

POLICY COUNCIL

STANDARDISING THE MEASUREMENT OF GUERNSEY'S GROSS DOMESTIC PRODUCT

1. Executive Summary

- 1.1. Economic output, commonly measured via Gross Domestic Product ("GDP"), is an important macroeconomic indicator and is integral to the Fiscal Framework. It is used by the States of Guernsey to set targets for capital investment and overseas aid and also to set limits on borrowing, should there be any. In addition, it is used to monitor economic growth (in the Island as a whole, as well as within individual sectors) and to inform related policy decisions.
- 1.2. The data used to calculate Guernsey's GDP has degraded over time and the methodology has not been updated since the 1980s. Temporary fixes have been used in recent years to counteract the data degradation and enable historically comparable figures to be calculated and published. However, some fundamental changes are needed in order to ensure that the published GDP provides an internationally comparable representation of the Island's economic output.
- 1.3. The Policy Council, with assistance from the United Kingdom Office of National Statistics, has identified the methodological changes that would be required for the Guernsey method of GDP calculation to be aligned with the latest version of the System of National Accounts ("SNA")¹. These changes could also enable the calculation of GDP for Alderney.
- 1.4. The purpose of this Policy Letter is to inform the States of the issues surrounding the calculation of GDP, and highlight the recommended solution and its associated timetable for implementation.
- 1.5. The States are asked to support the progression of a data collection project and its associated expenditure, which is currently anticipated to be in the region of £9,000 for the initial set up and approximately £2,000 per year thereafter (including estimated costs of staff time). The project will result in staff time cost savings equating to approximately £3,000 per year.

¹ The System of National Accounts (SNA) is the internationally agreed standard set of recommendations on how to compile measures of economic activity. The SNA describes a coherent, consistent and integrated set of macroeconomic accounts in the context of a set of internationally agreed concepts, definitions, classifications and accounting rules.

- 1.6. The States are also asked to approve the drafting of new primary legislation to ensure that the investment in the data collection project gains maximum return in the form of good response rates. Good response rates will be essential to the success of the data collection project and the subsequent improvements to the accuracy of calculation of GDP.
- 1.7. The States are also asked to note that, in the process of reviewing the calculation of GDP, some additional data requirements have been identified that it would be beneficial to collect from businesses. However, based on consultation responses, this may prove more difficult and therefore further investigations will be undertaken as to how to resolve these difficulties.
- 2. Drivers for change**
- 2.1. The importance of GDP**
- 2.1.1 Economic output, GDP, is an important macroeconomic indicator and is integral to the Fiscal Framework², a policy document which sets strict numerical parameters for the States' revenue funded expenditure with the aim of achieving 'permanent balance'. It is used by the States to set targets for capital investment and overseas aid, and also to set limits on borrowing, should there be any. It is the key measure of economic growth (in the Island as a whole, as well as within individual sectors) and informs related policy decisions. As such, its accuracy is paramount.
- 2.1.2 An example of this would be the resolution of the States, following consideration of the Personal Tax, Pensions and Benefits Review, that the Treasury and Resources Department should continue to closely monitor the appropriateness of the current corporate tax regime. In order to deal with this efficiently and with confidence in the conclusions drawn, the Department will require accurate GDP figures, to be used in addition to other economic performance indicators, such as company profits data.
- 2.1.3 Guernsey's GDP forms the basis of several of the key performance indicators for the Fiscal and Economic Policy Plan, which are reported each year in the States Strategic Monitoring Report³. The published figures are often used by third parties to compare the economy of Guernsey with that of other jurisdictions. Any inaccuracies in the published figures can therefore impact on the reputation of the Island.
- 2.1.4 The Economic Development Framework⁴ identifies the importance of the continued development of Guernsey's economic performance indicators. Objective 4 of the Framework, "*Tracking the development of Guernsey's economy*", included the following two aims:

² See www.gov.gg/fiscalframework

³ See www.gov.gg/kpi

⁴ See www.gov.gg/EconomicFramework

- Continue the development of the economic data set in order to measure and track the performance of the economy in the Bailiwick of Guernsey
- Achieve a greater understanding of the various business needs in the Island.

