SCC19R-R-0188(i) D

An Roinn Airgeadais
Department of Finance

Ms. Aileen Fallon,
Clerk to the Committee (Work Programme),
Special Committee on Covid-19 Response,
Leinster House,
Dublin 2, D02 XR20.

09 June 2020

Dear Ms. Fallon,

Your letter of 02 June inviting the Department of Finance to make a written submission to the Committee refers. Please find attached the Department's submission.

Given the role and function of the Department of Finance our response has focussed on your template "Fiscal Developments: Expenditure and Budgetary Position". We have addressed the questions posed by the Committee but we have also included an outline of the measures in which this Department has a role, as the Government seeks to limit the economic impact of the Covid-19 pandemic on both individuals and businesses.

If the Committee have any further queries they should be forwarded in the first instance to: margaret.fitzgerald@finance.gov.ie

Yours sincerely,

Derek Moran
Secretary General

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An Roinn Airgeadais
Department of Finance

Oireachtas Committee on Covid-19

Submission by the Department of Finance

June 2020

Introduction: Economic backdrop

1.1 The Covid-19 pandemic has dealt a serious blow to the Irish economy and to the public finances.[1] GDP is projected to fall by 10.5 per cent this year, with modified domestic demand – a better indicator of domestic living standards – set to contract by around 15 per cent. Recently published national accounts data for the first quarter of this year are consistent with these forecasts: modified domestic demand fell by nearly 4 per cent in the first quarter. At the same time, it is noteworthy that the exporting sector has performed somewhat better than expected, with very strong exports evident in the pharma-chem and ICT sectors.

1.2 The labour market has borne the brunt of adjustment: from a position of full-employment in the early part of this year, the unemployment rate is now (May 2020 data) 26 per cent (annex 1, figure A1).

1.3 The Government has taken extraordinary and unprecedented steps in order to cushion the blow – in so far as possible – for households and firms. Broadly speaking, these can be grouped according to:

- expanding healthcare capacity;
- providing income support to households; and,
- 'bridging the gap' for firms during the containment phase.

From a macroeconomic perspective, a key objective is to minimise the 'scarring', effects of the crisis (permanent disconnect between workers and the labour market; tumbling investment and business failure).

1.4 Since the onset of the pandemic, the cumulative additional discretionary support provided by Government now amounts to some €13.3 billion (the equivalent of 7.5 per cent of GNI*, see annex 2). The scale and scope of support being provided by Government is in line with international norms.

General Government Balance

2.1 The forecasts set out in the *Stability Programme Update* (April) provided for a general government deficit of €23 billion for this year (7.4 per cent of GDP). This is based on the assumption that economic activity bottoms out in the second quarter, with gradual recovery thereafter. The deficit arises from a combination of the effects of the automatic stabilisers (falling tax revenue and higher unemployment spending in line with the economy cycle) as well as discretionary, counter-cyclical policy measures. These discretionary measures are possible because of the improvement in the public finances in recent years.

2.2 Clearly, there is an elevated level of uncertainty regarding the path of the virus which, in turn, means that short-term prospects for the economy and public finances are inherently uncertain. Accordingly, scenario analysis was also documented in the *Stability Programme Update*. This showed that, in the event of delayed recovery (due to a 'second wave', for instance), the deficit could be up to €30 billion for this year.

2.3 The data set out in the May *Fiscal Monitor* are consistent with a deficit in the region €23 – 30 billion for this year.

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1 Clearly there have been impacts in other parts of society; the focus of this submission is the economy and public finances, given the mission of the Department of Finance.

2.4 For next year, a general government deficit of around €13.8 billion (4.1 per cent of GDP) is projected, as the economy recovers and the extraordinary support measures are unwound. This projection is, of course, contingent upon successful containment of the virus, both in Ireland and elsewhere.

Fiscal implications

3.1 The downward trend in the debt-income ratio has been reversed. Ireland's debt-GNI* ratio is set to increase from around 100 per cent last year to around 125 per cent this year. On a per capita basis, it must also be recognised that Ireland is amongst the most indebted counties in the world (an estimated €43,500 per person this year).

3.2 Ireland's gross national debt is forecast at €217 billion in 2020 and €232 billion in 2021, possibly rising thereafter.

