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THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

POLICY & RESOURCES COMMITTEE

THE REVIEW OF THE FISCAL POLICY FRAMEWORK AND FISCAL PRESSURES

The States are asked to decide:

Whether, after consideration of the Policy Letter entitled 'The Review of the Fiscal Policy Framework and Fiscal Pressures', dated 25 November 2019, they are of the opinion:

1) To adopt the Fiscal Policy Framework and its Principles as outlined in Section 5 of the Policy Letter.

2) To direct the Policy & Resources Committee, in consultation with all States Members and further to public engagement, to conduct a review to ensure that Guernsey's tax base is capable of raising sufficient revenues to meet long-term government expenditure needs in a sustainable manner within the boundaries of the Fiscal Policy Framework.

3) To agree that the review should be conducted in accordance with the Terms of Reference and methodology laid out in paragraphs 3.16 to 3.20 of the Policy Letter and be presented to the States for consideration by no later than June 2021.

The above propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications in accordance with Rule 4(1) of the Rules of Procedure of the States of Deliberation and their Committees.

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ISLAND OF GUERNSEY

POLICY & RESOURCES COMMITTEE

THE REVIEW OF THE FISCAL POLICY FRAMEWORK AND FISCAL PRESSURES

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

25 November 2019

Dear Sir

1. Executive summary

The Fiscal Policy Framework

1.1 The Fiscal Policy Framework (the Framework), first established in 2009, sets out the island's highest level of fiscal policy, including the boundaries within which more detailed fiscal policy should operate. The Framework provides a series of high-level principles which commit the States to an overarching theme of long-term permanent balance (not spending more than is received) and ongoing fiscal prudence. These principles define fiscal boundaries in terms of long-term fiscal balance and include limits on revenues, deficits and debt against which the States can be monitored and held accountable. It is designed to endure across multiple political terms to promote stability and consistency in fiscal policy.

1.2 This review of the Framework was made necessary by the revision of GDP[1] in 2017 and the beginning of the transition towards International Public Sector Accounting Standards (IPSAS) during 2018. The revised principles within the Framework reflect the evolution of fiscal policy-making since its inception. These principles are summarised as (see section 5 for details):

[1] Gross Domestic Product is a measure of the size of an economy. In Guernsey this is calculated as the sum of compensation of employees (such as wages and pension contributions), gross operating surplus (such as company trading profits), remuneration and profits of sole traders and the income of households.

Principle 1: Guernsey's fiscal policy should operate on a principle of long-term permanent balance.

Principle 2: The annual net deficit reported on the General Revenue accounts for any given year should not exceed 15% of operating revenues.

Principle 3: Annual net deficits reported in the General Revenue accounts should not be allowed to persist for more than five consecutive years.

Principle 4: Measures to address any identified or anticipated deficit must be incorporated in the States Medium Term Financial Plan (MTFP).

Principle 5: The aggregate amount of States' revenue should not exceed 24% of GDP.

Principle 6: Total capital expenditure over any States term should be maintained at a level which reflects the need for long and medium term investment in infrastructure and direct capital expenditure by the States should average no less than 1.5% of GDP per year averaged over a four year period.

Principle 7: The States' total debt should not exceed 15% of GDP.

1.3 The small size and open nature of Guernsey's economy means that long-term permanent balance is important and running a sustained deficit is not a realistic or prudent option. We must balance our long-term budget, which means that any increase in spending may need to be accompanied by an increase in taxation.

1.4 The Framework sets policy which should be applied in the long-term with few and infrequent changes. One of the core principles of the Framework (principle 5) is a limit on the aggregate revenues that can be taken from the economy through government taxes and charges. The review of the Framework is therefore an ideal opportunity for high level discussions about how large government revenues should be relative to the size of the economy. As such, this Policy Letter has been significantly expanded since its first publication in July 2019[2] in order to facilitate this discussion.

1.5 The States are facing a series of enduring fiscal pressures both through challenges to the sustainability of existing services as a result of the ageing population and growing demand for additional services (**see table 2.1 for**

[2] In September 2019, the States agreed to the Policy & Resources Committee's request to withdraw the policy letter entitled "Review of the Fiscal Policy Framework" in light of the mounting fiscal pressures.

details). This policy letter includes provisional analysis of these pressures to facilitate a debate on one of the most fundamental questions of any community: what level of public services should be provided and how much tax are we prepared to take from the economy and the community in order to provide these?

1.6 **The Framework sets the maximum amount of revenues that *could* be raised from the community given the growing clarity about the scale of these long-term pressures.** This will define the boundaries on the total size of the public sector in Guernsey.

1.7 The 24% of GDP limit on aggregate revenues applied in the Framework is broadly equivalent in monetary terms to the limit applied prior to this review. This limit was set with acknowledgement of the projected increase in demand for public services as the population ages. It provided headroom to accommodate the anticipated need to increase aggregate revenues beyond their current level to meet this demand. The situation has now progressed to a point where we are going to need to begin to make use of this headroom. The States are asked to reaffirm the commitment to this limit now the projected fiscal pressures are becoming a reality.

1.8 **The Framework does not define *how* revenues should be raised or what services should be provided.**

1.9 Once the principles of the Framework are agreed, the next stage of work in this area will be to review how the States might raise more money from the economy in a sustainable way within the limits agreed. The review will need to take into consideration both the parameters set in the Framework and the series of decisions States' Members will face in the coming months, which will have a significant impact on the scale of revenues required to support the provision of public services in the long-term.

1.10 Once the States have made in principle decisions on policy proposals (income and expenditure) there will need to be an iterative process of incorporating these into the MTFP and Annual Budgets. This will provide the States with the opportunity to approve the relative prioritisation of resources, and the speed and extent of the implementation of revenue raising measures and service developments on a rolling basis.

The Review of Revenues

1.11 It has been clear for many years that Guernsey faces significant fiscal and policy challenges. As the current political term draws to a close, there are a number of key policy initiatives intended to manage various aspects of demographic and other pressures being developed (see section 2 for details). Some of these items may be brought forward for debate without an identified sustainable source of funding. Each decision to increase spending will place a further requirement on the next Assembly to raise revenues.

1.12 Each policy brought forward for debate is undoubtedly done so with the best of intentions. Individually, within each policy, there are likely to be persuasive arguments to be generous; to support more services and provide larger subsidies. However, Government services are not free, for example: it costs between £7,300 and £8,800 for each standard off-island knee replacement and up to £20,000 for a more complex joint replacement surgery; a year's education for a secondary school pupil costs on average £8,100 to £8,900 in revenue expenditure (in addition there are significant capital costs); and it costs an estimated £45,000 to keep a prisoner in custody for a year (see Appendix A). These services are funded by taxation and more services and larger subsidies require higher taxation.

1.13 Committees could be directed to present each of these policies with a recommended source of funding, but this type of piecemeal approach is unlikely to result in an optimal solution.

1.14 As highlighted in the 2020 Budget Report (Billet d'État XXI, November 2019) it has become evident that we cannot support the increasing demand for such services on our current, comparatively small and narrow tax base. Guernsey currently collects only 21% of its annual GDP in revenues compared to 26% in Jersey and 38% in the UK (see Appendix B). Within this smaller tax base the States of Guernsey currently provides a broadly similar level of services to those provided in Jersey, but will be unable to sustain this. If we are to continue to provide our community with the range and quality of services they would expect to receive, we will need to raise more revenue from the economy to pay for them.

1.15 In recent years it has been possible to balance the budget with fairly moderate changes to the current tax system, such as the withdrawal of tax allowances for higher earners and the expansion of domestic property tax revenues with increased rates and a more progressive structure. However, the scale of the demands on public finances, estimated at between £79m and £132m (**see table 2.1 for details**), cannot, and should not, be met by a continual tweaking around the edges. Even at the lower end of the estimates, a substantial increase in funding would be required to support the complete profile of emerging policy. Therefore substantial changes to the tax base are needed.

1.16 Not all of this funding would be required immediately, but raising additional revenues on this scale from the local community over the medium term should be subject to careful consideration to ensure that it is done in a way that is both economically and socially sustainable and fair. Tax structures interact in complex ways and, without a wholesale approach to revenue raising, the risk of unintentionally introducing inequities and/or undermining the integrity of the tax base or the economy is high. A single, co-ordinated approach to revenue raising will create a more sustainable and equitable result.

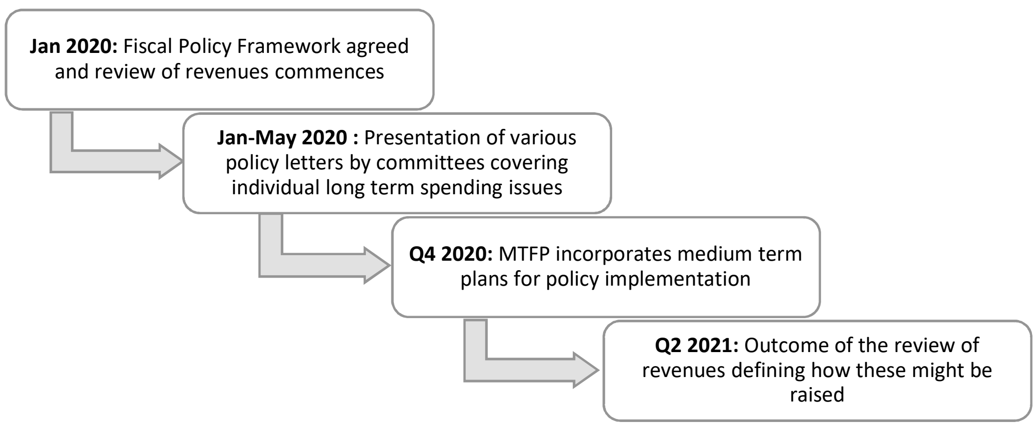
1.17 The States has a commitment to transformation and ensuring the provision of public services is cost effective. As resolved in the 2020 Budget, public service reform activity must continue to generate reform dividends in order to contribute towards balancing the budget. However, it is unrealistic to expect that efficiency savings, transformation and economic growth could generate the amount of resources required to meet the demands of all of the policy initiatives listed in this policy letter, particularly given the small amount of revenue currently collected in Guernsey relative to the size of its economy.

1.18 Ordinarily policy regarding how to raise additional revenues would be determined through the Medium Term Financial Plan (MTFP) and the Annual Budget (see section 6), however, this is a structural issue which requires separate more detailed review and more careful implementation which will need to span more than one MTFP.

1.19 The Policy & Resources Committee therefore proposes commencing a review of potential long-term options for ensuring that the tax base has the *capacity* to raise the amount of revenues required to meet long-term needs, incorporating consideration of options for generating additional revenues from:

i. the taxation of company profits with due regard to the need to maintain a tax system which is competitive, internationally acceptable and maintains tax neutrality[3];
ii. Extension or modification of the existing income tax and Social Security contribution system;
iii. A health tax;
iv. The addition of general or limited consumption taxes to the tax base.

Figure 1.1: Series of key publications and debates



1.20 The next MTFP, which will be published while this review is ongoing, will need to recognise and incorporate the likely impact of these policies in the medium term period (four years). This may include ensuring there are sufficient resources available to meet any interim funding requirements needed to support these policies in anticipation of longer term funding solutions to follow where this is appropriate.

1.21 The review and its recommendations will not be considered by the States until mid-2021 and implementation of revenue raising measures could take some time. The raising of significant revenues should not be implemented at a speed unnecessarily detrimental to the economy. As a result, the next and subsequent

[3] Tax neutrality is important for the continuing operation of the finance sector in Guernsey, enabling Guernsey to competitively facilitate the movement of international capital flows in the absence of the extensive network of double tax agreements available to larger jurisdictions. Tax neutrality ensures that the products and clients of the finance sector are taxed appropriately in the jurisdictions of origin, residence or investment, as appropriate, without any additional tax cost being imposed in Guernsey. Tax neutrality does not generally impede the taxation of profits on the regulated providers of services in the finance sector as is currently the case under the 0/10 regime.

MTFPs will also need to ensure that implementation of policy is managed and co-ordinated within the available resources.

1.22 This means that funding may not be immediately available to support all in principle decisions made by the States on these policy areas. There will need to be a managed and co-ordinated programme of prioritisation and implementation of both revenue and expenditure aspects and the co-operation of all committees will be required achieve this.

2. Developing fiscal pressures

2.1 There are a number of policy initiatives in development which will be presented to the States in due course which could have very substantial long-term financial consequences. It is not the role of this policy letter to discuss the relative merits of each and each will require its own policy letter setting out the issues, intended outcomes, detailed analysis (including economic and social impact), options and conclusions. Instead the intention is to bring to members' attention the potential cumulative effect of these policies. It should be noted that some of these items will be brought forward for debate without an identified sustainable source of funding. Each decision to increase spending will place a further requirement on the next assembly to raise revenues.

2.2 Each policy brought forward for debate is undoubtedly done so with the best of intentions. In each area there are various options for progressing the policy which may change the scale and distribution of costs borne by individuals and the economy. Individually, within each policy, there are likely to be persuasive arguments to be generous; to support more services and provide larger subsidies. But Government services are not free. Whether these are funded via general taxation or through Social Security contributions, more services and larger subsidies require drawing more money from the population. As discussed in section 3, the small size and open nature of Guernsey's economy means that long-term permanent balance is important. We must balance our long-term budget, which means that increasing spending means increasing taxation.

2.3 The following sections are not intended to prejudge the developments which are underway, but to provide an indication of the likely cost scale of these and to summarise the potential magnitude of the aggregate consequences. It is hoped that this will aid members, both in the debate on the Framework (particularly the deliberation of the limit on the total size of the public sector) and to better understand the context and interrelationship of policies to be brought forward.

2.4 It was acknowledged in the 2020 Budget Report that we will need to raise more revenue to meet the long-term demand challenges. A series of decisions will be taken by the States in the coming months which will determine how much more revenue will be needed. The States have a collective responsibility for the overall impact of its decisions and the cumulative annual cost and resource implications of the decisions members will face during this period could be particularly large. Members should remain aware of these cumulative costs. The next Assembly will need to find long-term funding solutions for every spending commitment that is made by this one. Compromise and balance will be essential.

2.5 The policy initiatives covered in this section are, without exception, large and complex with far reaching consequences. They should not be rushed. Neither would it be practical or possible to make all decisions on all these policies at once, but it is important to avoid a position where resources are prioritised to one area of policy development at the expense of others simply because it was the first to be brought forward for decision.

