Funding the Future

That Jersey black hole - and my 2007 forecast that it w...

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As yesterday's Guardian article on the mess Jersey finds itself in noted, that island is facing a [financial black hole of £125 million] a year. And what slightly irritates them is that I forecast that this would happen as long ago as 2007.

Now, I admit, I forecast that the problem would arise sooner that it did: I did not anticipate that Jersey would be willing to sell everything including the kitchen sink in an effort to stave off recognition of the fact that they are, essentially bust, but the reasons why the problem has arisen are almost exactly as I forecast and the sums involved uncannily similar (weirdly so, in fact: forecasting should not be this accurate as to scale). So I thought it worth sharing that 2007 blog here since some people have asked how I did this:

Jersey has published its budget for 2008, which includes forecast to 2012.

According to the budget all is well in the Isle. Having had a good 2006, with tax paid above expectation, it is forecasting much the same in 2007 (when tax receipts are based on 2006 profits). And it assumes the good times will continue to roll. This is a summary of their projections:

Actual 2006	Probable 2007		<------ Forecasts 2008	2009	2010	2011	2012 ------>
£m	£m		£m	£m	£m	£m	£m
		States Income					
398	440	Income Tax	460	480	495	515	535
-	-	0/10% Corporate Tax Structure	-	(9)	(77)	(82)	(87)
-	-	Goods and Services Tax	30	45	46	47	48
53	52	Impôts Duty	52	52	52	52	52
23	26	Stamp Duty	27	28	29	29	30
-	-	Tax/Stamp Duty on Share Transfer	1	1	1	1	1
42	34	Other Income	33	32	28	25	24
9	10	Island Rate	10	11	11	11	11
525	562	States Income	613	640	585	598	614
		States Expenditure					
465	482	Net Revenue Expenditure	505	525	546	565	583
39	42	Net Capital Expenditure Allocation	40	38	39	39	40
504	524	Total States Net Expenditure	545	563	585	604	623
		One-off expenditure					
-	-	Income Support - Transitional relief	10	6	4	2	1
21	38	Revised Forecast Surplus/(Deficit)	58	71	(4)	(8)	(10)

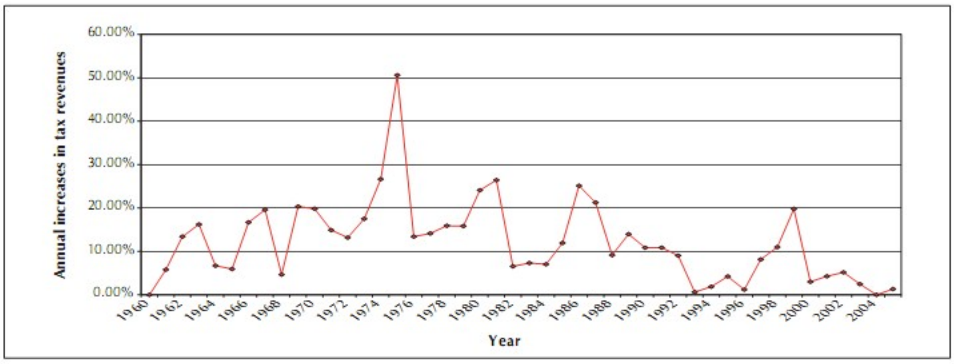
Near as makes no difference there is an implicit growth rate of 5% in the top line, which is the only line that makes this whole equation work. But, as the notes say:

The 2008 revenues are based on specific assumptions about the increase in taxable profits, earned and unearned income for 2007. These forecasts are cautiously optimistic but do not and can not make specific adjustment for the recent ‘credit crunch’ as figures are not yet available.

I think the term ‘cautiously optimistic’ is a little wide of the mark. The ‘credit crunch’ is on the offshore financial markets. It’s the SPVs, SIVs and CDOs that are based in Jersey and elsewhere that are being wiped out. New issues are not happening. This credit crunch is not a stage removed from Jersey, as for example the 2000 downturn was. This one is bang in the centre of St Helier for all practical purposes.

