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Guernsey Fiscal Policy Framework

Analysis and Information from GPEG

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THE GUERNSEY POLICY & ECONOMIC GROUP LBG

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Guernsey Fiscal Policy Framework

GPEG is pleased to see that The States are keeping to their timetable and that the Policy and Resources Committee (P&R) have published their proposals in a letter dated 21 November 2025 to update Guernsey's fiscal policy framework ('the Policy Letter').

You would be in an overwhelming majority of the Guernsey population if you do not know what fiscal policy is.

"Fiscal policy is the use of government spending and taxation to influence the economy." That is the definition that the International Monetary Fund (the IMF) uses.

As our currency is the UK pound we cannot control our money supply or interest rates which are the elements of (the different) Monetary Policy. Which is fortunate as monetary policy is not simple! So, we do not cover this.

The Policy Letter makes no effort to link the fiscal policy with economic health.

However, in Guernsey "Fiscal Policy" extends wider than the IMF definition and in some ways is less intellectually demanding. The term Fiscal Policy in Guernsey is really about the levels of government income (taxes), Government spending on current things and on long term investment, and the management of cash and investments and borrowings.

There is no natural perfect balance of these things – political decisions decide which levers are pulled and how hard.

Our politicians behave much the same as those in Westminster. They want to be re-elected which mostly they see as an objective best served by spending on things that make electors happy in time for the next election. For the last decade Guernsey has spent more than Government income and financed that partly by small increases in taxation, selling investments and borrowing. Each recent States has left a weaker balance sheet than it inherited from the last lot.

How to fund the gap between income and expenditure? (Nowadays always an excess of expenditure over income.)

In ascending order of electoral attractiveness: -

Taxation – increases are unpopular and difficult to get voted through – GST efforts are showing this very clearly. In any case the Island's lower than average tax regime is critical to the financial services industry and to attracting the well off. And more countries than were doing so a few years back are putting into place tax measures to attract the rich.

Tax increases will, at some point, start to reduce tax revenue, as companies and individuals are deterred and find better rates elsewhere.

Borrowing – the steady rise of debt is only slowly being recognised by the population but paying interest is unpopular and debt servicing has both the moral and financial potential of getting the kids, when they grow up, to fund the good times their parents had.

Cutting public expenditure is liked by a good proportion of the population but vested interests fiercely oppose cuts. The inability of our civil service and our politicians to find any States cost savings is really bad. The Fundamental Services Review announced in January has gone quiet – we can only hope it can be implemented quickly, as it could show areas of potential saving.

Finally Selling investments – perhaps, irrationally, this is not much noticed.

Overall Conclusions

A read of the Policy Letter makes it clear that the general intent of the current States is to spend more than its income and to fund this potentially by roughly doubling borrowings over its Term. The extent of borrowing will largely depend on the enactment, or not, of tax increases.

The Policy Letter wording provides numerous opportunities to allow The States to adopt virtually any financial policy that this States wants to.

At least the Policy Letter recommends balancing income and expenditure. But it is not specific on over what period. The previous framework said deficits should not be allowed to persist for more than five consecutive years. Regretfully, the Policy Letter does not reiterate this laudable aim.

The measure of 'healthy reserves' remains unclear. Probably the only hard number is the rainy day fund – called the Core Investment Reserve. The rest of the reserves are not appropriate to bring into fiscal policy, especially as we won't have any latitude within these reserves and no real prospect of adding to them. The Core Investment Reserve could easily be framed as a simple measure to help the Island adjust to a nasty economic shock with less pain.

Borrowing will be necessary to finance capital expenditure. However, taking on more debt is mortgaging the future. Do we really want to burden future generations with paying for our spending now? The States continue to avoid the difficult decisions on reining in costs or simply not doing things we cannot afford. What is clear is that significant taxation increases should be implemented – not only to balance the books, but also to provide funding for priority capital expenditure.

It is disappointing that certain of the measures do not use numbers set out in the IPSAS compliant, consolidated Accounts, but instead use adjustments to get close to the 'old basis'. In the interests of transparency, the measures should use numbers drawn from the consolidated Accounts as much as possible. Where this is not the case, we need the numbers to be subject to independent scrutiny.

Another urgent action for The States, which is proposed by P&R, is to establish an Infrastructure Investment Board tasked with working up the comprehensive investment strategy framework, both short-term and long-term. 'It should identify the community's infrastructure needs and establish a framework against which a consistent flow of investment can be prioritised.' We recommend that the Board should include on-Island, senior business people to provide wider perspectives.

The Policy Letter needs to incorporate long term care and pension reforms. An ageing population will increase these costs – ageing is a huge financial pressure and existing reserves are insufficient to cope with this. The Policy Letter is actually incomplete until long term care and pension reforms are concretely integrated into the long-term projections.