3.3 The deterioration in the fiscal 'starting point' – the increase in debt this year – must be seen in the context of unfavourable demographic trends. The fiscal costs associated with population ageing will become increasingly apparent in the coming decade. By 2030, it is estimated that additional expenditure amounting to around 1½ per cent of GDP could be needed simply to 'stand-still'.[2]

3.4 A further consideration is the fiscal rules. Given the scale of the Covid-19 crisis, the "general escape clause" of the *Stability and Growth Pact* (SGP) has been activated for the first time. This effectively suspends the regular application of the fiscal rules for the moment. However, it should be noted that the SGP itself has not been suspended or revoked. Along with almost every other Member State, Ireland will breach the 3 per cent Treaty deficit limit this year, potentially triggering the opening of an Excessive Deficit Procedure (EDP). Provided that the deviation is temporary and exceptionally related to Covid-19 an EDP will not be launched; nevertheless, the rules remain in place and provide an important, legally-binding anchor for fiscal policy over the medium-term.

Financing conditions

4.1 Gross financing needs in any period are determined by the deficit in that period as well as debt falling due (roll-over requirements) in that period. The availability of liquid assets – cash balances accumulated *inter alia* from previous debt issuance – can offset some of these gross needs.

4.2 In light of the updated fiscal position, including an estimated Exchequer Borrowing Requirement (EBR) of €15.6 billion, the National Treasury Management Agency (NTMA) has announced a revised bond funding range in 2020 of €20 - €24 billion for this year. Alongside the EBR, this would be sufficient to cover maturing debt of the order €18 billion (annex 1, figure A2).

4.3 Financing conditions at present remain favourable *inter alia* due to the backstopping role of the European Central Bank (the Eurosystem – the ECB and national Central Banks) will purchase around €1.6 trillion of euro area debt instruments this year, with purchases skewed towards sovereign debt, including via the so-called Pandemic Emergency Purchase Programme

[2] "Population Ageing and the Public Finances. Department of Finance (2018)"
https://www.gov.ie/en/publication/2e8463-population-ageing-and-the-public-finances/

(PEPP)).[3] Sovereign debt instruments that currently carry an exceptionally low coupon will, of course, have to be re-financed in future when the interest rate environment is unlikely to be as favourable. Ireland's experience in 2008-2011 shows just how rapidly the cost of market-based financing can change (see annex1, figure A3).

4.4 Borrowing costs must be seen in conjunction with the expanding volume of public debt. With gross public debt heading towards the €250 billion mark, an average interest rate of less than 2 per cent (the current position) generates an annual debt interest bill in the €4 – 5 billion range. An average rate of 3 per cent could see that annual bill grow to €7.5 billion, while an average rate of 4 per cent would generate a €10 billion bill per annum (the equivalent of Ireland's total corporation tax take). Therefore, unlike in recent years, and depending on the pace of recovery, Ireland could be issuing and refinancing debt against a less favourable backdrop and at a time of increasing debt ratios.

ECB asset purchases

5.1 In the current environment, there are two key constraints on public debt issuance, namely fiscal sustainability and eligibility for ECB purchasing programmes. The creditworthiness of the State is dependent upon putting the debt ratio on a downward trajectory over the medium-term. A visible medium-term anchor is essential – in the first instance bringing the deficit below 3 per cent in a multi-year, time-consistent manner and, subsequently, eliminating the structural component of the deficit. The timespan for eliminating the deficit is a matter for Government, subject to recommendations from the European Commission and Council.

5.2 Undoubtedly, ECB support will play a crucial role in ensuring economic recovery across the euro area. The expansion of its PEPP to €1.35 trillion, and its extension to at least end-June 2021 or until the ECB judges that the coronavirus crisis phase is over is important. In addition, the ECB has announced the reinvestment of maturing principal payments from securities purchased under the PEPP until at least end-2022. Given the sizeable Covid-19 related supply of sovereign debt that is coming to markets, eligibility for ECB purchase programmes is essential and the relaxation of ECB purchasing caps is positive for the euro area as a whole.

Revenue options in the short-term

6.1 The Committee refers to 'low hanging' fruit options in order to raise revenue. At the outset, it is important to stress that it is a matter for a new Government to decide the appropriate mix of taxation and expenditure policies, consistent with a medium-term fiscal target and the priorities set out in any Programme for Government.

6.2 Economic recovery will do some of the 'heavy lifting' in terms of closing the budget deficit. Tax revenues move in line with the economic cycle – as recovery takes hold, tax revenues can be expected to increase also.

