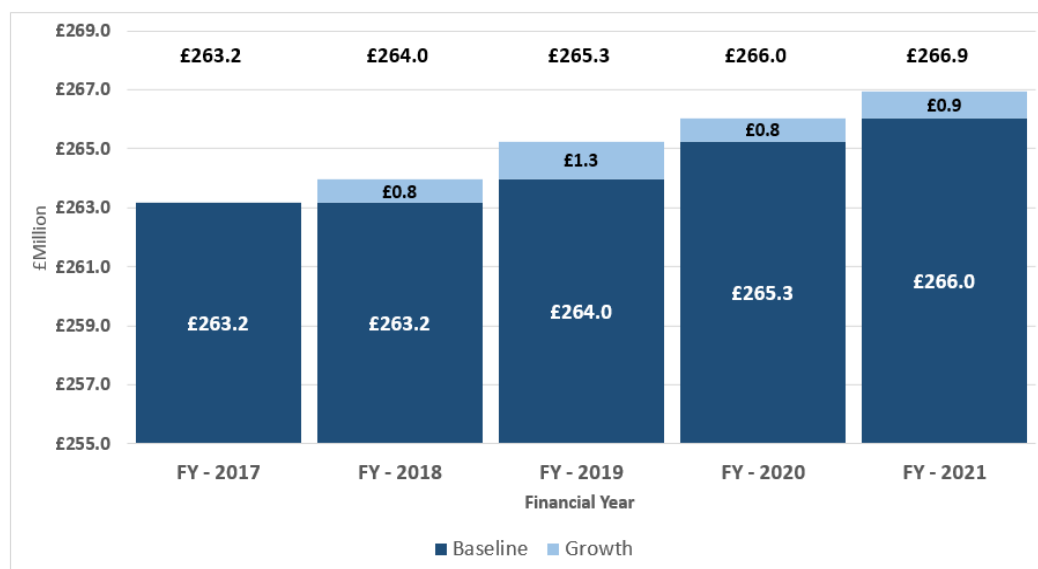
- 5.7 This section sets out the detailed results of the income modelling undertaken. 'Operational' income is not discussed in this section as it is contained within the net expenditure cash limits to Committees.
- 5.8 The Committee has only included changes to allowances and duties in this section where they have previously been approved by the States (for example, the withdrawal of mortgage interest relief or the annual real-terms increases on tobacco). No assumptions have been made in this section about future budget measures, like real-terms increases to fuel duty or changes to personal allowances.

Income Tax – Individuals (including Distributions)

- 5.9 The forecast for individuals' income tax (including Distributions) incorporates the measures that were taken as part of the 2017 Budget Report, for example, the changes to allowances, including the withdrawal of allowances for higher earners. The starting position has taken account of a positive upturn in ETI income tax receipts over the last year so that estimated 2017 total income from individuals is approximately £254.2million, some £6.3million above the budgeted figure of £247.9million which was set in mid-2016 before the effects of this positive upturn were realised.
- 5.10 For distributions the estimate is held at the budgeted position of £9million with no current evidence to suggest any variation from this baseline.

- 5.11 The forecast from this 2017 starting position is for positive real terms growth in the economy overall, but tempered to allow for some economic turbulence relating to BREXIT. Growth averages at 0.4% per annum above the prior year, before any budget measures, through a combination of higher salaries and distributions, tempered by changes in the working age population.

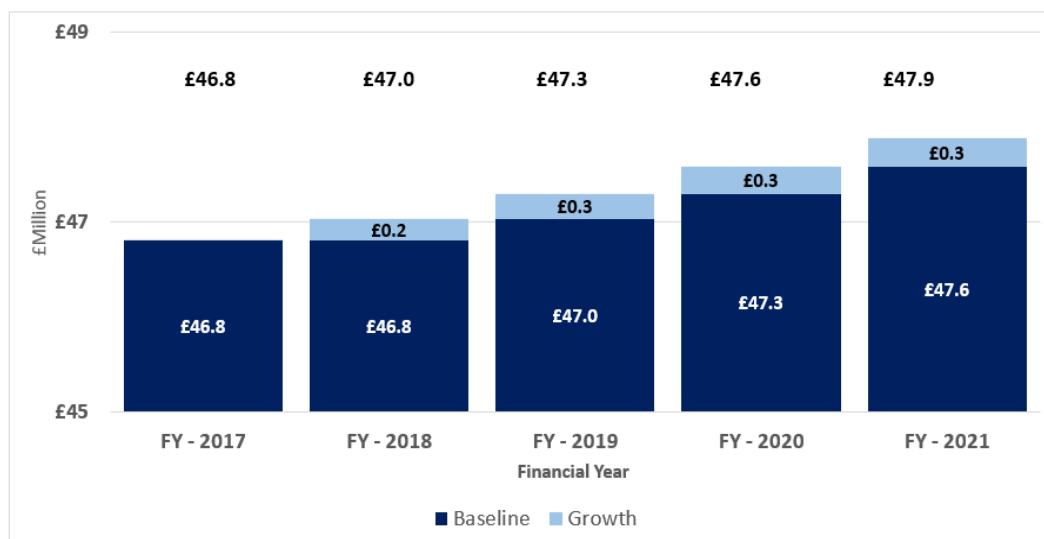
Table 10: Income Tax – Individuals (including Distributions)



Company Income Tax

- 5.12 The forecast real terms growth in overall Company Income Tax averages 0.6% per annum over the medium term. The starting position for 2017 is set at £46.8million which incorporates an element of the improved receipts in 2016 on top of the 2017 budget.
- 5.13 The underlying growth draws from a historical trend, reflecting Guernsey's resilience and management through periods of economic challenge and, as with Individuals' Income Tax, is tempered by allowance for the potential economic turbulence relating to BREXIT. The view forecast here is for limited underlying growth despite challenging economic conditions, supported by proactive efforts to support and develop the Island's business economy. However, no allowance is made for any economic stimulus that may result from initiatives set out in the Committee for Economic Development's Policy Plan.

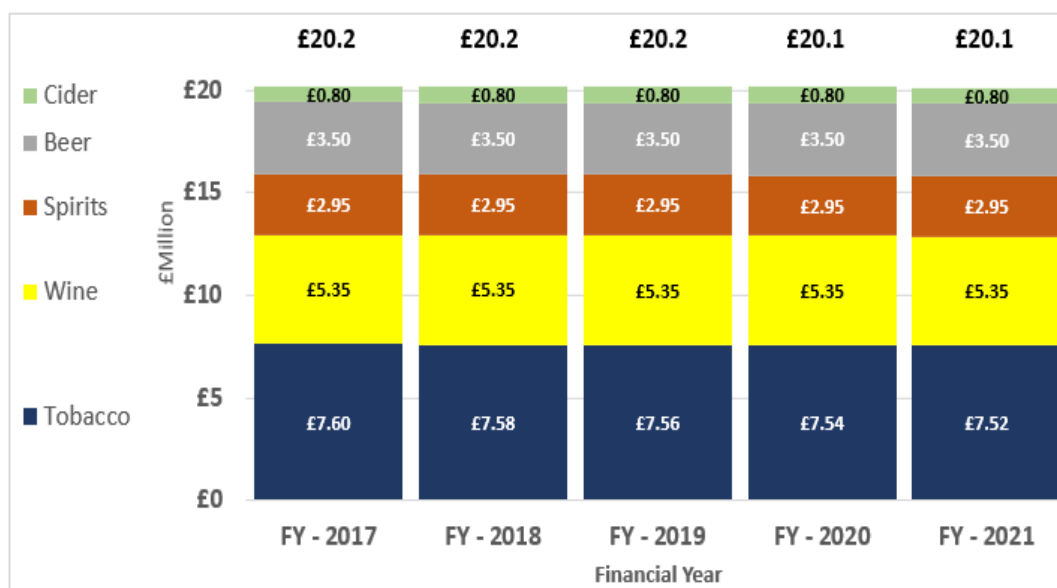
Table 11: Company Income Tax



Alcohol and Tobacco Duties

- 5.14 The 2017 forecast for this category is £20.2million in total, £1million lower than the budgeted total due to lower expected duties relating to tobacco.
- 5.15 The forecast for alcohol assumes that income remains flat over the period of review, i.e. at 2017 budgeted duties, consumption and expected income levels. Once again, no allowance has been made for any possible future duty increases.
- 5.16 For tobacco, annual real duty increases +5% for cigarettes (+7.5% for other tobacco products), in line with the existing tobacco strategy as this agreed policy is set to apply across the medium term period.
- 5.17 The underlying tobacco income position also includes a forecast 5% volume reduction per annum to allow for changing consumption habits, including the growing popularity of e-cigarettes, as well as the ongoing impact of high profile smoking cessation strategies. The percentage shift is an early estimate and a + / - 1% average movement per annum across the medium term period would have a forecast total impact of approximately + / - £0.3million.
- 5.18 Overall income from Alcohol and Tobacco Duties is therefore forecast to remain relatively flat over the medium term from the opening 2017 forecast, before considering any budget measures, such as duty increases for alcohol.

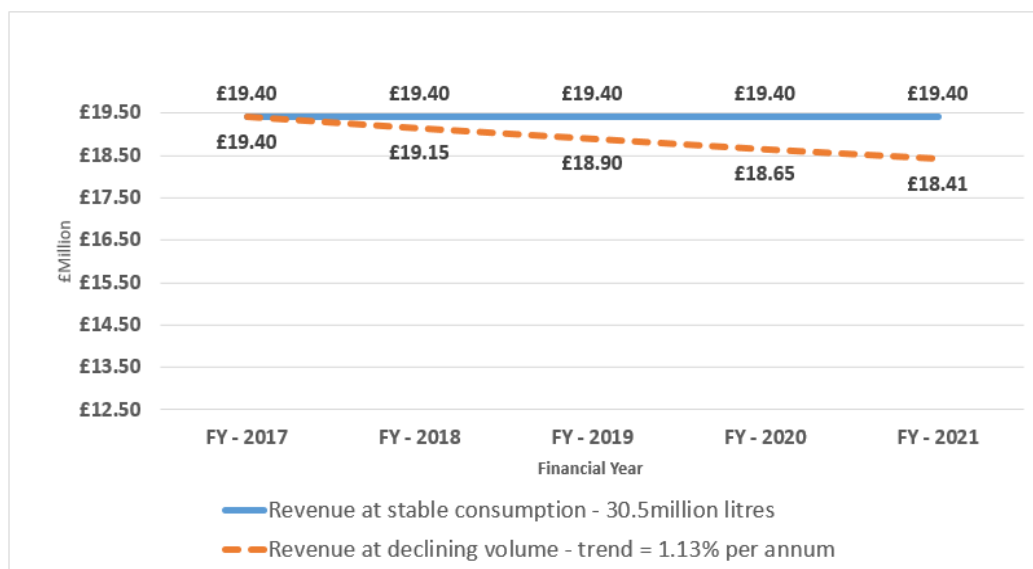
Table 12: Alcohol and Tobacco



Motor Spirit Duty

- 5.19 Excise duty on motor fuel is a shrinking tax base due to changing driving habits and more fuel efficient cars and the impact of this is highlighted in table 13. Excluding the consideration of any future budget measures, it is estimated that revenues per annum for 2017 - 2021 would total approximately £19.4million if current consumption levels were maintained.
- 5.20 However, the trend since 2008 suggests an annual decrease in consumption averaging 1.13%. Without an increase in duty, this would result in a revenue gap by 2021 of approximately £1million, growing over the medium term at approximately £250k each year. This forecast has been used as part of the baseline.

Table 13: Motor Spirit

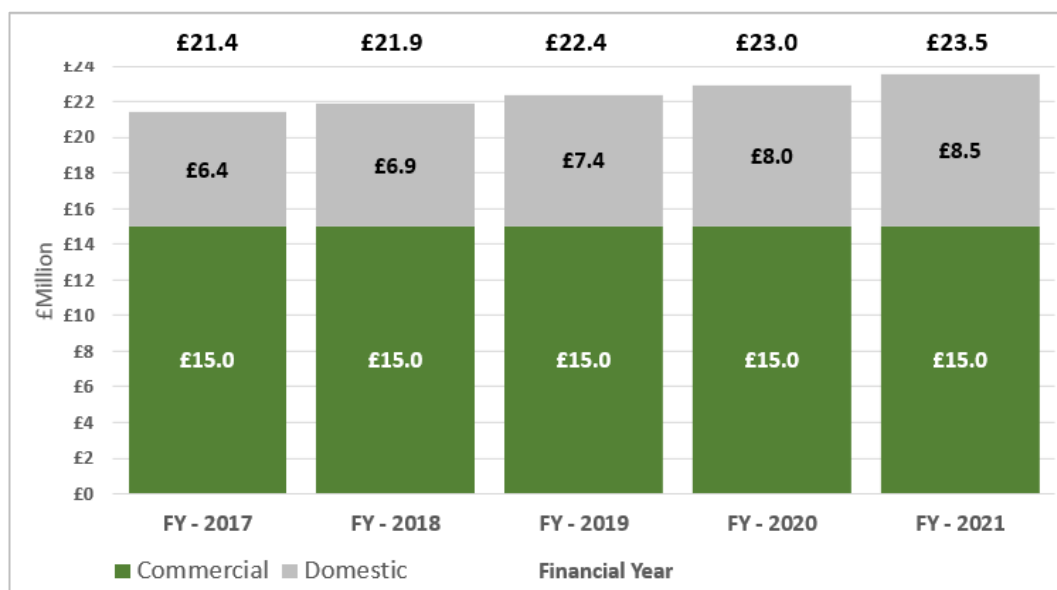


TRP

5.21 The forecast for domestic TRP is for growth in line with the existing States resolution which directs that domestic TRP be increased by no more than 7.5% in real terms between 2016 and 2025. This resolution sets the upper level for real-terms increases and was applied at this level in the 2017 Budget Report. The assumption made here is that domestic TRP is increased annually at 7.5% which would result in an additional £2.1million increase per annum by 2021, with annual growth averaging £0.5million on the previous year's estimate.

