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The 2024 Budget is presented amidst the ongoing debate on how to treat the significant structural imbalance in States' finances. The Budget is not, however, the tool to address the long-term sustainability of our Island's finances; rather it has a short-term focus and sets the financial policy for the year ahead. Notwithstanding this, the current fiscal challenges cannot be ignored when considering budget measures for the upcoming year and every effort has been made to balance the position as far as possible.

The 2024 Budget projects a small surplus of £24m, which on the face of it might be considered a good result, but what has not been factored into that surplus is the States' capital expenditure or depreciation. Further, this surplus does contain estimated investment returns of £25m for the year, which as we know with the recent significant losses in 2022 are incredibly volatile. By stripping out investment returns, which should really be considered as capital appreciation or depreciation rather than income, we can see the underlying financial performance of the States. In the case of this Budget that would be a net result of circa zero, or break-even, before depreciation or capital expenditure has even been considered. Yet capital expenditure is unavoidable.

The Budget surplus turns into a **deficit** of £13m, when an estimate for depreciation is included, and that includes the £25m gains from the volatile and hard to predict investment returns. However, owing to a historic underinvestment in capital expenditure the current annual depreciation charge is significantly less than what would be expected if capital spend had been in line with policy. As a result of this underinvestment, the current depreciation charge does not represent the level of cash the States should invest in its fixed assets, as many of the States' assets have been fully depreciated already.

When considering capital investment, the latest estimate for the cost of the major capital portfolio prioritised for this term is £560m, with £130m of this spend originally planned for 2024. This excludes the cost for minor capital replacements, which totals £20m per annum on average. This would turn the £24m surplus into a deficit of £126m. However, it should be noted that the actual value of the capital portfolio for the remainder of this term is currently under review as part of the Funding & Investment Plan debate in October, so how much the States will spend next year is still undecided.

According to the States-approved Fiscal Policy Framework we should be investing an average of 2% of GDP into capital expenditure over the long-term. This would currently equate to £78m per annum, meaning the £24m surplus would become a **deficit** of circa £50m should capital spend be taken into account at this more conservative level. Still, this is clearly not affordable and further illustrates the underlying structural deficit the States are currently operating.

The structural deficit being operated today is being sustained only by the use of reserves built up in the past. However, these reserves are declining. 2022 saw an overall deficit of £135m, funded through reserves. Every year that the financial performance of the States results in a deficit, our reserves will reduce. In addition to this, as our reserves deplete it will not be possible to rely upon investment returns to 'prop up' our dwindling surplus. As reserves get smaller so will the size of any investment return. Should the States need to liquidate investments to fund day to day expenses more of our reserves will need to be invested in

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short-term instruments rather than for the long-term, which would likely result in lower financial returns. This would represent a double hit to our financial position if we continue to bank on those returns to help cover our spend. This would be a very precarious financial position to be in.

Further to this, the balance of the Core Investment Reserve is significantly lower than it should be. This is the only long-term reserve where the capital value can be made available to be used in the exceptional and specific circumstances of severe and structural decline or major emergencies. States' policy is that the target balance of the Core Investment Reserve should be 100% of General Revenue income in order to provide sufficient resilience in the event of one of these scenarios emerging. As at the end of 2022 the balance was £158m, only 25% of the General Revenue income budget for 2024, meaning £460m would need be added to the reserve to reach this target balance. This will only be possible if sufficient General Revenue surpluses are generated over and above what's needed to sustain required capital expenditure.

Although the current fiscal challenges are evident every effort was made in delivering this Budget to generate additional income from the existing tax base, without negatively impacting the community or Island as a whole. Real-terms increases of £2m have been included through the raising of tax caps, TRP rates and duties, alongside general inflationary increases of £15m (3.9%), but these measures alone are nowhere near enough to cover the States' increasing expenditure requirements.

In a bid to deliver a no real-terms growth expenditure budget for 2024, all Committees bar the Committee *for* Health & Social Care were requested to deliver annual budget savings of 2.5% (amounting to £6m), to offset the financial pressures of delivering health and care services to an ageing population. Although this savings target was met in part - generating budget savings of £4m of the £6m target – these were more than offset by Committees requesting additional budget as a result of rising costs for operating their existing services. General inflation was initially applied to budgets at a rate of 5.5%; however, after a review of all expenditure budgets inflation has had to be included at 6.1%. Along with other unavoidable cost pressures, this has resulted in the 2024 expenditure budget increasing by £37m, which includes a real-terms increase of £5m (1%).

It is clear from the budget rounds that the Committee *for* Health & Social Care has significant cost pressures. It submitted a request for additional budget of £10m – on top of the general inflation allowance of £5m already applied to the cash limit for 2024. The Policy & Resources Committee has proposed a £4m real-terms increase rather than awarding the full £10m requested, which was based on recent financial modelling that sought to project the cost of rising demand on health and social care services in Guernsey, as well as considering what was currently affordable. However, this does mean that there is particular risk within this Budget with regards to the provision of healthcare and this is only expected to worsen in the future.

As well as the cost pressure of delivering existing services, there is also demand for an expansion to services and the introduction of new ones. This has manifested in the

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requirement for £11m of additional expenditure budget in 2024 to deliver on the priorities of the Government Work Plan and to fund previously agreed service developments.

Finally, all bar one of the unincorporated trading assets are currently operating at a deficit – resulting in a need to temporarily move from a purely 'user-pays' to a partially 'taxpayer-funded' model. In September 2022 the States agreed to fund the Guernsey Waste deficit from General Revenue, with an allowance of £500k made in this Budget. In addition, the States agreed in the 2023 Budget that the Ports' £6m deficit would be funded from General Revenue and this Budget proposes a provision of £4m for 2024. Further, a provision of £500k has been made to fund the Guernsey Dairy deficit as its reserves have been depleted and are now unable to cover the deficit. Going forwards if the fees and charges paid by the users for these entities can't be increased sufficiently to cover the costs of operation, there is an unfair additional burden on the taxpayer meaning that, for example, in the case of Guernsey Ports all taxpayers are subsidising mooring fees for those with boats.

As mentioned, the States are already operating a structural deficit. It is not something that might happen in the future; it is happening today. This means that actions have to be agreed in the very near future in order to move to a sustainable financial position and proposals have been put forward in the recently published Funding & Investment Plan. It is clear from this Budget that incremental income and cost saving measures have no prospect of delivering long-term permanent balance and that the Assembly's decision as to how we achieve this cannot be delayed any longer.

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