So its important to look at what happened the last time Jersey experience the boom times. This graph shows trends in Jersey tax revenues, and is from its 2004 budget (not on line):

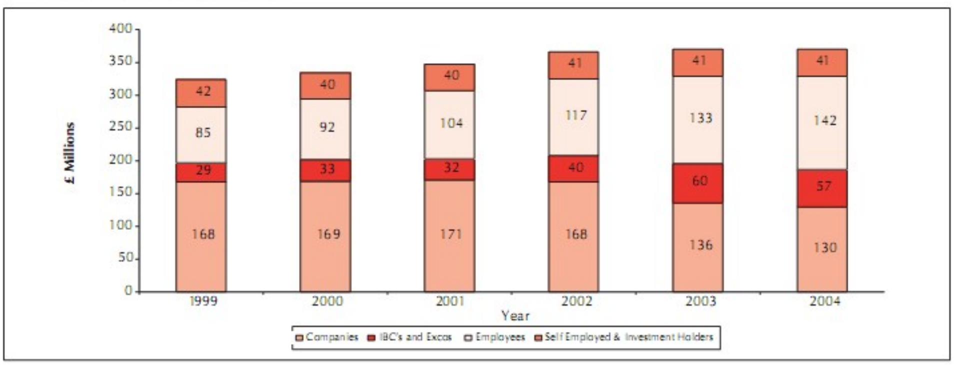
Table 10.1
Income Tax Revenues – 40 Year Trends



In booms (1984 — 87 and 1996 — 2000) Jersey sees very high tax growth. Afterwards it can flat line. It does whenever there is a downturn in the market (1993 — 1996 and 2000 — 2005).

This graph shows that, again from the 2004 budget and showing real revenues to 2003 and anticipated 2004:

Table 10.2
Sources of Income Tax Revenues



The top line would read:

1999, £324m

2000, £334m

2001, £347m

2002, £366m

2003, £370m

2004, £370m.

The actual income in 2004 was, according to the 2006 budget £363m and 2005 was £370m. So, for five years (2001 — 2005) real growth was 1.5% on aggregate, and effectively 0% from 2002 to 2005 inclusive, a real decrease when inflation is considered.

But on the back of two good years Jersey is now forecasting growth of 5% when there is every sign that it's only core business sector is in crisis. 0% might be a good substitute.

And the loss from 0 / 10 needs to be properly stated. It is not £77 million on 2010 — even Senator Le Sueur admits it is much higher than that now. I estimate (using his own data) that it is at least £118 million, which will of course rise with inflation. So, let's substitute growth at a generous 1.5% and this real loss into the forecast and this is what happens:

	2006 £m	2007 £m	2008 £m	2008 £m	2010 £m	2011 £m	2012 £m
Per Jersey budget	398	440	460	480	495	515	535
If grows at 1.5%	398	440	447	453	460	467	474
Gap	0	0	-13	-27	-35	-48	-61
Revenue loss per Jersey	0	0	0	9	72	82	87
Likely revenue loss	0	0	0	30	118	130	145
Extra loss	0	0	0	-21	-46	-48	-58
Total gap	0	0	-13	-48	-81	-96	-119

But that's not the end of the story. It's ludicrous that the Budget is based on an estimate of the impact of 0 / 10 calculated in 2005. Tax revenues that year were £370 million and the revenue loss was estimated to be £85 million and income from companies which will give rise to the loss was just £186 million (source, 2006 budget). In 2008 the headline income take from companies is £228 million. Just scale the tax loss up in proportion to that and it has to be £100 million in 2010. If Senator Le Sueur's *estimate is under by this sum mine must be as well. That results in the following table, for now:*

	2006 £m	2007 £m	2008 £m	2008 £m	2010 £m	2011 £m	2012 £m
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Gap	0	0	-13	-27	-35	-48	-61
Revenue loss per Jersey	0	0	0	9	72	82	87
Likely revenue loss per Tax Research	0	0	0	30	118	130	145
Aditional loss	0	0	0	15	15	15	15
Extra loss	0	0	0	-36	-61	-63	-73
Total gap	0	0	-13	-63	-96	-111	-134

The conclusion is obvious. Jersey is not going to break even. Jersey has a massive black hole.

And even this assumes that the massive increase in tax income over the last couple of years can be sustained, and there is no evidence that this will be the case given the size of the credit crunch and its relevance to Jersey.

Put nicely, the place is going bust. Not quite as fast as Northern Rock maybe, but just as certainly.

I wonder when the financial services industry will begin to bail out?