5.22 Commercial TRP has been assumed to be maintained in real-terms over the period and any increase above this would be included as a budget measure.

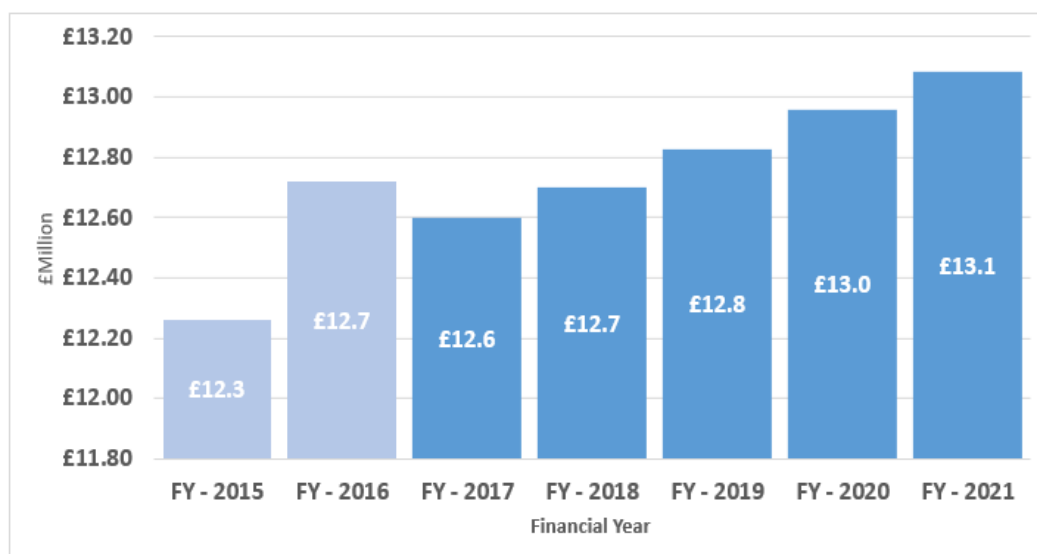
Table 14: TRP



Document Duty

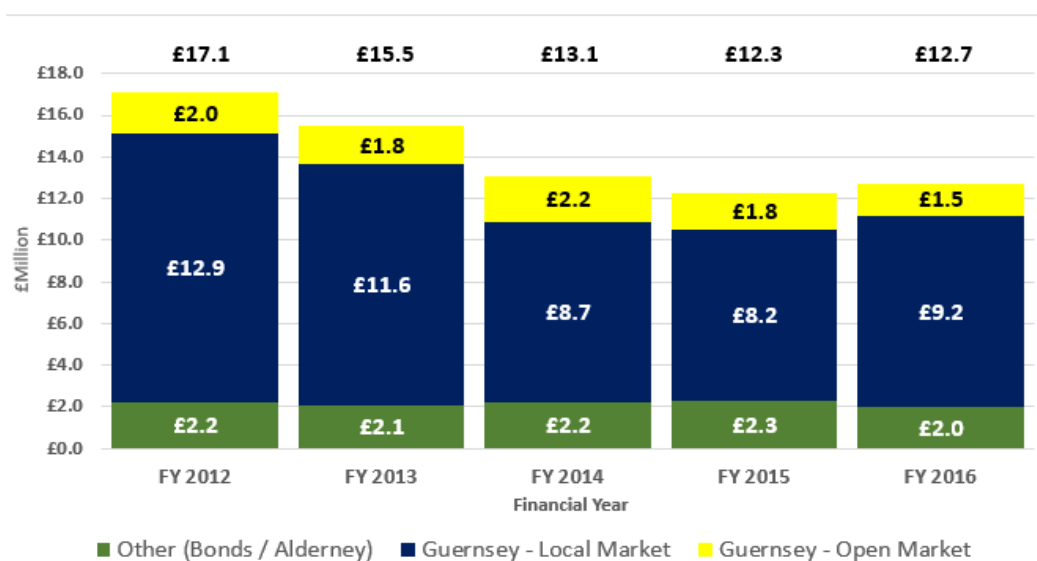
- 5.23 Document Duty is a particularly difficult category to forecast with dependence on both the number of property transactions and the sale price, with the relatively low number of transactions and no discernable seasonal trends making receipts volatile.
- 5.24 The approach taken, summarised in table 15a, is to forecast an overall growth trend from the 2016 outturn strengthening from 0.5% to 1% per annum between 2017 and 2019 remaining at approximately 1% per annum from 2019 onwards.
- 5.25 The starting point for this medium term forecast is lower than the approved budget for 2017 as early indications are that receipts will be lower than budgeted this year. However, this is a position that can be significantly influenced by any spikes in property sales, such as higher value properties.
- 5.26 The restructuring of Document Duty approved as part of the 2017 Budget Report was designed to provide a boost to the housing market and it is anticipated that this boost will occur albeit it is difficult to predict with any certainty in terms of timing. In addition to this the introduction of 'document duty anti avoidance duty' is expected to contribute to growth in this income stream although no specific assumption can be made in relation to value since there is no data on which to base a forecast.

Table 15a: Document Duty



5.27 Table 15b shows the Document Duty performance for the periods 2012 – 2016 split by open market, local market and bonds and reflects the overall reduction in revenues over that period, albeit with moderate recovery in 2016. The table indicates that, although there is a perception of a decline in the open market it is difficult to read any particular trend into these numbers. Notwithstanding that, the Policy & Resources Committee acknowledges the importance of the open market and is concerned at the historic low levels of transactions in this sector. Therefore, the Committee will be exploring ways that sales in the open market category might be stimulated resulting in higher document duty and possibly other economic benefits.

Table 15b: Document Duty – Local and Open Market



Capital Returns

- 5.28 The target returns to be generated from the States' trading entities, both incorporated and unincorporated⁵, are assumed to total £30million over the period, growing from the 2017 budgeted position of £5million to £7million by the end of the period. However, although the returns are shown on an annual basis, there is no requirement for them to be 'smooth' or regular since they are assumed to be appropriated to the Capital Reserve, as part of the overall target investment of 3% of GDP per annum.
- 5.29 The increase in the required return over the period is partly designed to off-set the cost pressure being faced by General Revenue through the removal of the annual transfer from the Solid Waste Trading Account of £1.6million following the implementation of the new waste strategy. However, the return assumed has been reduced from that used as part of the 2017 Budget Report of £8million per annum.
- 5.30 The estimates of return remain un-validated at this stage. The STSB and the Policy & Resources Committee are currently undertaking an exercise aimed at defining the level of returns possible, taking into account the requirement of the States that specific account is taken to any resulting impact on charges to customers. There is also a need to better understand any existing barriers to so doing and how these might be removed or reduced.
- 5.31 The Policy & Resources Committee acknowledges the significant challenges of making regular target returns which were envisaged in the formation of the STSB. However, there are opportunities for the generation of business efficiencies, enhanced commercial focus and different capital structures which, if balanced with the need for the entities to invest in infrastructure, will generate such returns. Areas that could support this include:
- Changes to the dividend policies of the incorporated entities to recognise their different capital requirements;
 - Capital restructuring of the incorporated and unincorporated entities, including the refinancing of capital investment previously funded by General Revenue and agreed debt to equity ratios;
 - Commercial development opportunities for the unincorporated entities to generate new income streams.

⁵ The incorporated assets comprise Guernsey Electricity Limited, Guernsey Post Limited, Cabernet Limited (the holding company for Aurigny) and JamesCo750 Limited (which holds the fuel tank ships). The unincorporated assets are Guernsey Water, States Works, Guernsey Harbours, Guernsey Airport and the Guernsey Dairy.

5.32 The Policy & Resources Committee appreciates that there is a risk that these returns will not prove affordable or realistic. Should the total assumption of £30million not materialise over the period then there will be a knock-on impact to General Revenue and a requirement to increase the appropriations to the Capital Reserve commensurately which would could delay the removal of the deficit; reduce the funding available for new or improved services; and delay the replenishment of reserves.

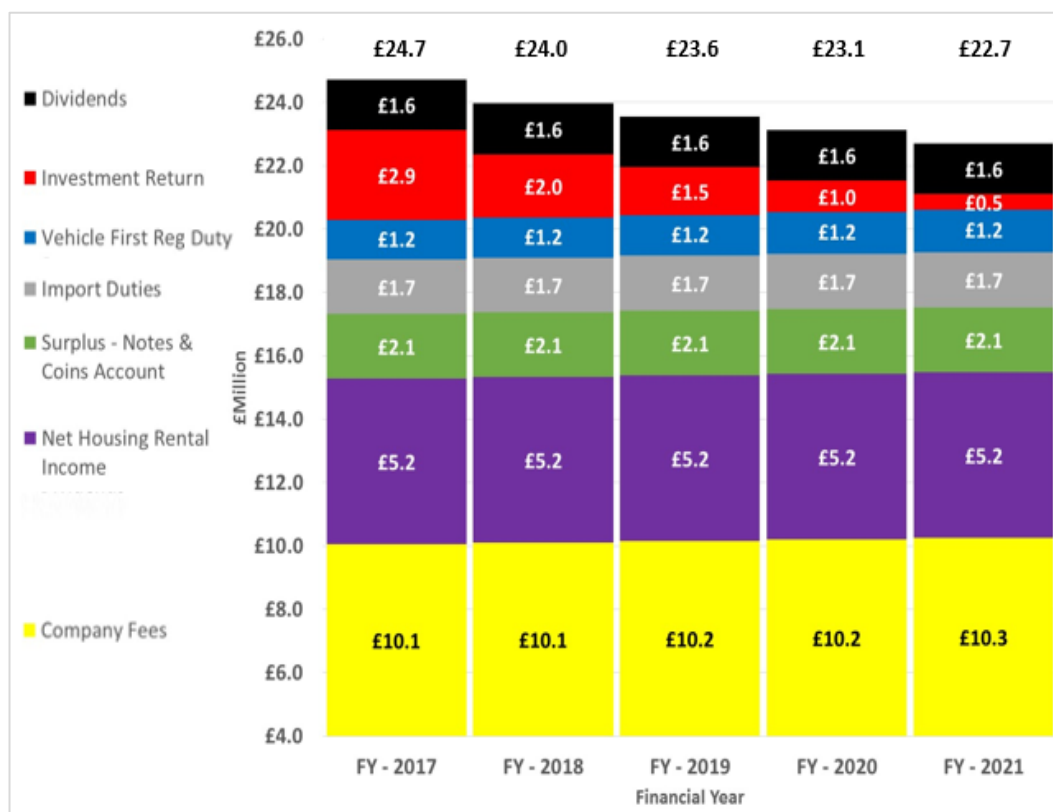
Other Income

5.33 Within 'other income' there are a number of categories that are expected to remain relatively stable over the medium term, including;

- **Company Fees:** Moderate 0.5% real growth.
- Dividends from the incorporated entities (Guernsey Post Limited and Guernsey Electricity Limited) have been held constant at the 2016 level of £1.6million. The Committee does not currently have any medium to long term forecasts for the financial performance of these entities. The work being undertaken to determine the appropriate level of returns will also need to incorporate dividend returns.
- **Net Housing Rental Income:** Held flat with the latest 2017 forecast with any impact relating to SWBIC detailed separately within later sections that highlight cost pressures.

5.34 Investment returns are expected to reduce over the medium term due to the funds in the Future Guernsey Economic, Corporate Housing and Transformation & Transition Funds being utilised, thus reducing the overall investment total to generate returns.

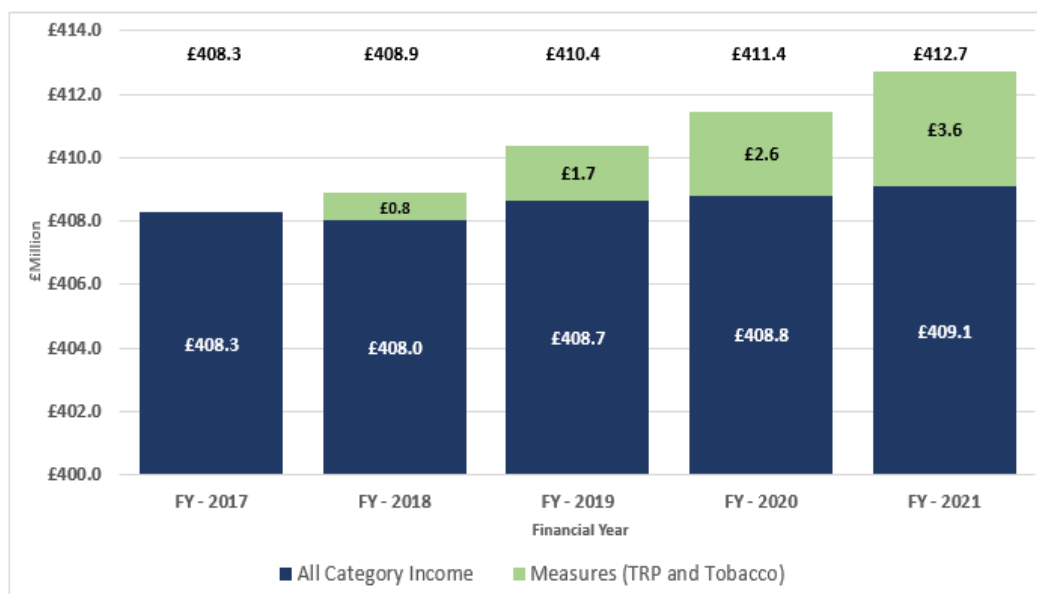
Table 16: Other Income



Baseline Income Position

5.35 Table 17 summarises the overall underlying income position before the impact of any further income measures are considered. The starting point for 2017 is £408.3million which is forecast to grow to £412.7million by 2021. The average real terms growth percentage across the period 2017 – 2021 is low at 0.3% per annum with the underlying growth within Income Tax and categories such as Document Duty offset by reductions in Other Income, such as Investment Returns and in Tobacco where the impact of agreed measures are offset by forecast volume reductions. Growth is not expected to occur evenly, with 2018 – 2019 modelled closer to 0.4%, a combination of Income Tax underlying growth set higher in those years and before Other Income reduces in later years.