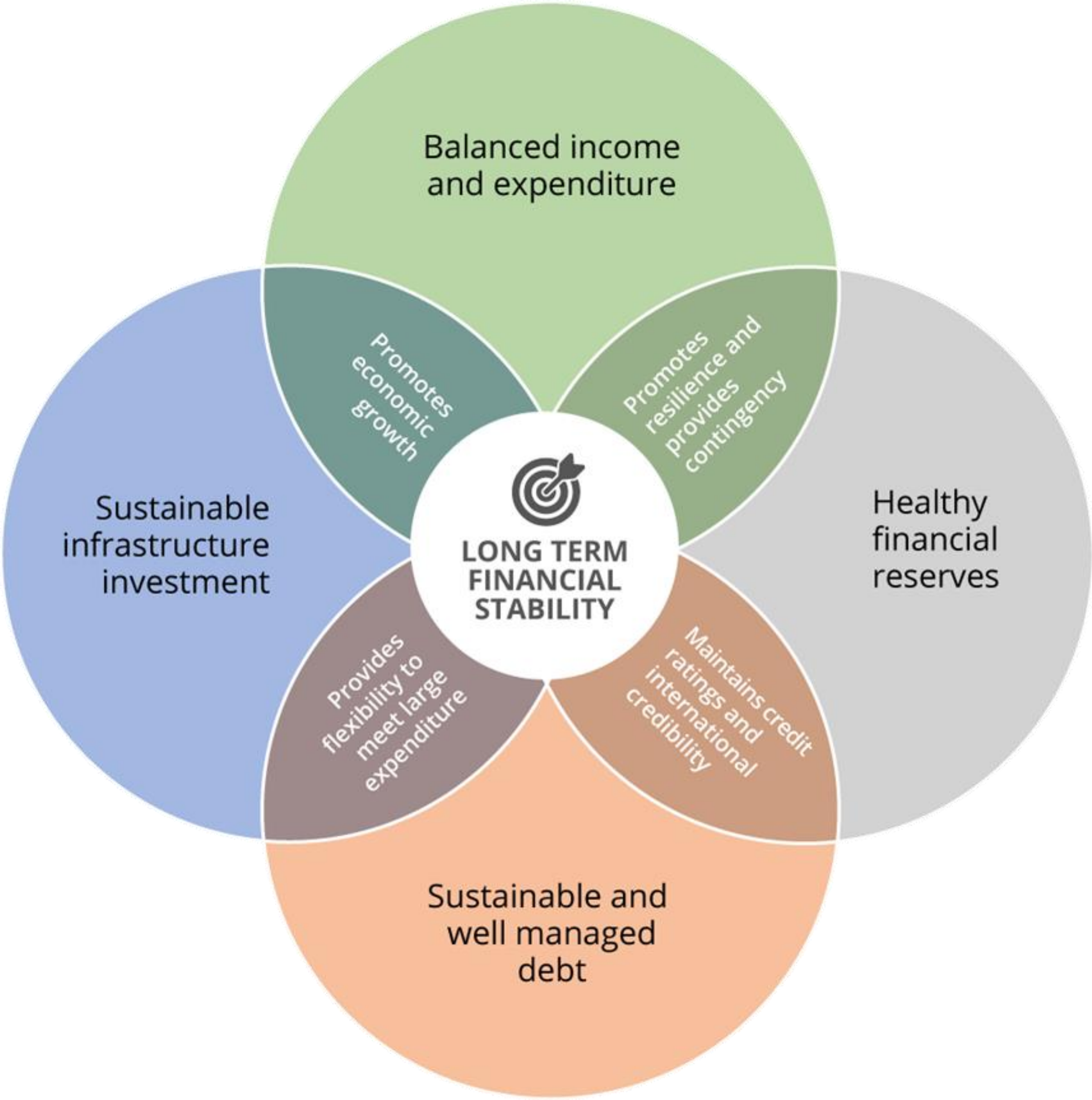
Introduction: The Policy Letter

One of the reasons given for revising the policy is because the States' Accounts now comply with International Public Sector Accounting Standards (IPSAS). It is therefore disappointing that certain of the measures used do not use figures set out in the Accounts but instead make adjustments and omissions to effectively get close to the old basis. In the interests of transparency and accountability, GPEG recommends changing the measures to use numbers drawn directly from the IPSAS compliant consolidated accounts. One version of the truth is plenty.