2.2. Issues with GDP accuracy and international comparability

- 2.2.1 The method used to calculate GDP has not been updated since the 1980s and, therefore has not kept pace with changes to the international SNA, which was last updated in 2008. As a result, over time Guernsey's measure has become less comparable with figures published by other jurisdictions.
- 2.2.2 More crucially, the States' ability to calculate GDP figures that are comparable with its own historically published figures has also reduced over time. This is due to changes in the content and timing of data available from Income Tax as a result of tax regime changes (most notably zero/10). This affects the accuracy of the first published estimates of GDP, which can give a considerably different picture to the final figures which are only available three years later.
- 2.2.3 Further details regarding each of these issues are provided in Appendix 1.

2.3. Opportunity to calculate GDP for Alderney

- 2.3.1. The Alderney Economic Development Study report, completed by Frontier Economics in August 2014, identified that, "there is a lack of good economic data on Alderney on which to base policy and measure the impact of any development or other strategy." The assessment was that, "improving the accuracy and availability of data is central to setting and monitoring appropriate policy."
- 2.3.2. Following on from this, a recommendation was included in a States Report for debate in December 2014. The resolution was to, "Direct the Policy Council and Commerce and Employment Department to work with the States of Alderney Policy & Finance Committee, as appropriate and where resources allow, to improve the collection and analysis of more robust economic data pertaining to Alderney."
- 2.3.3. Independently, Alderney States Members have previously raised concerns informally about the inability to calculate a separate GDP for Alderney. This has not been attempted to date, due to the known issues with the Guernsey methodology, which could not be avoided for Alderney, since the same data limitations (referred to in section 2.2 above) would apply.

- 2.3.4. The improved methodology proposed in this Policy Letter can equally be applied to Alderney, so it is intended that the project will encompass Guernsey (including Herm and Jethou) and Alderney. This will enable the calculation of a separate GDP for Alderney, which will greatly help the monitoring of economic trends in Alderney.
- 2.3.5. The legislation required (see section 3 below) will cover both Guernsey and Alderney.

3. Improvements to GDP methodology and legislative requirements

- 3.1. Advice from the United Kingdom Office of National Statistics has enabled the Policy Council to identify how its method of calculating GDP could be updated to bring it in line with the SNA 2008. Some elements which are not currently included can be implemented relatively easily e.g. rental incomes and owner occupied imputed rents⁵, can be calculated using data collected to monitor the Corporate Housing Programme. However, other changes would require access to data which is not currently available from any States' department or regulatory authority.
- 3.2. The advice indicated that the necessary additional data would need to be collected directly from businesses⁶, as is the case in the United Kingdom and the Isle of Man, where there is legislation⁷ which enables this information to be required from businesses for the purposes of calculating GDP. At present, the States of Guernsey does not have any such statutory powers and voluntary surveys asking for data of this kind have not provided enough responses to be statistically reliable.
- 3.3. It has therefore been concluded that there is a need for new legislation to be put in place to ensure data collection is both comprehensive and timely. The legislation in the form of a Law would be modelled loosely on the Statistics of Trade Act 1947⁸. In broad outline it is proposed that a Statistics (Guernsey and Alderney) Law would be enacted that would enable the Policy Council, by notices served on relevant businesses in Guernsey and Alderney, to require those businesses to submit periodical estimates or returns about economic output . Additional essential elements of the Law would include –
- A statutory duty placed on the Policy Council to undertake a census of economic output or production and to produce statistics at regular intervals.

⁵ Owner occupied imputed rent is the theoretical value an owner occupier pays to itself instead of paying rent to a landlord.

⁶ "Businesses" includes all resident corporations and self employed people that employ others, along with not for profit organisations.