Table 17: Baseline Income Position



5.36 The Income section has highlighted that without taking proactive measures our overall income growth is forecast to be limited, with some categories set to reduce without action. Taking into account the economic factors and the challenges that we face and will face over the medium term, it is critical that opportunities to develop our income streams are maximised so as to secure current and future service delivery, manage developing cost pressures, underpin the required transformational changes and support the outcomes sought from the Policy & Resource Plan.

5.37 This also underlines the importance of the mandate of the Committee *for* Economic Development in stimulating economic growth and diversification strategies.

EXPENDITURE FORECAST

Baseline:

5.38 The total financial adjustment to cash limits as a result of the 3% target in 2017 was £6.6million. At the time of writing, a total of £4.6million of this has been 'signed off', a further £1.4million is in delivery, with £1.5million not yet identified on a recurrent basis. There are no material one-off or cyclical values in the 2017 Budget and therefore it is considered an appropriate baseline from which to initiate the medium-term expenditure forecast.

Further savings targets:

5.39 The 3% targets introduced into the 2017 budget were the first stage of a larger programme, planned to cover the financial years 2017 – 2019 and referenced in the 2017 Budget Report. No such further reductions have been included in the baseline forecasts in order to be able to model the ‘as is’ position before any measures or changes are introduced.

Cost pressures:

5.40 The cost pressures included in the forecast are:

- **Social Welfare Benefits Investigation Committee (SWBIC) Proposals**

It is assumed that the SWBIC proposals relating to the development of a coordinated and sustainable system of social benefits and approved by the States in March 2016⁶ will be implemented in the second half of 2018. The resolution of the States directed that the measures be implemented when affordable. Although it could be argued that it is not yet affordable since a deficit persists, there was a strong will for these proposals to be implemented and the Committee considers it important to tackle the funding as soon as practically possible.

The financial impact used in the SWBIC report has been updated to take account of the increase in the 2017 benefit limitation and is included as £1.9million for six months in 2018 (assuming a mid-2018 go-live), £3.5million in 2019 (transition phase), £3.3million in 2020 (final year of transition) and then £3.2million per annum from 2021. The financial impact of these proposals is currently being reviewed and remodelled to give as accurate a picture as possible prior to the implementation of the measures.

- **Waste**

To date, there has been a degree of “cross-subsidy” between waste income and the States’ Trading Supervisory Board’s General Revenue funded operations with an annual transfer (£1.6million in 2017) from the Solid Waste Trading Account to General Revenue. The full implementation of the Waste Strategy will have a direct financial impact on the core General Revenue financial position, since Guernsey Waste will operate as a separate States’ trading asset and utilise all its generated income to support waste operations. It is assumed that the new charging regime will come into force from 2019 onwards with a resulting impact of £1.6million per annum.

⁶ Billet d’État VII, February 2016.

- **Other**
Other cost pressures have been set at £1.5million per annum, or roughly 0.5% of expenditure to reflect a range of pressures that will require management and mitigation wherever possible so as to limit the net impact. These include:
 - The increased costs of running existing services due to tactical demand changes (volume and complexity pressures which will escalate through the medium term and beyond). This is particularly the case for health and social care services where other measures will need to be taken to re-design services in order to manage such pressures;
 - Temporary transitional costs relating to the implementation of strategies, for example, the implementation of the changes to the operating model of secondary education;
 - The impact across the States of the introduction and management of new regulatory requirements such as General Data Protection Regulation (GDPR);
 - The revenue impact of projects currently funded by the Future Guernsey Economic Fund, should they be prioritised for continuation beyond the current funding phase;
 - The costs of dealing with Brexit; and
 - The Aurigny Group is forecasting significant losses which include a structural loss for the Alderney routes. This will ultimately lead to material cost pressures for the States either through re-financing Aurigny or the funding/partial funding of a public service obligation on the Alderney routes.

There are no existing funding sources for such cost pressures and many are at an early stage in terms of both assessing their potential financial impact and whether they can be either significantly reduced or avoided entirely through changing models of service delivery and managing or diverting demand. The value used in this Plan is an early estimate and so could be significantly below the total of all such pressures. This reinforces the need to progress with Public Sector Reform so that such pressures can be managed in a flexible, coordinated, informed and strategic manner.

Routine Capital

- 5.41 Routine Capital Allocations are being combined with the appropriations to the Capital Reserve to simplify the treatment of capital and provide greater clarity as set out below. However, the allocations to routine capital are held steady over the period.

Grant to the Health Service Fund

- 5.42 In the 2017 Budget Report a one-off suspension of the annual grant was proposed and confirmed by the States in the Budget debate, with the Budget Report setting out the justification;

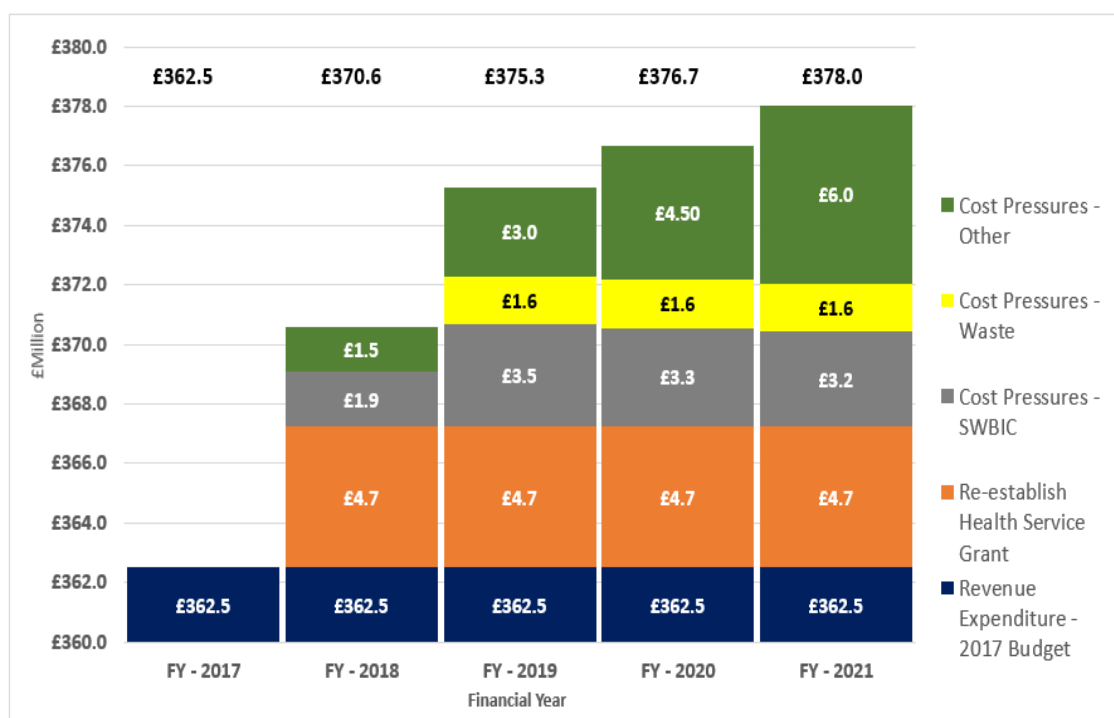
“The Policy & Resources Committee considers that this is a proportionate measure given the overall demands on General Revenue funding and is appropriate given the specific shortfall in relation to funding health and social care services in 2017...this shortfall has arisen due to the delay in establishing a transformation programme and the cost pressures being managed in 2016 in respect of agency staffing and off-island treatment and therefore the Committee for Health & Social Care and the Policy & Resources Committee remain confident that benefits have only been delayed”.

5.43 The assumption in this section is that the grant payment from General Revenue is reinstated in 2018 and continues over the period.

Summary Net Expenditure Forecast

5.44 Table 18 summarises the medium term revenue expenditure forecast based on the assumptions stated earlier in this section and below.

Table 18: Medium Term Expenditure



Capital Appropriation

5.45 The budgeted position for the overall transfer to the Capital Reserve in 2017 meets the 3% GDP target investment due to the positive impact of the refinancing of Belle Greve Wastewater Outfall Project at approximately £19million. From 2018 to 2021 the appropriation from General Revenue will need to increase to between £42million and £43million per annum, alongside other transfers and investment returns in order to meet the target value of 3% of GDP. Although it may prove

unaffordable to fund a level of 3% per annum in the short term, this approved States' target remains the aspiration should it be affordable.

Table 19: States' Capital Appropriations – Achieving the 3% GDP Target

Budget					
GDP	2017 (£m)	2018 (£m)	2019 (£m)	2020 (£m)	2021 (£m)
Re-flated Guernsey GDP (2016 Statistics)	£2,375	£2,386	£2,396	£2,406	£2,416
3% of GDP = Target Capital Expenditure Per Annum	£71	£72	£72	£72	£72
Transfers to the Capital Reserve:	2017 (£m)	2018 (£m)	2019 (£m)	2020 (£m)	2021 (£m)
General Revenue Appropriations	£30	£43	£42	£42	£42
Routine Capital Allocations	£11	£11	£11	£11	£11
Capital Income	£5	£6	£6	£7	£7
Capital Income - Property Sales		£1	£1	£1	£1
Total General Revenue Transfers	£45	£60	£60	£60	£60
Investment Returns	£7	£7	£7	£7	£7
Other Reserve / Fund Transfers	£26	£5	£5	£5	£5
Total Other Transfers	£33	£12	£12	£12	£12
Total Capital Reserve Investments	£78	£72	£72	£72	£72

Note: The General Revenue Appropriation to support major capital projects would need to average £42.5million for 2018 and 2019 and then £42million for 2020 and 2021, assuming the other mechanisms for reaching the 3% of GDP annual investment were as per table 19.

BASELINE FINANCIAL POSITION

5.46 Table 20 shows the overall financial position when the assumptions for both income and expenditure are combined and assuming a capital appropriation in line with table 19 above.

Table 20: Overall Baseline Financial Position

	FY - 2017 £m MTFP	FY - 2018 £m MTFP	FY - 2019 £m MTFP	FY - 2020 £m MTFP	FY - 2021 £m MTFP
Underlying Income Position:	£408.3	£408.9	£410.4	£411.4	£412.7
2017 Cash Limits:	(£362.5)	(£362.5)	(£362.5)	(£362.5)	(£362.5)
Health Service Grant - Reinstatement:		(£4.7)	(£4.7)	(£4.7)	(£4.7)
Estimated Cost Pressures		(£3.4)	(£8.1)	(£9.4)	(£10.8)
Underlying Expenditure Position:	(£362.5)	(£370.6)	(£375.3)	(£376.7)	(£378.0)
Capital Income - Returns from Trading Assets	£5.0	£5.5	£6.0	£6.5	£7.0
Capital Income - Property		£1.0	£1.0	£1.0	£1.0
Financial Position before Capital Appropriation:	£50.8	£44.8	£42.1	£42.3	£42.7
Capital Appropriation: Major Capital	(£29.8)	(£42.6)	(£42.4)	(£42.2)	(£42.0)
Capital Appropriation: Routine Capital	(£10.5)	(£10.5)	(£10.5)	(£10.5)	(£10.5)
Capital Appropriation: Capital Income	(£5.0)	(£6.5)	(£7.0)	(£7.5)	(£8.0)
Total Capital Appropriation	(£45.3)	(£59.6)	(£59.9)	(£60.2)	(£60.5)
Overall Surplus / (Deficit)	£5.5	(£14.8)	(£17.8)	(£17.9)	(£17.8)

- 5.47 The forecast total structural deficit over the period 2018 and 2021 totals approximately £70million. The deficit remains stable between 2019 and 2021 because, before adding any income measures or further savings targets, the forecast growth in income balances off the cost pressures detailed in the expenditure section. The increase between 2018 and 2019 relates mainly to the assumption that SWBIC costs will only be incurred for half of 2018 and will then see an increase to a full year impact from 2019.
- 5.48 The net underlying structural deficit has been managed through a reduced capital appropriation in recent years. Although there is a part to play for such reductions, any material and sustained reduction in the allocation to capital would limit investment in larger infrastructure projects or to support transformational activity in order to mitigate longer-term pressures.
- 5.49 One-off benefits, as seen in 2016, can alleviate the situation and are welcome, but the Plan needs to develop a more sustainable and structural solution to provide fiscal strength. Therefore, the next section explores a means of balancing the overall position through a combination of restricted capital allocations, measures to increase revenues and reductions to expenditure through changes to the way that services are delivered.

