Economic developments in the Channel Islands

Mark Boleat, August 1975

The Channel Islands claim, with no little justification, to be among the more prosperous and most rapidly growing communities in Western Europe. Their success is based on three foundations:

a) An excellent physical environment in the form of a good soil, an agreeable climate and attractive scenery.

b) Close ties with United Kingdom such that the Islands are virtually an integral part of the British economy.

c) Independence, which allows the Islands to frame their own laws, particularly in respect of taxation.

These factors have resulted in an economic structure based largely on agriculture, tourism and finance. The Islands differ markedly in their economic structure with Guernsey still having a large farming industry while Jersey depends far more heavily on tourism and finance. The smaller Islands, the most prominent of which are Sark and Alderney, are very much in a world of their own - and in that respect are like many other Islands - and they do not have the sophisticated economic structure enjoyed by their larger neighbours.

Success brings its own problems and in the last few years the Islands have had to look carefully at the ways in which their economies have been developing, and a number of policy changes have been implemented. This article examines the changing economic structure of the Islands and the major problems that are having to be faced.

Agriculture

Agriculture is the oldest industry in the Channel Islands and, as in so many other communities, the one whose future is most in doubt. When the prosperity of farmers depended on natural conditions and sheer hard work the Islands did well because they were able to get their produce to Britain before the mainland producers who do not enjoy such a favourable climate. Tariffs levied by Britain served to protect the Islands' produce from Continental competition. Agriculture remains an important industry in the Islands and, moreover, one that is very much a part of the way of life. In Guernsey, some 16% of the labour force is employed in farming and the industry accounts to no less than 70% of visible exports, mainly in the form of tomatoes and flowers. In Jersey, under 10% of the labour force is employed in farming and the volume of exports is only half that of Guernsey. Nevertheless, the farming community is very important in social and political terms.

The problems facing agriculture in the Channel Islands came into prominence at the time of the negotiations for British entry into the European Community. It rapidly became clear that at the very least the Islands could expect Britain to remove tariff barriers against Continental producers and this in itself posed a severe competitive threat. If the Islands chose to remain outside the Community then levies would have to be imposed on their exports to Britain. Being totally inside or outside the Community presented a cruel dilemma to the Islands for while agriculture could only survive inside, full membership would have presented great problems for the tourism and banking industries - largely as a result of tax harmonisation. Guernsey's dependence on horticulture tipped the scales in favour of remaining in while Jersey was happier to go it alone in order to protect tourism and banking. In the event the British Government removed the dilemma by negotiating an exceptionally good "in but out" arrangement for the Islands which, in effect, meant that they were inside the Common External Tariff but were not subject to the other provisions of the Treaty of Accession.

The threat, now materialising, of increased competition from Continental producers came at the very time when the underlying weaknesses of agriculture in the Islands were becoming more apparent. Investment has been inadequate and marketing techniques have left a lot to be desired with farmers resisting attempts to co-ordinate and centralise marketing arrangements. The Islands have also failed to take advantage of freer access into the more prosperous Continental market. A recent report by the Advisory and Finance Committee in Guernsey revealed that tax proceeds from agriculture were little more than the cost of the financial aid given to the industry and it suggested that the low level of modernisation was such that the ability to revitalise the industry was in doubt. Future policy towards the industry is still in doubt, and at the end of 1974 the Island's Parliament rejected the proposals of a working party; new proposals are still awaited. Other things being equal the authorities would clearly like horticulture to be modernised rather than having to rely on new and untried industries which are unlikely to fit into the way of life.

Similar problems exist in Jersey although the small size of the industry means that a running down is not so serious. If strict economic criteria were being applied then there is no doubt that the industry would be allowed to decline but subsidies are paid for social, environmental and political reasons. Jersey's economic adviser, Colin Powell, aptly described the situation in his annual Budget report: "There is nothing to suggest that the future for agriculture can be seen as anything other than an extension of the present situation whereby the market opportunities in both the United Kingdom and on the Continent, while in demand terms are sufficient to absorb the Island's production, are not sufficient in price terms to give growers generally an income which can be said to be maintained in real terms……it is difficult to contemplate a situation in the next few years other than one where the agricultural community receives considerable amounts of support from the taxpayer."