2.6 The role of the proposed review of revenues will be to design a tax structure *capable* of raising revenues up to the limits of the Framework. It is not expected that all the potential revenues will be required at once (if at all).

2.7 Once the States have made in principle decisions on policy proposals there will need to be an iterative process of incorporating these into the MTFP and Annual Budgets. This will provide the States with the opportunity to approve the relative prioritisation of resources, and the speed and extent of the implementation of revenue raising measures and policy decisions on a rolling basis. In some cases this may mean that funding to implement decisions made in principle will not be available immediately. The aim of this process should be to ensure that the expansion of the tax base is balanced against the need to allocate appropriate amount of resources to key priorities at an appropriate time.

2.8 Cost estimates presented are based on the best estimates of the cost envelope available at the time of publication. It is to be expected that these will be changed and refined as the policies develop.

Drug Funding: supporting NICE recommendations

2.9 The range of drug treatments available to local residents is under review following a Requête, laid by Deputy Roffey during 2018, entitled "Drug Funding" (Billet d'État XXVII, December 2018). The Requête sought to make all drugs approved for use in the UK NHS available to patients in Guernsey with public funding, but was successfully amended to facilitate a formal review of the matter.

2.10 The resulting review by the Committee *for* Health & Social Care, expected to be published concurrent with this policy letter, has considered a range of possible options for extending the range of drugs and treatments available from public funding. It is evident from this closer examination that the costs implications are significantly higher than the initial estimates quoted in the debate on the Requête. Current estimates suggest that, depending on the approach taken and the extent to which members wish to extend the availability of treatments, the long-term cost implications could be anywhere between £5m and £12m a year.

Review of primary care

2.11 In December 2017 the States approved the Partnership of Purpose (*Billet d'État XXIV, December 2017*), a ten year programme working across organisational boundaries, to evolve service delivery and create an integrated model designed to improve islanders' health and wellbeing, deliver user-centred care focused on prevention and early intervention and help mitigate rising health and care costs.

2.12 The review of primary care is part of the delivery of the Partnership of Purpose. Primary care is defined for these purposes as General Practice and the Emergency Department. This work will seek to realise a range of practical, organisational and financial benefits, all centred on facilitating patient-centred care in line with the agreed aims of the Partnership of Purpose.

2.13 The Committee *for* Health & Social Care intends to bring proposals to the Assembly recommending that all providers work within a technical and statutory framework which supports integrated working and the delivery of consistent high-quality care. Informed by improved health intelligence, the Committee intends to work with existing providers to trial new ways of working that reshape the primary care model to become increasingly cost effective and support direct access to services where appropriate. The key focus will be ensuring that all islanders have the ability to access the right professional at the right time in the right environment with the right information.

2.14 One of the key aims of the Partnership of Purpose is fair access to care: ensuring that low income is not a barrier to health through proportionate funding processes based on identified need. How best to achieve this aim in the context of primary care forms part of this work stream.

2.15 While improving cost effectiveness and efficient functioning of the system to mitigate long-term cost increase is an important part of this, there are cost implications, particularly in relation to the issue of affordable access to primary care for the user. For the purpose of illustration of the potential scale of the cost, without other reforms it is estimated that to provide all primary care services either at lower cost to the user or free of charge without any other changes could cost in the region of £9m to £20m per annum.

Supported living and ageing well: The Long Term Care Fund

2.16 The first stage of the Supported Living and Aging Well Strategy was brought to the States in 2016 (Billet d'État III, February 2016) and there were a number of work streams initiated to implement the recommendations. The most fiscally significant of these is the work stream undertaken by the Committee *for* Employment & Social Security to examine the future of the Long Term Care Fund.

2.17 This Fund, which receives income from Social Security contributions, was created in 2003 and provides a substantial subsidy towards the cost of residential and nursing care, primarily for older people. However, at its inception it was noted that in the long-term it would require more funding to make it financially sustainable. Despite the 0.5% increase in contributions applied in 2017 (Billet d'État XXVII, November 2016) current projections suggest that, without any change in policy, an increase in contributions of approximately 0.7% (valued at approximately £11m at 2019 prices) will be required to stabilise the Fund.

2.18 There are a number of policy options under discussion including:

- bringing the funding of community based long-term care services into the scope of the scheme, which will increase the long-term financial demand on the Fund;
- re-balancing the distribution of the costs between the Fund (and by implication contribution rates paid primarily by working age individuals) and individuals receiving the benefit; and
- reviewing the mechanism by which an individual might contribute to the cost of their care.

2.19 The policy area is complex. There are a number of private sector and not-for-profit providers who supply the majority of current services and the projections show a very substantial increase in demand for these services in the medium and long-term. Any changes to the policy and funding structure need to consider the financial sustainability of the fund; the need to ensure continued participation and future investment by private sector providers; and the fairness and equity of the system for both contributors and beneficiaries.

2.20 Options currently under consideration include increases in contribution rates of between 0.4% and 1.2%. Including any General Revenue cost implications this could require a total value of additional funding of between £7m and £23m.

States pensions

2.21 The Guernsey Insurance Fund supports £130m of State's Pension[4] expenditure as well as a number of smaller income replacement benefits. The most recent actuarial projections (Billet d'État XXVII, November 2016) suggest that, at the current central assumptions of earnings growth and investment return, an estimated increase in contributions of 0.5% would be required to fund the current uprating policy.

2.22 This would mean that in order to maintain a policy of increasing pensions by one third of the real (above inflation) increase in median earnings until 2025 and by RPIX thereafter a further £8m of income would be required. A more generous long-term up-rating policy would require further funding.

2.23 The existing policy to reduce the uprating of the pension to RPIX only by 2025 is contingent on the introduction of a secondary pension scheme to enhance personal provision. The implementation of this scheme has been delayed and the proposed phasing of its introduction means that it will be some years before members are making significant contributions. Therefore, the uprating policy will need to be reconsidered before 2025.

2.24 Investigations are underway to examine whether it might be possible to consolidate the governance of the Social Security Funds with the General Revenue Reserves. This may include options which could improve the investment performance of the Social Security Funds which may reduce the required funding. The next full actuarial review is due in 2020.

[4] Formally the Old Age Pension

Secondary pensions

2.25 The second policy letter on the Secondary Pensions project is also due to be brought to the States for debate in the first quarter of 2020. This will recommend the introduction of legislation to make it mandatory for employers to offer an auto-enrolment pension scheme to all qualifying employees. It will also recommend the launch of a States supported scheme which will be open to all employers and individuals to join. This will provide affordable access to pension products for small employers and lower income individuals, who are currently priced out of the market by the administrative cost of such schemes.

2.26 There are considerable long-term benefits of increasing pension saving in our community. Current estimates suggest the level of saving is wholly inadequate to support most people in a comfortable retirement and increasing the savings rate could reduce long-term reliance on the benefit systems. The administrative cost of existing schemes is such that their availability tends to be restricted to larger employers and those operating within the finance and professional sectors. As a result for many median and low income employees opportunities to save effectively for retirement are limited, which has a tendency to exaggerate income inequalities as people move in to retirement.

2.27 However, increasing pension saving in this way comes with both direct and indirect costs to the States. Estimates suggest that an additional £100,000 a year will be required to ensure employers are complying with the new legislation. There may also be an estimated £8m in lost tax revenue by 2029 from the tax relief granted on the contributions of people brought in to pension savings for the first time. A further £700,000 a year of additional income support costs may be incurred to compensate claimants for the reduction in their net income should they choose to remain enrolled in the scheme.

2.28 Increasing pensioner income in the long-term should raise tax receipts, reduce income support payments to retirees and will balance a large part of the indirect costs over time. However, these effects will take generations to rebalance and the States will need to replace the net lost income and fund net additional expenditure for an extended period. The total annual fiscal impact is estimated to peak at £9m in 2029.

Public Sector Terms and Conditions

2.29 The terms and conditions of the various public service pay groups have evolved organically over time. Some pay groups have reference groups in the UK. Others have evolved relative to private and/or industry sectors in Guernsey and the need to compete for staff resources. This has resulted in different working hours, leave entitlements, sickness management and pay arrangements in different pay groups.

2.30 The public sector workforce generally has a value set that includes a motivation to serve the community. Public sector remuneration packages meet or fall below comparable roles in the private sector but when roles are 'read across' or reviewed on the basis of a job evaluation scheme in some cases there are considerable differences in the value of the full terms and conditions packages offered by the States of Guernsey as the single employer. The achievability of many of the States' transition programmes is centred on the organisation being better able to manage its deployment of staff. This is hampered through this myriad of terms and conditions which often result in skilled service providers moving to the better remunerated roles in the public sector.

2.31 The Policy & Resources Committee has commissioned a review of the terms and conditions of all public sector pay groups including nursing and care staff, teachers and lecturers, public service employees and established civil servants. This work is examining pay, benefits, working hours, and leave entitlement and sickness arrangements with a view to enabling harmonisation.

2.32 An options appraisal should analyse the potential for job matching across the entire public service based on the principles of fair and equal pay. This would fundamentally change the pay structure and usher in very significant long-term cost implications. The Policy & Resources Committee intends to report the findings of the Review by March 2020. The current estimates for the annual, direct cost to General Revenue upon completing the full recommendations are circa £35m to £40m a year.

General Healthcare and other pressures

2.33 In addition to the above, there are more general pressures on the baseline budgets. Health and social care services in particular are beginning to feel the effects of increasing demand. The Committee *for* Heath & Social Care was awarded an additional £6.2m in the 2020 Budget to meet above inflation pressures on its baseline costs, and settlement of 2019 and 2020 pay awards for staff in the Agenda for Change pay group at a level substantially higher than inflation to address historic pay issues would push this significantly higher. While efforts are being made to manage the increasing demand efficiently to limit the increasing costs, it is likely to prove impossible to avoid a long-term real increase in the cost of providing health care services.

2.34 With the transfer of services provided via the Guernsey Health Service Fund to the Committee *for* Health & Social Care's formal mandate and cash limits anticipated in 2021, it will also be necessary to absorb the estimated £1.5m shortfall on the GHSF (currently supported from investment income and by drawing down the fund reserves) into General Revenue. While in the medium term the investment return on the Fund will still be available to support some of the projected cost, it is not a sustainable solution.

2.35 Current estimates, based on a detailed investigation of baseline costs of healthcare services and demographic pressures, suggest that net of possible savings from transformation these cost could exert an upward pressure of between £1m and £2m a year.

2.36 Demographic pressures are also likely to arise in other areas, including but not limited to Income Support, ambulance services and the provision of suitable accessible housing.

2.37 There are also non-demographic pressures to consider including: climate change; the proposed review of the basket of goods used to determine Income Support rates could put upward pressure on costs; ongoing financial support to Aurigny in order to protect the Bailiwicks' lifeline air links; and the funding of the sports strategy.

Funding Capital investment and replenishment of reserves

2.38 There is also a commitment to fund the Island's capital programme. The capital programme supports the investment in the key infrastructure which is required for the proper functioning of the economy and the provision of public services. Projects funded from the Capital Reserve include the redevelopment of the education estate, the capital elements of the implementation of the Future Digital Services Strategy and the maintenance of Guernsey's coastal defences.

2.39 The recommended minimum level of investment in capital to be supported by General Revenue presented in this Policy letter is set at 1.5% (see section 5) and this level of funding is the approved allocation for 2020. If this is increased to 2% it would require an additional £16m a year of funding.

2.40 The States are also under direction to increase the size of the Core Investment Reserve (previously Contingency Reserve) to the equivalent of one year's revenue income. This Reserve forms an important part of the States approach to long-term sustainable management of its finances. The Contingency Reserve was used to fund deficits over the period following the introduction of zero/10. To comply with the spirit of the principle of permanent balance this Reserve should be replenished and to achieve this the States will need to generate a surplus which can be transferred to the Reserve.

2.41 There are also directions in place to replenish the Transformation & Transition Fund and Future Guernsey Economic Fund using the return from the projects supported therefrom. The reinvestment of returns from such projects is key to ensuring the ongoing capacity of the States to invest in both transformation and economic growth.

Combined pressures

2.42 The combined impact of these developments, if they are all progressed, could require additional annual revenues of between £79m and £132m over a five to ten year period. Between £71m and £124m of this amount is required to cover additional costs and £8m to replace lost income from the implementation of the secondary pension scheme.

Table 2.1: Summary of known long-term fiscal pressures

	Estimated long-term funding requirements		**Notes**
Policy Area	**£m per annum**	**% GDP**	
NICE treatment funding	£5m - £12m	0.1% - 0.4%	Policy letter Published 25th Nov 2019
Primary care services	Provisional est. £9m - £20m	0.3%-0.6%	
Health and Social care demand (net of savings)	£5m-£10m over 5 years	0.1%-0.3%	
Long Term Care funding	£7m - £23m	0.2% - 0.7%	Pending Policy Letter in 2020
States Pension	£8m - £18m	0.2% - 0.6%	Pending actuarial review in 2020
Secondary pension	£8m lost revenue £1m additional costs	0.2% lost revenue 0.03% additional cost	Pending Policy Letter Q1 2020
Public Sector terms and conditions	£35m-£40m	1.1% to 1.2%	Pending Policy Letter in Q1 2020
Total	**£8m lost revenue £71m-£124m additional costs**	**0.2% lost revenue 2.2%-3.8% additional costs**	
Indicative Total Revenues (without further savings)		**23.5%-25.1% of GDP**	

2.43 In 2019 Guernsey is expected to generate government revenue equal to approximately 21.3% of GDP. Without economic growth or transformation and cost saving elsewhere to alleviate some of this pressure, progression of all the policy areas outlined would raise the size of aggregate revenue in Guernsey to between 23.5% to 25.1% of GDP.

2.44 There are areas where money might be saved or pressures mitigated. The Partnership of Purpose (Billet d'État XXIV, December 2017), the Reform of Health Care Funding agreed in 2019 (Billet d'État X, June 2019) and the modernisation of the Princess Elizabeth Hospital provide opportunities to make more effective use of the resources we have and mitigate some of the upward pressure on healthcare costs.