6. CLOSING THE GAP

- 6.1 The Policy & Resources Committee believes that the burden of eliminating the structural deficit must be shared between taxpayers, particularly those most able to pay, and a reduction in the cost base through the reform of public services - which will lead to working differently, changing and improving the way services are delivered to enable savings to be made. The Committee estimates that, over the Plan period, a total net annualised improvement to the baseline of £40m is necessary to close the gap and is proposing that 65% of this value, £26m, is realised through public service reform initiatives and 35%, or £14m, from targeted tax measures.
- 6.2 Taking a medium term view to the eradication of the underlying deficit through targeted increases in revenues, the reform of the public service (resulting in a lower cost base) and a short-term adjustment to the amount put aside for future capital infrastructure projects should enable a fiscal surplus position to be realised that enables investment in public services and the replenishing of reserves.

REVENUE RAISING MEASURES

- 6.3 The Annual Budget of the States is the mechanism for seeking changes to taxes and duties and it would not be appropriate to set out detailed measures for revenue raising in this Plan. However, for the purposes of closing the gap, it is assumed that net real-terms revenue raising budget measures will be put in place over the plan period which will raise an additional £14million per annum by 2021. This is in addition to those measures already resolved and being implemented (such as the withdrawal of mortgage interest relief) which are contained in the baseline position.
- 6.4 The Policy & Resources Committee's tax proposals over the Plan period will seek to "raise additional revenues as far as possible from individuals and entities most able to bear the burden" in line with the agreed objective of the States. The initiatives being explored, for which proposals will be brought forward in future Budget Reports, include further phases of the withdrawal of income tax allowances for higher earners; continued targeted expansion of the 10% intermediate income tax band; and seeking an increased business contribution from those who receive the most commercial benefit from the island and its infrastructure.
- 6.5 The first phase of the project to withdraw tax allowances for higher earners was implemented in the 2017 Budget Report. This phase introduced the withdrawal of the personal income tax allowance at a rate of £1 for every £3 that a person's income exceeds the Upper Earnings Limit (UEL) for social insurance contributions and is raising approximately £2.4million per annum. Further phases of this work will look at including other tax allowances and then the threshold for withdrawing allowances. The level of revenues raised will ultimately depend on the threshold

set: a £100,000 threshold would raise a further £1.5million; a further reduction in the threshold of £25,000 to £75,000 would yield a further £2million. The issue of high marginal rates for individuals when considered alongside Social Security contributions would be a problem if the threshold for withdrawal is set lower than the UEL for social insurance contributions and therefore the Committee is progressing this work in conjunction with the Committee *for* Employment & Social Security.

- 6.6 Measures are also being examined on company income tax and commercial TRP which would see further tax charges for some of those entities not currently liable to any income tax. However, there are limitations to raising material revenues from such a limited sub-set of our small tax base and it would be naïve to assume that the entire burden can rest on the shoulders of the few.
- 6.7 Therefore, the Committee's tax measures are also likely to include limited wider increases in taxes and/or duties. These may include real-terms increases in fuel or alcohol duty; the expansion of excise duty to other fuel oils; and real-terms increases in commercial TRP and/or the addition of new categories. Possible measures will be researched and the impact analysed before proposals are put before the States.
- 6.8 The assumptions used in this Plan will see real-terms budget measures totalling in the order of £3.5million per annum. However, should economic growth outstrip the assumptions used in this Plan, resulting in higher tax revenues, this may reduce the need for such budget measures over the period.

PUBLIC SERVICE REFORM

- 6.9 Public services are at the very heart of the island's community. Moreover, because the island is changing, so must our public services if we are to keep up with those changes and continue to deliver the services that our community needs.
- 6.10 There are some important factors which contribute to this need to change, these include:
- Our community's shifting demographics and the declining proportion of the population in work;
 - The States of Guernsey's evolving workforce requirements;
 - Changing expectations and needs of our service users; and
 - Supporting Guernsey's economy, and helping to meet the challenges we face in a competitive world.
- 6.11 Recognising the need for significant change, in September 2015, the States endorsed "A Framework for Public Service Reform"⁷. An ambitious programme,

⁷ Billet d'État XVI, Sept 2015, p1928

Public Service Reform aims to transform the organisation, management and delivery of public services to meet these challenges.

- 6.12 The Framework for Public Service Reform introduced the concept of a reform dividend, achieved when a strong underlying financial position allows savings to be re-invested in the services where they are needed most. However, Public Service Reform was established as a ten-year initiative, with many of its larger, more complex programmes of transformation anticipated to deliver the majority of their benefits in the second half of this period. Given the anticipated scale of the funding gap highlighted in this Plan it is now necessary to identify opportunities to accelerate the delivery of this 'reform dividend' wherever possible and to use the savings to close the underlying deficit in the first instance.
- 6.13 The challenges we face in preparing for the future mean that any measures that are taken to meet them must be consistent, co-ordinated and occur across every aspect of public service provision. It will not be enough for Committees to continue to work in isolation to simply do some things better or for a little less money and then seek to reinvest any resulting savings in local priorities. It will be necessary to adopt a fundamentally different, 'whole system' approach to changing and improving if Public Service Reform is actually to succeed.
- 6.14 The Policy & Resources Committee believes, that reform dividends in the region of £26million per annum by 2021, generated through recurring savings in revenue expenditure across all service areas (including Health & Social Care), is required. Once a sustainable surplus has been achieved, the reform dividends should be made available for re-investment in priority policy or service delivery areas.
- 6.15 This total is similar to the levels set out in the 2017 Budget Report which included savings applied to non formula-led General Revenue budgets (excluding Health & Social Care) for 2018 and 2019 of 5% per annum. In addition, savings from tactical, productivity and efficiency savings in Health & Social Care as set out in the "*Costing, Benchmarking & Prioritisation Project at the Health & Social Services Department*" report prepared by BDO Limited⁸ which resulted in £8.2million of additional temporary funding being provided until such time as sustainable savings could be delivered were included.
- 6.16 Having seen more detailed analysis of the opportunities for delivering savings and realistic timeframes for doing so coupled with an improved baseline position thanks to strengthening revenues, the Committee now considers it appropriate to extend the period over which such savings are realised to four years in order to improve the chances of successfully delivering a transformed organisation and sustainable reform dividends rather than resorting to cutting services.
- 6.17 The work undertaken on behalf of the Policy & Resources Committee in Health & Social Care, Home Affairs and Education, Sport & Culture to cost and benchmark

⁸ Billet D'Etat XIX 2015, Annual Budget for the States for 2016

services has identified opportunities for tactical, productivity and method changes, as well as more radical transformation, that would lead to savings. This gives the Policy & Resources Committee, and hopefully those host Committees, confidence that reducing the cost base of the States without cutting services is possible. It will be necessary to take a medium term approach to delivering many of the opportunities identified and we must be prepared to invest in the changes required through the Transformation & Transition Fund. However, the costing and benchmarking reports provide a list of areas that can be explored and delivered as part of Public Service Reform.

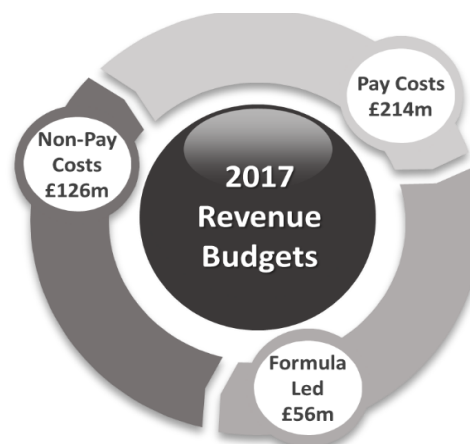
- 6.18 The Committee recognises that setting a Committee based savings target, calculated as a fixed percentage of each cash limit, is a crude way of applying targets and perpetuates the 'siloed' approach to delivering savings. Therefore, only a small universal savings target of between 0.5% and 1% per annum has been assumed as part of the overall strategy for the medium term. This recognises the need for all service areas to continue to deliver incremental improvements in efficiency and value for money in areas which might be outside the scope of any wider initiatives. It also mirrors arrangements in place with some of our core external suppliers, such as the Medical Specialist Group.

Themes for Generating Savings

- 6.19 The Committee is proposing that the majority of the savings should be targeted at an organisational level. The primary focus for the delivery of savings over the medium term should be on a small number of clearly defined initiatives.

- 6.20 Figure 1 shows the split shows the split of the 2017 general revenue budget across the three high-level categories of expenditure, Pay Costs, Non-Pay costs and formula led expenditure. In determining the potential scale of savings that can be achieved over the period there has been an underpinning assumption that significant savings from formula led expenditure are unlikely. This recognises it is unlikely that measures will be implemented in the medium term, that will have a material or sustainable impact on demand for services with formula-led budgets and that as a result savings in this category of expenditure are unlikely. In fact, with the introduction of the measures proposed by SWBIC, formula-led expenditure will increase over the period.

Figure 1 - 2017 Baseline



- 6.21 Therefore, the approach focuses on securing reductions in the remaining two areas of pay and non-pay costs by specifically targeting five areas of significant opportunity. These opportunities have been selected because they have the

potential to realise large-scale benefits (£1m - £5m+) without impacting on outcomes for customers; and the benefits are achievable over the medium term.

- 6.22 These initiatives will need to be supported and co-ordinated by the Civil Service Leadership Team and overseen by the Policy & Resources Committee, but their successful delivery will require the full support of all Principal Committees and active participation and delivery by all service areas.

1. Service Design

The development of digital capabilities is a core component of the 'Service Design' opportunity. As well as enabling the release of early savings, digital capabilities can also provide the platform for genuinely transformational change across services. While it may be the use of technology that ultimately allows the removal of waste and automation of activity, it would be a mistake to view this initiative simply as an "IT" project. At its core, it is about the customer focused review and re-design of services, with the aim of creating an effortless user or customer experience.

Service design and digitisation has been used widely and successfully in both the public and private sectors in the UK and globally to rapidly identify and deliver cost reduction while maintaining or even improving the customer experience. Trials of these approaches are currently taking place in a small number of specifically chosen services – namely income tax and the Hub in the first wave, and a number of service areas have already expressed an interest in participating in the next tranche. The aim of these trials is to test the approach within the public service in Guernsey and confirm its potential to identify savings.

When cost savings are made through changing services, a significant proportion are likely to come from reducing pay costs. In some cases, particularly where services have been digitised, these savings will come from the need for fewer staff in those areas which have been the subject of change and improvement.

The public service is well placed to deal with this given the age profile of staff and the number of retirements likely in the next five years - as well as natural turnover. However, it would be naïve to think that all of this change can be managed through 'natural wastage'. The public service is going to need to be ready to deal with the displacement of staff and to facilitate, this we are looking at HR policies and procedures as well as HR capacity and skills to manage this; for example, there is a need for an organisational approach to re-deployment; there is a need to work closely with the private sector to understand where skills can be transferred; and a need for a programme of re-skilling. Managing vacancies and optimising redeployment will always be the top priority as redundancy comes at a significant cost – both financial to

the taxpayer and personal to the individual concerned. Therefore, it is only once all other options are exhausted, that consideration will be given to a programme of redundancies as a last resort.

2. Managing Sickness Absence

The total cost of sickness within the public service is estimated to be several million pounds per year. Effectively managing sickness absence therefore, not only has the potential to secure on going improvements in the health and wellbeing of staff, a core objective of Public Service Reform, but it can also secure a reduction in the overall cost of employment. In many cases sickness absence does not result in additional costs, and while reducing sickness in these areas increases capacity, it does not immediately deliver a cashable saving. In these instances, converting this additional capacity into a cashable saving that can be extracted and re-invested elsewhere is a long-term process.

However, in a number of service areas - particularly health care, teaching and the emergency services - sickness absence is often covered through the use of overtime, agency or bank staff, which can result in significant additional unplanned costs. It is these areas where it is anticipated that savings can be made in the short to medium term.

3. Managing Overtime and Allowances

In 2016 the cost of overtime was approximately £6m. A significant proportion of this expenditure, around £2.2m per year, is incurred by the unincorporated trading assets and is therefore not a cost to general revenue. However, the majority of the remaining expenditure on overtime, c£3.5m, occurred within services provided by three Committees - Health & Social Care, Home Affairs and Education, Sport & Culture.

Redesigning and digitising services, improving recruitment and retention in certain areas and promoting staff wellbeing all have the potential to partially reduce the total cost of overtime payments and the Policy & Resources Committee is committed to ensuring service areas receive the support necessary to deliver savings in this area.

4. Property Rationalisation

A further benefit of thinking differently about how services are delivered and where they are delivered from is the opportunity to reduce the size of the operational property state occupied by the Public Service. As services move on-line and more internal processes are automated opportunities to consolidate the operational estate will arise.

Despite being the largest owner of land and property in the Island, the States have no overall strategic plan by which to determine how best to allocate and manage the property portfolio in order to deliver policy and operational objectives.

The rationalising of States' property holdings remains a key strategic aim, but optimising the associated benefits will require a step change in the approach to the management of property assets. The framework for Public Service Reform reaffirms the pivotal role "Estates Optimisation" has to play in the reform of public services, not just from the perspective of reducing the cost of operating and managing buildings or increasing their capacity, but also in ensuring that they support the delivery of value for money, facilitate modern ways of working for staff and help improve customer service.

The objectives include:

- Reducing the overall costs of operating the public service estate;
- Increasing the flexibility and capacity of public service office accommodation;
- Supporting improvements in efficiency and customer service through the introduction of modern ways of working;
- Introducing new space standards for public service office accommodation; and
- Seeking opportunities to rationalise the public property portfolio and dispose of surplus property.