Much of the Policy Letter effectively tries to arrive at the "structural" deficit. This is basically the deficit between current tax revenue and current spending in an "average year" for capital expenditure. However, the concept is not easy to apply accurately. Forecasts of revenue are inevitably imprecise, inflation will vary from forecasts, investment returns will vary and more - but the biggest variable will be the very discretionary capital investment levels. We do not have a comprehensive infrastructure plan and even if we did, unless we learn not to repeat the massive cost overruns incurred in recent projects, actually estimating future capital expenditure, other than roughly, is a fool's errand.

Longer term, the ageing population will tend to increase health costs and particularly long-term care costs. There is no provision in the fiscal plan for these yet it seems likely that these items will cost over, possibly well over, £50 million pa (in today's currency) within a decade.

The policy framework is described in the Policy Letter pleasantly and symmetrically, as four pillars with overlaps and nice colours. (*Pillars eventually topple*….)



Balanced income and expenditure – Pillar 1

GPEG agrees that this is a fundamental financial principle – provided you remember the need to fund capital expenditure.

Instead of the revenue surplus/deficit, the proposed measure is to use a structural surplus/deficit for planning. But this is not a measure fully based on IPSAS compliant accounts. This inevitably introduces confusion and complexity.

Further confusion is generated by saying that success 'looks like' achieving a 'balanced budget averaged over an economic cycle'. The problem is you only know you have been in a cycle afterwards!

And then 'This should adjust for cyclical fluctuations in revenue and expenditure to determine the structural position'. This adjustment is always going to be very approximate – estimating economic growth or contraction a few years forward is simply impossible.

But generally this "Pillar" is a policy going in the right direction but it needs to be enforced year by year,

Sustainable infrastructure investment - Pillar 2

GPEG understands the importance of a comprehensive infrastructure strategy. GPEG agrees that there needs to be a framework established against which a consistent flow of investment can be prioritised.

A lot is made in the paper about fixing Guernsey's capital spending at 3% of GDP.

The correct analysis is that capital spending forecasts should first consist of essential spends to keep things like the ports operating. It should also include (if cash is available) capital investment which has an economic purpose and will improve the economy.

Any further expenditure is in the hands of politicians – it's stuff that improves life on the island and also needs cash.

These categories have little to do with the level of GDP and **no particular percentage of GDP** is the right answer.

The only benefit of fixing 3% of GDP as a target is that it makes life easy for the Civil Service.

Giving it a budget of 3% of GDP - a level never historically reached - may have the effect of funding rubbish projects to use the funding. The wrong target!

We totally agree that infrastructure needs to properly planned, budgeted and project managed. It is not any of these things now. A sensibly constituted Infrastructure Investment Board, using on-island talent in preference to expensive off-shore consultants, would not be short of good things to do.

The Policy Letter bizarrely has three unexplained categories of Capital Investment:

- 'Monitored Capital Investment', which includes most forms of capital spend.
- 'Monitored Separately' covering public sector housing investment and, very oddly, private sector housing development.
- And 'Excluded' which includes the Dairy and more significantly Aurigny.

We really do not understand these categories or their significance.

States housing spend is to be treated separately from other infrastructure spending. We see no good reason for this.

GPEG also believes the capital investment strategy needs to adapt to the demands of an ageing population. This needs debate and important decisions.

Sustainable and well managed debt - Pillar 3

For this measure, the Policy Letter proposes that it refers to Guernsey’s direct debt liabilities, excluding debt on other entities which are consolidated (as set out in paragraph 5.10). GPEG thinks this is a nonsense. There is no legitimate reason why the measure of debt liabilities is not the number in the consolidated accounts. The accounts include debts relating to all consolidated entities and the measure must be this total.

Clearly the States could never allow one if its trading entities (say the Ports or Electricity) to fail and not pay off its debt.

Debt is debt!

A key point on debt, in our opinion, is set out in the Policy Letter, namely that responsible borrowing by Guernsey depends on the availability of surpluses to service debt repayments.

But furthermore, it also depends on the capacity of income to meet interest on the debt. We find it surprising that the servicing of interest is not mentioned.

The proposal is to have an aggregate debt liability within limits which are independently assessed, removing the previous limit of 15% of GDP.

GPEG thinks commercial loan criteria will provide its own limits, when linked to the servicing of interest and debt repayments.

Further debt during this States’ Term of at least £270 million is likely to be required. The projects as set out in the January 2025 States paper amount to £419 million and new borrowing of £155 million was set out as being required. The 2026 Budget seeks to add two further projects, namely the Leales Yard site and the Future Inert Waste Disposal project. No estimates of cost have been given, but previous estimates talked about £35 million and £30 million respectively. This takes new borrowing requirements to £220 million. Add in something for the usual overruns…..

Then there is funding for the shortfalls from the deficits forecast in the 2025 outcome and the 2026 budget, which could add a further £50 million.