2.45 Elsewhere, Public Service Reform includes a programme of service design initiatives which seek to improve organisational efficiency, freeing resources which can be used elsewhere. The policy letter debated in September 2019 entitled "Transforming education programme & putting into effect the policy decisions made by the States in 2018" (Billet d'État XVI, September 2019) identified net annual savings (after reinvestment) of £1.8m to £2.2m a year.

2.46 Economic growth would also provide additional revenues by increasing the employment, earnings and company profits which are taxed in Guernsey, albeit that the link between government revenues and GDP growth in any given year is an imperfect one.

2.47 The States can make further expenditure savings and will continue to prioritise these. However, it is unrealistic to assume that efficiency savings, transformation and economic growth could free up or generate the amount of resources required to meet the demands of all the policy initiatives listed above. Even at the lower end of the estimates, a substantial increase in funding would be required to support the complete profile of emerging policy.

3. A review of long-term revenue raising options: terms of reference

3.1 In total these known pressures summarised in the previous section could amount to a potential need for additional funding of between £79m and £132m over the next five to ten years. Without mitigating some of this pressure through expenditure savings and economic growth this would require an increase in the size of the tax base to between 23.5% and 25.1% of GDP. This level of additional funding cannot be met without making substantial changes to the existing tax base.

3.2 The options for raising revenues on this scale are in reality fairly limited. To give an indication of scale it is estimated that to raise the amount of revenue collected each year to 24% of GDP (the limit recommended in this Policy letter), or approximately £84m at 2019 prices, from **existing** tax systems would require one of the following:

i. An increase in the headline personal income tax rate (currently 20%) by 7%; or
ii. An increase in Social Security contribution rates by 7%; or
iii. An increase of an estimated 350% in all domestic and commercial TRP rates.

3.3 To raise the same amount through a change in the structure to the system might require either:

v. A higher earners rate applied to individuals earning over £50,000 of 45%; or
vi. A broad based GST of 8%.

3.4 The most appropriate course may be to choose a combination of measures, but the review will need to consider how such measures might interact. Provisional estimates of how much revenue would be raised by specific measures independently are included in Appendix C.

3.5 Corporate taxes are also included in the scope but substantially more work is required before realistic estimates of how much might be raise can be included. The corporate tax environment and other taxes charged against corporate have changed substantially since the introduction of Zero/10:

- Commercial TRP rates were increased significantly in 2008 and have been increased further in subsequent budgets;
- The Social Security contributions for employers have been subject to both a significant increase in the upper earnings limit and increases in the employer's contributions rate since 2007;
- The coverage of the 10% and 20% tax rates have been extended significantly since 2012, and now cover most administrative and management functions within the regulated finance sector in addition to banking activity, large retailers, hydrocarbons, the aircraft registry and medicinal cannabis cultivation and use;
- Companies are now required to exchange significantly more information on their activities under FATCA and UK Intergovernmental agreements made in 2014;
- Guernsey adopted the OCED's minimum standards on Base Erosion and Profit Shifting requiring the introduction of exchange of tax rulings and country by country reporting in 2016 and 2017; and
- Guernsey implemented substance legislation in 2019 following the screening exercise undertaken by the EU.

3.6 A full timeline of the changes made on the corporate and other tax systems is included in Appendix D.

3.7 These changes have recouped much of the revenue lost in the move to zero/10. The total real value of taxes and contributions paid by the corporate sector, including TRP, company fees and employer's Social Security contributions has reduced by less than 10% between 2006 and 2019 (see Appendix E).

3.8 The global and regulatory conditions in which the corporate tax system operates have also changed significantly since it was last subject to review in 2012. The corporate tax system is also subject to continual monitoring under the following resolution (Billet d'État IV, March 2015):

"To direct the Treasury and Resources Department, having due regard for the need to provide a stable platform, maintain business confidence, support and encourage financial services and to retain an internationally acceptable and competitive tax environment for the islands' businesses, to continue to closely monitor the appropriateness of the corporate tax regime, and to report back to the States should it consider any changes are necessary."

3.9 Any consideration of corporate taxes needs to carefully consider the impact on the local economy, Guernsey's competitive position as an off shore finance centre and changing international standards. At the current time no estimates are currently available of what revenues it might be possible to raise from the corporate sector. Given the extent to which 10% and 20% rates have already been extended and the tax already levied on distributions to local shareholders which captures most smaller, locally owned businesses, it is unlikely to be feasible to raise sufficient revenues to meet the all of the long-term revenue need from this source without undermining the sustainability of the Islands' economy or its international position.

3.10 Corporate income taxes do not operate in isolation from the personal tax and indirect tax system. Any changes in the corporate tax system which might impact levels of economic activity and, by implication employment and earnings on the Island, are likely to have a further impact on revenues from income taxes, contributions and consumption taxes. These interrelationships will be carefully considered before any proposals for change are made.

3.11 Other taxes which might be considered, such as excise taxes on motoring or alcohol; or environmental taxes, have a limited capacity to raise revenue. This is because the nature, and in most cases, the intent of these taxes is to change consumer behaviour. Environmental taxes, for example, are specifically designed to encourage people to change their behaviour to avoid the tax. The higher the rates are set, the larger the behavioural change made in response. As measures applied to raise revenues to any significant extent they are likely to be self-defeating.

3.12 While some of these pressures identified present more obvious funding mechanisms (for example Long Term Care Funding and State Pensions tend to lend themselves to funding by increase in Social Security contribution rates) taking a piecemeal approach to raising revenues on this scale is unlikely to provide an optimal solution.

3.13 Each option, or combination of options, would have a different impact on individual households. The various elements of any package may also interact in complex ways. For example, an increase in direct taxes such as income tax will mean that households have less disposable income to spend and might negatively affect the amount raised through consumption and excise taxes

3.14 Substantial changes in taxation can also have a material impact on the economy which needs to be considered, an aspect which becomes more complex with the inclusion of taxes on corporate profits and the need to ensure that our corporate tax system remains internationally acceptable, competitive and maintains tax neutrality. The implications of such substantial changes are too wide reaching for such decisions to be made without extensive research and deliberation.

3.15 The Policy & Resources Committee is therefore proposing that a review be launched to investigate options for ensuring Guernsey's tax base is able to sustainably and fairly raise sufficient revenue to meet the Bailiwick's long-term funding requirements.

3.16 **The terms of reference for this review will be as follows:**

- To present options for restructuring the tax base so that it has the capacity to raise revenues up to the limits of aggregate revenues proposed in the Fiscal Policy Framework in a sustainable way within the boundaries of the Framework (to be agreed following consideration of this Policy Letter);
- To investigate mechanisms for raising additional revenues including:
    - the taxation of company profits with due regard to the need to maintain a tax system which is competitive, internationally acceptable and maintains tax neutrality[5];
    - Extension or modification of the existing income tax and Social Security contribution system;
    - A health tax;
    - The addition of general or limited consumption taxes to the tax base;
- To investigate options for the implementation of these measures in such a way as to minimise the economic impact of changes to the tax structure; and
- To provide analysis of the financial, economic and social implications of any options presented.

3.17 This review will not consider any form of capital taxes which are considered incompatible with Guernsey's status as a finance centre.

3.18 The review will be led by the Policy & Resources Committee with engagement with States Members and Committees in the initial stages of the process to capture their views on potential options and before any final proposals are published. Further detailed engagement with the Committees *for* Employment & Social Security and Health & Social Care will be undertaken in relation to Social Security contributions and health taxes. The process will also include public engagement.

3.19 The Policy & Resources Committee will report back to the States on the outcome of the review by no later than June 2021.

[5] Tax neutrality is important for the continuing operation of the finance sector in Guernsey, enabling Guernsey to competitively facilitate the movement of international capital flows in the absence of the extensive network of double tax agreements available to larger jurisdictions. Tax neutrality ensures that the products and clients of the finance sector are taxed appropriately in the jurisdictions of origin, residence or investment, as appropriate, without any additional tax cost being imposed in Guernsey. Tax neutrality does not generally impede the taxation of profits on the regulated providers of services in the finance sector as is currently the case under the 0/10 regime.

3.20 The work stream will incorporate the resolution made in the debate on Reforming Health Care Funding (Billet d'État X, June 2019) to:

"direct the Policy & Resources Committee in consultation with the Committee for Employment & Social Security to progress the second stage of the work stream, as described in section 10 of this Policy Letter, and review the structure of Social Security contributions collected for the support of health and social care services and ensure that these are appropriate, fair and sustainable, and to consider the prioritisation of this work stream for the new Assembly in the 2021-25 Policy & Resource Plan"

Resource requirements

3.21 Budget has already been allocated to expand the internal analytical capacity of the States and it is believed that the staffing requirements can be met within these resources. Further financial resources may be required to procure independent expert validation of analysis, external analysis where the skills are not available internally, to support the public consultation and to provide a suitable programme of public communications. If necessary, the Policy & Resources Committee will use its delegated authority to make funding of up to £150,000 available from the Budget Reserve.

4. History of the Fiscal Policy Framework

4.1 The original Framework was agreed by the States in 2009 (Billet d'État XI, April 2009) and was intended *"to underline the credibility of fiscal policy and provide reassurance to taxpayers about the sustainability of future States spending plans".* The Framework was presented and agreed in the context of an anticipated deficit following the restructure of the corporate income tax system and proposals laid by the Treasury & Resources Department to borrow in order to finance part of the capital programme. While the States did not issue any debt until 2014, the Framework was adopted in full.

4.2 While it has been extended and amended, the basic tenets of the Framework, those of fiscal prudence and control, remain.

4.3 The most significant change to the Framework since its inception was an extension to incorporate the Social Security system in 2015 (Billet d'État IV, March 2015) to promote a more co-ordinated approach to raising revenues. This extension formally recognised the role Social Security contributions play in supporting public services, the flow of money between the Social Security system and General Revenue, and the common impact that contributions and general taxation have on the population. The extension also eliminated the potential for the Social Security system to become a vehicle for revenue raising outside the scope of the Framework. Further minor amendments were made to the Framework within the first Policy & Resource Plan in published 2016 (Billet d'État XXVIII, November 2016).

4.4 At the end of 2017, following a review of the methodology used to calculate GDP in Guernsey, undertaken with assistance from the Office of National Statistics, substantial revisions were made to the published GDP figures. Shortly after this, the first phase of work to transition the States Accounts towards the internationally accepted accounting framework, IPSAS, was implemented in 2018 with the publication of the 2017 accounts. This changed the definition of some of the income and expenditure measures reported in the accounts.

4.5 With the majority of the criteria outlined in the Framework comprising account data benchmarked against GDP (see section 5), these two changes combined prompted a need to conduct a full review of the Framework.

4.6 In addition to considering the Framework in light of the revisions to the data, the review also considers the development of Fiscal Policy in Guernsey over the decade since its first introduction, including clarifying how the Framework operates in the context of the medium term financial planning framework introduced in 2016.

4.7 In the 2017 Annual Independent Fiscal Policy Review the authors noted:

> *"The changes to the Island's GDP and the corresponding effect on the Fiscal Framework's rules… represents an opportunity for the island to re-evaluate its fiscal position, spending levels and core strategies"*

5. Framework principles

Principle 1: Guernsey's fiscal policy should operate on a principle of long-term permanent balance.

5.1 This has been the governing principle of the Framework since its introduction and all subsequent principles stem from this. It means that, over the long-term, Guernsey should not spend more money on public services than it receives in revenues. While larger countries can, and sometimes do, run deficits for a sustained period, this can have damaging consequences as amply demonstrated during the sovereign debt crisis with its interlinked banking crisis.

5.2 Countries such as Greece and Ireland, which had accumulated a significant amount of government debt, found themselves unable to meet the repayments on that debt when the economic crisis of the late 2000's put their economies into recession. For Guernsey, a micro-economy with a heavy reliance on international trade, this is a particular threat. Short periods of modest deficits may be necessary or unavoidable, but they should be balanced by periods of surplus.

5.3 Long-term balance is about more than just balancing the Annual Budget. It is about managing the States' resources in the long-term to ensure fiscal sustainability. This principle will be supported with indicators which monitor:

- The value of the Core Investment Reserve, recognising that the value of these assets should be increased over time in line with the current policy of targeting one year's revenues as the balance of the Reserve (as approved in the Medium Term Financial Plan 2017-2021).

- The long-term projections of the Guernsey Insurance Fund and the Guernsey Long Term Care Fund, recognising the planned drawdown of these funds to support demographic change and the aim to maintain these reserves with at least two years of expenditure (as referenced in the Personal Tax, Pensions and Benefits Review (Billet d'État IV, March 2015).

Principle 2: The annual net deficit reported on the General Revenue accounts for any given year should not exceed 15% of revenue income[6].

5.4 This principle sets out the maximum value of any deficit the States might have in any given year. Previously, this criterion has been set relative to GDP but the review concluded that it would be more appropriate to benchmark the size of the deficit against the revenues raised from general taxation[2]. This approach was broadly supported by those States Members who attended the engagement workshops on this review.

5.5 This principle is to govern the net deficit, the calculation of which is outlined in table 5.1. Under the revised accounting rules, internal transfers between States' reserves (such as the allocation to the Capital Reserve) are no longer included as expenditure but actual capital spending is included instead. This will eventually be replaced by a measure of depreciation in line with IPSAS.

Table 5.1: Illustration of accounting positions for 2019 accounts

General taxation	+
Committee operating income	+
Misc income	+
Revenue Income	+
Committee expenditure	-
Revenue Expenditure	-
Operating surplus/deficit	+/-
Investment return	+/-
Capital receipts	+
Accrued losses	-
Finance charges	-
Capital spending (to be replaced with depreciation)	-
Net Surplus/Deficit	+/-

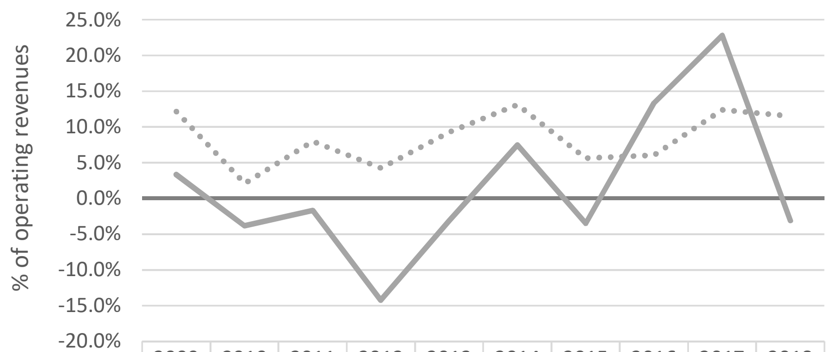
5.6 However, this definition of deficit is subject to some significant volatilities. The first is from the uncertainty of investment returns, which can rise and fall with the movement in financial markets. The second is the inclusion of actual capital spending, which in a jurisdiction of Guernsey's size can vary very significantly from one year to another.

