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GPEG Commentary: THE POLICY AND RESOURCES COMMITTEE MAJOR PROJECTS PORTFOLIO REVIEW

Analysis and Information from GPEG

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THE POLICY AND RESOURCES COMMITTEE MAJOR PROJECTS PORTFOLIO REVIEW

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RESOLUTION, OPTIMISM AND DEFER AND DELAY

On 17 January 2025, P&R published their Major Projects Portfolio Review.

In this paper, you'll see that we have done our best to estimate what's going to happen with the capital projects that are needed.

Bluntly, we see no way that capital expenditure can run, even at the levels proposed by P&R, without significant amounts of GST being raised. By significant, we mean at least twice the level of 5% proposed under GST Plus. Deputy Lyndon Trott has agreed that a rate of 5% won't be enough and warned the States' Assembly on 5 February 2025 that more will be needed to repair the States' finances.

The P&R Major Projects Portfolio Review is based only on projects currently identified. It seems reasonable to assume that the expenditure on the major projects identified will happen during 2025, 2026 and 2027. What is certain is that more projects will be needed as we go through the next States' Term. But the assumption in the Review (and our calculations here) is that no additional projects are added.

You may remember that the States were totally unable to find meaningful cost savings recently – failing even to realise half its budgeted gesture of savings of £0.8m last year.

Now we are to develop a plan for a Fundamental Services Review, with the aid of our politicians' standard prop of external consultants, to ensure that any conclusion on cost reduction will be well into the next States. It will follow half a dozen similar and largely ignored reviews since 2008.

It seems safe to assume that nothing will happen in the next few years to reduce the current expenditures of the States. So what is to be done to provide funds for desired capital expenditures?

Well, now it seems all of the 22 major capital projects (all of which are said to "have merit") "should be progressed" and that a substantial number of other ("in flight") capital projects will be continued. The only project that looks to be in jeopardy is the Alderney Airport "rehabilitation". (It is actually a significant improvement). Prioritisation is not something our government seems to have much stomach for.

The paper shows that the tax revenues are barely sufficient, even **after** increases in tax, and on optimistic assumptions, to fund current expenditures and that **any** capital investment has to be funded by the sale of investments or by increased borrowing.

Tax revenues from 2025 onwards assume £30m annually from a new tax on large companies under the OECD's Pillar II proposals. Unfortunately for us, this has been dealt a major blow by President Trump ordering the withdrawal of the United States from the global tax agreement. It seems we are already £30m down on our numbers for tax revenue.

Something radical will have to be done to fill up the Island's coffers again.

In 2021 GPEG published a paper on the basics of capital expenditure – it remains valid today.

https://www.gpeg.org.gg/_files/ugd/58aa14_2f76df78307444e39b43eddb4f5d7256.pdf

We should be willing to debt fund capital expenditure that generates an economic return above the cost of borrowing. We are not given details of financial cost benefit calculations and only one project, the putative Construction Village Project, is forecast to save its cost of £5m. (Low flying porcine objects appear).

We should also fund truly essential investment. Some part of the £167m capital spend now proceeding on the hospital is probably essential. Considering the furore about overspends and project control over the last year or so it was remarkable to learn from the 20th January 2025 update on the "Our Hospital Modernisation" from the Committee for Health and Social Care that "the figures will become clearer as work progresses on the business case".

Doubtless in the £118m allocated to education there will also be some essential spend. And it will also be true that there will be some economic

return from better education, but no cost benefit analysis seems to be lurking around.

Mostly any efforts to find cost/benefit or other more objective support for the proposed capital expenditure come up blank.

The P&R paper is really difficult to follow. Non-experts will struggle with concepts such as a General Revenue surplus, or a bond reserve, or the concept of a reserve being available to pay bills - all serving to confuse the average voter. Beware of the use of the word "transformation ", it allows flexibility in whether transformation costs are treated as capital or income as may suit the politician presenting the numbers.

But what really matters are the investments held, cash (if any) and borrowings of the States. You can meet liabilities for capital spending from cash flow from taxation (less operating cash items), from selling investments and from increasing borrowings.