Tourism

Tourism has become a major industry in the Channel Islands, especially Jersey. The attractions of the Islands are a climate which is consistently better than that in the English resorts; attractive scenery; a reasonable balance between an English and a Continental atmosphere and a low rate of tax on alcohol, tobacco and luxuries. In the past few years new competitive advantages have been added in the form of a sharp decline in the exchange rate of sterling which has considerably increased the cost of Continental holidays and the difficulties experienced in the foreign package tour industry.

The importance of the tourist industry in Jersey can be judged from the fact that the Island attracts 700,000 visitors annually (the native population is only 73,000) and the industry accounts for some 40% of national income and a similar proportion of tax revenue. In Guernsey the industry operates on a much smaller scale with 200,000 visitors annually (native population, 51,000) and a contribution to national income of about 17%.

Both Islands are near their capacity in the summer months so scope for expansion of tourism is limited. Current policy is aimed at developing the “shoulder” months (April, May, June, September and October) when space capacity is available. The Islands, in particular Jersey, have also been developing strongly as conference centres and new facilities are being developed for this purpose.

An important trend in the tourist industry in the Channel Islands has been the expansion of Continental trade. The Islands are within 20 miles of the French coast and, in addition to local air and sea services, direct flights are available to and from several major European cities. The fall in the value of sterling has contributing greatly to making the Islands attractive to Continental visitors who now number nearly 250,000 a year. Their expenditure per day tends to be higher than the British tourists and this makes them all the more welcome by local shopkeepers.

The tourist industry is inevitably affected by the problem of inflation, and hotel rates are being pushed up by 20 - 30% this season with the likelihood of another big increase in 1976. Escalating air and sea fares are also serving to make the Channel Islands that little bit more expensive compared with English resorts. In Guernsey, a particular problem is the falling availability of bed spaces resulting from guest houses being converted into residential property and the general reluctance of local people to put in the long hours needed for a far from generous return.

While the expansion of the tourist industry can be expected to moderate its continued prosperity seems assured. Continental resorts seem unlikely to become cheaper in relation to the Islands, and increasing costs in line with inflation should not be too much of a deterrent to those who visit the Islands year after year. However, if, as seems probable, real incomes in Britain are severely squeezed over the next 12 months then British holidaymakers will clearly have less to spend; the Islands will be hoping that any loss of revenue on this account will be balanced by greater expenditure from an increased flow of more prosperous Continental visitors.

Wealthy immigrants

For many years the Channel Islands have attracted rich people in search of a stable low tax area with the British way of life. The attractions of the Island in this respect are readily apparent; an income tax rate of 20p in the pound and which is very much a sacred cow, no capital and wealth taxes and free movement of funds to and from Britain. Despite the low tax rates, wealthy immigrants contribute a great deal to the local exchequers. The wealthiest 500 “rentiers” in Guernsey pay 10% of the Island’s taxation while 1,000 investment holders in Jersey account for no less than 40% of the Island’s tax revenue.

Both Islands, while recognising the debt that they owe to wealthy immigrants, have had cause for concern at the pressure put on resources, particularly housing, by the never ending flow of people in search of a safe haven for themselves and their money. Guernsey has tackled the problem by splitting the housing market into two with a closed section open to residents and essential immigrants and an open section of about 1,000 dwellings open to all-comers. Jersey is more dirigiste in its approach and consent has to be sought by any immigrant wishing to purchase a house. The Island's current policy is to allow an increase of just 15 a year to its stock of wealthy immigrants and the authorities basically aim to select those who will contribute most to the Exchequer. 1974 was a bumper year in this respect and the 24 wealthy immigrants (a net increase of 15) allowed into the Island in the first 10 months of the year had total assets of £45 million and a potential annual tax yield of £350,000.