6.3 Nevertheless, behavioural and other changes mean that the post-Covid economy could be different to the pre-Covid one. From a budgetary perspective, this means that at least part of the deficit is unrelated to the economic position: it is 'structural' in nature. European Union law – the fiscal rules – require this to be corrected.

3 Announced 12 September 2019 to start from 1 November 2019: QE 4 = €20 bn per month
12 March: €120 bn in 2020
18 March: PEPP €750 bn in 2020
4 June: additional PEPP of €600 bn and extension to mid-2021.

6.4 On the revenue side, all taxes are distortionary and any changes will have implications for economic activity. The least damaging are those that involve low rates / broad base as well as taxes on immobile factors of production (such as property). In addition, while economically damaging in the short-term, some tax changes can be welfare-enhancing over the longer term, perhaps the best example being environmental taxes.

The temporary wage subsidy scheme

7.1 The Temporary Wage Subsidy Scheme (TWSS) was introduced to minimise the increase in unemployment and, simultaneously, to maintain the employee-employer relationship. The scheme began on 26th March and was initially scheduled to provide support for a 12-week period. However, because restrictions are set to remain in place for certain businesses and sectors, Government has decided to extend the scheme until end-August.

7.2 As the economy re-opens according to the Government's revised 'roadmap', the Department is closely monitoring the TWSS, notably the position with regard to sectors that are now returning to work. The results of this and the recovery of the economy will be used to inform any future changes to the TWSS.

7.3 The TWSS allows employees to continue to work for their employer – as such there are no perverse incentives associated with returning to work from an employee's perspective. The possibility that employers will continue to avail of the scheme for longer than is necessary remains a concern and, in these circumstances, future changes to eligibility for the scheme will be kept under review. Finally, it should be noted that any major changes to the TWSS will require legislation.

Supports for households and SMEs via the banking sector

8.1 Important regulatory policy measures implemented by the Central Bank of Ireland include reductions in capital buffers. These changes allow banks to increase and restructure lending to borrowers that need assistance.

8.2 These measures have been complemented by the co-ordinated approach adopted by the Irish banking sector to help their business and personal customers who have been impacted by Covid-19. The sector has introduced flexible loan repayment arrangements, including a payment break of up to six months on mortgages and other loans for personal borrowers impacted by Covid-19.

8.3 To date over 140,000 payment breaks have been approved, including around 80,000 mortgage breaks. The sector has also introduced a range of new credit facilities for SMEs to assist them to restock and recover; provided support for buy-to-let bank customers with tenants affected by COVID 19; and, halted court proceedings for three months. It should be noted that these payment breaks are operational matters for banks themselves: they deal with the contracts between bank and customer, in which the Government has no role.

8.4 The Government is implementing considerable support to the SME sector through the banking sector and expects the sector to use these supports for the benefit of their consumers. These supports include:

- The adaptation of the existing Brexit Loan Schemes to become **the Covid-19 Working Capital Loan Scheme**. Work is underway with the European Investment Bank and the

European Investment Fund to deliver the expansion of this scheme along with the **Future Growth Loan Scheme**.

- Work is also underway on the EIB €25 billion **Pan-European Pandemic Guarantee Fund** that will be leveraged to deliver €200 billion of supports across Europe. Ireland will be working to secure significant support from that source.
- The Government has also recently announced the establishment of the €2 billion **Covid-19 Credit Guarantee Scheme**. SMEs will be able to borrow between €10,000 and €1 million for terms ranging from 3 months to 6 years with a guarantee of 80 per cent. The guarantee can be applied to a wide range of lending products and borrowers will go directly to the banks and no pre-eligibility process with Strategic Banking Corporation of Ireland is involved. The Credit Guarantee Scheme will also be open to primary producers. However, legislation is required to establish the scheme.

Policy response at a European Union level

9.1 At European Union level, a comprehensive package of measures, amounting to €540 billion, was endorsed by the European Council on 23rd April as part of the response to the economic effects resulting from the COVID 19 pandemic. This package includes three safety nets to minimise the short-term economic consequences of the crisis for workers, businesses and member states. It has three elements: **ESM's Pandemic Crisis Support Instrument**, the new **SURE Instrument** to protect jobs and workers, and the EIB's **pan-European Guarantee Fund**.