Whilst these are medium to long-term objectives, the re-introduction of explicit savings targets in 2017 and the requirement to deliver significant further savings over the medium term means that current business strategies are also focused on accelerating the release of sustainable and recurring revenue savings. Consequently, a number of initiatives are now being actively pursued with the specific intention of releasing cashable savings over the next three years. These initiatives include:

- Increasing the capacity of Sir Charles Frossard House and Edward T. Wheadon House;
- Vacating Grange Road House and Cornet Street;
- Consolidating Social Care and Education community and peripatetic services on a single site releasing Lukis House, Swissville and potentially a number of other properties;

- Consolidating the Home Affairs estate allowing the termination of a number of current leases, as part of the Home Operational Services Transformation programme (HOST).

5. Procurement

In 2016 the States did business with approximately 6,000 different suppliers accounting for £175million of expenditure. Around 300 of those suppliers have expenditure in excess of £100,000 per annum representing around £97million. An additional 200 suppliers have expenditure above £50,000 and account for further £15million. Whilst it is not possible to influence all of this expenditure to deliver recurring savings as some may be capital expenditure or one-off, it is estimated that around 200 suppliers and £60m of spend could be captured by a programme to improve the terms and rates of contracts with the States.

Therefore, a short term program has been initiated which will focus initially on the top 200 suppliers in terms of expenditure, both on and off island. Suppliers will be contacted by trained staff and requested to contribute to our spend reduction targets through a review of their own prices and commercial terms with the States of Guernsey. This should lead to an immediate and sustainable positive impact.

The medium term procurement plan will incorporate the following themes:

- An holistic and coordinated approach to managing States-wide common expenditure e.g. Facilities Management;
- Dedicated procurement resource for Service Area specific spend;
- A category based approach to Procurement adopted across the States;
- Better alignment to budgeting and planning processes to enable early involvement and to optimise the States' ability to achieve value for money;
- Redesign of policy and processes to allow a more contemporary approach;
- Improved analytics to capture, analyse and track spend;
- Better control over supplier approvals and management of the 'tail' to reduce the overall supply base; and
- Investment in contract/supplier management processes, tools and training.

6.23 Alongside this medium term work to deliver savings through service improvements, the planning for the longer term whole system redesign of services will continue. For example, the Committee for Health & Social Care is leading the redesign of health and social care services for the future; and officers from social security contributions and income tax services have been working closely together to design a new, integrated collection service. Further whole system redesign is

envisaged for justice and equality and education services and other areas of public service. By the end of this four-year period, it is expected that such service improvement will have started to be implemented and savings will be starting to accrue. It has not been possible to estimate the value of such savings at this stage before understanding the proposals. However, this increases the confidence levels in the ability to deliver the proposed savings over the period of £26million.

- 6.24 Indicative upper and lower ranges for potential savings over the period, based on the modelling and analysis undertaken to date are set out in Table 21. The savings have been estimated for delivery between 2018 and 2021, a two-year extension to the estimate included in the 2017 Budget Report. This four year period recognises the challenges expressed in hastily delivering service change, and has been possible due to the improved base revenues.

Table 21: 2018 - 2021 Indicative Recurrent Annual Saving Ranges

Category	High £m	Low £m
0.5% - 1% Universal Efficiency Total	£12.0	£6.0
Procurement	£12.6	£5.4
Property Rationalisation	£2.2	£1.0
Non-Pay Total	£14.8	£6.4
Service Design	£7.5	£2.5
Overtime	£1.9	£0.3
Sickness	£0.9	£0.14
Pay Total	£10.3	£2.9
Overall Total	£37.1	£15.3

- 6.25 The range of potential savings is between £15million and £37million. These ranges are based on early analysis of available data and significant further work will be necessary to quantify them in more detail. It should also be noted that it is extremely unlikely that all initiatives will be capable of achieving the upper end of the ranges and therefore these values should not be considered as savings targets.

However, the Committee is confident that the potential opportunities warrant further research and investigation and represent realistic strategies to achieve the £26million baseline annual savings required over the medium term.

Tracking Benefits and Investing in Programmes and Projects

- 6.26 One of the lessons learned from the Financial Transformation Programme, and highlighted in the review undertaken by the Public Accounts Committee⁹, was the importance of ensuring that clear guidance and rules for the identification and measurement of benefits are established at the outset. Such guidance and a clear system for recording and monitoring savings is now in place so as to inform and support stakeholders at all levels across the States. It is critical that monitoring

⁹ May 2015, KPMG 'Financial Transformation Programme: 'Cost / Benefit Review'.

benefit realisation holds high priority when planning projects and that the achievement of benefits is monitored by focused reporting and tracking. For the savings initiatives advanced in this Plan, such monitoring will be critical to ensuring that the overall financial position remains affordable and realistic.

- 6.27 A number of the above initiatives, particularly property rationalisation and service design will require significant investment over the next two – three years in order to enable the release of savings. They will need be prioritised for investment from the Capital Reserve and the Transformation & Transition Fund accordingly.

UPDATED FORECAST FINANCIAL POSITION

- 6.28 Table 22 updates the forecast financial deficit from table 20, with the amendments to include the revenue raising measures and savings programme.

Table 22: Revised Overall Financial Position

	FY - 2017 £m	FY - 2018 £m	FY - 2019 £m	FY - 2020 £m	FY - 2021 £m
	MTFP	MTFP	MTFP	MTFP	MTFP
Underlying Income Position:	£408.3	£408.9	£410.4	£411.4	£412.7
Forecast Income Measures		£3.5	£7.0	£10.5	£14.0
Income Position After Measures	£408.3	£412.4	£417.4	£421.9	£426.7
2017 Cash Limits:	(£362.5)	(£362.5)	(£362.5)	(£362.5)	(£362.5)
Health Service Grant - Reinstatement:		(£4.7)	(£4.7)	(£4.7)	(£4.7)
Estimated Cost Pressures		(£3.4)	(£8.1)	(£9.4)	(£10.8)
Impact of Expenditure Savings		£5.5	£11.7	£18.8	£26.1
Underlying Expenditure Position:	(£362.5)	(£365.1)	(£363.5)	(£357.8)	(£351.9)
Service Developments				(£3.5)	(£7.0)
Capital Income - Returns from Trading Assets	£5.0	£5.5	£6.0	£6.5	£7.0
Capital Income - Property		£1.0	£1.0	£1.0	£1.0
Financial Position before Capital Appropriation:	£50.8	£53.8	£60.8	£68.1	£75.8
Capital Appropriation: Major Capital	(£29.8)	(£36.8)	(£42.4)	(£42.2)	(£42.0)
Capital Appropriation: Routine Capital	(£10.5)	(£10.5)	(£10.5)	(£10.5)	(£10.5)
Capital Appropriation: Capital Income	(£5.0)	(£6.5)	(£7.0)	(£7.5)	(£8.0)
Total Capital Appropriation	(£45.3)	(£53.8)	(£59.9)	(£60.2)	(£60.5)
Overall Surplus / (Deficit)	£5.5	£0.0	£1.0	£8.0	£15.3

- 6.29 The table shows that a surplus position is attained by 2019 which enables the reform dividend to be used, as envisaged, to reinvest in new or improved services or meeting increased demand from 2020 onwards where this surplus grows to a more significant level.

- 6.30 Further work is required to better understand any future service demands arising from the changing demographic and the financial implication of this. The work being undertaken in initiatives such as the Supported Living & Ageing Well Strategy and Transforming Health & Social Care Services should help understand the likely residual demand growth once those strategies and plans have been put in place which are focussed on mitigating such demand.
- 6.31 In addition, although there are currently no clearly identified or costed pipeline new or improved services, the Policy & Resources Committee has assumed that the policy work being undertaken by the Committees will ultimately lead to such proposals and has therefore made an allowance of £3.5million per annum in both 2020 and 2021.
- 6.32 It is hoped that, in future iterations, the Policy & Resource Plan will facilitate longer term planning such that a good understanding is available at an early stage of the likely implications of policy proposals which would allow prioritisation of such developments. However, at this stage in the evolution of the Policy & Resource Plan, the Committee considered it important to make an estimated allowance of the amount likely to be available for investing in those plans and initiatives that best deliver the outcomes set out and agreed in the Policy & Resource Plan.
- 6.33 However, the Committee considers it important to stress that financial sustainability should be central to the thinking on policy development. It is not sustainable for every new strategy or plan to come with a significant price tag for implementation. Policy is a critical element in the design and delivery of the reform of public services and it is vital that financial considerations are central to the thinking in such work.
- 6.34 The residual surplus from 2020 will need to be utilised to rebuild depleted reserves. The Committee is proposing that the following approach is taken to dealing with surpluses:
- The General Revenue Account Reserve is used for managing any in-year shortfalls in income, short term cyclical variations and other timing issues. The Policy & Resources Committee proposes that the policy for the average balance in the General Revenue Account Reserve should be set at 5% of revenue income and that this should be replenished as soon as possible after any required drawdown;
 - The Contingency Reserve was used to fund deficits over the period following the introduction of Zero-Ten. This fund was therefore depleted ahead of the establishment of the Core Investment Reserve. The Committee proposes that, in line with previous policy, the States' objective should be to increase the value of the Core Investment Reserve to one year's revenue income. The Policy & Resources Committee will make proposals as part of the annual Budget Report

for any appropriations to the Core Investment Reserve when the overall financial position is in surplus.

7. SENSITIVITY ANALYSIS

- 7.1 Due to the inherent difficulties with forecasting with regards to income in particular, this section explores areas of sensitivity and indicates possible improved or worsened financial positions as a result of changes to the assumptions used.

Economic Growth

- 7.2 Income growth underpins public service provision but is particularly challenging to forecast. The Plan has taken a prudent approach to growth in an attempt to deliver a Plan that is realistic and sustainable. The revenue forecast driven by economic growth utilised in the plan is a prudent one but is one that we should be looking to outstrip significantly, encouraging and facilitating economic growth and taking the opportunities presented in this period of international change and transition.
- 7.3 Any upside on economic growth will help to remove the deficit earlier than forecast and could lead to reform dividends being available to fund prioritised initiatives earlier rather than contributing to recovering a balanced baseline.
- 7.4 The policy work being developed by the Committee *for* Economic Development will be pivotal in delivering any upside in revenues of this nature. Support and investment will be made available, through the Future Guernsey Economic Fund, to initiate and support meaningful projects that have clear and measurable impacts on both the Island economy, its international standing and by way of result, identifiable improvement in our tax receipts.
- 7.5 Table 23 illustrates different growth scenarios and the likely impact on income tax receipts:

Table 23: Sensitivity Analysis: Taxation – Positive

Income Tax - Individuals (Including Distributions)	FY - 2017 (Base)	FY - 2018	FY - 2019	FY - 2020	FY - 2021
Medium Term Financial Plan Growth Rate	£263.2	£264.0	£265.3	£266.0	£266.9
1% growth		£265.8	£268.4	£271.1	£273.8
2% growth		£268.4	£273.8	£279.3	£284.9
3% growth		£271.1	£279.2	£287.6	£296.2

Companies Taxation	FY - 2017 (Base)	FY - 2018	FY - 2019	FY - 2020	FY - 2021
Medium Term Financial Plan Growth Rate	£46.8	£47.0	£47.3	£47.6	£47.9
1% growth		£47.3	£47.7	£48.2	£48.7
2% growth		£47.7	£48.7	£49.7	£50.7
3% growth		£48.2	£49.7	£51.1	£52.7

- 7.6 If 1% growth was achieved in Individuals' Income Tax (including distributions) then over the medium term the cumulative difference to the forecast in the plan would total £17million. The rewards of attaining growth are clear to see although recognised as a challenge to attain.

Lower Underlying Income Tax Receipts

- 7.7 The starting position for the Plan forecast is based on latest estimates of revenue income in 2017. There is a risk that these forecasts prove optimistic. If the starting point is revised to £254million, i.e. Individuals at £245million (which is in line with 2016 performance), and distributions at the budgeted total of £9million, then the revenues going forward are of course impacted significantly. With the growth scenario utilised in the medium term plan the result of a lower starting point means that by the end of 2021 the total for Individuals (including Distributions) are still £5.6million short of the 2017 starting position, meaning that the deficit would effectively be £37.1million greater and it would take over 1% underlying growth from that lower base to ultimately match the assumptions that we have in the plan.

Table 24: Sensitivity Analysis: Taxation – Negative

Income Tax - Individuals (Including Distributions)	FY - 2017 (Base)	FY - 2018	FY - 2019	FY - 2020	FY - 2021
Medium Term Financial Plan Growth Rate	£254.0	£254.8	£256.0	£256.8	£257.6
1% growth		£256.5	£259.1	£261.7	£264.3
2% growth		£259.1	£264.3	£269.5	£274.9
3% growth		£261.6	£269.5	£277.6	£285.9

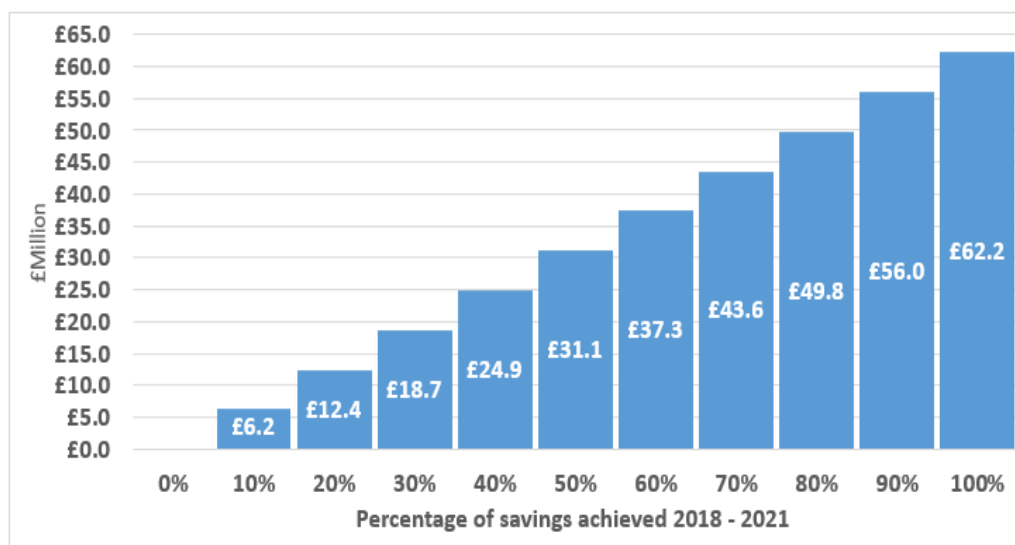
Higher or Lower Net Migration

- 7.8 A net increase of 100 residents is calculated to result in an annual benefit to the Island purely in taxation terms of approximately £0.4million per annum. Therefore higher or lower net migration would lead to a corresponding change in tax receipts.
- 7.9 Any increase or decrease in net migration would also impact on expenditure although this has not been quantified.