The Major Projects Forecast (Table 3 in the paper) shows (in 1st January 2023 £s) £474m of capital needed at 1st January 2023 to complete the 22 projects (and other "in flight projects") and from the text (Table 4 in the paper) we learn that £405m now remains to be spent. The implication is that £69m has been spent. However, the 10% inflation since the original estimates does not seem to have been provided in the forecasts so we need to add say £40m to the latest estimate. It also shows very little allowance for the traditional underestimations of States capital project costs. You can only guess at this but 10% is actually low end and would add c£50m to the costs. Recent examples include the 30% overrun on IT for patient records, and the reported £30m on the Hospital capital spend.

The largest contract ever signed by the States was the £200m IT transformation project. We don't know what's been spent – and quite a lot has gone into revenue spend, not capital. We do know that the capital costs for this IT contract are divided among projects such as Transforming Education Digital, My Gov Digital and Digital Infrastructure. We simply cannot easily identify the total amount still to be spent under capital projects. For example, we know that Deputy Al Brouard commented about the Health Electronic Patient Record IT capital expenditure in August 2024, saying that the forecast was revised to £22.2m following a thorough review of the remaining work. This appears to be the £22m for 2023 onwards shown

in Table 3. We do know that the whole IT project is considerably overspent. However, publicly available information on the IT project doesn't enable us to identify overspends.

It is also worth remembering the annual £23m of "routine" (roads, PCs etc) capital spend which has to be funded on top of the major projects. This is based on the 2025 Budget estimate of £93m for the 4 years from 2025 to 2028 (section 7 of the 2025 Budget). Again this is based on 2023 prices with no allowance for inflation.

What about timing? When will expenditure on major projects happen? It seems reasonable to assume it will be mostly gone during the course of 2025, 2026 and 2027. On the doubtless rash assumption that no more capital spending is commenced it seems like we would need 3 x £23m plus inflation = £75m for routine capital spend and £419m (from Review 1.6) + inflation say £40m plus overruns £50m = £584m. Say £600m. It is readily admitted that these figures are not precise.

However operating cashflow of the States is forecast at near breakeven for 2025, operating surpluses in 2026 and 2027 are forecast at c£100m pa. These estimates are reliant on "the States implementing changes to increase revenues" (politics) "and reduce costs" (porcine aviators are seen) "as previously agreed", noting that GST cannot be introduced until 2027. The estimates are also reliant on a healthy economy – which we don't currently have. GDP in real terms seems to have fallen by c6% in 2024 with the only growth segment being public administration.

So over 3 years we spend c£400m more than we earn. Simply borrowing this today would probably be difficult – if doable interest rates would be painful at 7% or more. This would mean £28m of annual interest.

Selling investments would reduce our investment income by a similar amount. There is no easy escape.

Things that could be done:

Cut spending. A radical rethink of revenue expenditure budgets is required. We cannot continue with setting budgets based on the prior year's expenditure.

Reduce or meaningfully delay capital spend. Again it seems impossible but it clearly is not.

Publish meaningful cost/benefit analysis on major capital projects to allow consideration of whether debt funding would be the right way forward.

Increase taxes. Increasing GST to yield £150m or so more each year. Depending on the rest of the overall ultimate tax package this would increase GST to well into double figures rather than the threatened 5% or 8%.

One easy capital spend cut –

Alderney Runway. There is no credible economic case for this. C2,000 people live on Alderney. The original budget of £24m for seriously improving the airport was made to look worryingly inept by the lowest contractor's tender at £37m. The States are now considering the project at a maximum of £24m – the only merit of this number is that it is the same as the original estimate. A functional solution could be achieved for much less.

Conclusion

None of this is easy and, at the end of the day, the solution is a blend of tough choices as to priorities, increased and politically unpopular taxation and the wind of realism blowing strongly through the public sector and its management. The electorate will reluctantly accept tax increases if they see their money going into those capital projects that survive and not into unrealistic pay increases (and commensurate pension increases burdening future generations) for the non-frontline public sector. We all need strong political leadership that manages this financial situation for the good of all of us, including for future generations who did not create this mess.