[6] This definition excludes revenues from investment return or capital receipts

5.7 As the accounting policies progress further towards IPSAS, capital expenditure will be replaced by depreciation in the definition of the net deficit. This should smooth one source of volatility. However, given that the volatility of investment returns will remain, it is proposed that the operating position is also monitored as part of the Framework. This will ensure that any review is able to identify pressures developing within the operational income and expenditure of the States which might be otherwise disguised by movements in investment or capital spend.

5.8 The 15% of revenues income proposed is broadly equivalent in monetary terms to the 3% of GDP prior to the revisions. The current monetary value of this is approximately £75m. If the historical time series is restated to be consistent with the proposed definition, the deficit has never breached this level.

Figure 5.1: General Revenue surplus deficits as % of revenue income



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Net surplus/(deficit)	3.3%	-3.8%	-1.7%	-14.3%	-3.1%	7.5%	-3.5%	13.3%	22.8%	-3.1%
Operating surplus/(deficit)	12.2%	2.1%	8.0%	4.3%	9.3%	13.1%	5.7%	6.1%	12.4%	11.6%

Principle 3: Annual net deficits reported in the General Revenue accounts should not be allowed to persist for more than five consecutive years.

5.9 This principle recognises that, as well as limiting the size of deficits it is necessary to limit the length of time over which they can persist. Even relatively modest deficits can drain resources if allowed to persist over time.

5.10 Like previous versions of the Framework, this principle therefore restricts the maximum permitted length of a deficit to five years. Under the principle of long-term permanent balance, periods of deficit need to be balanced by periods of surplus to replenish reserves.

Principle 4: Measures to address any identified or anticipated deficit must be incorporated in the States Medium Term Financial Plan.

- This might include a combination of reductions in expenditure, revenue-raising measures and measures to stimulate growth appropriate to the circumstances of the deficit.

5.11 Deficits can differ significantly in their nature and the response to a deficit needs to be tailored to the conditions prevailing at the time. There are numerous different responses to a deficit including cutting spending, raising revenues or stimulating growth (which may conceivably involve increasing spending) and each may be appropriate in different circumstances.

5.12 The intention of this principle is to require a formal response to a deficit, without pre-determining the most appropriate response. The principle ties the response to a deficit, actual or anticipated, into the process surrounding the MTFP. The MTFP includes forecasts of the expected financial position over the four-year period it covers and, if a deficit is anticipated, it should put in place appropriate measures to prevent or address it. While the MTFP is only routinely produced once every four years, it can be updated and amended in response to an unanticipated deficit should one arise in the intervening period.

Principle 5: The aggregate amount of States' revenue should not exceed 24% of GDP.

- This includes all forms of taxation from within General Revenue, Social Security contributions and the operating income of committees, but does not include the return on investments.

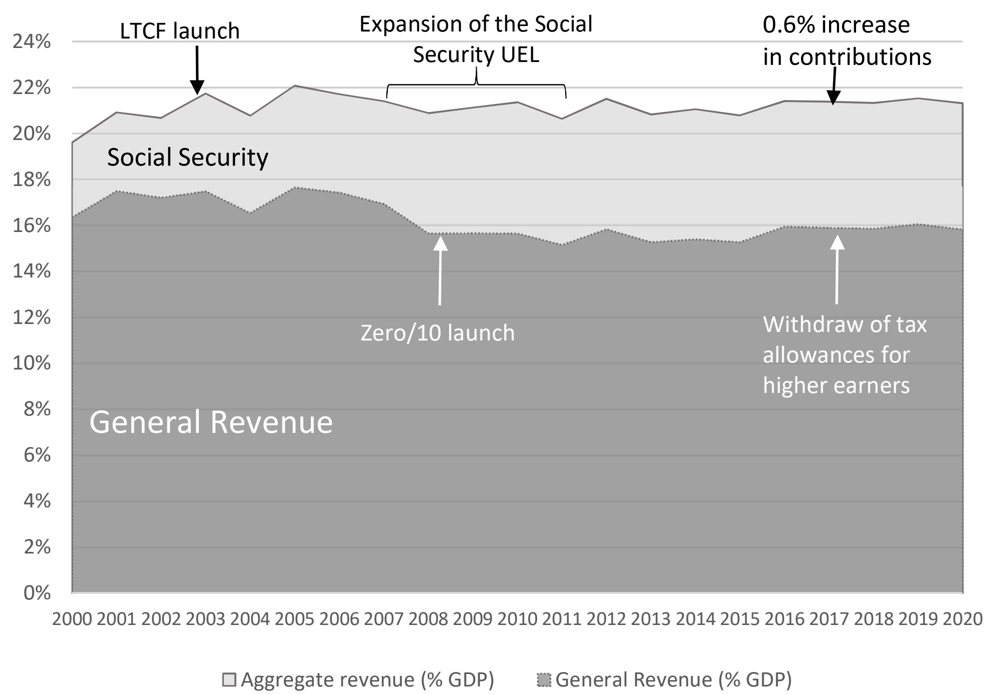
5.13 This principle governs the aggregate size of the public sector in Guernsey. Its intention is to provide a limit on the maximum amount of money it is deemed appropriate to take out of the general economy to be redirected to the provision of public services. With the exclusion of investment income, government revenue is generated from taxes and charges levied on local residents and businesses and Guernsey's status as a low tax jurisdiction is an important part of its competitive position as a finance centre.

5.14 In 2019, aggregate income of the States was estimated to be equal to 21.3% of GDP. Aggregate income has been at approximately the same level (between 21.0% and 21.5%) for most of the last twenty years. Only during 2005 and 2006, at the height of the property boom (when document duty receipts were some

£10m larger in real terms they are expected to be in 2019), were aggregate receipts higher than those forecast for 2020.

5.15 The revenue lost in the move to the zero/10 corporate income tax regime in 2008 was largely replaced by the expansion of the Social Security contributions system and other smaller changes made to other taxes and duties since. None of the individual changes made to the tax base since the expansion of the Social Security system, including the increase in the Social Security contribution rate and the withdrawal of allowances for higher earners from 2017, has raised sufficient additional revenue to make a clearly visible difference to the graph presented in figure 5.2 below.

Figure 5.2: Aggregate income (excluding Investment returns) as a percentage of GDP



5.16 What has changed over this period is the distribution of revenues between the various taxes and other revenue sources. In 2007 20% of aggregate income was sourced from company income taxes compared to 10% of aggregate income in 2019 (including tax on distributions).

5.17 However, the decisions made at the time that zero\10 was introduced significantly increased the contribution from companies from other sources, including employers Social Security contributions and commercial TRP. As a result the *total* value of revenues from the corporate sector has declined in real terms (adjusted for inflation) from £201m in 2006 to £184m in 2019; a real decrease of less than 10%

5.18 Over the same period the proportion of revenues gained from Social Security contributions has increased from 21% to 26% as a result of the significant increase in the Upper Earnings Limit and increases in contribution rates. The proportion of funding gained from excise, motor and property taxes has increased from 9% to 13%. A further breakdown of how States revenues are generated is provided in appendix E.

5.19 The current aggregate revenues are about 2.7% of GDP (approx. £84m) below the proposed limit. This spare capacity is not designed to encourage additional spending. In the same manner as the previous iteration of the Framework, the limit recognises that Guernsey faces some significant long-term spending pressures as outlined in previous sections.

5.20 As described earlier in this Policy Letter, these pressures include those exerted on our pension provision, health and services because of the ageing of the population. The analysis suggests that known pressures will require an increase in aggregate revenues of between £79m and £132m of additional revenues (of which £8m is required to replace lost income) before consideration of measures to reduce spending elsewhere, mitigate the level of expenditure growth or growth the economy. With prudent and cautious management it should be possible to manage these long-term pressures within the recommended 24% of GDP envelope.

5.21 At 2019 prices, moving from revenues 21% of GDP to 24% of GDP will take up to £84m out of the economy. This is a substantial increase in the size of the public sector which could have a material impact on consumption levels and economic activity. Broad estimates suggest that an increase in taxation of this magnitude could supress GDP by up to 2%. The increase in the savings rate which is expected to accompany the launch of secondary pensions could reduce GDP by a further 1% (reducing over time as people draw on their pensions). The total negative impact on GDP could be as much as 3%.

5.22 While it would be easy to increase the size of the public sector beyond 24%, there is a need to maintain financial discipline and a focus on providing services in an efficient and cost effective manner. **Acknowledging that there is a need to increase the size of the public sector should not be seen as a release on expenditure control. The Policy & Resources Committee is of the opinion that**

setting a limit on revenues which is challenging but achievable is the best way to deliver this.

5.23 Long-term plans must be realistic and it has become clear that it will be necessary to increase revenues towards this limit to meet the demand for services. However, there remains scope for further savings and mitigation of expenditure growth to be achieved in the delivery of public services though Public Service Reform programmes such as the Partnership of Purpose, the Transformation of Education and the transformation of transactional and business support services and this must remain part of the solution. In light of the scale of the expenditure pressures faced by the States, it is more important than ever to continue efforts to deliver necessary services in a cost-effective way.

5.24 The States may also need to consider whether there are elements of its service provision that are no longer the best use of the resources dedicated to them. A review of Family Allowance is already underway and the States may wish to consider other areas where it might be possible to redirect resources to more effective areas.

Principle 6: Capital expenditure over any States term should be maintained at a level which reflects the need for long and medium term investment in infrastructure and direct capital expenditure by the States should average no less than 1.5% of GDP per year averaged over a four year period.

- This should be identified through the infrastructure plan and the medium term capital plan. The MTFP should ensure sufficient resources are allocated to deliver on these requirements.
- Direct capital expenditure includes any capital spending supported with recourse to general taxation or reserves.

5.25 Previous iterations of the Framework have included a requirement for the States to spend 3% of GDP per annum on capital expenditure. However, in practice a number of difficulties were encountered in effectively monitoring this:

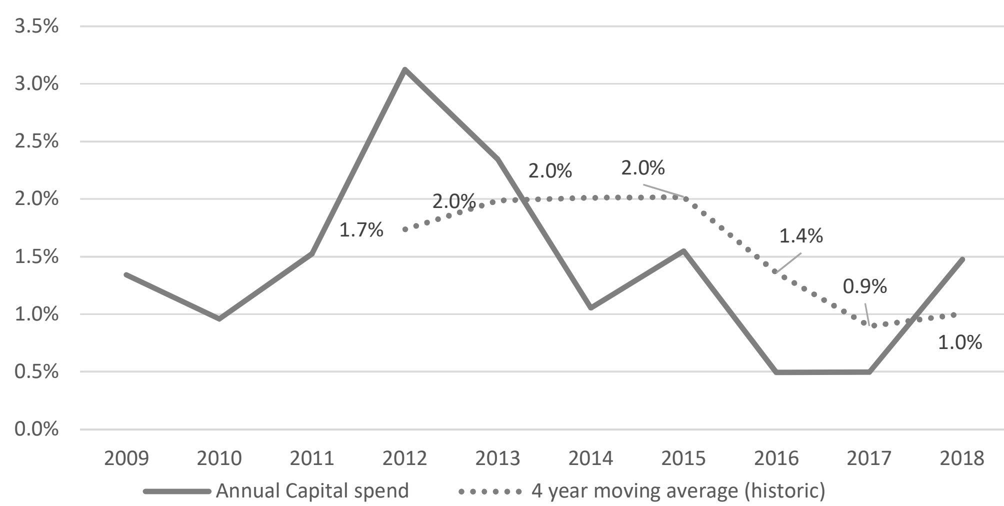
i. Because of the small size of the economy, capital expenditure is very volatile and even maintaining a consistent medium term average is challenging.

ii. The definition of capital expenditure was unclear. The Capital Reserve is no longer the only source of capital funding for the States and their unincorporated entities: the Belle Greve outfall, for example, was re-financed from the Bond Reserve. Neither was it clear whether investment via the States unincorporated entities, over which the States have full control, should be included within the scope.

iii. The 3% target was chosen based on "international norms" but, in reality, levels of capital investment vary enormously between countries and the infrastructure needs of a jurisdiction like Guernsey may be substantially different to those of larger economies.

5.26 The target has been met in only one year of the ten years since the first edition of the Framework was published. That year was 2012 (see figure 5.3) when there was an exceptionally large amount of development (the Guernsey Airport pavements project and the final stage of the build of the Les Beaucamps High School). Beyond the financial considerations, the management and labour required to sustain this level of development year on year would be incredibly challenging, which suggests the target set was too high to be realistically attainable on a long-term basis. The upward revision of GDP in 2017 amplified this issue.

Figure 5.3: Direct Capital spending as a % of GDP



5.27 The Policy & Resources Committee considered the revision of this criteria at length and concluded that a tightly defined target for capital spend, even at a lower level, was not constructive. The recommendation was instead to formally embed within the Framework the principle that there should be a continual review of the infrastructure needs of the islands within the infrastructure plan and the Medium Term Capital Plan. The MTFP should make available the resources to meet these needs. This will bring the requirement to continually assess and adequately fund capital development within the scope of the assessment of the States performance against the Framework as discussed in section 5.

5.28 Because of the volatile nature of capital spending in Guernsey, one of the functions of the MTFP will be to ensure that enough money is appropriated into the Capital Reserve each year to meet the necessary costs of the capital programme in the medium term and smooth the effect of the "lumpy" in year capital spend on the States cash flow.

5.29 However, reflecting on the feedback from the workshops held with States Members, it is also proposed that the principle should include a minimum level of investment which should be financed from General Revenues. The proposed minimum, 1.5% of GDP, will incorporate capital spend financed directly by general taxation (i.e. from the Capital Reserve). This minimum is set slightly higher than the 1.4% achieved in the 10-year period analysed in figure 5.3, and the 1.0% achieved in the last four years. Setting the minimum slightly above that achieved over the last ten years is intended to recognise the under investment in infrastructure over the last three years in particular.

