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Ibec submission to Special Committee on Covid-19 Response on Fiscal Developments

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Key messages

1. **Roll out a €15 billion reboot plan within the first 100 days of Government formation:** Government must do whatever it takes to restore the economy and should endeavour to offset the collapse in GDP with increased public spending, tax supports and investment. It is likely that the automatic stabilisers, including enhanced welfare supports, will offset about 30% of GDP decline and the remaining 70%, or €20 billion, should be allocated through a stimulus package to be primarily delivered during 2020 and 2021. This would involve new measures of about €15 billion, in addition to supports already announced by Government and would leave a Government deficit of around 11% of GDP. The scale of the package is both affordable and necessary and would be in line with international expert opinion and best practice.

2. **Return a balanced current budget at an appropriate pace:** Begin an orderly return to normal fiscal policy by unwinding emergency support measures as the economy recover only when the economic situation recovers sufficiently. Review those emergency supports through a social dialogue process to understand which might be worth making part of broader economic, labour market or enterprise policy.

3. **Provide stimulus measures for consumers and impacted business sectors:** a range of targeted stimulus measures should be provided as soon as containment measures are removed. These should include tax changes to support employee voucher benefits, additional social welfare payments, grants to aid required social distancing investments and the reintroduction and expansion of the 9% hospitality VAT rate.

4. **Establish a Commission on Taxation:** Government should immediately establish a Commission on Taxation in order to address both the immediate tax revenue challenges of the crisis and a range of other long-term issues such as environmental taxes and the sustainability of the wider tax base.

5. **Introduce an 'investment rule' into domestic fiscal rules:** Setting an explicit, multi-annual investment target, compliance with which should be assessed under the 2012 Fiscal Responsibility Act.

1. Introduction

I am pleased to communicate the views of Ibec and its members on the issues surrounding the budgetary position in Ireland as a result of COVID-19.

Ibec is Ireland's largest business representative. Our positions and policies are shaped by our diverse membership, who are home grown, multinational, big and small and employ 70% of the private sector workforce in Ireland.

The structure of our membership is reflective of the Irish economy with just over 10% of member businesses employing over 250, 30% employing between 50-250 and 60% are firms employing under 50 employees.

Ibec itself is a substantial business team of 245 professionals and 36 trade associations covering a range of industry sectors including retail, financial, food, drink, telecommunications, medtech, biopharma, property, utilities, forestry, audio-visual, manufacturing, travel, hospitality and many more.

Our Small Firms Association, along with the small and medium enterprises across our sectors, also capture the breadth and diversity of firms across the country. We have 6 offices around Ireland as well as an international office in Brussels. Ibec is Ireland's largest lobbying organisation.

2. Economic backdrop

We are currently living through the sharpest compression of economic activity in living memory. Whilst many of the collapsing economic figures presented in this report are the result of necessary public health decisions, their impacts on incomes and cashflow are no less real. The recent roadmap published by Government gives welcome clarity on when sectors may expect to be allowed to re-open again, but normal conditions will not return for some time. Contrary to early hopes, the public health and economic crises' will not be of a temporary nature.

Table 1: Key indicators annual % change	2020	2021	2021 (relative to 2019)
Consumer spending	-13.8%	8.2%	-6.7%
Investment	-39.1%	36.2%	-17.1%
Exports	-7.0%	6.0%	-1.5%
Imports	-15.2%	12.9%	-4.3%
GDP	-11.1%	6.4%	-5.4%
Domestic demand (domestic capex and consumption)	-19.7%	12.2%	-9.9%
Inflation	-0.5%	1.2%	0.7%
Employment	-14.2%	12.2%	-3.8%

Source: Ibec forecasts

Early signs in other economies are that that consumer fear of the virus and ongoing social distancing will play a major role along the path to demand normalisation. We now must accept that the impact