⁷ The UK Statistics of Trade Act 1947 and The Isle of Man Statistics Act 1999

⁸ The UK Statistics of Trade Act is introduced as "An Act to enable certain government departments to obtain more readily the information necessary for the appreciation of economic trends...". It describes how (subject to various conditions and given due notice) people are required to provide the information requested via "census" forms issued by the UK government.

- A statutory duty placed on relevant businesses to submit estimates or returns when requested by the Policy Council.
- Powers for the Policy Council to determine the form of estimate or return and the matters about, and period within, which businesses must submit information and to determine the businesses or classes of businesses that are obliged to submit estimates or returns and those that are exempt from obligation.
- Powers for civil penalties to be imposed on businesses that fail unreasonably to submit estimates or returns when requested.
- Powers for the Policy Council by regulation to add to or amend the matters about which estimates or returns must be made.
- Restrictions on the disclosure of information, or certain types or classes of information, obtained further to powers exercised under the Law

3.4. In practice it is envisaged that many of the administrative functions under the Law will be delegated to officers for them to exercise on behalf of the Policy Council.

3.5. Before, however, making such a recommendation, research has been carried out into the feasibility of collecting the additional necessary information directly from businesses on a statutory basis.

4. Consultation with businesses regarding potential additional data requirements

4.1. In early 2014, businesses in Guernsey and Alderney were asked for their views on the provision of data to the States. Responses were received from 117 businesses and business groups (105 in Guernsey and 12 in Alderney), which represents a sample of approximately 5% of employers. The responses were generally positive and the majority (63%) of those businesses were in favour of the States having statutory powers to require the data needed to improve GDP calculation. Businesses also provided feedback regarding the logistics of providing the information. This feedback has been used to inform the proposals put forward in this Policy Letter.

5. Proposed Changes

5.1.1. The Policy Council is proposing the implementation of a much improved methodology for the calculation of GDP. From 2016 onwards, this will allow a more accurate calculation of GDP within a reasonable timeframe each year, bringing it closer to international standards (to make it more easily comparable with other jurisdictions); and enabling a separate GDP to be calculated for Alderney.

5.1.2. The proposal involves collecting profits and up to two other key pieces of information from businesses each year (see section 5.2 below). It entails using this information along with other data that is already available to implement methodological updates.

5.1.3. It should be noted that, since these proposed methodological changes are likely to impact on the headline GDP figure, a transition period of at least three years will be needed in order for there to be a smooth introduction of the figures calculated using the revised method. The aim will be to calculate GDP for 2015, 2016 and 2017 using both methods. The transition will be completed in 2018 (when the 2017 figures are calculated).

5.2. Obtain profits data directly from businesses

5.2.1. If company profits information for all Guernsey based companies could be made available at the time of the tax return submission (for which the deadline is November following the year in question), rather than following tax assessment, the element of estimation required for the timely publication of GDP could be greatly reduced.

5.2.2. As highlighted in paragraph 2.1.2, there is also now a requirement for more complete profits information for the purpose of monitoring the appropriateness of the current corporate tax regime. If the information is requested jointly by Income Tax and Policy Council, both requirements could be met, while minimising the effort required of businesses.

5.2.3. When consulted⁹, 82% of the businesses that responded indicated that it would be “easy” for them to provide the Policy Council with profits information (referred to in the survey as gross operating surplus). On this basis, it is felt that it could be made mandatory for all businesses to provide this information.

5.2.4. Respondents indicated that they could provide the information annually (or more frequently) in 94% of cases and 88% of businesses would prefer to provide the information online. A web-based mechanism for collecting this data on an annual basis would need to be developed (see Appendix 2 for indicative costs). The intention would be to develop the data collection mechanism in advance of any statutory powers being introduced, so there can be a year of voluntary data submissions and testing (depending on how quickly the legislation can be drafted), while businesses familiarise themselves with the new requirements.