9.2 The **ESM Pandemic Crisis Support Instrument** is an important safety net both in terms of its magnitude and its availability to euro area Member States. However, it is not likely that Ireland will avail of the facility, given a strong track record of market access and, at least thus far, this has not been affected by the pandemic.

9.3 The **SURE Instrument** could potentially offer access to a useful pool of liquidity that has a long maturity. However, any decision will depend on the market rates and the maturity of loans offered by the Commission. If these are attractive, then we may consider it, in consultation with our National Debt Management Office, the NTMA. It will be a matter for the new Government, when formed, whether to apply for the SURE Scheme. This decision will be informed by the National Reopening Plan for the Irish Economy and the policy direction of the new Government.

9.4 Irish companies will be able to apply for funding and there are no restrictions on the sectors of the economy covered by the **pan-European Guarantee Fund**. The total volume of operations supported by the Guarantee Fund in a given participating Member State will be subject to fund-specific concentration limits. Ireland and other countries are keen that the Fund will treat all contributing countries fairly and transparently so that all countries, big and small, can benefit.

9.5 The European Commission on 27th May published revised proposals for the next Multiannual Financial Framework (MFF) to run from 2021-2027 to be supplemented by a proposed temporary European recovery instrument called *Next Generation EU*. The total amount being proposed for the period 2021-2027 is €1.85 trillion in commitments (€1.1 trillion for the MFF and €750 billion for *Next Generation EU)*.

9.6 It is proposed that *Next Generation EU*, which is designed to help Member States recover from the economic effects of Covid-19, will be financed by "temporarily" increasing the Own Resources ceiling to 2.0 per cent of EU Gross National Income, allowing the Commission to borrow €750 billion on the financial markets to fund measures over the period 2021 - 2024. In terms of allocation, €500 billion will be in the form of grants to Member States, with the remaining €250 billion as loans. This additional funding to be channelled through EU Budget programmes, will be repaid back between 2028-2058 drawing on future EU Budget contributions from Member States or the Own Resources of the Union.

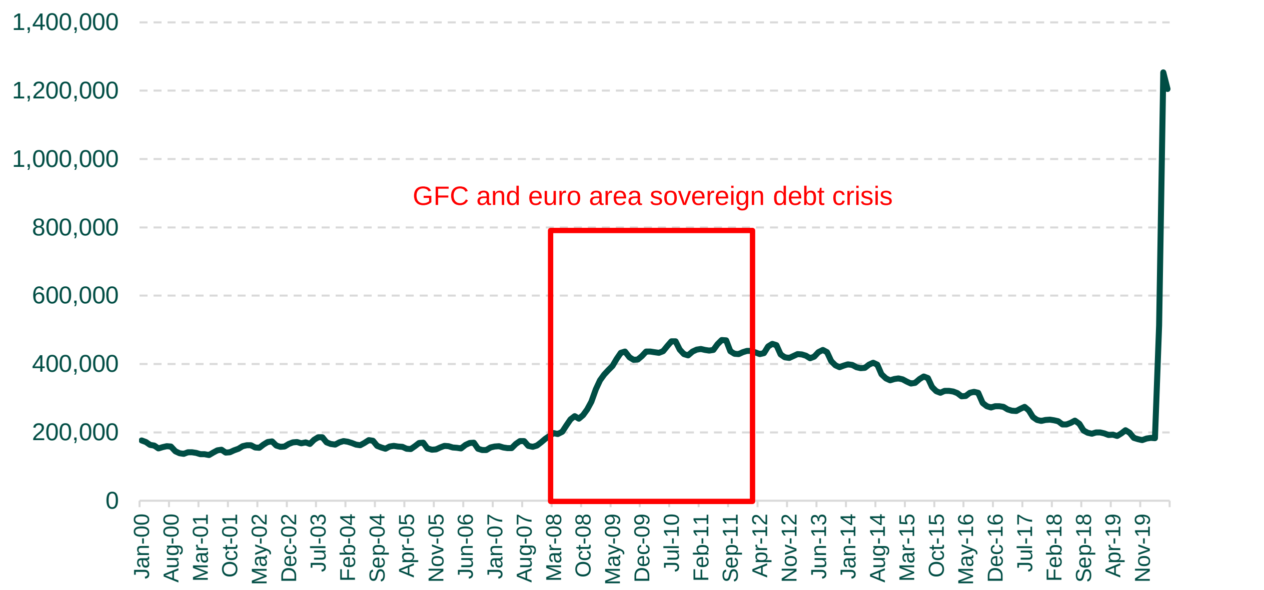
9.7 It is important to highlight that Ireland is a net contributor to the EU budget – the amount paid will exceed the amounts drawn down.