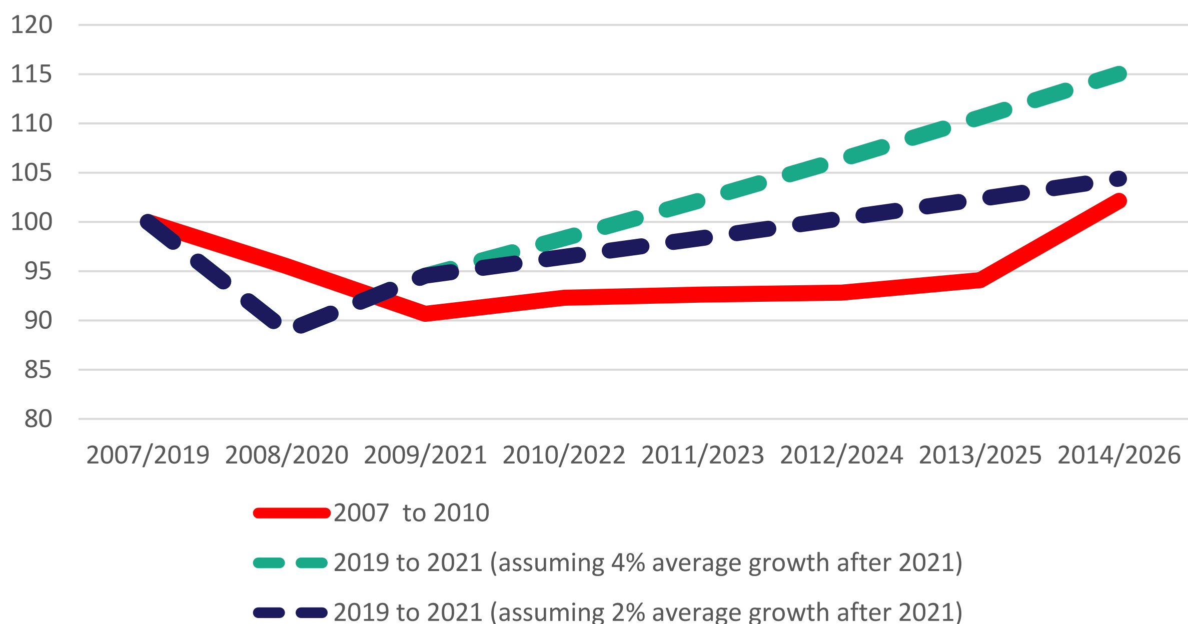
of living with the virus is likely to be a year or more. During this period, there is also a growing risk of a cliff-edge Brexit happening in December 2020, ongoing uncertainty about global tax reform, and a prolonged reduction in global economic capacity. Just like a decade ago, recovery will rely on Ireland's export lead growth model delivering to its full potential in the years ahead.

2.1 The labour market

Given the current uncertain environment, any economic forecasts are bound to have significant margins for error but having some central scenario is important for business planning. Our approach to modelling Covid-19 is based on complementing our normal demand side projections of the economy with analysis of the impact of the implementation of the Government's re-open roadmap and social distancing on sectoral capacity. In this, we have relied on significant input from our members. A recent Ibec survey of over 550 CEOs showed that over 80% have seen a hit to their profitability in 2020. Two-thirds of those companies have suffered substantial losses. Almost 20% of CEOs have had to close their organisation completely.

In the same Ibec survey, almost half of our CEOs expect a return to pre-Covid demand to take six months or more. As a result of ongoing social distancing, most firms in consumer facing sectors may remain loss making until 2021. On the other hand, our research shows that 48% of firms have less than three months cash reserves. Our best assessment is that constraints on output during the lockdown will see output fall by between one-quarter and one-third in Q2 2020 on an annual basis. GDP for the full year of 2020 will be down by more than 11% on 2019 and it will be 2022 before we again reach 2019 levels of economic activity.