Principle 7: The States' total debt should not exceed 15% of GDP.

- Gross debt can be deployed only to finance the investment in infrastructure or assets.
- Any project or acquisition supported with recourse to government debt must be able to generate sufficient revenue to meet the repayment of that debt.
- The definition of debt includes any direct borrowing and contingent liabilities associated with guaranteeing the borrowing of States trading entities, States owned enterprises and Non-Government Organisations (NGOs)
- Guarantees or assurances offered on the operational cash flow arrangements of the States trading entities and states owned enterprises (for example the guarantee of overdraft facilities) are excluded.

5.30 The approach to and practicalities of government debt and the investment in infrastructure has changed significantly since the original iteration of the Framework. This principle broadens the definition of debt and provides greater clarity of what direct government debt might be used for and in doing so recognises the evolution of financial management and the way in which infrastructure development is managed in Guernsey,.

5.31 Under this principle government debt can only be used to buy, develop or improve assets which have both a community and commercial value.

5.32 It also allows for the fact that these assets may not necessarily be directly owned by government. The States have increasingly sought to place revenue generating services in a more commercial context. For instance, Guernsey Water is operated as a trading entity, managed and operated on a commercial basis at arm's length from government. The Belle Greve outfall, which is a key part of the waste water disposal infrastructure, was refinanced from the Bond issue in 2014 recognising that, as a revenue generating long-term asset, this was a more appropriate source of financing than the Capital Reserve.

5.33 The principle as now drafted also places a clearer and tighter restriction that projects funded by debt must be able to generate sufficient revenue to service their share of that debt.

5.34 As well as the issue of external debt in 2015 the States act as a guarantor or otherwise provided surety for debt held by a number of States associated entities and NGOs, including Cabernet Ltd (the company which owns Aurigny Airlines) and the Guernsey Housing Association. Recognising that the States' hold ultimate liability for these debts and that these entities are investing in assets which have value to the community, this principle has been expanded so that the limit on borrowing encapsulates these contingent liabilities.

5.35 The States also offer surety on some of the short-term cash flow arrangements for these associated entities. For example the States offer surety on behalf of Aurigny to Barclaycard regarding unflown flights. These are short term financing arrangements required for the day to day operations of these entities and do not represent long-term debt or investment in assets. They are therefore excluded from this definition.

5.36 This addresses concerns raised in the review of the bond issue commissioned by the Scrutiny Management Committee in 2017 (States Bond Issue, KPMG) regarding the clarity of the definition of borrowing used in the Fiscal Policy Framework.

5.37 The level of direct debt and contingent liabilities which would be captured by this definition are detailed below. The figure states the maximum liability possible for these agreements.

Table 5.2: Maximum liability for current loans and contingent liabilities

Direct liabilities	**£m**	**% GDP**
States of Guernsey Bond	330	
Captured Indirect and contingent liabilities		
Cabernet limited (pending loan for aircraft purchase guarantee maximum value)	51	
Guernsey Housing association (letter of comfort re revolving credit facility, maximum)	15	
Total	**£396**	**13.0%**

6. Relationship with the MTFP and Annual Budgets

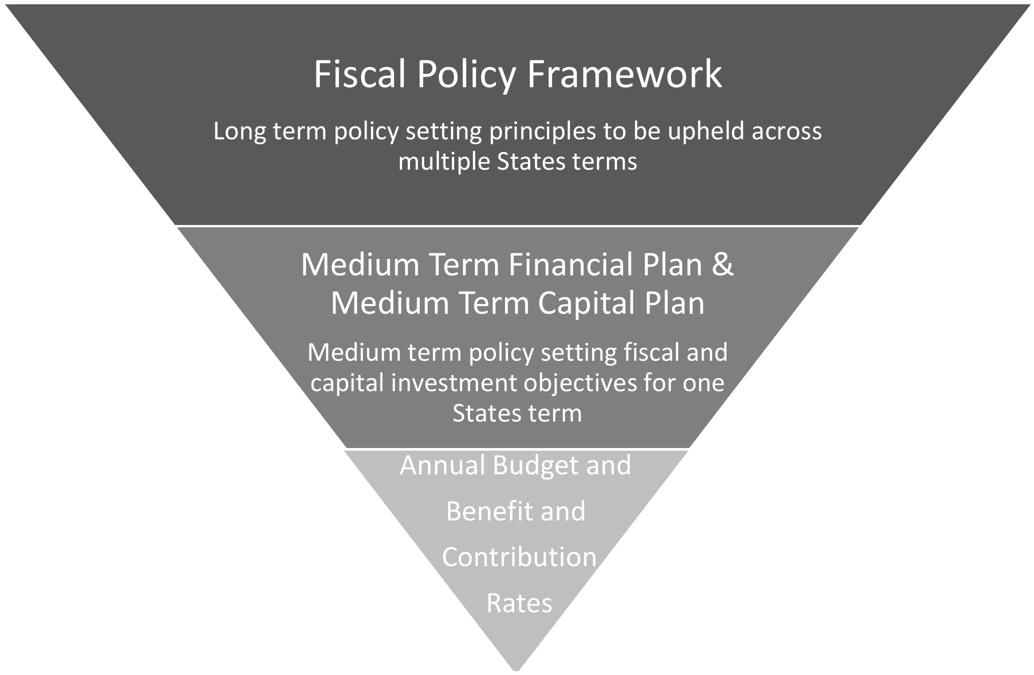
6.1 The Framework sets high level, long-term fiscal policy and is intended to define the boundaries within which more detailed and shorter-term policies should operate.

6.2 Policies which need to be more adaptable to the prevailing circumstances, requiring more frequent revision, should be set within the more detailed, shorter term policy vehicles. For example, the detailed response to a period of economic stress should be defined within the MTFP and implemented through the Annual Budget.

6.3 The States more detailed fiscal policy setting vehicles, the MTFP, the Medium Term Capital Plan (MTCP), the Annual Budget and the Annual Benefit and Contribution Rates Report, should operate subject to the principles of the Framework. These fiscal policy vehicles are intended to work cohesively, setting progressively more detailed policy covering progressively shorter time frames.

6.4 This structure is designed to ensure continuity and certainty in the application of long-term fiscal policy, while retaining the flexibility to adjust to conditions as they arise within the boundaries set. This provides some assurance to islanders about Guernsey's commitment to fiscal prudence, while retaining the freedom for each States to pursue more detailed objectives about how this is achieved.

Figure 6.1: Hierarchy of fiscal policy formation



6.5 For example, the Framework sets a limit on aggregate income. The 2020 MTFP will incorporate the States agreed policy objectives and present a plan to make sufficient resources available in the medium term within the principles of the framework to begin delivering these. The 2021 and subsequent Annual Budgets will begin the implementation this plan.

6.6 The Framework will equally apply in relation to the Annual Benefit and Contribution Rates reports laid by the Committee *for* Employment & Social Security. For example, the Committee *for* Employment & Social Security has active work streams investigating policy surrounding the States' Pension and the Long-Term Care scheme, both of which have been highlighted as potentially requiring an increase in revenues to sustain them. Any proposals to increase contribution rates to fund these will need to take the limitation on aggregate income into consideration.

6.7 The next and subsequent MTFPs will need to consider the medium term impact of the policies discussed in this policy letter to ensure that implementation is managed and co-ordinated within the available resources. The proposed review of revenues is not due to return to the States until mid-2021 and implementation of revenue raising measures could take a substantial amount of time. Neither should the raising of significant revenues be implemented at a speed unnecessarily detrimental to the economy.

6.8 This means that sustainable funding for these policies may not be immediately available to fund all “in principle” decisions made by the States on these policy areas. There will need to be a managed and co-ordinated programme of prioritisation and implementation of both revenue and expenditure aspects and the input from all committees will be required achieve this.

7. Reviewing compliance with the Framework

7.1 Prior to the restatement of GDP at the close of 2017, Guernsey’s performance against the Framework was subject to an annual external review. This added a level of assurance and credibility to the Framework and provided an opportunity for external assessment of the fiscal and economic risks Guernsey faces. However, at a strategic level, economic and fiscal risks typically change slowly and as a result such annual reviews can become repetitive and lose value over time.

7.2 The annual review process is also costly in both financial and staff resources. The last annual review cost £45,000 and managing and co-ordinating the process and providing the necessary information required an estimated 150 hours of staff time.

7.3 Compliance with the specific criteria of the Framework is straightforward to assess, requiring only the extraction of the relevant information from the Accounts. It is therefore proposed that this be incorporated into the Annual Budget. This would ensure the metrics to assess performance against the Framework would be available on an annual basis.

7.4 Areas where the States have diverged from the Framework will be clearly identified and the reasons for the divergence explained.

7.5 A periodic external review is proposed to fulfil the more detailed and nuanced role, including more subjective analysis. This review, which will be conducted every four years at the outset of the new political term. It will be timed for publication shortly after the election of a new States, to help inform the production of the MTFP for the next four years which will govern States fiscal policy making for that term.

7.6 It is proposed that the first review in the new format should take place in 2020 and that it should be timed so that it might help inform the debate on the next

MTFP. It is also proposed that the terms of reference be extended to incorporate assessment of the delivery of the 2017-2021 MTFP. External reviewers will be tasked with:

- Assessing compliance with the principles of the Fiscal Policy Framework
- To identify short, medium- and long-term threats to compliance with the Fiscal Framework;
- To assess performance of recent finances against the objectives of the current MTFP;
- To identify risks and issues which should be addressed in the subsequent MTFP;
- Identify any structural change which may suggest that review of the Framework may be necessary.

7.7 Conducting an annual review is estimated to cost £180,000 over a four year period. It is estimated that the more detailed review, conducted once every four years, would cost £70,000, representing a saving to General Revenue of £110,000 over a four year period.

7.8 Should an economic or fiscal shock make a significant impact on the States' ability to operate within the principles of the Framework outside of this timetable, provision could be made for an ad-hoc review.

8. Consultation and engagement

8.1 A series of workshops were organised for States Members to discuss provisional propositions through March 2019. All members were invited and, excluding members of the Policy and Resources Committee, 23 States Members and Alderney Representatives attended across five sessions.

8.2 Members were given a presentation of draft proposals and given the opportunity to provide feedback. This feedback was used to further refine the principles contained within this policy letter.

8.3 Officers have also engaged with the authors of previous Annual Independent Fiscal Policy Reviews for advice and feedback on draft proposals. This feedback has also been incorporated in to this policy letter.

9. Compliance with Rule 4

9.1 Rule 4 of the Rules of Procedure of the States of Deliberation and their Committees sets out the information which must be included in, or appended to, motions laid before the States.

9.2 In accordance with Rule 4(1), the Propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications. She has advised that there is no reason in law why the Propositions should not to be put into effect.

9.3 In accordance with Rule 4(3), the Propositions are not requesting the States to approve funding but the Policy & Resources Committee will use its delegated authority to make funding of up to £150,000 available from the Budget Reserve to undertake the review.

9.4 In accordance with Rule 4(4) of the Rules of Procedure of the States of Deliberation and their Committees, it is confirmed that the propositions have the unanimous support of the Committee.

9.5 In accordance with Rule 4(5), the Propositions relate to the duties of the Committee to advise the States and to promote and facilitate cross-committee policy development and to develop policies relating to fiscal policy and the financial resources of the States.

Yours faithfully

G A St Pier
President

L S Trott
Vice-President

A H Brouard
J P Le Tocq
T J Stephens

APPENDIX A: TAX LIABILITY AND THE COST OF SERVICE PROVISION

Individuals in the local community pay a proportion of their gross income in taxes and contributions and also pay other taxes and duties. These in turn are used to pay for public services and benefits including schools, hospitals, roads, police and fire services, contributory and universal benefits.

This appendix is intended to illustrate the extent of the taxes an individual might be expected to pay both on an annual and lifetime basis.

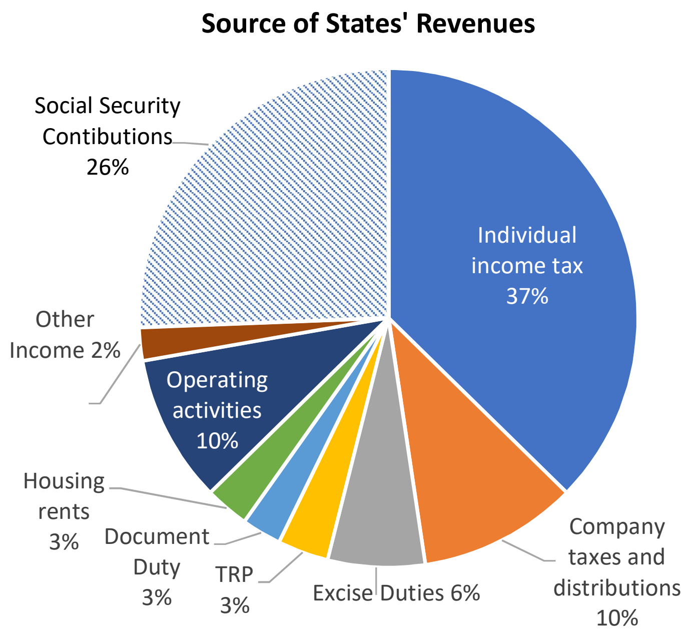
It also illustrates the average value of services consumed by households.

The analysis has been simplified given that tax liabilities and service use can vary hugely depending on personal circumstances.

REVENUES RAISED

The government collects approximately £700million in revenues (or 21% of GDP) each year including income tax, Social Security contributions and other taxes and duties. Approximately 63% of this revenue is generated from income taxes and contributions that are charged against people's income made up of 37% from income tax and 26% from Social Security contributions (including contributions paid by employers).