5.3. Obtain up to two other key pieces of information directly from businesses

5.3.1. In addition to the profits information referred to above, if up to two other key pieces of information could be collected from businesses it would enable the Policy Council to realign the GDP calculation method with the latest version of the SNA (albeit a simplified version, more appropriate to the comparable size of the jurisdictions of Guernsey and Alderney). This other information can be summarised as follows:

⁹ See Appendix 3 for a full summary of consultation questions and responses.

- Employers would be asked for the value of employer contributions to pension schemes (to give the full picture of the remuneration package provided to employees). The consultation responses indicated that this would be easy for 84% of those businesses responding.
- Further information relating to net interest income (the value and the breakdown by source (local vs. non local) is required from finance corporations, which would be easy for 93% of businesses, according to the consultation responses.

5.3.2. On the basis of the consultation responses, it is felt that it could be made mandatory for all employers to provide the value of employer contributions to pension schemes and for all finance businesses to provide information on net interest income.

5.3.3. Responses regarding the logistics of providing all of this information were similar to those regarding the provision of profits information, so the intention would be to collect the information at the same time via a web-based mechanism (further details in Appendix 2). It is not anticipated that collecting these additional pieces of information will significantly affect the development or on-going costs.

5.3.4. Finally, an assessment of the depreciation of assets held by not-for-profit organisations is desirable, although this is less significant in terms of its proportion of total GDP. More not for profit organisations indicated that this would be difficult or not possible than the number that indicated it would be easy (the latter represented 40%); therefore, it is intended to make collection of data on depreciation of assets voluntary rather than mandatory.

5.4. Methodological updates

5.4.1. If the data referred to above were to become available to the Policy Council, not only would the method used to calculate GDP be brought in line with international standards, but other methodological and presentational updates, not reliant on sourcing the information referred to above, could be introduced at the same time. For example, the economic sectors into which total GDP can be broken down could be updated in line with the internationally comparable economic sectors used to present all the other economic information published by the Policy Council.

6. Need for additional information

6.1. As part of this review, it became apparent that there were other data needs that could be met by combining these requirements with improved GDP data collection. It was indicated that some investment and policy making decision processes could be improved if additional data broken down by economic sector (and finance sub-sector) were available on a regular basis.

6.2. Consequently, during the consultation, businesses were also asked about the potential of providing some specific additional information (listed below) on a voluntary basis.

- Hours worked by employees
- Level of participation in employee health insurance schemes
- Level of participation in employee company pension schemes
- Details of premises
- Turnover/sales by geographic area
- Costs by geographic area
- Looking ahead – factors that it is foreseen will affect growth.

6.3. This list of information was compiled in consultation with the Commerce and Employment Department and the Environment Department. It also contains some information which the Policy Council has been asked to provide during recent years and information on hours worked by employees, which Policy Council has long sought, in order to improve the measurement of median earnings.

6.4. The consultation responses indicated that the ease of providing this information varies from one piece of information to the next. Businesses which responded to these questions indicated that it would be easy to provide information on levels of participation in employee health insurance and company pension schemes in 82% and 87% of cases respectively. Hours worked by employees, details of premises and the forward looking questions were reported to be more challenging, with between 63% and 67% of businesses saying this would be easy. Providing turnover and costs by geographic area was reported to be even more problematic, with between 41% and 47% of respondents saying it would be easy, but the majority indicating it would be difficult or not possible.

6.5. Businesses were also asked how likely they would be to provide this information if it were to be requested on a voluntary basis and again the responses varied considerably.

6.6. In light of the consultation responses, it is proposed that this information should not be requested initially alongside GDP data. However, providing there continues to be a valid need for obtaining this data, it is proposed that potential approaches for collecting this information should be further investigated. The mechanism implemented to collect GDP data would be sufficiently flexible that it could be expanded to include further data collection. It should be noted that there may be a cost for this expansion if it is pursued.