9.8 While much of the details have yet to be teased out, a staff working document from the Commission estimates that Ireland may potentially receive a total of up to €3 billion (€2 billion in the form of grants and €1 billion in the form of loans) under this initiative.

9.9 Heads of State and Government are expected to discuss the Commission's MFF and *Next Generation EU* proposals at the European Council on 19th June.

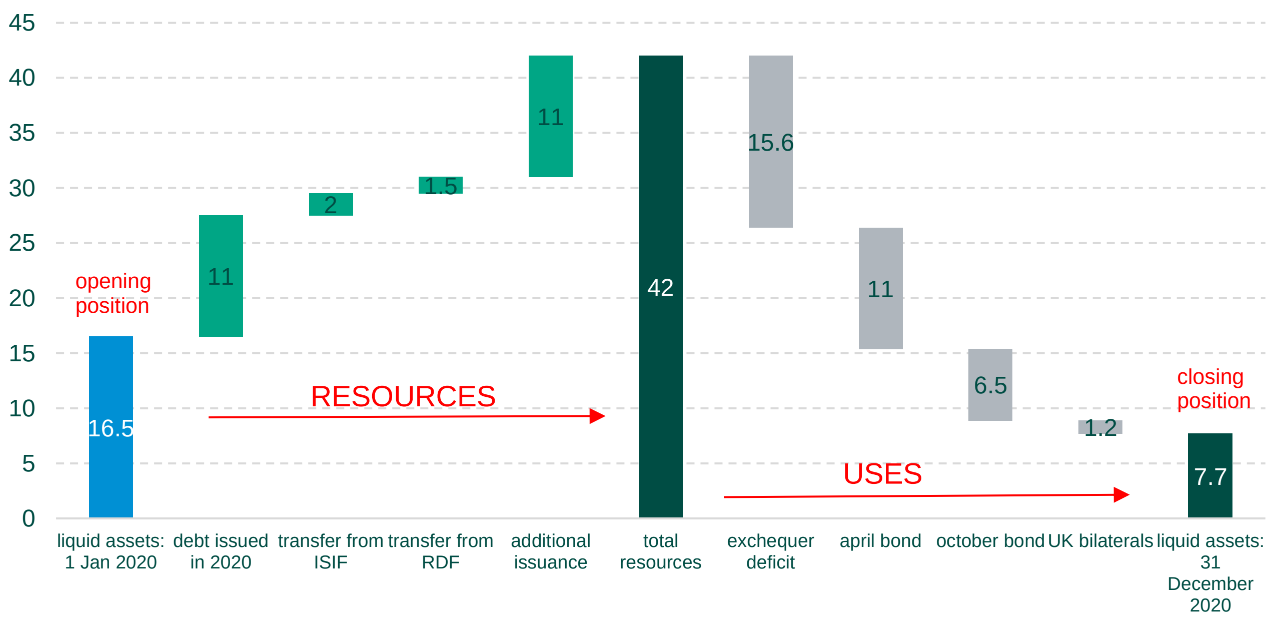
Annex 1

Figure A1: live register unemployment (including those on PUP), number



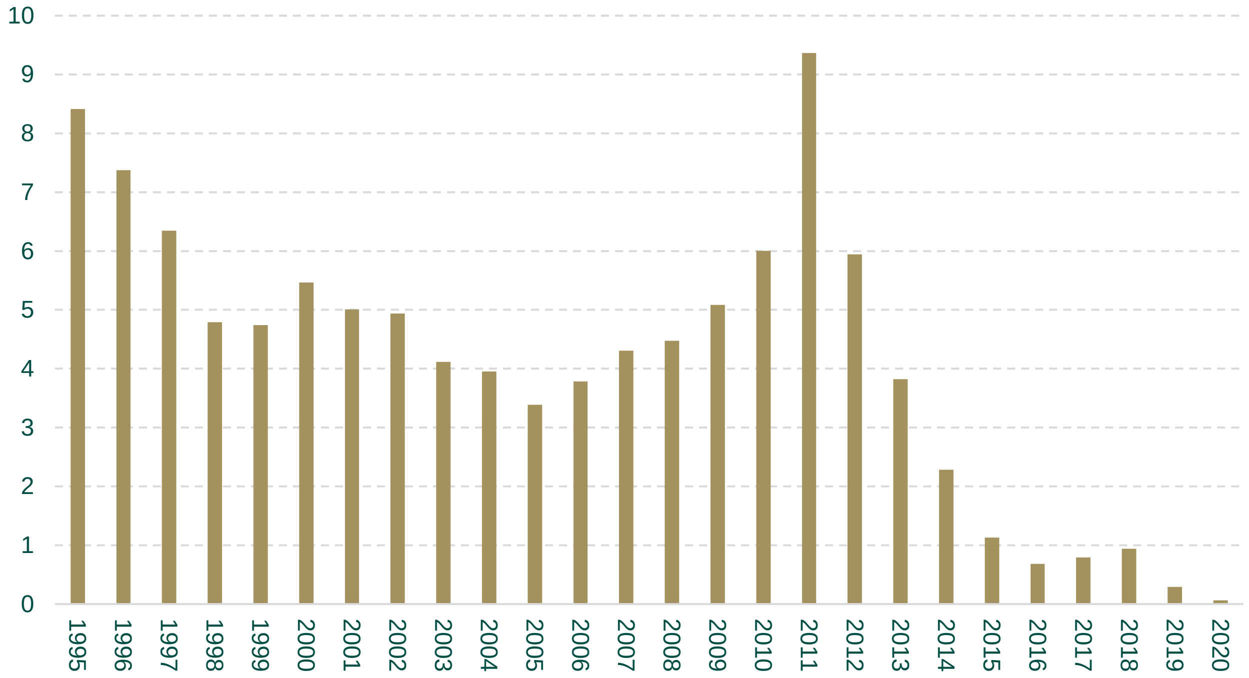
Source: Department of Finance