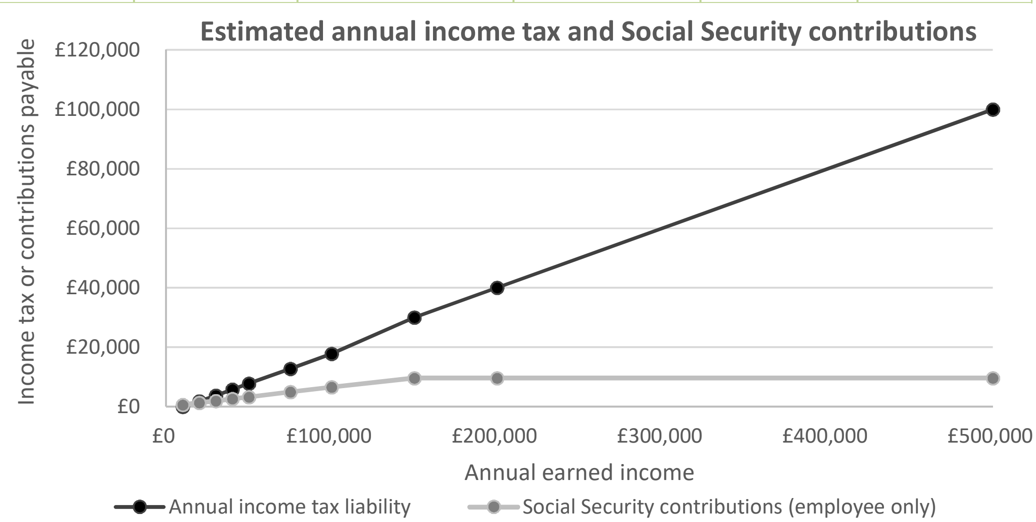
The remaining income is generated from a variety of sources. 10% is generated from income taxes charged on company profits (compared to 7% in the UK) and on the distribution of profits and 6% from excise duties. TRP and document duty each comprise 3% of total revenues as summarised in the chart below:



Guernsey's tax take is unusually small relative to the size of the economy. Guernsey collects aggregate revenues (excluding investment return) of 21% of its GDP. Jersey collects revenues equal to 26%[7] of their GDP while the UK collects 38%.

The table and chart following show the total amount of income tax and Social Security contributions a single individual might pay in the course of a year depending on their level of income. The estimates assume an individual receives their income from employment, are under the States' pension age and entitled to only the basic personal tax allowance. In practice, many people are entitled to other allowances such as relief on mortgage interest or pension contributions which would reduce their tax liability.

Individual annual income	Annual income tax liability	Social Security contributions (employee only)	Other taxes	Estimated total taxes paid	% of gross income
£10,000	£0	£660	£770	**£1,430**	14%
£20,000	£1,800	£1,320	£770	**£3,890**	19%
£30,000	£3,800	£1,980	£780	**£6,560**	22%
Median Earnings (£33,600)	£4,500	£2,200	£790	**£7,490**	22%
£40,000	£5,800	£2,640	£800	**£9,240**	23%
£50,000	£7,800	£3,300	£820	**£11,920**	24%
£75,000	£12,800	£4,950	£875	**£18,625**	25%
£100,000	£17,800	£6,600	£930	**£25,330**	25%
£150,000	£30,000	£9,658	£970	**£40,628**	27%
£200,000	£40,000	£9,658	£1050	**£50,708**	25%
£500,000	£100,000	£9,658	£1,200	**£110,858**	22%



[7] Calculated from published consolidated revenues and published GDP for 2018 available at www.gov.je

Over the course of a lifetime annual payments can total a very significant amount.

Example 1:
A low income working couple who each enter the workforce in jobs paying below the median for their age group. One member of the couple leaves the workforce to care for the couple's two children for a period of ten years, returning to work part time when their youngest child begins school and increasing their working hours over time. Their combined gross household income before benefits peaks at about £40,000.

If we assume both members of the couple live to average life expectancy, between them a couple in these circumstances might pay in the region of £260,000 in income taxes, social insurance contributions and other taxes over their lifetime.

Example 2:
A similar couple with a shorter break from the workforce and an income closer to the median household income, peaking at around £55,000, would be expected to pay in the region of £440,000 over the course of their lifetime.

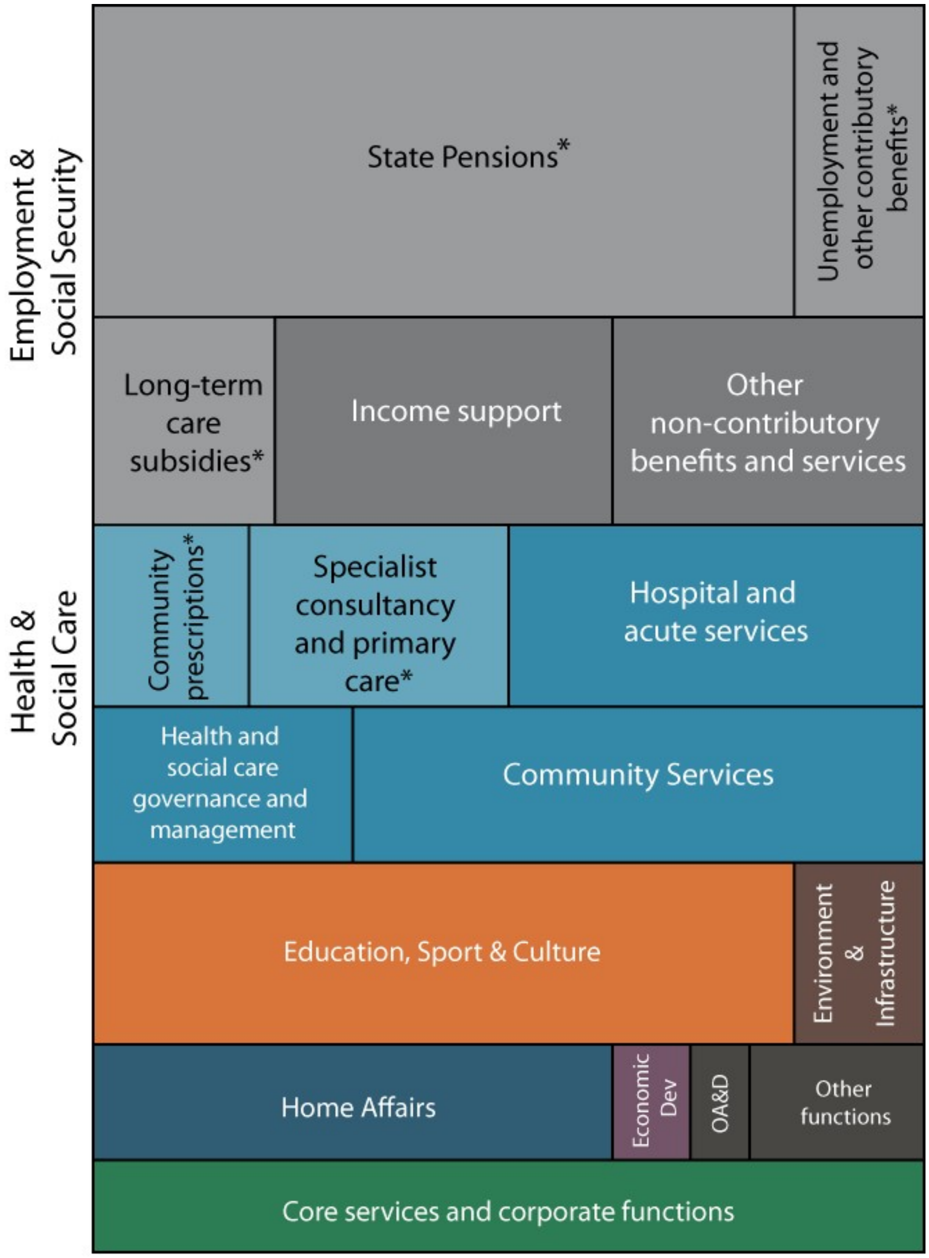
Example 3:
A couple in more affluent circumstances peaking at a gross household income of £100,000, might have a total lifetime contribution in terms of taxes and contributions of £920,000.

Example 4:
A very high income couple, with a joint income peaking at around £750,000 could make a total lifetime contribution of as much as £5,000,000 if they were resident in Guernsey for their whole working life.

SERVICE PROVISION
The revenues collected through taxes and duties is used to provide the community with public services. The diagram overleaf shows how the money collected from the community is spent each year, with *the size of each box proportional to the annual spend* in that area.

In total, 38% of the total amount of money spent on services each year is on Social Security benefits of which the largest item (more than £120m in 2019) is the payment of pensions. 21% of total spending is dedicated to health and social care services. **This means that in total almost 60% of States' expenditure is in areas that are highly sensitive to the ageing of the population.**

Distribution of States' expenditure



* These benefits and services are funded from the Social Security System and are not directly funded from general revenue
OA&D = Overseas Aid & Development

The table below provides estimates of the cost of providing some public services on an annual basis, both *per capita* for entire service areas and the unitary cost of specific services:

Health and Social Care services (including long term care)	
Total *per capita* cost per annum	£3,000
One year of nursing care subsidies	£44,200
One year of residential care subsidies	£23,700
One year of insulin prescriptions	£1,300
One year prescription of a rare cancer drug	£530,000
Heart transplant[8]	Up to £140,000
Standard knee replacement surgery (provided off island)	£7,300-£8,800
Complex knee or hip operation [8]	Up to £20,000
Pace maker implant [8]	£4,500
Average cost of oncology day care case [8]	£1,176
Average cost of other day care case [8]	£955
Cost per day of a neonatal intensive care bed [8]	£3,500
Average subsidy on a prescription	£9.31
Education services	
Total cost *per capita* per annum	£1,100
One year of primary education per pupil[9]	£4,800-£6,300
One year of secondary education per pupil[9]	£8,100-£8,900
One year grant to Student at university in South of England on a standard course at high level of subsidy[10]	£14,000
Pensions and contributory benefits	
Total *per capita* cost of pensions and contributory benefits	£2,300
One year's state pension at full rate	£11,300
One year of severe disability benefit	£5,532
Average death grant	£565

[8] Partnership of Purpose (*Billet d'État XXIV, December 2017*)
[9] States costing and benchmarking report, BDO, May 2017
[10] Committee *for* Education, Sport & Culture guidance for students

Universal benefits (including legal aid)	
Total *per capita* cost of all universal benefits	£900
Family allowance for a family with two children for one year	£1,500
Average annual cost of an income support claim for a pensioner household	£7,400
Average annual cost of an income support claim for a working family	£12,700
Law and order	
Total *per capita* cost of policing, fire and rescue, prison, probation and border services	£400
Cost of prison services per prisoner [8]	£45,000
Border costs per passenger [8]	£2.25
Average cost of a fire and rescue service call out	£3,600

Across the course of a person's life time they may benefit from a significant level of public services. Some of these, like education provision, they might benefit from directly. Others, like the provision of law and order provide a more indirect benefit to the community as a whole.

The analysis overleaf outlines the direct services an average couple with two children might be expected to utilise across their lifetime. This assumes that they attend school on the island to the age of 18, require a fairly typical amount of health care and require, between them, approximately five years of long-term care services.

Some of the most costly services provided are used by only a very small minority of households. Such services include the provision of care and support services for very vulnerable children, treatment of rare or complex health conditions or off island placements for individuals with complex long-term care needs. Lifetime costs for households requiring such services could significantly exceed the upper estimates presented.

Estimate lifetime direct service costs of a couple with two children

Estimated cost of education:	£190,000
Estimated receipt of family allowance for 2 children:	£27,000
Estimate cost of free pre-school:	£7,000
Estimated health care costs[11]:	£200,000-£600,000
Estimated long-term care costs:	£150,000
Estimated pension receipt:	£261,000
Estimated total cost of direct services:	**£835,000 - £1,235,000**

Households are also able to access financial support for periods of their life when their income is insufficient to meet their needs. A low income working family, who require an income support top-up to their income while their children are living at home, and again in their retirement, might claim an estimated £430,000 across their lifetime.

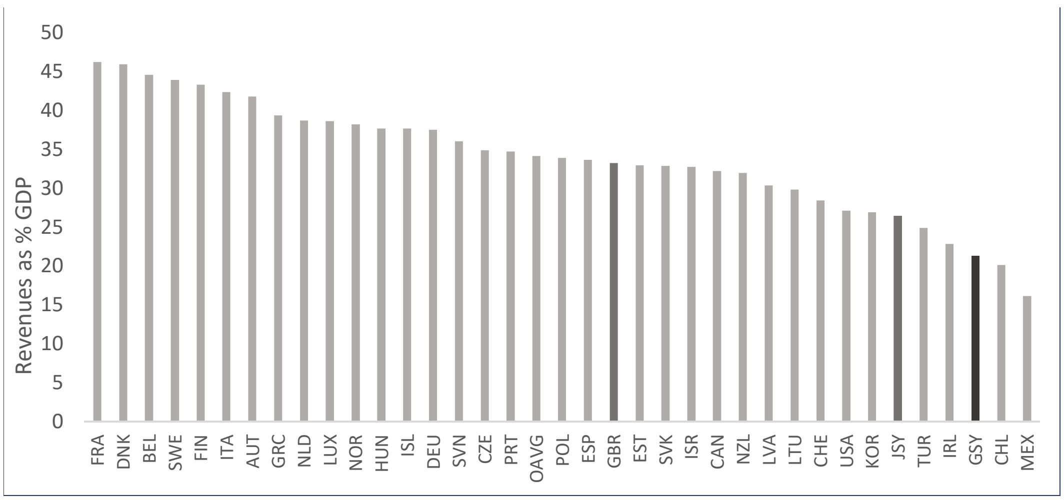
A household closer to the median might be expected to claim for periods when their income might be restricted. For example they may need assistance while they have young children, if one member of the household were to find themselves temporarily unemployed or to support them during retirement if they have insufficient savings or if they need to continue paying rent after they retire. A median income household such as that described earlier might claim in the region of £150,000 of financial support during their lifetime.

[11] These are very broad estimates derived from aggregate accounting data cross checked against estimates made in other jurisdictions. Insufficient data is available to make accurate estimates of lifetime healthcare cost in Guernsey.

APPENDIX B: COMPARISON OF REVENUES WITH OECD COUNTRIES

Guernsey currently raises aggregate revenues, excluding investment return equal to 21.3% of its GDP. The analysis presented below details how this compares to OECD jurisdictions (with the addition of Jersey). Guernsey has a high level of GDP per capita and does not need to provide national defence services which make it more practical to sustain a relatively low level of revenues relative to GDP. A low level of revenues relative to GDP provides a competitive advantage in competing for international business which in turn enables Guernsey to sustain its high level of GDP per capita. Countries that collect high levels of revenues for their economy, such as France and Denmark, typically offer a more comprehensive range of public services than those with a smaller tax base.