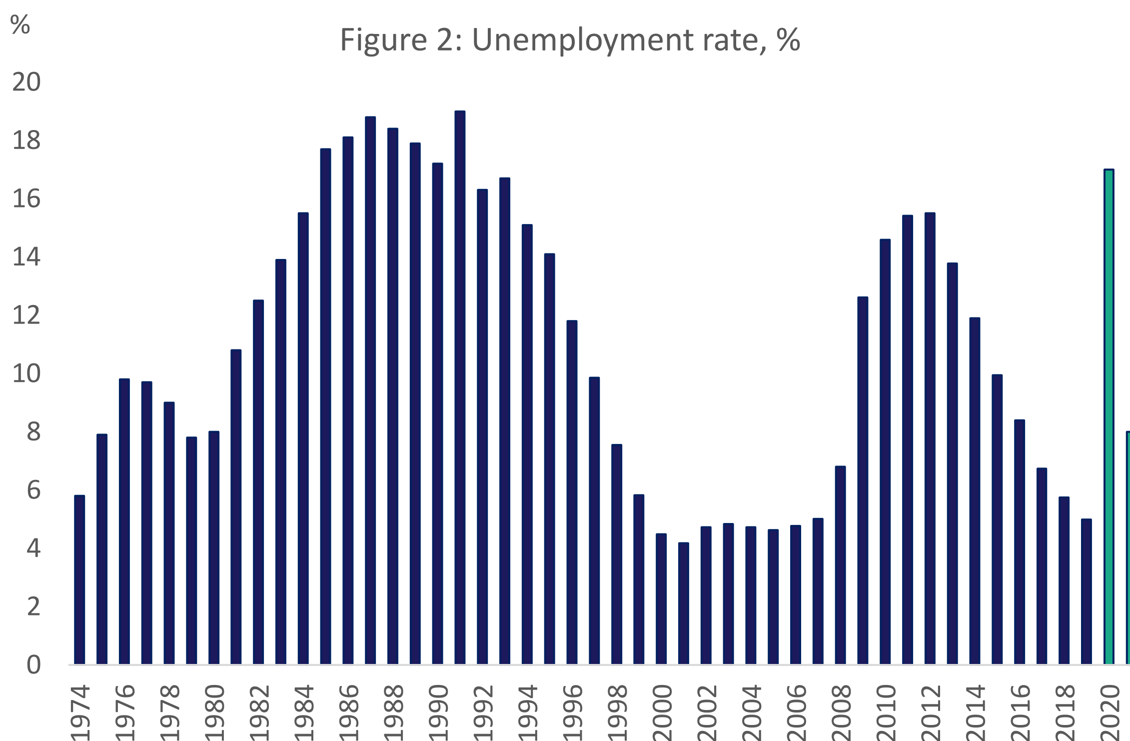
Figure 1: The current crisis versus the GFC, index of GDP (2007/2019 = 100)



Source: Ibec calculations

Current unemployment levels paint a stark picture of the impact of Covid-19 and associated containment measures. Unemployment has jumped to 26% according to the new COVID-19 adjusted unemployment rate, which includes numbers on the pandemic unemployment payment with the traditional measure of unemployment. Combined numbers on the live register and PUP are now over 800,000, the highest number of people out of work in the history of the state. While March and April saw a surge in unemployment amid widespread labour market disruption, we have now reached a point where the dramatic rise in unemployment is levelling off, with numbers on the PUP decreasing slightly in recent weeks from their peak of 598,000 in early May.

Those unemployed in the wake of Covid-19 are disproportionately younger workers, who represent a high proportion of employees in retail, hospitality and tourism, the sectors worst affected by lockdown measures. Workers under 25 make up one fifth of all pandemic unemployment payment recipients, despite representing just 12% of the labour force. Experience from the 2008 financial crisis indicates that youth unemployment is particularly intractable and there are likely to be longer term implications for this cohort as these sectors are also those which face the greatest difficulties in reopening and a return to normal staffing levels in the medium-term.