Negative Sensitivity: Non-achievement of Savings Targets

- 7.10 Table 25 below summarises the impact of partial delivery ranges for savings programmes and the impact on the underlying position. At the absolute worst case where no progress is made then the impact over the period 2018 – 2021 would total £62.2million of additional costs over the period when compared to the forecast assumptions.
- 7.11 The ranges are clearly significant, for example, a 70% achievement of the programmes below will have succeeded in delivering a balance of £43.6million in cumulative savings when compared to the current position due to significant progress over four full years.
- 7.12 It will be vital that the plans for delivering these savings are properly scoped, risks understood and timescales realistic at the outset. Monitoring of delivery will then give early warning of any deviation, allowing plans to be refined or new initiatives to be explored.

Table 25: Sensitivity Analysis: Savings Targets



Inflation

- 7.13 Inflation is set to increase over the short term and is expected to rise above 3% before the close of 2017. High inflation could lead to real pressure on both revenue and capital expenditure, leading to price increases and unit costs for minor and major purchases that are above the resource baseline of the States. It is therefore essential that we are proactive with procurement strategies, securing contracts that limit generic exposure to such increases.
- 7.14 The challenge of controlling public sector pay is increased in times of high inflation. It will be important to recognise the cost of living in pay negotiations alongside the overall financial health of the States. With a pay budget at approximately £217million a 1% inflationary pressure would result in an additional cost of £2.2million per annum.
- 7.15 Inflation creates threats to mitigate but also presents opportunities. If public sector expenditure can be protected from the full impact of inflationary increases, growth in Income Tax may outstrip increased expenditure.

Summary

- 7.16 The medium term is uncertain and we could experience reductions in taxation due to economic turbulence, potentially significant additional revenues from strong economic growth or material gaps in the financial position through non-delivery against savings plans. Such fluctuations across the medium term further complicate forecasting and trend analysis. This Plan takes a prudent approach to estimates over the period but recognises the potential upside and downside risks. Material deviations from the Plan will require close monitoring and possible adjustments to the fiscal strategy.

8. MEDIUM TERM CAPITAL PLAN

Introduction

- 8.1 There are inherent difficulties in forecasting income and expenditure over extended periods, with increasing uncertainty the further ahead you look. However, the Policy & Resources Committee has compiled a four year forecast of revenues and expenditure in order to commence planning for this term of Government and support the first phase of the Policy & Resource Plan.
- 8.2 The ultimate objective of the capital portfolio is to support the achievement of the vision set out in the Policy & Resource Plan and the delivery of the strategic objectives for the States through investment in infrastructure and systems.
- 8.3 It is also essential that we invest in the projects which are financially viable, the recurrent costs of which can be met and that the proposed outcomes represent value for money. Capital assets underpin the delivery of a range of core public services and effective management of these assets is necessary for States to realise their economic goals and deliver better public services. Improved capital planning provides confidence that assets will be well managed; future investment will align with the outcomes sought by the States; and the current level of outputs will continue to be delivered.
- 8.4 The States have, in recent years, split capital into routine capital allocations and appropriations to the Capital Reserve. Routine capital allocations have been managed at a Committee level whereas Capital Reserve projects have been considered on a prioritised basis across the public service. The distinction between routine and strategic capital has been blurred at the edges with some straightforward, routine projects costing just above the threshold being subject to the same rigorous processes as critical strategic projects with multi-million pound budgets.
- 8.5 The annual approach taken to routine capital has led, on occasion, to tactical short-term investment and a lack of good capital planning which ensures that assets are well managed and plans are in place for maintenance, replacement and disposal. The 2017 Budget Report set out the intention of the Policy & Resources Committee to propose changes to the approach to routine capital in this Plan which lengthen the planning horizon for all assets and takes a service or function view rather than a purely Committee perspective.
- 8.6 The Policy & Resources Committee is now recommending a revised, States-wide approach to general revenue funded routine capital alongside proposing that all capital projects are in future managed according to their scale and complexity. This should ensure that the States have appropriate influence and oversight of large projects with investment of over £10million but that a more streamlined and proportionate approach is taken to low risk, low cost projects with an investment of under £2million.

- 8.7 The Policy & Resources Committee recommends that, in future, one single capital appropriation be proposed each year which incorporates all capital expenditure and no longer distinguishes at the allocation level between routine allocations and appropriations to the Capital Reserve for strategic investment. The management of capital investment would then work along the following lines:

Maintain & Routine Replacement Projects

- 8.8 It is proposed that projects to maintain the operation of existing services and routine replacement projects with a value of below £2million (including what is currently classified as routine capital) should be grouped into categories based on the nature of spend and that the appropriate Head of Profession or service lead be responsible for proposing a prioritised list of projects for approval by the Policy & Resources Committee and inclusion in the Budget Report. This should speed up the delivery of these projects and ensure that they are integrated into medium term routine capital plans.
- 8.9 A prioritisation process will be undertaken which is proportionate to the scale of the projects and will enable the development of rolling programmes. This will enable better functional planning by the Heads of Profession or service leads and ensure funds are directed across the States to the most appropriate projects rather than being based on the availability of capital allocations and local needs alone.
- 8.10 The amount allocated will, in the first instance, be based on historic routine capital expenditure with the addition of an allowance for current straightforward Capital Reserve proposals with a value of less than £2million.
- 8.11 The proposed categories are:
- Property maintenance and minor works;
 - Information Technology;
 - Medical equipment; and
 - Vehicles and other equipment.
- 8.12 Each Committee will be required to approve the capital projects it would wish to see included in the plan. The States are asked to delegate authority to the Policy & Resource Committee so that, once a prioritised list has been approved and proportionate business cases developed, capital votes up to a maximum of £2million can be approved.
- 8.13 The Policy & Resources Committee also wishes to take this opportunity to tidy up an anomaly in the delegated authorities given by the States in terms of the Ports. Currently, the Ports, through the STSB, only has delegated authority to approve capital votes up to £250,000 in line with all other Principal Committees. It would be more appropriate for the STSB to have more control over the Ports capital expenditure which is funded through the Ports Holding Account. Therefore, it is

recommended that delegated authority is given to the STSB in respect of the Ports Holding Account of up to £2million per project.

Major Capital Portfolio Projects

8.14 The approval pathway will in future be scaled appropriately to ensure that the necessary assurances are obtained before progressing the project. The pathway will depend on the estimated value and risk profile of project. A scalable approach to project funding should have the benefit of reducing the burden of the States having to discuss low-value or replacement type projects with the consequential delays to project delivery.

8.15 It is proposed that the States will continue to approve the inclusion of projects and programmes into the capital portfolio but that they will then be managed as follows:

- **Non-routine small projects - Estimated value range < £2m**

The States are recommended to delegate authority to the Policy & Resources Committee to approve project business cases and funding for all projects with a value up to £2million once the States have approved the admission of the project into the portfolio. This should speed up the delivery of low cost and low risk projects and programmes.

- **Medium projects - Estimated value range: £2m to £10m**

These projects should continue to be managed in the same way with the Policy & Resources Committee having delegated authority to approve funding for progressing the early stages of the project. A policy letter will need to be prepared to seek States approval when the project is ready to tender for the preferred solution. At this stage, the States should be asked to delegate authority for opening the capital vote to the Policy & Resources Committee provided the value is within agreed ranges and the specification and outcomes remain unchanged.

- **Large projects - Estimated value: Greater than £10m**

It is suggested that States are given the opportunity to understand, influence and shape the scope of large significant projects at an early stage. Therefore, once the strategic outline case has been completed which sets out the strategic case for the project; defines the outcomes required and looks at a long list of options for delivery, a policy letter should be prepared seeking States' approval to proceed in the direction proposed. This should avoid committing substantial resources to projects before getting wide agreement to the proposed direction of travel.

The States would then also be asked to approve the developed project when it is ready to go out to tender for the preferred solution. As with the medium

projects, it is anticipated that the Policy & Resources Committee would then be given delegated authority for opening the capital vote provided the value is within agreed ranges and the specification and outcomes remain unchanged

Portfolio Development

- 8.16 The approach to and development of the capital portfolio is detailed in Appendix 1, and has focussed on ensuring there is a value for money driven approach to the review, assessment and development of the projects included in the portfolio. Account has been taken of the feedback previously given that the capital portfolio processes have been slow and cumbersome and this has led to a set of simplified steps with regards to the key processes to ensure that project management disciplines are followed but are flexible and scale-able.
- 8.17 Since the November 2016 Budget Report, significant work has been undertaken by the portfolio team and the category leads to better understand the scale, risk and timeframes of the projects. The Policy & Resources Committee would now like to propose that the following projects, listed by category and scale, are approved to form the capital portfolio for the next four year period (in addition to those legacy projects already underway). A summary of each of these projects is attached at Appendix 1:

Table 26: Portfolio Projects in the Maintain Category

MAINTAIN CATEGORY		
Small	1	Coastal Flood Defences (Phase 1)
	2	Longue Hougue Breakwater
	3	CCTV Replacement
	4	Footes Lane Refurbishment
	5	St Sampson Fire Main
	6	Town Fire Appliances
Medium	7	Cremation Services
Large	8	Affordable Housing Programme (Phase 1)
	9	Affordable Housing Programme (Phase 2) (Pipeline)
	10	Hydrocarbon Supply (Pipeline)
	11	Inert Waste Solution (Pipeline)

	12	Coastal Flood Defences (Phase 2) (Pipeline)
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Table 27: Portfolio Projects in the Grow Category

GROW CATEGORY		
Small	1	Cyber Information
Medium	2	Castle Cornet Refurbishment
Large	3	Digital Infrastructure
	4	Guernsey Runway Extension (Pipeline)
	5	Guernsey Sea and Air Connectivity (Pipeline)
	6	St Peter Port Harbour Action Area Development (Pipeline)

Table 28: Portfolio Projects in the Transform Category

TRANSFORM CATEGORY		
Small	1	Digital Court
	2	Health & Social Services LAN
	3	Office Rationalisation SCFH Phase I
Medium	4	Contribution and Tax Services programme (CATS)
	5	SAP Roadmap
	6	Office Rationalisation SCFH (Phase 2)
	7	HSC Peripatetic accommodation
	8	HSC Property Rationalisation
	9	Future Digital Services
	10	Digital Channel Shift (Phase 1)
Large	11	Digital Channel Shift (Phase 2)
	12	The Education Estate Development - (Phase 1)

	13	The Education Estate Development – (Phase 2) (Pipeline)
	14	Princess Elizabeth Hospital (PEH) Re-profiling – (Phase 1)
	15	PEH Re-profiling – Phase 2 (Pipeline)
	16	Home Affairs Estate Rationalisation

8.18 In line with previous portfolios and in order not to unfavourably prejudice obtaining tender prices for projects which could lead to the States paying more than necessary, no cost estimates for individual projects have been included at this stage.

8.19 The Policy & Resources Committee wishes to stress that the States are not being asked at this stage to allocate any specific budget to any of the projects within the portfolio. Inclusion in the portfolio allows the States to have a clear list of prioritised projects which are being developed. A firm budget will be allocated when the proposals have been developed further and the proposed solution identified.

Pipeline Projects

8.20 Through the prioritisation process it became apparent that a number of the proposals submitted are longer term in nature and are not likely to commence anything but planning within this medium term prioritisation period. This has given an opportunity to extend the planning horizons for the portfolio and recognise this forward-looking assessment of the proposed projects.

8.21 The Policy & Resources Committee is recommending that these proposals be classified as pipeline projects which will be considered for inclusion in the capital portfolio following the next prioritisation round. This should provide transparency for the general public about how the infrastructure they rely on is being maintained and improved; some certainty to the supply chain to support capacity planning; and planning certainty to the proposers of projects.

8.22 Large high risk complex projects take time to scope, plan and procure. Taking a longer term view allows for better planning and scoping and, if there is a need, pipeline projects will be able to seek funding to develop. However, formal inclusion in the portfolio and the final investment decision will not be made until the next period

8.23 It is proposed that the following should be included in the portfolio as pipeline projects:

- Hydrocarbon Supply;
- Inert Waste Solution;
- Affordable Housing Programme (Phase 2);
- Coastal Flood Defences (Phase 2);
- The Education Estate Development (Phase 2);
- Guernsey Sea and Air Connectivity;
- Guernsey Runway Extension;
- St Peter Port Harbour Action Area Development; and
- PEH Re-profiling – (Phase 2).