Figure B1 OECD revenues as % GDP



Jurisdiction	Revenues as % GDP		Jurisdiction	Revenues as % GDP		Jurisdiction	Revenues as % GDP
FRA[12]	46.2		**DEU**	37.5		**NZL**	32.0
DNK	46.0		**SVN**	36.0		**LVA**	30.4
BEL	44.6		**CZE**	34.9		**LTU**	29.8
SWE	44.0		**PRT**	34.7		**CHE**	28.5
FIN	43.3		**OAVG**	34.2		**USA**	27.1
ITA	42.4		**POL**	33.9		**KOR**	26.9
AUT	41.8		**ESP**	33.7		**JSY**	26.5
GRC	39.4		**GBR**	33.3		**TUR**	24.9
NLD	38.8		**EST**	33.0		**IRL**	22.8
LUX	38.7		**SVK**	32.9		**GSY**	21.3
NOR	38.2		**ISR**	32.7		**CHL**	20.2
HUN	37.7		**CAN**	32.2		**MEX**	16.2
ISL	37.7						

[12] Data source: https://data.oecd.org/tax/tax-revenue.htm. Note that the data source for this data is different to that used in the 2020 budget and that figures may vary

APPENDIX C: ESTIMATED REVENUES RAISED BY TAX MEASURES

This appendix provides provisional estimates of the indicative amount of revenue that might be raised from various measures. Whilst some allowance has been made for the dynamic effects they would have on the economy, significantly more work is required before these can be presented as formal options for raising revenues.

These estimates do not take into account any of the complex cross relationships between various forms of taxation and government spending. For example, in increase in the income tax rate would reduce the capacity to raise revenues from a consumption tax; and increases in tax rates and Social Security contributions place an upward pressure on income support costs.

Headline income tax rates

Income Tax Rate	Additional Revenues £m
20.5%	6.8
21.0%	13.5
21.5%	20.3
22.0%	27.1
23.0%	40.0
24.0%	53.0
25.0%	66.0
26.0%	79.6
27.0%	93.2

Domestic and commercial TRP rates

Commercial and Domestic TRP rates (increase)	£m
50%	12.7
100%	25.3
150%	38.0
200%	50.7
250%	63.3
300%	76.0
350%	88.7
400%	101.3

Withdrawal of personal allowances

Keeping threshold at £100,000, reducing ratio to 1:4 Marginal rate (employed): **31.6%** (self-employed): **36%**	**£600,000**
Keeping threshold at £100,000, reducing ratio to 1:3 Marginal rate (employed): **33.3%** (self-employed): **37.7%**	**£1.4m**
Keeping threshold at £100,000, reducing ratio to 1:2 Marginal rate (employed): **36.6%** (self-employed): **41%**	**£2.3m**
Reducing threshold to £90,000, keeping ratio at 1:5 Marginal rate (employed): **30.6%** Marginal rate (self-employed): **35%**	**£900,000** Additional taxpayers subject to WOPA: **400**
Reducing threshold to £90,000, reducing ratio to 1:4 Marginal rate (employed): **31.6%** (self-employed): **36%**	**£1.6m**
Reducing threshold to £90,000, reducing ratio to 1:3 Marginal rate (employed): **33.3%** (self-employed): **37.7%**	**£2.5m**
Reducing threshold to £90,000, reducing ratio to 1:2 Marginal rate (employed): **36.6%** (self-employed): **41%**	**£3.6m**
Reducing threshold to £80,000, keeping ratio at 1:5 Marginal rate (employed): **30.6%** Marginal rate (self-employed): **35%**	**£2m** Additional taxpayers subject to WOPA: **1,000**
Reducing threshold to £80,000, reducing ratio to 1:4 Marginal rate (employed): **31.6%** (self-employed): **36%**	**£2.9m**
Reducing threshold to £80,000, reducing ratio to 1:3 Marginal rate (employed): **33.3%** (self-employed): **37.7%**	**£4m**
Reducing threshold to £80,000, reducing ratio to 1:2 Marginal rate (employed): **36.6%** (self-employed): **41%**	**£5.2m**

Broad based GST (based on work completed in 2014)

GST rate	Revenue raised (£m)
3%	30
4%	41
5%	51
6%	61
7%	71
8%	81
9%	92
10%	102

Higher personal income tax rate

Income Tax Rate	Threshold £	Additional Revenues £m	Number Taxpayers Affected
25%	50,000	20.0	8,600
30%	50,000	40.0	8,600
35%	50,000	60.0	8,600
40%	50,000	80.0	8,600
45%	50,000	100.0	8,600
50%	50,000	120.0	8,600
25%	75,000	13.6	4,100
30%	75,000	27.2	4,100
35%	75,000	40.8	4,100
40%	75,000	54.4	4,100
45%	75,000	68.0	4,100
50%	75,000	81.6	4,100
25%	100,000	10.6	2,500
30%	100,000	21.3	2,500
35%	100,000	31.9	2,500
40%	100,000	42.5	2,500
45%	100,000	53.1	2,500
50%	100,000	63.7	2,500
25%	150,000	7.2	1,200
30%	150,000	14.5	1,200
35%	150,000	21.7	1,200
40%	150,000	28.9	1,200
45%	150,000	36.1	1,200
50%	150,000	43.3	1,200
25%	200,000	5.5	700
30%	200,000	11.1	700
35%	200,000	16.6	700
40%	200,000	22.1	700
45%	200,000	27.6	700
50%	200,000	33.1	700

APPENDIX D: TIMELINE OF REVENUE RAISING CHANGES TO THE TAX BASE AND OTHER EVENTS

Corporate taxes, commercial TRP and employer social security contributions		**Personal income tax, employee and self-employed social security contributions and domestic TRP and excise duties**
• Zero/10 approved (Billet d'État XI, June 2006)	**2006**	• Personal allowances frozen • Above inflation increases in excise duties
• Employers upper earnings limit increased for £36k to £54k • 100% increase in commercial TRV (Tax on Rateable Value) (replaced with TRP in 2008)	**2007**	• Personal allowances frozen • Above inflation increases in excise duties including 20% increase on alcohol • Above inflation increase in domestic TRV • Employee/ self-employed upper earnings limit increased for £36k to £54k
• Zero/10 introduced (0% standard rate, 10% applied to banking activity, 20% applied to CICRA regulated entities and ownership of buildings) • Employer contribution rates increased by 1.0% • Upper earnings limit for employers contributions increased to £108k • 100% increase in commercial TRP on commercial properties and 400% increase on TRP on regulated finance and land approved for development.	**2008**	• Personal allowances frozen • Above inflation increases in excise duties including 20% increase on alcohol • Replacement of TRV with TRP • Employee/ self-employed upper earnings limit increased to £65k
• 50% increase in TRP for regulated finance	**2009**	• Above inflation increases in excise duties • Employee/ self-employed upper earnings limit increased to £80k
• Above inflation increases in commercial TRP	**2010**	• Above inflation increases in excise duties • Above inflation increases in domestic TRP • Employee/ self-employed upper earnings limit increased to £92k
	2011	• Personal allowances frozen • Above inflation increases in domestic TRP • Employee/ self-employed upper earnings limit increased to £105k

Corporate taxes, commercial TRP and employer social security contributions		Personal income tax, employee and self-employed social security contributions and domestic TRP and excise duties
	2012	• Above inflation increases in excise duties • Above inflation increases in domestic TRP • Employee/ self-employed upper earnings limit increased to £120k
• 10% rate extended to provision of fiduciary services, domestic insurance business, insurance manager and insurance intermediary business • Deemed distribution regime repealed	**2013**	• Above inflation increases in excise duties • Employee/ self-employed upper earnings limit increased to £132k (completing alignment with employers limit increased by inflation since 2008)
• FATCA and the UK Intergovernmental agreement introduced	**2014**	• Above inflation increases in excise duties • Above inflation increases in domestic TRP
• 10% rate extended to provision of fund administration services • Exempt application fee doubled from £600 to £1,200 • Above inflation increase in commercial TRP (lower increase applied to retail)	**2015**	• Personal allowances frozen • Above inflation increases in domestic TRP
• 10% rate extended to provision of custody services • 20% rate extended to the importation and/or supply of hydrocarbon oil or gas in Guernsey and to large retail business (taxable profit of more than £500,000) • Above inflation increase in commercial TRP (excluding retail) • Guernsey joined the BEPS Inclusive Framework in June 2016 introducing country by country reporting (a minimum standard) • Guernsey adopted the Common Reporting Standard on Automatic Exchange of Information	**2016**	• Personal allowance frozen • Above inflation increases in domestic TRP • Above inflation increases in excise duties • Reduction in mortgage interest relief

Corporate taxes, commercial TRP and employer social security contributions		**Personal income tax, employee and self-employed social security contributions and domestic TRP and excise duties**
• Above inflation increase in commercial TRP • 0.1% increase in employer contribution rates • Introduction of Exchange of Tax Rulings (BEPS minimum standard)	**2017**	• Age related tax allowance reduced to balance real increase in personal tax allowance • Above inflation increases in Domestic TRP • Above inflation increases in excise duties • Withdrawal of personal allowances from higher earners • 0.6% increase in employee contribution rates • 0.5% increase in self-employed and non-employed contribution rates • Reduction in mortgage interest relief
• 10% rate extended to provision of investment manager services (except where those services are provided to Common Investment Vehicles) • Introduction of higher TRP rate for legal services • Above inflation increase in commercial TRP	**2018**	• Age related tax allowance reduced to balance real increase in personal tax allowance • Above inflation increases in domestic TRP • Withdrawal of other allowances from higher earners • Reduction in mortgage interest relief
• 10% rate extended to income from operating an investment exchange and income from compliance and other related activities provided to regulated financial services business • Introduction of a higher commercial TRP rate for accountancy services and non-regulated financial services • Introduction of economic substance requirements	**2019**	• Age related tax allowance reduced to balance real increase in personal tax allowance • Real increases in domestic TRP • Introduction of progressive domestic TRP (for properties with TRP value >500) • Reduction in threshold and rate of withdrawal of allowances from higher earners • Reduction in mortgage interest relief • Increase in tax caps to restore real value

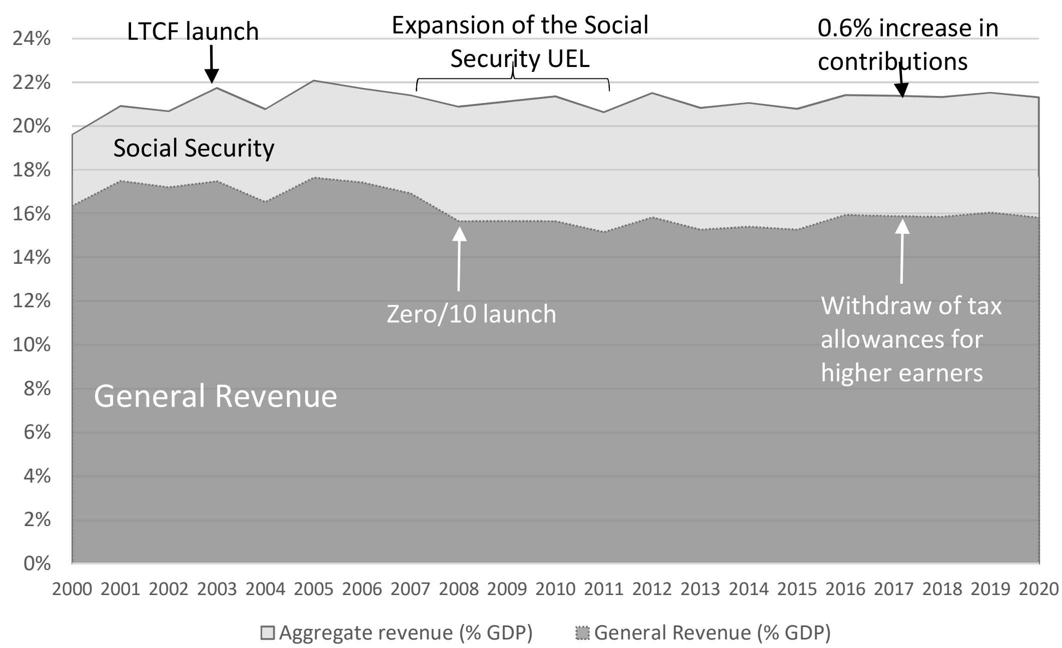
Corporate taxes, commercial TRP and employer social security contributions		Personal income tax, employee and self-employed social security contributions and domestic TRP and excise duties
• 10% rate extended to income from the activity of operating an aircraft registry • 20% rate extended to income from the licensed activity of cultivation/use of cannabis plants • Commence phased process to align commercial TRP for all office accommodation with rates charged on regulated finance activity.	**2020**	• Real increase in personal tax allowance and Age related tax allowance removed • Above inflation increases in excise duties • Real increases in domestic TRP • Continuation of introduction of progressive domestic TRP (for properties between TRP values of 200 and 499) • Reduction in mortgage interest relief

APPENDIX E: HISTORY OF REVENUES IN GUERNSEY

This appendix details how revenues in Guernsey have changed between 2006 and 2019. The data shows the extent to which the distribution of Guernsey's tax base has changed and demonstrates the relative scale and volatility of various income streams.

Aggregate revenues have remained broadly constant relative to GDP for almost 20 years. The loss of revenue incurred at the introduction of zero/10 in 2008 have been recovered from other income sources. However, there has been a significant shift in the underlying distribution of States' revenues.

Figure E1: Aggregate income (excluding Investment returns) as a percentage of GDP



The most evident change is in the degree of reliance placed on taxes on corporate profits (including distributions). In 2007, 23% of Guernsey's aggregate revenue was from corporate income taxes, reducing to 11% in 2008 after the introduction of zero/10 and to 10% by 2019 (see table E4). It should be noted that the expansion of the employer Social Security contributions and significant increases in commercial TRP mean that the reduction in the total contribution from the corporate sector is smaller; falling from 31% in 2006[13] to 26% in 2019. Expressed in 2019 prices, the total revenue from the corporate sector has fallen from £201m in 2006 to £184m in 2019; a real decrease across this period of less than 10%.

[13] Changes to the Social Security system were commenced a year ahead of the move to zero/10

As a revenue stream, taxes on company profits are highly volatile. Year by year, shifts in the annual revenues gained from corporate taxes in excess of 10% in either direction are not unusual (see table E3). These revenues are very sensitive to economic conditions and in periods of strong growth they tend to rise sharply, but fall again in times of economic stress.