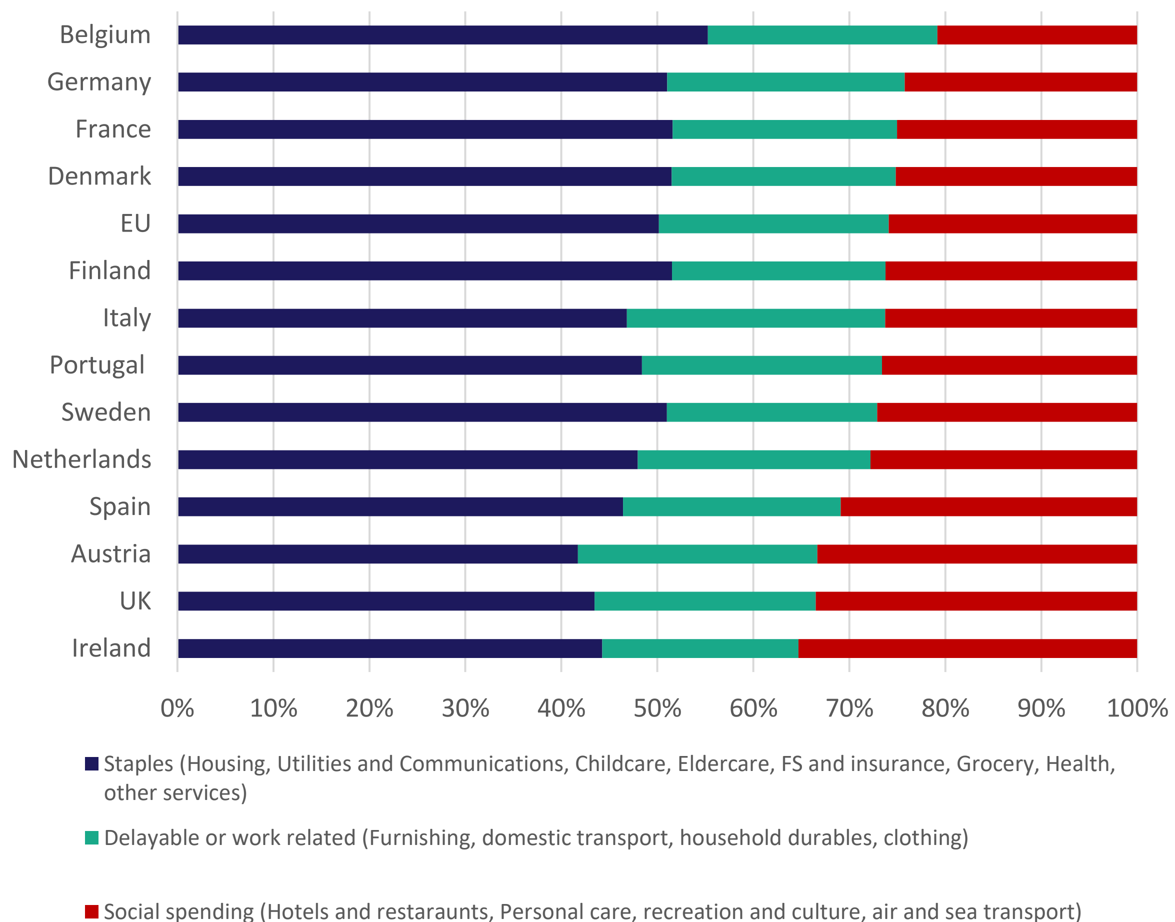
Source: CSO and Ibec forecasts

Our estimates based on sectoral analysis of capacity under the Government roadmap suggests that, in a best-case scenario, unemployment will fall from over 28% in Q2 to 16% by Q4 and finally to around 7% by the end of 2021. It will be 2022 by the time the labour market recovers to its pre-crisis level.

2.2 Investment and consumer activity

Residential and commercial construction makes up about two-thirds of total domestic investment (excluding intangibles and aircraft leasing) in a normal year. Whilst completions in residential construction were up 17% annually in Q1 2020, the lockdown and capacity constraints which followed mean that our expectation for completions is a reduction from 21,000 units in 2019, to closer to 15,000 units in 2020. When it comes to business investment, ongoing uncertainty about the viability of commercial projects and damaged balance sheets will see firms focus on deleveraging ahead of fresh investment.