Funding the Portfolio

- 8.24 The 2017 Budget Report set out the movements on the Capital Reserve over this portfolio period, including estimated appropriations from General Revenue, anticipated Capital Income received from Trading Assets and returned surpluses on existing projects and property sales. The estimated funding available, after holding back an allowance for urgent and emergency projects, was £282million.
- 8.25 This funding model has now been updated in this Plan. The result is that the total estimated funding has increased to in the region of £300million, largely due to the exceptional investment returns achieved in 2016 and the decision to seek to appropriate the full 3% of GDP to the Capital Reserve over the medium term.
- 8.26 As part of the 2017 Budget Report a proportion of the total funding was allocated to each category to reflect their relative importance balanced with the value of submitted proposals: 30% to Maintain; 50% to Transform; and 20% to Grow.
- 8.27 At the time of the Budget Report, the total value of the proposals was £690m, which clearly presented the problem that not all projects could be funded. Following a series of detailed follow up meetings to gain a greater understanding of each project, further work by the projects, and other changes the overall required has now fallen to £236million in this period, accounted for as follows:
- Reductions in estimated project costs: £152million
The significant changes that made up this movement were: refinement of the education estate proposals with a £53million reduction; a better understanding of the scope of the Critical Digital Infrastructure project leading to a reduced value of £40million; the preferred option for the Alderney airport having reduced by £27.5million; and a £22million reduction in the planning value for the PEH Re-profiling project following refinement of the scope.
 - Removal of two projects from the portfolio: £18million
The Bus Depot and Solar PV projects have been removed from the portfolio. The former due to no identified need other than a contingency and the latter as it was considered that there are other ways of delivering the desired outcomes.

- Removal of projects with potential for Bond funding: £53million
The inert waste and digital infrastructure projects both appear suitable for loan financing from the bond proceeds at this stage. Therefore, the planning values have been removed from the portfolio. Should it prove necessary to fund the either the entirety or part of the costs from the Capital Reserve, they may need to be added into the portfolio at a later date.
- Removal of full value of pipeline projects: £230million
As set out in paragraphs 8.20 to 8.23 above, a series of projects are longer term in nature and therefore would only require seed funding in this period to commence planning and scoping.
- Removal of all Ports projects: £7million
Following discussions between the officers supporting the Ports' capital projects and those working on the development of the portfolio, all bids for funding from the Ports have been removed and are assumed to be funded from the Ports Holding Account. Once again, should future changes mean that Capital Reserve funding is sought then they may need to be added to the portfolio at a later date or funded through loans from the bond proceeds.

Table 29: Category Allocations - From Budget Report 2017 to Revised Proposal

Category	Agreed Allocation (£m)	Initial Funding Proposal (£m)	Revised Funding Proposal (£m)
Maintain	£85	£275	£46
Transform	£141	£282	£185
Grow	£56	£133	£6
TOTAL	£282	£690	£236

- 8.28 The significant work undertaken to understand and build the portfolio now means that the allocation to the 'Grow' category exceeds the proposed projects. However, the Committee does not think that the allocation should be changed at this stage as it considers it important that the importance of the Grow category as an enabler for delivering the outcomes set out in the Policy & Resource Plan should not be underestimated. It is possible that, as a result of the development of the Policy & Resource Plan identifying gaps between policy aspirations and capital plans and further opportunities arising over the period, the States will be asked to approve additional projects in this category.
- 8.29 Further, the 'Transform' category remains oversubscribed. This is largely due to the scale of the capital investment sought in this period by the Committee for Education, Sport & Culture for the proposed changes to the education estate. The

Policy & Resources Committee remains committed to ensuring that an appropriate solution is put in place to deliver an education estate that can support the educational outcomes sought. The Committee therefore remains hopeful that the cost of this category can be reduced.

9. POLICY & RESOURCES COMMITTEE PRIORITY FISCAL POLICIES/PROJECTS

Independent Taxation

- 9.1 Under the current tax system a married couple are assessed jointly, with the husband responsible for submitting the tax return, disclosing income for himself and his spouse and receive a married person's allowance irrespective of whether one or both spouses receive income. Provisions have recently been put in place for civil partners to have the same rights and co-habitees who are in receipt of family allowance can elect to transfer allowances between the partners.
- 9.2 This system discriminates against women and treats those unmarried co-habiting couples who do not have children differently, as they have no entitlement to transfer any unused allowance.
- 9.3 The Policy & Resources Committee considers that this system is outdated and inequitable and that people should be treated independently for tax purposes and assessed in their own right. Therefore, the Committee intends to progress a move to independent taxation over this term.
- 9.4 Whilst it is inevitable that this would increase the number of individuals in the tax system (as married couples change from being one taxpayer to become two), the removal of the ability to transfer allowances, the removal of the need to alter people's tax affairs on marriage and separation, and the receipt of interest information directly from banks, should mean that, under a system of independent taxation, a substantial proportion of taxpayers may be relieved from the need to complete tax returns each year, and for those that still do, many should be capable of being automatically assessed.
- 9.5 Independent taxation would also mean that the calculation and collection of income tax would become more aligned with social security, which assesses social insurance contributions separately for married couples. Such simplification of the tax system and alignment with social security will be essential if the full benefits possible as part of the Contributions and Tax Services programme are to be realised.
- 9.6 The Policy & Resources Committee recognises that the States have considered and rejected similar measures in the last term. This was based on the impact that such a change would have on the financial position of married persons should transferability of allowances cease. Therefore, consideration will need to be given to the treatment of the transferability of allowances under any proposed system as the Committee recognises the financial implications of making such a change due to the married person's allowance being set at double the personal allowance. The practicalities and proposed method of implementation will need to be considered further before proposals are brought to the States.

Returns from Commercial Entities

- 9.7 During 2015, the Treasury & Resources Department commenced work to determine the appropriate level of investment return that should be generated from the States' trading assets. This work resulted in £10m return of capital from the States owned incorporated assets which has been transferred to the Capital Reserve. It remains the view of the Policy & Resources Committee that the trading assets, both incorporated and unincorporated, should generate a return to the States of Guernsey, which in turn could be transferred to the Capital Reserve to be reinvested in future capital infrastructure.
- 9.8 The STSB has now been established with a mandate to manage these entities and is applying a more commercial model and rigour to the trading assets. Such an approach should result in dividends and return of capital / equity to the States as owner with improved focus on efficiency to ensure that this does not detrimentally affect customers by resulting in fees and charges being increased.
- 9.9 The Committee will work closely with the STSB to set a clear policy in respect of returns from trading entities. Consideration will be given to appropriate dividend policies for each entity given capital requirements; return on capital employed; and funding for past and future capital investment.

Property

- 9.10 In addition to the trading entities, the STSB also has responsibility for Property Services. A more disciplined approach to the use, management purchase and disposal of property assets has the potential to provide sustainable income streams through rental income or one-off capital receipts through the disposal of surplus properties.
- 9.11 The Committee wishes to work with the STSB to develop a pipeline of properties to be disposed of (and potentially a short list of target assets to purchase/develop). This will enable the Policy & Resources Committee to better plan its capital portfolio, and manage its cash flow.
- 9.12 Fundamental to better management of the estate will be a more disciplined and efficient use of States' owned assets by internal users. The Committee therefore intends to work with the STSB to ensure that property usage is properly monitored and controlled through regular performance reporting. From 2018, it is intended that a system is put in place to report notional 'rental' space or cost for all office accommodation (whether that be States owned or commercially rented) to enable a cultural change which enables those occupying space to be aware of the significant costs of doing so.
- 9.13 Over time, the Committee believes that this will lead to a more efficient use of the estate, potentially freeing up further assets for disposal.

Social Investment Commission

- 9.14 As set out in the Committee policy plan, one of the Committee's priorities will be developing and implementing a commissioning framework so that, in future, it will be easier for the States as an organisation to commission services and monitor their delivery.
- 9.15 In order to support this, the Committee wishes to exploit all available sources of finance which might support the commissioning of services and enable investment in longer-term preventative strategies that could significantly reduce the pressure on the future public service.
- 9.16 The second phase of this work would involve ensuring that funding which is currently paid by way of grants and subsidies to the third sector is used to help deliver on desired outcomes.
- 9.17 Therefore, the Committee is working with the Association of Guernsey Charities to explore the establishment of a social investment commission as a vehicle to act as an enabler of social investment projects and funder of the same.

Innovation and Infrastructure Fund

- 9.18 The Policy & Resources Committee believes that there is an opportunity, through the investment funds under its control, for the States to invest in local innovation and/or infrastructure to the overall benefit of those funds and the wider economy. The impact to the Guernsey economy could come from, inter alia, attracting Fintech opportunities to the island; improving the local skills base; helping diversify the economy; increasing the use of local service providers (lawyers, accountants, fund administrators etc); providing higher quality employment opportunities; and supporting the digital policy framework.
- 9.19 The Committee believes that the driver for such a fund must be a commercial return objective appropriate to the type of investments being considered and that risk must be balanced and controlled through diversification and investment limits.
- 9.20 The Investment & Bond Sub Committee is progressing this initiative and is hoping that it will be shortly be presented with a suitable investment opportunity by a local reputable investment manager. It is envisaged that any investment would be made into a fund structure, so that – as with any other fund into which the States invests – the fund manager would be responsible for running the fund and making all investment decisions.

Funding Health and Long Term Care

- 9.21 The Policy & Resources Committee announced as part of the 2017 Budget Report its intention to review the current system of social insurance health service

funding to try and tackle some of the underlying equity issues in that system; make the overall collection of taxes and contributions more progressive by applying an allowance; and provide a more transparent funding mechanism which places all spending on health and social care services directly under the control of the Committee *for* Health & Social Care.

- 9.22 The Committee has been working with the Committee *for* Employment & Social Security on this project, and both Committees felt it appropriate to include in this review the method of funding long-term care through the Long Term Care Fund and work is being progressed on this project.
- 9.23 There are no further resource implications, efficiencies or measures included in this report, aside from the reinstatement of the Health Service Grant, and a further update will be provided in the 2018 Budget Report.

Resource Accounting

- 9.24 The States' Accounts are currently prepared on a 'modified accruals' basis which means that not all international accounting standards are applied, most notably, we account for capital expenditure in the year of purchase rather than holding the asset on the balance sheet and depreciating it over its useful life. This means it is difficult to appreciate the ongoing value of those assets and understand the true cost of their use by Committees. This leads to an opaque picture regarding the true cost of the services we deliver, a lack of focus on driving the best value from these assets and an inability to compare costs and financial performance year on year.
- 9.25 The States have already decided to adopt a resource accounting model and implement International Public Sector Accounting Standards - an internationally recognised set of principles laying down best practice and guiding the preparation of accounts in the public sector – but to date it has not been possible to progress this project due to competing priorities.
- 9.26 The Policy & Resources Committee recognises the benefits of resource accounting are far broader than simply the method by which accounts are prepared. Moving to this approach improves accountability; enables better decision making; eases comparability and leads to a better use of assets.
- 9.27 The Committee now wishes to ensure that this project is progressed in this term with an incremental introduction commencing with fixed asset valuation and accounting.

Priority Based Budgeting

- 9.28 The current system of budgeting in the States is largely incremental. Although zero based budgeting principles are adopted, service leads and managers largely seek

a small increase on the previous year's budget. This leads to static and outdated budgets being set which do not reflect the current priorities of the States.

- 9.29 The Committee intends to roll out a system of priority based budgeting on an incremental basis over the next three years. Work has already commenced on this project as part of the recent costing, benchmarking and prioritisation projects in Education, Sport & Culture and Home Affairs. One element of this project was to design a priority based budgeting approach capable of being adopted across the States.
- 9.30 The approach adopted enables an objective scoring process to consider different services and examine their relative priorities. Ultimately, this should allow sufficient visibility and understanding of the cost base that decisions can easily be made to re-allocate resources between services and across Committees.

Health Tax

- 9.31 In relation to the 2017 one-off suspension of the Health Service Grant the longer-term strategic review of overall Health Service Funding and its potential reform were indicated in the Budget Report;

“The Policy & Resources Committee has had initial discussions with the Committee for Employment & Social Security on this matter and agreed that there is merit in examining the options in more detail and exploring all of the risks and opportunities. Therefore, the Committees are intending to work together over the next year, in consultation with the Committee for Health & Social Care, in considering the reform of health service funding and will report back with proposals as part of the 2018 Budget Report”.

- 9.32 Work is being progressed on this project to review the way in which revenues are collected for the provision of Health and Long-Term Care Services that are currently being funded through Social Security contributions. The objective of the project is to provide more transparency and consistency in the way we pay for these types of service, while providing an opportunity to make our overall tax systems fairer and more progressive. There are no further resource implications, efficiencies or measures included in this report, aside from the reinstatement of the Health Service Grant, and a further update will be provided in the 2018 Budget Report.