Figure A2: gross financing needs in 2020, € billion



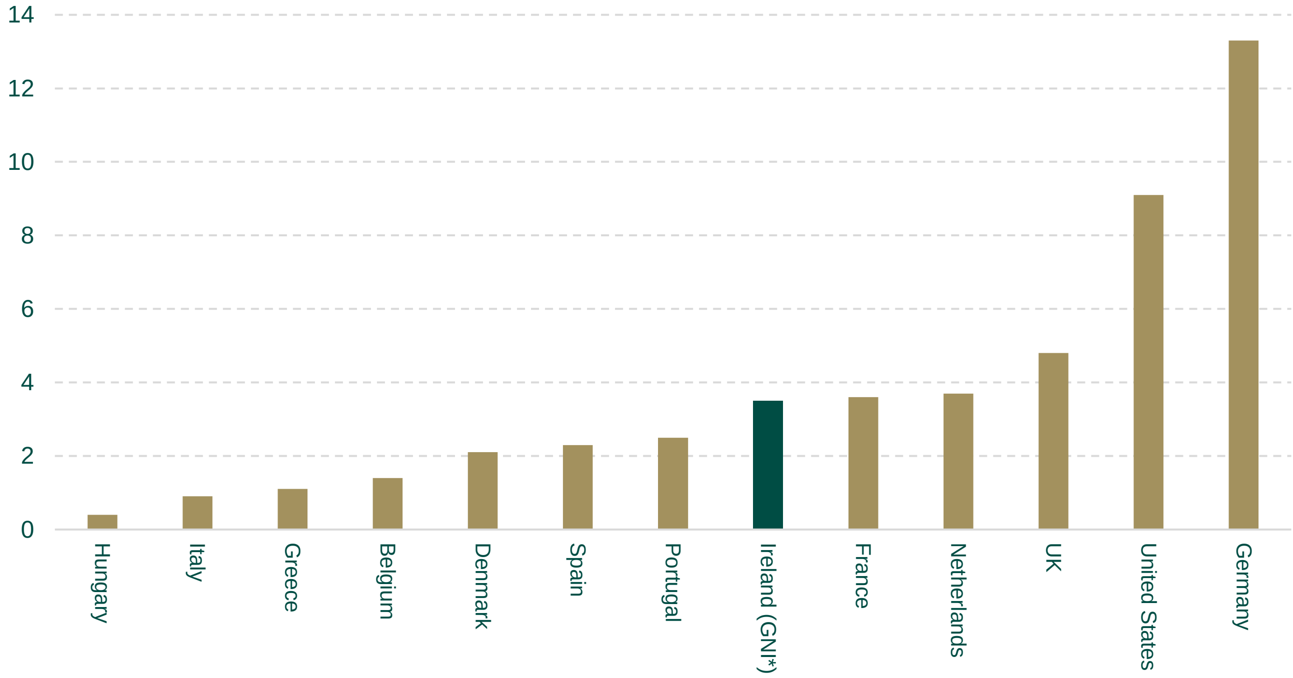
How to read graph:
The NTMA had €16.5 in liquid assets at the beginning of the year
The NTMA has borrowed / intends to borrow a total of €22 billion
€3.5 billion has been transferred to the Exchequer from the Ireland Strategic Investment Fund and Rainy Day Fund.
This means total resources available to the State of €42 billion. This will be used to finance:
An Exchequer deficit of €15.6 billion;
Maturing debt instruments amounting to €18.7 billion.
This will leave liquid assets of €7.7 billion at end-year.
Source: Department of Finance, NTMA. All figures are approximate