In the future the Islands are likely to experience more difficulty in recruiting wealthy immigrants, partly as a consequence of the domicile rules for Capital Transfer Tax. Indeed, in the first six months of 1975 Jersey has only been able to give permission to three wealthy immigrants to settle. This may partly be due to the difficulty that people are experiencing in disposing of assets, particularly property, in Britain but it does seem likely that the Islands will have to settle for poorer wealthy immigrants in future.

Finance centre activities

It is in their role as finance centres that the Channel Islands have made major progress over the past 15 years. The low tax status that they offer, combined with political stability, a lack of bureaucracy and freedom of access to the London money markets have combined to attract banks, investment trusts, unit trusts, international holding companies and a variety of other financial institutions. Increased controls and taxation, particularly in Britain, together with greater international flows of trade and money over the past ten years have served to further enhance the attractions of low tax areas. The Channel Islands are quick to point out that they have never set themselves up as tax havens and are inclined to sneer at some of the more artificial finance centres which have been established in recent years, notably in the Caribbean. However, the Islands make no secret of the fact that they welcome the finance business and steps have been taken to ensure that all the necessary facilities are available such that the industry can flourish.

Jersey has always taken the lead in developing the finance business, and the initial step was taken in 1962 when the Island's Parliament was persuaded to remove its antiquated anti-usury laws which prohibited interest rates in excess of 5%. Led by Hill Samuel and Kleinwort Benson the banks were quick to set up in Jersey and ancillary services, particularly in the accounting and legal fields, rapidly developed. It is a source of credit to both Islands that their legal and accounting businesses have largely remained in the hands of locals and this has contributed to giving the Islands a reputation for stability and reliability.

A by-product of the Common Market negotiations was increased efforts by the Islands to understand their own economies and, as a result, both Jersey both Guernsey now boast very able economic advisers who have done much to ensure that the Islands receive the maximum possible benefit from their finance industries. The successful outcome of the Common Market negotiations itself helped the finance industry by removing uncertainty as to the future status of the Islands vis-à-vis the United Kingdom. In June 1972 the Islands received another boost through the reduction in the boundaries of the Sterling Area to comprise just the United Kingdom, Eire, the Channel Islands, the Isle of Man and, more recently, Gibraltar. This action by the British Government served to strengthen the competitive advantage of the Channel Islands in relation to those territories excluded from the area.

The Islands have adopted differing policies towards finance centre activities over the past few years. The Jersey authorities, faced with clear signs of an overheating of the economy and with ill-informed protests from some members of the community who felt that the Island was not getting a sufficient return from finance sector activities, decided, at the end of 1973, to call a halt to the introduction of deposit taking facilities. At that time deposits held in the Island were around the £1,000 million mark compared with little more than £100 million in 1966. A subsequent report by Jersey's Policy Advisory Committee quashed the notion that the Island was not getting an adequate return from the banks by pointing out that the average tax paid per person employed by the banks (other than the Clearing Banks and the local Savings Bank which between them only hold about 20% deposits in the Island) was no less than £2,000 compared with a figure of £200 for the economy as a whole. In 1974 the Island's Parliament made a commitment to expand the finance industry although it has been made clear that only those institutions which have something special to offer the Island, particularly in the form of Continental connections, will be allowed in. In this spirit the Algemene Bank Nederland and the Hongkong and Shanghai Banking Corporation have recently been given permission to establish in the Island. Foreign currency deposits in Jersey now stand at about £125 million and there is hope that this figure can be increased considerably in the future.

Guernsey took advantage of Jersey's restrictive policy actively to encourage the expansion of the banking industry, and between mid-1972 and mid-1974 the number of deposit taking institutions in the Island increased by 50%. Deposits held in the Island rose from £162 million to £383 million over the same period and tax revenue from the industry has already passed the £1 million mark (about £1,200 per employee). However, like its sister-isle Guernsey has found that the growth of banks has put a great strain on resources and recruitment of new institutions is being slowed down with precedence being given, as in Jersey, to international banks and particularly those with Continental connections.