The lower reliance on company taxes within the current tax base has undoubtedly reduced the overall volatility of revenues making these more stable and predictable. However, it has also weakened the link between Government revenues and GDP growth on a year by year basis.

To recover the lost revenues the States have increased reliance on other sources of revenues, primarily through the expansion of the Social Security system. Social Security contributions from employers increased in real terms by 33% between 2007 and 2008 as a result of a substantial increase in the upper earning limit applied and a 1.0% increase in the contribution rate for employers with effect from January 2008 (States' Economic and Taxation Strategy 2006, Billet d'État XI, June 2006).

Contributions for other classes were also increased over a five year period by way of a matching increase in the upper earnings limit. A further increase in the contribution rate to meet various policy objectives was applied from January 2017 (Billet d'État XXVII, November 2016) (see appendix D). As a result the total amount of money collected from the contributions system has increased in real terms from £131m (at 2019 prices) in 2006 to £184m in 2019 – a cumulative real increase of 40.5%.

As a result of these changes the reliance on Social Security contributions has increased from 20.3% of aggregate revenues in 2007 to 25.5% in 2019. Combined with revenues from the personal income tax system, this mean that Guernsey has an unusually high reliance on taxes charged against income (which includes employer's Social Security contributions). In 2019 Guernsey, 63% of Guernsey's revenues were gained from the personal income tax and Social Security contributions compared to 56% in 2007. This has reduced slightly from its peak of 65% in 2015[14] as a result of the expansion of other revenue streams. These revenues are subject to cyclical variation, but tend to be more stable in nature than taxes charged on company profits.

Elsewhere the States has seen significant shifts in revenues over this period as a result of changes in the housing market. Nominal receipts of document duty in 2007 at the

[14] This figure is lower than that which was quoted in the 2015 Personal Tax, Pensions and Benefits review because States accounting practices now include gross rental income from the social housing stock (as opposed to income net of rent rebates) and operating income attributable to the funds earmarked within the General Reserve as revenues.

height of the housing boom totalled £26.4m (or £32.5m at 2019 prices). The following year these had fallen to only £15.4m, reducing government revenues by £11m in one year. As an indication of scale this loss of revenue was equal to approximately 20% of the fall in corporate tax revenues between 2007 and 2008 and approximately 67% of the revenue recouped from employer's contributions as described above. The contraction of the housing market and the loss of document duty receipts has therefore played a more significant role in the changes in the States fiscal position than has been widely recognised.

The housing market has yet to recover to its peak level of activity. Between 2014 and 2016 document duty receipts were, in real terms, less than half their peak value and while receipts increased in both 2017 and 2018 they are at only 55% of their peak. The portion of aggregate revenues derived from document duties has fallen from 5.2% in 2007 to 2.4% in 2019.

TRP is one of the most stable and easily forecast revenue streams in the profile of aggregate revenues since it is less subject to cyclical economic factors. As has been widely discussed TRP on both commercial and domestic properties has been increased significantly. Substantial increase to commercial TRP were made between 2007 and 2008 and increases in both commercial and domestic TRP rates have been applied since. As a result TRP's contribution to the aggregate States revenues has increased in real terms by £17.5m in real terms between 2007 and 2019. However, despite its prominence in debate it represents only 3.5% of aggregate revenues in 2019.

Revenues from excise (including motor tax prior to 2008) have also increased. Increases relate to measures applied both to raise additional revenues and those explicitly applied in order to discourage damaging behaviours (for example the increase in taxes on tobacco products in line with the recommendations of the tobacco strategy). The nature of these taxes is that consumers tend (and in some cases are specifically intended to) change their behaviour to avoid the tax. As such that their capacity to raise significant revenues is limited. Raising rates significantly typically has the effect of reducing the demand for the taxed goods, so they become self-defeating if applied for the purpose of raising revenues to any extent.

Table E1: Revenues by source at current prices (nominal £m)[15]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Individual income taxes	160.7	178.4	218.1	209.1	204.8	218.1	227.5	227.1	236.8	238.4	245.8	253.8	260.8	272.5
Company taxes	109.4	118.0	59.2	64.2	52.8	51.9	53.4	54.5	61.3	51.6	56.9	70.3	71.7	69.8
Excise and motor taxes	19.8	22.7	28.0	29.2	31.9	33.2	35.1	35.5	36.8	37.5	41.8	42.2	45.2	45.9
Document duty	20.8	26.4	15.4	13.9	17.8	17.1	17.1	15.5	13.1	12.3	12.7	17.0	17.6	17.0
TRP/TRV	6.3	6.2	10.5	12.7	13.9	14.9	16.0	16.3	17.2	19.0	20.0	20.7	22.9	25.1
Misc revenue[16]	23.7	27.8	29.1	28.2	26.2	28.7	31.0	30.5	30.6	35.1	35.6	34.6	34.2	39.0
Operating income[17]	37.2	38.8	42.0	44.3	48.3	51.2	51.0	52.5	50.0	54.4	55.1	60.9	66.5	67.9
SS Contributions Employer	37.7	43.4	59.8	61.7	63.0	65.1	66.5	67.1	69.3	68.1	70.8	73.6	76.4	78.7
SS Contributions Employee	40.6	47.3	52.2	54.0	55.9	58.5	60.3	61.3	63.6	62.5	64.9	73.1	75.7	77.9
SS Contributions Self-employed	8.4	10.5	11.2	11.5	12.4	13.3	14.0	14.5	15.8	16.0	15.9	16.3	16.8	17.3
SS contributions Non-employed	4.3	5.3	6.1	6.8	6.9	7.1	7.5	7.9	8.5	8.7	8.5	9.5	9.9	10.2
Total	468.8	524.8	531.6	535.6	533.9	559.1	579.3	582.7	602.9	603.5	628.1	671.9	697.7	721.4

[15] These represent actual monetary values presented in a given year

[16] Misc income was restated in the 2017 account to incorporate gross housing income. Gross housing rents were not recorded in the accounts prior to 2016. For 2007 to 2015 this value has been inferred from historic series

[17] Operating income was amended in the 2017 accounts to include income generated on accounts held within the general reserve. Prior to 2006 the value of this has been inferred

Table E2: Revenues by source at constant 2019 prices (real £m)[18]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Individual income taxes	219.3	219.3	258.2	249.6	241.9	251.3	256.2	250.5	256.0	256.1	262.1	265.8	265.8	272.5
Company taxes	145.1	145.1	70.1	76.7	62.4	59.8	60.2	60.2	66.2	55.4	60.7	73.6	73.1	69.8
Excise and motor taxes	27.9	27.9	33.1	34.8	37.6	38.2	39.6	39.2	39.8	40.2	44.5	44.2	46.1	45.9
Document duty	32.5	32.5	18.2	16.6	21.1	19.7	19.3	17.1	14.2	13.2	13.6	17.8	17.9	17.0
TRP/TRV	7.6	7.6	12.4	15.1	16.4	17.2	18.0	18.0	18.6	20.4	21.3	21.6	23.4	25.1
Misc revenue[19]	34.1	34.1	34.4	33.7	30.9	33.0	34.9	33.7	33.1	37.7	38.0	36.3	34.8	39.0
Operating income[20]	47.7	47.7	49.8	52.9	57.0	59.0	57.4	57.9	54.1	58.4	58.7	63.8	67.8	67.9
SS Contributions Employer	53.4	53.4	70.8	73.7	74.3	75.1	74.9	74.0	74.9	73.2	75.5	77.1	77.9	78.7
SS Contributions Employee	58.2	58.2	61.8	64.5	66.0	67.4	67.9	67.6	68.7	67.2	69.2	76.5	77.1	77.9
SS Contributions Self-employed	12.9	12.9	13.2	13.8	14.7	15.3	15.8	16.0	17.1	17.2	16.9	17.1	17.1	17.3
SS contributions Non-employed	6.6	6.6	7.3	8.1	8.1	8.2	8.4	8.8	9.1	9.3	9.1	9.9	10.1	10.2
Total	645.1	645.1	629.3	639.5	630.4	644.2	652.6	642.8	651.7	648.4	669.7	703.7	711.2	721.4
Total personal/domestic taxes and charges[21]	294.6	326.2	355.2	349.1	348.2	358.7	364.8	357.2	362.0	360.6	369.2	386.3	387.8	395.6
Total corporate/employer taxes and charges[22]	200.5	215.9	164.1	176.5	164.3	165.8	166.2	164.7	173.1	162.4	171.2	185.2	185.9	184.3

[18] These represent the monetary values in any given year adjusted for the effects of inflation. For example figures presented for 2007 represent the monetary value of revenues in that year multiplied by the cumulative effect of inflation between 2007 and 2019.

[19] Misc income was restated in the 2017 account to incorporate gross housing income. Gross housing rents were not recorded in the accounts prior to 2016. For 2007 to 2015 this value has been inferred from historic series

[20] Operating income was amended in the 2017 accounts to include income generated on accounts held within the general reserve. Prior to 2006 the value of this has been inferred

[21] Personal income taxes + employee & non-employed Social Security contributions + self-employed contributions up to the employee rate + domestic TRP

[22] Corporate income taxes + distributions + employer Social Security contributions + self-employed contributions above the employee rate + commercial TRP + company fees

Table E3: Change in revenues by source at constant 2019 prices (real annual % change)[23]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Individual income taxes		8%	18%	-3%	-3%	4%	2%	-2%	2%	0%	2%	1%	0%	3%
Company taxes		5%	-52%	9%	-19%	-4%	1%	0%	10%	-16%	9%	21%	-1%	-5%
Excise and motor taxes		11%	19%	5%	8%	2%	4%	-1%	2%	1%	11%	-1%	4%	0%
Document duty		23%	-44%	-9%	27%	-7%	-2%	-11%	-17%	-7%	3%	31%	1%	-5%
TRP/TRV		-5%	63%	22%	9%	5%	5%	0%	3%	10%	4%	2%	8%	7%
Misc revenue[24]		14%	1%	-2%	-8%	7%	6%	-4%	-2%	14%	1%	-5%	-4%	12%
Operating income[25]		2%	4%	6%	8%	3%	-3%	1%	-7%	8%	1%	9%	6%	0%
SS Contributions Employer		12%	33%	4%	1%	1%	0%	-1%	1%	-2%	3%	2%	1%	1%
SS Contributions Employee		13%	6%	4%	2%	2%	1%	0%	2%	-2%	3%	11%	1%	1%
SS Contributions Self-employed		22%	3%	4%	7%	4%	3%	2%	7%	1%	-2%	1%	0%	1%
SS contributions- Non-employed		22%	11%	11%	0%	1%	3%	4%	4%	2%	-2%	9%	1%	1%
Total		9%	-2%	2%	-1%	2%	1%	-1%	1%	-1%	3%	5%	1%	1%

[23] These are the annual changes in revenues adjusted to remove the effects of inflation

[24] Misc income was restated in the 2017 account to incorporate gross housing income. Gross housing rents were not recorded in the accounts prior to 2016. For 2007 to 2015 this value has been inferred from historic series

[25] Operating income was amended in the 2017 accounts to include income generated on accounts held within the general reserve. Prior to 2006 the value of this has been inferred

Table E4: Distribution of revenues by source (% of total revenues)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Individual income taxes	34.0%	34.0%	41.0%	39.0%	38.4%	39.0%	39.3%	39.0%	39.3%	39.5%	39.1%	37.8%	37.4%	37.8%
Company taxes	22.5%	22.5%	11.1%	12.0%	9.9%	9.3%	9.2%	9.4%	10.2%	8.5%	9.1%	10.5%	10.3%	9.7%
Excise and motor taxes	4.3%	4.3%	5.3%	5.4%	6.0%	5.9%	6.1%	6.1%	6.1%	6.2%	6.6%	6.3%	6.5%	6.4%
Document duty	5.0%	5.0%	2.9%	2.6%	3.3%	3.1%	3.0%	2.7%	2.2%	2.0%	2.0%	2.5%	2.5%	2.4%
TRP/TRV	1.2%	1.2%	2.0%	2.4%	2.6%	2.7%	2.8%	2.8%	2.9%	3.1%	3.2%	3.1%	3.3%	3.5%
Misc revenue[26]	5.3%	5.3%	5.5%	5.3%	4.9%	5.1%	5.3%	5.2%	5.1%	5.8%	5.7%	5.2%	4.9%	5.4%
Operating income[27]	7.4%	7.4%	7.9%	8.3%	9.0%	9.2%	8.8%	9.0%	8.3%	9.0%	8.8%	9.1%	9.5%	9.4%
SS Contributions Employer	8.3%	8.3%	11.3%	11.5%	11.8%	11.7%	11.5%	11.5%	11.5%	11.3%	11.3%	11.0%	11.0%	10.9%
SS Contributions Employee	9.0%	9.0%	9.8%	10.1%	10.5%	10.5%	10.4%	10.5%	10.5%	10.4%	10.3%	10.9%	10.8%	10.8%
SS Contributions Self-employed	2.0%	2.0%	2.1%	2.2%	2.3%	2.4%	2.4%	2.5%	2.6%	2.7%	2.5%	2.4%	2.4%	2.4%
SS contributions- Non-employed	1.0%	1.0%	1.2%	1.3%	1.3%	1.3%	1.3%	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Total personal/domestic taxes and charges[28]	45.7%	50.6%	56.4%	54.6%	55.2%	55.7%	55.9%	55.6%	55.5%	55.6%	55.1%	54.9%	54.5%	54.8%
Total corporate/employer taxes and charges[29]	31.1%	33.5%	26.1%	27.6%	26.1%	25.7%	25.5%	25.6%	26.6%	25.0%	25.6%	26.3%	26.1%	25.5%

[26] Misc income was restated in the 2017 account to incorporate gross housing income. Gross housing rents were not recorded in the accounts prior to 2016. For 2007 to 2015 this value has been inferred from historic series

[27] Operating income was amended in the 2017 accounts to include income generated on accounts held within the general reserve. Prior to 2006 the value of this has been inferred

[28] Personal income taxes + employee & non-employed Social Security contributions + self-employed contributions up to the employee rate + domestic TRP

[29] Corporate income taxes + distributions + employer Social Security contributions + self-employed contributions above the employee rate + commercial TRP + company fees