7. Resource Implications

7.1. The cost to implement these proposals would be in the region of £9,000 for the initial set up and approximately £2,000 per year thereafter, including estimated costs of staff time (see Appendix 2 for further details). These costs can be met from existing resources.

- 7.2. From 2018 onwards, after implementation, the staff time costs will reduce from £3,000 (as per the current method) to £2,000 per year (using the new method). This offers a savings of £1,000 of staff time per year and so the project would break even 13 years after implementation. It is proposed that the time saved would be redeployed for other essential research work.
- 7.3. The Law envisaged is unlikely to be particularly lengthy and the substantive provisions should be relatively straightforward to draft. In the circumstances, roughly 5 working days might be required for the legislative drafter of the Law to prepare a working draft. There will be additional time required to prepare some of the documents (e.g. the relevant form of estimate or return) that will be needed for the purposes of practical implementation of the legislation and proposed policy. This administrative work will fall to be undertaken by officers of the Policy Council.

8. Consultations

8.1. Commerce and Employment Department and Treasury and Resource Department

- 8.1.1. The Commerce and Employment Department Board supports the proposals outlined in this Policy Letter, considering them to represent a pragmatic approach.
- 8.1.2. Staff at Income Tax were consulted regarding the proposals in this Policy Letter and, since 80% of company income tax returns are filed by accountants on behalf of their clients, the Guernsey Society of Chartered and Certified Accountants was also consulted. It was highlighted that, if submission of the data were to be via the income tax online services (one of the options included in Appendix 2), accountants would need to collate that information from their clients, which would have an inevitable cost to the accountants. This information will be borne in mind when the preferred option is determined.
- 8.1.3. Income Tax staff also highlighted that, whilst online filing of company income tax returns is mandatory, self-employed individuals (including those in partnership) may file their personal income tax returns online or on paper. At present only 37% of those in business file their personal income tax return online. As such, a paper alternative to the online GDP data collection form would also be made available and the additional cost of this is included in the estimates provided.

8.2. Alderney Policy and Finance Committee

- 8.2.1. The Policy and Finance Committee fully supports the proposed changes to enable a GDP to be calculated specifically for Alderney.

8.3. Law Officers of the Crown

- 8.3.1. The Law Officers have been consulted about the proposals contained within this Policy Letter. They have advised that the proposed Law can be drafted within the timetable required to facilitate the introduction of the first mandatory data collection in January 2017 provided that the drafting is given the necessary priority by the Policy Council.

9. Compliance with Principles of Good Governance

- 9.1. The Policy Council is satisfied that the proposals conform with the six Principles of Good Governance, particularly as they will facilitate compliance with: Core Principle 1, focusing on the organisation's purpose and on outcomes for citizens and service users; Core Principle 4, taking informed transparent decisions and managing risks and; Core Principle 5, developing the capacity and capability of the governing body to be effective.

10. Conclusions

- 10.1. The issues surrounding the calculation of GDP described in this Policy Letter can only be resolved by collecting some additional data directly from businesses. If the States wish to safeguard the accuracy of GDP, Guernsey's core qualitative measure of economic growth, some (relatively small) investment will be needed in order to develop a mechanism to collect the necessary data. Legislation will also be required to ensure that the data is provided in a timely and comprehensive manner, and is robust enough to enable the publication of accurate GDP data within a reasonable timeframe.
- 10.2. By collecting this data from Alderney businesses alongside those based in Guernsey, it will be possible to separately calculate the GDP of Alderney, enabling economic performance in Alderney to be monitored in a way which is not possible at present.

11. Recommendations

- 11.1. The States are asked to:
- i) Agree that the method of calculating GDP be updated as set out in this Policy Letter; and
 - ii) Direct the preparation of such legislation as may be necessary to facilitate the collection of data as outlined in sections 3.3, 5.2.3 and 5.3.2 of this Policy Letter.

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Chief Minister

27th July 2015

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