In the longer-run, investment will be demand led and debt constrained. Our recent CEO survey showed 35% of CEOs expected a reduction in demand for office space from their firm over the next three years as a reaction to Covid-19. Only 11% expect an increase in capital expenditure. On the other hand, 42% saw opportunities for investment in technology and 61% intend to make changes to their physical workspace. Domestic investment will follow any recovery in consumer spending and global demand at a lag. As a result, we expect investment (excluding IP and aircraft leasing) to fall by about one-third in 2020 before experiencing a partial bounce back in 2021.



Source: Ibec analysis, using Eurostat data

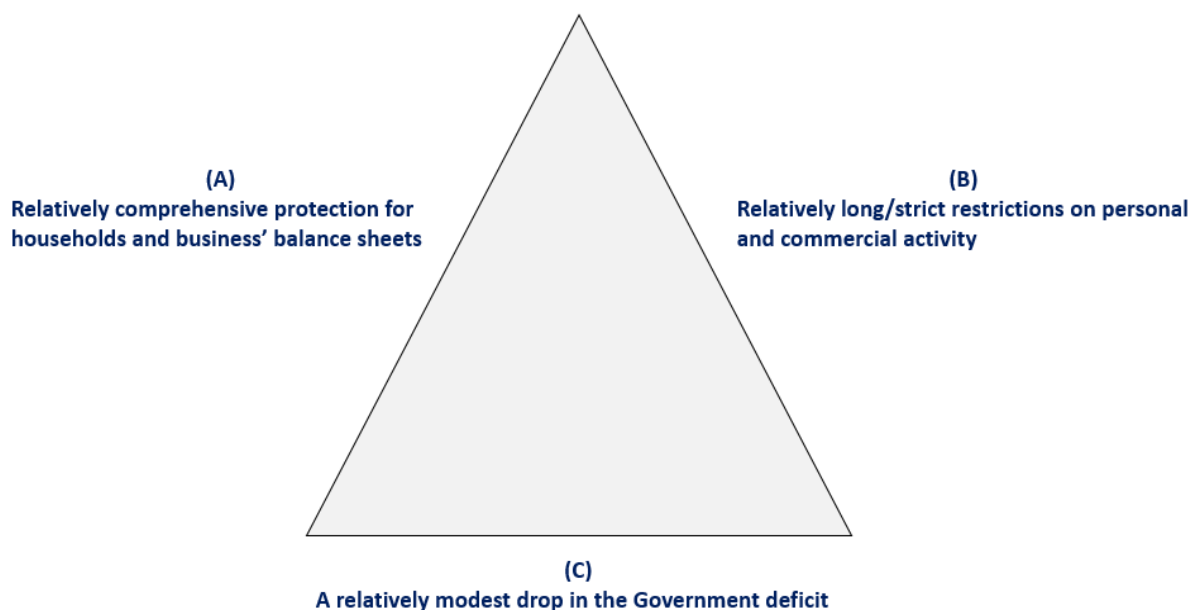
Evidence on a consumer recovery from countries leaving lockdown has been mixed. Recent survey data from the European Commission has shown that business confidence and sales expectations in consumer facing sectors such as hospitality and retail fell as quickly in countries with strict lockdowns, like Ireland, as those with more relaxed restrictions. This has played out in the hard data too. A recent paper, using bank account data, from the University of Copenhagen compared spending in Sweden which has mostly remained open and Denmark, which had instituted an Irish style lockdown. Consumption fell by 29% in Denmark annually and by 25% in Sweden. Here at home, Central Bank card data shows total spending (credit, debit, ATM withdrawals) fell by €795 million a week between the first week in March and the last week in April. 70% of that fall (€562 million) happened before the lockdown was instituted at the end of March. Whilst our understanding will develop over the coming months, it seems consumers will return only gradually to normal activity where there is a significant physical exposure to others.

What is clear is that the greater share of social and deferrable purchases in our basket of consumption means that, in the short-term, Irish consumer spending is likely to fall more sharply than other countries experiencing similar restrictions and economic effects. It also means, however, that Irish household savings are on-trend to rise significantly in mid-2020. Whilst household incomes are being supported by the State, Irish households are constrained in their spending. On average household deposits in their bank accounts have grown by around €500 million each month since January 2019. In April 2020, however, there was a €3 billion spike in household deposits in their bank accounts. This is the biggest monthly jump in household savings on record, going back to 2003. The April savings alone were worth about a fifth of what the mid-2000s SSIA scheme released into the Irish economy in 2006 and 2007. This points to an increase in the savings rate from 11% in 2019 to over 20% in 2020.Where those savings go in the second half of this year and into 2021 will be a key determinant of how quickly we return to normal levels of economic activity.