The Channel Islands are satisfied that their finance industries will continue to grow although not at the spectacular rates recorded in the recent past. The authorities do not foresee the British government attempting to clamp down on the use of the Islands as finance centres if only because money held there remains within the Sterling Area and can be influenced by British monetary policy. Relations between local authorities and the Bank of England have always been good and the Islands are quick to act against any dubious business. The Brussels Commission also seems content to let the Channel Islands alone. An official recently admitted that it did not seem possible to prevent the use of low tax areas especially with Luxembourg being a full member of the Community.

Light industry

Manufacturing industry represents only a very small fraction of economic activity in the Channel Islands but in recent years there have been steps to encourage it, both to diversify the economic base and to provide employment opportunities for school leavers. The main facilities that the Islands are able to offer, apart from the obvious tax benefits, are good communications, relatively cheap labour and freedom from the ever-increasing volume of legislation facing employers in Britain. Having very few natural resources the Islands are best suited to the production of low-volume high-value goods such as electronic and scientific equipment.

In Jersey, light industry accounts for 3% of the labour force and about 5% of tax revenue. The total value of output in 1974 is estimated at £10 million with the electronics company RCA accounting for a significant proportion. The authorities foresee some expansion in the sector in the future but light industry will remain a relatively unimportant part of the economy.

Guernsey took a positive decision to encourage industry in 1972 and the total value of output is expected to rise from under £4 million in that year to £10 million in 1976. The sector is very much dominated by the American oscilloscope manufacturer Tektronix which alone employs over 500 people. Two fairly substantial companies were allowed to set up in the Island in 1973 but both only provided female employment and the Island has been turning away other firms that would also rely heavily on female labour; a little success has been recorded in attracting small firms needing male labour. Like Jersey, Guernsey has come up against the pressure on resources problem, notably with respect to land, and efforts to attract new industry have been reduced.

Immigration

It is clear from the preceding analysis that the Channel Islands have been in danger of overheating. Unlike other economies they cannot use monetary policy (because they are part of the British monetary system) or fiscal policy (for fear of upsetting the finance industry) to dampen down economic activity. Consequently, policy makers rely heavily on physical controls such as those already noted in relation to wealthy immigrants.

In Guernsey, increased economic activity caused the population to grow, largely through immigration, at an annual rate of 1.4% between 1961 and 1971 with the rate accelerating to a quite unsustainable 2% at the end of the period. The Advisory and Finance Committee has recommended that the annual rate of increase should be cut to 1% by 1976 and 0.5% thereafter. With the natural rate of increase running at 0.3%, this entails quite a significant cutback in the rate of growth in economic activity, hence the reduced efforts to attract banks and light industry.

Jersey is faced with a similar, if less acute, problem. The Island is less densely populated than Guernsey, population has been growing at a lower rate, although still high by British standards, and for the past few years births have been exceeded by deaths. The Island has set itself the target of an annual rate of increase of population of 0.7%. In addition to being more selective and allowing financial institutions into the Island the authorities have taken powers to control all industrial development and the sale of agricultural land, and these measures should help ensure that economic activity is only allowed to expand in line the population target.

Relations with Britain and General Economic Problems

The Channel Islands are proud of their connections with Britain but, over the past few years, a few matters have arisen to cause some in the Islands to doubt the value of these links.

The first such measure was the Common Market negotiations. Clearly if Britain was to enter the European Community then the status of the Channel Islands would be in need of fundamental review; indeed, under the Treaty of Rome the Islands would have automatically entered the Community as overseas territories for whose external relations a member state is responsible. In Jersey, a movement grew up claiming to defend the Island's freedoms. Its arguments were based solely on emotion but it secured quite undue publicity and certainly embarrassed the Island's authorities. The latter, together with their Guernsey counterparts, worked quietly and effectively behind the scenes with the British authorities and the result was the exceptionally good terms already noted.