Borrowing at 31 December 2024 (per the Accounts) was £400 million, being 11.5% of GDP. Adding new borrowing of, say, £270 million would give a total of £670 million, which amounts to nearly 20% of GDP. So overall, we are doubling debt as a percentage of GDP without bringing in any future requirements for capital expenditure.

The Policy Letter refers to an E&Y report from 2023 as stating that Guernsey could sustain debt of 30% of GDP without adversely impacting its strong credit rating. We have had no access to that report – but it is obviously out of date.

The Paper contains one of the oddities which we frequently find in States’ papers. Long-term debt “must remain within appropriate, independently assessed limits. An assessent (*think they mean ‘assessment’*) of the States’ borrowing capacity must be conducted no more than 24 months prior to issuing new long-term debt.

Why (if needed at all – after all it’s the debt market’s view that determines what can be done?) 24 months rather than at the time of issue?? As usual we need ‘credible, independent expertise’ – we wonder if this is an attempt at getting more revenue for an existing consultancy relationship?

But an overriding concern is that low reserves plus rising debt plus an ageing population creates an unsustainable path and reduced fiscal resilience.

Healthy Reserves - Pillar 4

This deserves a paper to itself. It is conceptually confusing.

What is a “reserve”?

We have two types of reserve. One is a segregated pool of investments – these are the Social Security Funds. These can cover the next few years benefits (<u>not</u> the whole liability) if fresh contributions are not made.

The other two types of reserve involve just book entries – (1) The Core Investment Reserve which is supposed to be used only if things are really bad, and (2) the General Revenue Reserve which is described as funding cashflow. The General Revenue Reserve is currently £350 million (after adjusting for allocations for specific purposes).

These unfunded reserves are reasonably irrelevant and vaporous (and have no physical existence) which is fortunate as the Core Investment Reserve should be c£700 million if previous States policy had been enforced, but because of past spending is £182m. There are no real world consequences to this!

Actually, the only really relevant number is the Core Investment Reserve – the “rainy day” fund. The rest are not appropriate to bring into fiscal policy, especially as we won’t have any headroom on the measures that are proposed, nor do we have any real prospect of increasing them.

The Policy Letter says that these reserves fulfil ‘a range of strategic functions essential to the financial health of the States’. Which is a bold statement as many countries manage perfectly well without them.

The Fiscal Policy Review Panel recommends that the Core Investment Reserve be increased to 30% to 60% of GDP. This is roughly £1bn to 2bn. Two or three decades of consistently running modest surplus cashflows might get to these sorts of numbers. The huge, suggested range tells you there is no science to setting this target, as to see what you need to survive an awful shock depends on how pessimistic you are!

In the event of a horrible world financial collapse, there **might** well be relief from the UK, or even the IMF, which could help with survival. But if they don’t then we would have use all the States’ assets to deal with the problem.

But the most likely economic catastrophe here is not a short term problem but the loss of much of our key financial services industry, perhaps due to over, or under, regulation. This would be a long term problem which no conceivable “rainy day” fund could cover. Though a fund capable of helping the island adjust with less pain is a desirable possibility.

The Policy Letter settles for Total Reserves to be at least 43% of GDP – which might be missed very shortly as deficits continue to pile up. The Policy Letter proposes a 50% aspiration for the long term which, as the long term is defined as 10 years plus in the Policy Letter, this astrological proposal is unlikely to be ever executed.

Selling States’ owned investments is one way to fund current spending of all types. There is something like £1.7bn of these assets which compares to external debt of £0.4bn.

There is a dilemma that never gets resolved. Rationally if you believe that investments will generate a better rate of return than the cost of borrowing you would borrow the highest sensible number and buy investments. On the other hand if you believe that borrowings will cost more than the return on investments you would sell investments and repay debt.

We do neither.

(*The long term fixed rate bond (£330 million) we have issued is cheaper than currently available debt and you could be more confident that investment returns would exceed the interest cost on this bond – however this would not apply to fresh borrowing.)*

This strange world of some segregated funds that are just part funded and other allocated reserves with no segregated investments is befuddling. Externally the Policy Letter expresses the view that reserve levels are important to credit ratings – GPEG suspects that this is not true. Complication does not help credit ratings - ability to pay is what debt providers look to and a "normal" set of accounts is the basic tool.

We believe that simplification would help everyone.

Other Reading

We commend the following GPEG papers as relevant to the topic:

1. Capital Expenditure in Guernsey dated January 2021 – https://www.gpeg.org.gg/publications (under Spending and Taxation)
2. The Fiscal Policy Panel & Chocolate Tea Pots dated April 2025 – https://www.gpeg.org.gg/publications (under Spending and Taxation)
3. GPEG Commentary on the Guernsey 2026 Budget – https://www.gpeg.org.gg/publications (under Spending and Taxation)