RECOMMENDATIONS

1. To approve the approach detailed in the Medium Term Financial Plan for achieving a return to an underlying financial surplus by 2019 through a combination of savings targets and income measures totalling approximately £40 million and to direct the Policy & Resources Committee to take account of the Medium Term Financial Plan when formulating proposals for inclusion in annual Budget Reports.
2. To approve that the General Revenue Appropriation to the Capital Reserve should be the lower of that which achieves an overall annual investment of 3% of GDP or an amount that results in a balanced budget position.
3. To direct the Policy & Resources Committee, when the General Revenue Appropriation to the Capital Reserve achieves an overall annual investment of 3% of GDP, to include proposals in the annual Budget Report for use of any surpluses, to replenish other States' Reserves (having regard to the policies set out in recommendations 4 and 5) such as the General Revenue Account Reserve or the Core Investment Reserve, or to invest in service developments, the Future Guernsey Economic Fund, the Transformation and Transition Fund or new services.
4. To approve a policy for the target balance of the General Revenue Account Reserve of 5% of annual General Revenue Income.
5. To approve a policy for the target balance of the Core Investment Reserve of 100% of General Revenue Income.
6. To approve the Capital Portfolio as per the projects listed in tables 26, 27 and 28, classified as small; medium; and large projects.
7. To approve that the process contained within paragraphs 8.6 to 8.15 is adopted as the approval process for capital projects.
8. To delegate authority to the Policy & Resources Committee to approve opening capital votes for any project with a value not exceeding £2 million, funded from the Capital Reserve.
9. To delegate authority to the States' Trading Supervisory Board to approve opening capital votes for any project with a value not exceeding £2 million, funded from the Ports Holding Account.

10. To approve the projects listed in paragraph 8.23 as pipeline projects.

APPENDIX I

CAPITAL PORTFOLIO PLAN

1. The approach taken in the capital prioritisation exercise has sought to build on previous experience and incorporate 'lessons learned' and best practice guidelines.
2. The work to define the Portfolio has been developed in four phases:

I Understand

The purpose of this phase is to obtain a clear and transparent view of the current projects in the portfolio plus the projects which are in planning, under development and wishing to be included in the portfolio.

Proposals were invited from across the organisation by completion of an on-line form designed to gather all necessary information. In May 2016, each new Committee was asked to confirm that all proposals submitted in respect of their mandated areas of responsibility remained a priority. As a result of this exercise, all proposals were confirmed and one additional proposal submitted.

In total, 51 proposals were submitted with a total estimated capital value of approximately £690million.

II Prioritise

A panel of senior officers was established to consider the proposals. The panel met with all of the submitting teams to ensure that there was an opportunity to explain the background to the proposals and enable questions to be asked in order better to understand and challenge the proposal before scoring was finalised.

The proposals were then assessed and scored in accordance with the strategic alignment and desired outcomes; investment objectives; benefits – with cash releasing benefits given a higher weighting; and the number of and anticipated level of impact on each type of potential beneficiary.

While a reasonably standardised and structured approach has been deployed, and is of value, judgment has also been exercised; this has not been a 'tick-box exercise'

III Categorise – Main Categories

All Projects were categorised according to three categories:

- Maintain – maintain the operation of existing services
- Transform – transform service delivery in line with public service reform
- Grow – benefit the island or a specific sector of the economy

This approach made it easier to understand the make-up of the portfolio and to make decisions on the optimum use of available funding and resources.

A member of the Chief Executive's Management Team was assigned to each category in order to lead its progression and work closely with the portfolio team to further challenge and scrutinise the proposals within each category following the initial prioritisation.

IV Balance and Plan

The initial prioritisation resulted in a ranked list of proposals. A significant amount of work has been completed in order to be able to propose a balanced, affordable capital portfolio.

The portfolio has been 'balanced' in order to ensure that the prioritised projects represent the optimum return on investment when taking account of factors such as ensuring a manageable spread of projects to avoid any unsustainable burden which would adversely impact 'business as usual'; exploring risks and the complexity of the project; examining funding options; and understanding the likely timelines.

The Portfolio Director and category leads have worked with the project leads to examine the impact of deferral; investigating alternative solutions; exploring all funding options (including alternative sources); undertaking feasibility analysis; and defining an affordable project scope.

All proposers were asked to give indicative timescales for the definition, design, delivery and closure phases of their projects as part of the initial proposal form. In discussions with proposers it became clear that several projects would not require funding for delivery until the next round of capital prioritisation. It is being proposed that these projects are included as 'pipeline' projects and are developed for inclusion in the next round.

3. The portfolio plan provides a baseline against which progress will be monitored and managed. The plan contains:
 - Approval pathway and delegated authority;
 - Summary of projects to be included in the portfolio;

- Summary of projects included from previous rounds; and
- Proposed scheduling and timing of the projects.

Approval Pathways and Delegated Authority

All projects within the portfolio must be developed and presented in accordance with the best practice 5-case business case model. The business case is developed in three key stages:

Scope – scoping the project and preparing the strategic outline business case (SOC).

Plan - Planning the project and preparing the outline business case to confirm the preferred solution which offers optimal value for money (OBC).

Procure – Procuring the option chosen at OBC, putting in place delivery plans and providing the final detailed costing of the full business case (FBC).

The States' approved assurance process examines large programmes and projects at the end of each stage. For smaller less risky projects some of the stages may be combined. The objective of this process is to scrutinise projects and programmes from the perspective of delivery of optimum public value for money; the optimum combination of net whole-life public value, risk and cost including quality (and fitness for purpose) to meet the needs of the proposing body. The reviews inform decision makers at key approval points in their lifecycle in order to provide the necessary assurance that they are in a position to progress successfully to the next stage of their development.

It is proposed that the approval pathway is scaled appropriately to ensure that the necessary assurances are obtained before progressing the project. The pathway will depend on the estimated value and risk profile of project as follows:

Non-routine small projects - Estimated value range < £2m

The States are recommended to delegate authority to the Policy & Resources Committee to approve project business cases and funding for all projects with a value up to £2million once the States have approved the admission of the project into the portfolio. This should speed up the delivery of low cost and low risk projects and programmes.

Medium projects - Estimated value range: £2m to £10m

These projects should continue to be managed in the same way with the Policy & Resources Committee having delegated authority to approve funding for progressing the early stages of the project. A policy letter will need to be prepared to seek States approval when the project is ready to tender for the preferred solution. At this stage, the States should be asked to delegate authority for opening the capital vote to the Policy & Resources Committee provided the value is within agreed ranges and the specification and outcomes remain unchanged.

Large projects - Estimated value: Greater than £10m

It is suggested that States are given the opportunity to understand, influence and shape the scope of large significant projects at an early stage. Therefore, once the strategic outline case has been completed which sets out the strategic case for the project; defines the outcomes required and looks at a long list of options for delivery, a policy letter should be prepared seeking States' approval to proceed in the direction proposed. This should avoid committing substantial resources to projects before getting wide agreement to the proposed direction of travel.

The States would then also be asked to approve the developed project when it is ready to go out to tender for the preferred solution. As with the medium projects, it is anticipated that the Policy & Resources Committee would then be given delegated authority for opening the capital vote provided the value is within agreed ranges and the specification and outcomes remain unchanged.

Summary of projects to be included in the portfolio

There is a further significant work required to develop the projects including examining all options; investigating alternative solutions; exploring all funding options (including alternative sources); undertaking feasibility analysis; and defining an affordable project scope.

It is intended that funding is made available from the Capital Reserve to support the development of the initiatives to inform consideration at key approval points.

It is proposed that the assessed and moderated projects listed below be included within the portfolio to be further progressed:

Project Name	Description
Affordable Housing Programme	Seeking funding for CESS to acquire (either directly or through housing associations) land upon which to develop affordable housing. The States will become less dependent on the private rental sector for keyworker accommodation; and will replace substandard States-owned keyworker accommodation with new-builds.

Castle Cornet Refurbishment	Aiming to refresh some areas of the Castle including some of the museum exhibits to encourage visitors to the attraction and increase income from it.
CATS	Programme looking at the way in which the contribution and taxation services could be improved and to update the working practices and supporting it systems and operational
CCTV Replacement	Upgrade and replace the Public Safety CCTV System which is in place at the Airport, Harbours, Town Centres, Courts, Police Headquarters and Beau Sejour Leisure Centre.
Coastal Repairs	Continuing programme of works carrying out repairs to the islands damaged coastline. Some of these works date back to the winter storms of 2013 but were of lower priority.
Coastal Flood Defences	Investment in flood defences to mitigate against sea level rises focussing on the St Sampson's / Bridge area of the island but also investigating other areas for future investment including Belle Greve, Bordeaux, Port Gras, Cobo
Cremation Service	Replacing the cremator at the Foulon site with bringing it up to date with current air quality standards and the need to be able to deal with an increasing number of bariatric
Cyber Information	This project will aim to improve the protection of data held within the Bailiwick and the ability to prevent and respond to the increasing threat of cyber-attacks.
Digital Infrastructure	Looking at the future digital infrastructure on the island and planning the strategy to deliver enhanced high speed connectivity to both homes and businesses on the island.
Digital Channel Shift (Phase 1)	Changing the way that the States of Guernsey offers its services and to move towards a 'Digital by Default' form of communication and service provision should help to make it easier and quicker for businesses to manage their
Digital Channel Shift (Phase 2)	Changing the way that the States of Guernsey offers its services and to move towards a 'Digital by Default' form of communication and service provision should help to make it easier and quicker for businesses to manage their
Digital Court	The Digital Court project seeks to digitise all functions provided by the court, allowing for digital sharing of data, "Enter data once and use it many times".

The Education Estate Development	The Education, Sport & Culture Committee will return to the States in June to set out their options for delivering the changes to secondary and further education. This will include a move to a three high school model and will make use of existing buildings within the education estate but will also require some newly constructed ones too.
Footes Lane Refurbishment	Replacement of the athletics track ahead of the 2021 Island Games and associated works to improve facilities for both competitors and spectators including accessibility for disabled users.
Future Digital Services	States of Guernsey IT Infrastructure Refresh.
Guernsey Runway Extension	This project seeks to extend the current runway at Guernsey Airport to enable larger aircraft to land in Guernsey. This will enable new routes to be opened and will go some way to meeting predicted increased resident demand in the future, as well as the aspirations of the Tourism Strategy to increase visitor numbers by 100,000 by 2025.
Harbour Action Area	Investigate the development of a thriving and vibrant harbour and seafront through the development of local planning briefs for the Harbour Action Areas. This presents an exciting opportunity for the seafront and the Island as a
Home Affairs Estate Rationalisation	Home Affairs looking at the rationalisation of properties currently being used by the Home Affairs Committee and ways to improve service delivery and release leased
HSC LAN	Upgrade of the IT hardware within the HSC sites. This project is considered to be a key enabler for transformation within the health care offered on island.
HSC Peripatetic Accommodation	Consolidation of HSC Peripatetic – Aiming to consolidate the HSC community services onto a single site (KE VII) which will allow for greater collaboration between teams, easier access for service users and offer opportunities for efficiencies and combining common services. This will also move staff out of several other properties which are no longer suitable for the types of services now being offered and could be released to

HSC Property Rationalisation	Carrying out a review of the property portfolio of the Health & Social Care Committee and determining an appropriate strategy for the c.52 buildings (e.g. maintain / repair / refurbish / dispose / alternative use).
Hydrocarbons	A programme to investigate and develop options to identify a preferred way forward to secure the future of hydrocarbon supply into the island.
Inert Waste	The Proposal is for the provision of a new inert waste disposal solution for the Island. Currently the States of Guernsey has relied on coastal land reclamation for the
Longue Hougue Breakwater	Project to return the breakwater to original state following use as part of the historic St Sampson's Harbour Development works. This will also be key piece of work as Longue Hougue is used for inert waste material to avoid
Office Rationalisation Project 1 – SCFH	Project aiming to consolidate staff into fewer buildings thus releasing or removing rental liability of the freed up offices.
Princess Elizabeth Hospital Re-profiling	Reviewing the PEH Hospital layout and where necessary making changes to ward positions to help deliver the islands health services in a more efficient and effective manner and help support the moves towards treating more patients in the community
SAP Roadmap	Upgrade to the organisations enterprise resource planning system of both platform and user modules. Would lead to an improved workforce planning system which could release significant savings by reducing reliance on bank staff.
St Sampson's Fire Main	Replacing the pressurised water ring-main that serves as the fire suppression for the offloading of liquid fuels and gas to the island at St Sampson's Harbour which has reached the end of its useful life.
Town Fire Appliances	Replacing the turntable ladder fire appliance used by the Town Fire Service.

Summary of projects included from previous rounds

These programmes and projects will continue to develop into delivery. Any unspent balances at closure will be returned to the Capital Reserve for use by future programmes and projects.

The introduction of the three categories within this current planning cycle has been a useful way to differentiate across the portfolio and so the existing programmes and projects have been categorised in the same way (although this does not affect the allocations of funding to each category):

Category	Project Name	Stage
Grow	Alderney Airport Runway	Design
Maintain	Bus Fleet Replacement	Delivery
Transform	Electronic Document Management System (Income Tax Office)	This project has now been included as part of the CATS Project
Transform	Electronic Health & Social Care	Delivery
Transform	Guernsey College of Further Education	This project is now part of the Education Estate Development
Maintain	Leopardess Fisheries Protection Vessel Replacement	Design
Transform	Mental Health & Wellbeing Centre	Retention/Snagging
Maintain	Sea Wall Pointing / Storm Damage Repairs / Coastal Repairs	Delivery
Maintain	Radiology Replacement Programme	Delivery
Maintain	Prison Fence Replacement	Delivery
Maintain	La Mare De Carteret High School Remedial Works	Delivery
Transform	Les Beaucamps High School	Retention/Snagging
Grow	Airport Pavements	Retention/Snagging
Maintain	SCFH Roof Repairs	Retention/Snagging
Maintain	Longue Hougue Sea Defences	Retention/Snagging

Scheduling and Timing of the projects

Key milestone data provided by the projects will be used as a baseline against which delivery of the portfolio can be measured.

This approach should help to provide both long-term and short-term overviews of the cycle enabling improved resource and cost planning. This will also provide a clear view of the contribution that the portfolio will make to deliver the strategic objectives of the organisation.