The second controversial issue was section 45 of the 1974 Finance Act which effectively preventing people who moved to the Islands from losing their British domicile for the purposes of the Capital Transfer Tax. Again, there was much ill-informed huffing and puffing with talk of the Island's fiscal independence being eroded and of the measure being the thin end of the wedge. Once again the Islands' authorities worked through the usual channels to secure the actual and promised amendments to the proposal in respect of those features about which the Islands could justifiably complain. The whole matter was something of a nine-day wonder and while accepting that the measure will have implications for the Islands' wealthy immigrant industries, it is not a pre-cursor to anything more serious.

What does concern the Islands most of all at present is inflation. With the exception of the effects of changes in indirect taxes and subsidies the rate of inflation in the Channel Islands mirrors that in Britain; it could not be otherwise given the monetary union that exists and that over half of all goods sold in the Islands are imported from Britain. It is their peculiar tax structure which makes the Islands particularly vulnerable to inflation. Far from enjoying the proceeds of "fiscal drag", the Jersey and Guernsey Governments are in precisely the opposite situation. The only indirect tax is the excise duty on alcohol, tobacco and petrol and, of course, the revenue from this source does not keep pace with inflation unless the unpopular measure of increasing the rates is taken periodically. However, even when this is done the Islands face a problem because much excise duty revenue is derived from visitors buying their duty-free allowance in the Islands before they return to Britain. If prices in the Islands are significantly above the duty-free prices that apply on boats and aircraft then the inevitable consequence is that an increase in tax rates can lead to less revenue being collected.

Income tax (which is levied on both individuals and companies which trade in the Islands) presents similar problems. There are no higher tax rates therefore pay increases cannot push people into higher tax brackets as happens in Britain. More important is that income tax is not collected through PAYE and rather has to be paid in a lump sum by the end of the year following the year in which the income was earned; tax revenue from companies is liable to be received even more in arrears. However, the costs of running the Island increase in line with inflation and thus the authorities have to pay this year's bills with income from the preceding two or three years.

This pressure on the Government's budgets has come precisely at the same time as the cutting back of economic activity which must also affect tax receipts. However, while the Islands have been remarkably successful in holding down the size of the public sector there are always strong pressures to increase the size of the public sector. The subsequent dilemma facing the Islands has been well explained by Jersey's Economic Adviser (Colin Powell) (the comments apply equally to Guernsey): "the Island has achieved its present level of prosperity through business growth stimulated by the low tax status. If that growth is now held back by Government action because of a natural desire to protect the environment and quality of life of this small Island, pressure could be exerted on the tax base if an attempt was made to maintain the rate of improvement in public services only sustainable at the previous higher rates of income growth".

The scope for increasing the tax base in the Islands is limited although Jersey does have a committee looking into the subject; a property tax, a general sales tax and a tax on trusts are all areas of study. The Island has already sharply increased excise duties although at the risk of losing revenue for the reason already noted. In an attempt to increase their tax revenue Jersey and Guernsey did agree, in 1974, to double the tax on "corporation tax companies" (those which are registered but which do not trade in the Islands) from £300 to £600 annually and this would have meant an increase in tax revenue of £600,000 per annum in Jersey alone. Clearly one Island could not go it alone in this field because business would simply be transferred to the other Island and, by acting together, the authorities hoped both Islands would benefit. In the event the Guernsey Parliament did not approve the measure and Jersey had to follow suit leaving an unwelcome gap between revenue and expenditure.

Both Jersey and Guernsey are looking to cut back on capital expenditure as a means of balancing their books. Guernsey's Chancellor, Conseiller Edward Collas, is dissatisfied with the economy measures already being taken and there is talk of a three-year freeze on capital projects. Jersey has already delayed new capital projects and Conseiller Collas's opposite number, Senator Cyril Le Marquand, has warned that further tough measures will be forthcoming.

Some in the Islands are inclined to blame Britain for their problems and to believe that the Islands should detach themselves from Britain so as to be able to prosper through their own efforts without the millstone of the British economy around their necks. Fortunately such views are not taken seriously in the Islands' parliaments and the authorities are all too aware of the extent to which they depend on the close links with Britain. The Islands have prospered through their connections with Britain and they accept that they have to live with the problems caused by these connections.