Figure A3: Irish 10-year borrowing costs, annual average, per cent



Source: Department of Finance, NTMA.

Figure A4: Government fiscal^ support, per cent of GDP



^ the measures set out only include fiscal measures; when additional supports such as loan guarantees are included, the figure for all countries increases.
Source: Department of Finance (for Ireland) and Bruegel (for other Member States).

Annex 2

Table 1: overview of economic support measures, grouped by sector

date	measures	€ billion
	employee / household / business supports	**11.3**
	of which:	
	1. *employee supports*^	
09-Mar	Self-isolation unemployment benefit; sick pay for self-isolation	
24-Mar	Wage subsidy scheme; pandemic unemployment benefit	
	2. *household supports*	
16-Mar	LPT deferred by 2 months	
18-Mar	Stamp duty on credit cards deferred by 3 months	
18-Mar	BPFI announces payment breaks available of up to 3 months on mortgage and personal loans	
30-Apr	BPFI extends payment breaks for mortgages and personal loans by additional 3 months	
	3. *business supports*	
09-Mar	Liquidity funding for affected businesses ^^	
13-Mar	Interest and penalties for certain late payments by employers suspended	
13-Mar	March 2020 RCT rate review suspended (construction sector)	
18-Mar	BPFI announce payment breaks available of up to 3 months on business loans for impacted customers	
20-Mar	Rates payments for certain impacted sectors deferred until May	
09-Apr	Further liquidity funding & loan schemes for SMEs ^^	
30-Apr	Payment breaks available extended from 3 to 6 months on business loans for impacted customers	
02-May	Arrangements for Accumulated Tax Liabilities (legislation required)	
02-May	ISIF *Pandemic Stabilisation and Recovery Fund* to support medium and large enterprises	
02-May	Increased Credit Guarantee Scheme (legislation required)	
02-May	Waiving of commercial rates for businesses closed due to public health requirements (3 months)	
02 May	Reconnection Fund for micro and small businesses	
	other supports	**2.0**
	of which:	
	1. *health sector supports*^^^	
09-Mar	Improving capacity, increasing staffing, overtime	
13-Mar	Customs 'green routing' for critical pharmaceutical goods	
25-Mar	Securing capacity of private hospitals	
07-Apr	Additional funding (Covid-19 Action Plan) and supports for nursing homes^^^^	
	2. *financial sector measures*	
18-Mar	Central Bank reduced the Counter-Cyclical Buffer (CCyB) from 1% to 0%	
	3. *housing sector supports*	
19-Mar	Moratoriums on evictions and rent increases for duration of Covid emergency	
19-Mar	Notice period for tenancies of less than six months increased to 90 days	
19-Mar	Flexibility for BTL landlords to facilitate forbearance to affected tenants	
	total measures	**13.3**

* Certain additional sectoral measures are being funded from within existing resources.
^ Estimated level of expenditure across all schemes being in the region of €4.5 billion over the 12-week period
^^ Additional Exchequer funding of c €¼ billion will support liquidity measures of approximately €1 billion.
^^^ Approximately €2 billion gross required for Health measures, including the delivery of the *Covid-19 Action Plan*.
^^^^ Additional funding to expand capacity and procure equipment in accordance with the *Covid-19 Action Plan*.
Rounding may affect totals. BPFI = Banking and Payments Federation Ireland.
Source: calculations by Departments of Finance and Public Expenditure and Reform.

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