3. Rationale for intervention

The Government's most recent forecasts showed that €16 billion (70%) of the €23 billion deficit planned for 2020 would be linked to the lockdown related hole in tax revenues, rather than changes in tax rates or spending increases. If we plan to have a longer lockdown than most developed countries then we cannot, at the same time, plan to run a deficit which is at the lower end of that same group of countries. That is, unless, we plan to do much less to protect households and business from the economic fallout. We can do any two of these three things, but not all three. This is the trilemma which the next Government will have the unenviable task of solving. Recent accelerations in the roadmap, where they can be delivered safely, are welcome in this regard.

Figure 4: The 'Covid' trilemma



Our view is that further significant measures will need to be taken over the coming months to protect the balance sheets of households and business. In our recent 'Reboot and Recovery' campaign we outlined the need to run a deficit which matches the loss in economic output. We expect GDP to fall by around 11% or €37 billion in 2020. Our Government response should be of the same scale as the crisis. As part of this, a further €15 billion in stimulus measures will be necessary in 2020 and 2021. This should be provided in extended income supports to households, liquidity supports to business, programmes to get people back into jobs, and bringing forward maintenance and investment projects from an extended capital plan.

This would leave us in line with other developed countries. The average deficit across Europe will be above 10% by the end of the year, the UK deficit will be north of 15%, and the US deficit will reach 20%. The true cost of the crisis will depend on how quickly normal economic activity can return. Over 90% of the additional new spending to combat Covid-19, so far, is linked to falling tax revenues or additional health and income supports which should wind down in line with the virus itself. The remaining return to fiscal health will take several years and should not be rushed.

As the economy recovers there will need to be a new European style social dialogue process, including a new Commission on Taxation, to consider how best to provide for new policy programmes over the coming years. It must also make best use of new streams of European funding for the Green New Deal and other private funding sources. To avoid repeating the mistakes of the past, we must put in place a binding fiscal target for investment spending.

Our Covid debt in 2020 will be financed at almost no cost to the exchequer thanks to the policy action of the European Central Bank. That situation may be different in four or five years' time but given the globally shared and symmetric nature of the Covid shock, it is equally likely to be the same.

Unlike in 2010, Government borrowing costs are unlikely to move asymmetrically in the coming years as a result. The other key determinant of our interest rates then, as it was after the last crisis, will be our continued potential for growth. There is far more risk to that growth potential in doing too little to combat the impact of the crisis than in doing too much.

4. Ibec view on fiscal policy and stimulus measures

The significant negative impact of COVID-19 on the economy will be reflected in the Government finances. The deficit will hit double digits, as a percentage of GDP, in 2020. Far from being a negative, this will be a sign that Government has done the right thing. In a world where Central Banks are committed to keeping financing costs low, we should do whatever it takes to combat the economic crisis.

In the longer term, a recovering economy will help to deliver a return to a balanced current budget, expenditures on cyclical items will fall and tax revenues will recover. When it comes to capital spending, we must make this the first crisis in a generation where we continue to invest in projects, rather than retrench, as the crisis hits.

A return to fiscal health will take several years and should not be rushed but it should not prevent us from planning for the future after the pandemic. We must learn the lessons of the last decade and have confidence on the economy's capacity to recover and grow.

4.1 The impact of COVID-19 and the way things are now

Ireland is likely to go from running a balanced budget to a significant deficit in 2020. The deficit this year could be more than 10% of GDP depending on the duration of the public health crisis and the scale of the measures taken to combat COVID-19.

A significant part of the expected government deficit for 2020 is linked to temporary policy measures and falling tax revenues. The quicker the economy recovers over the coming years the quicker these measures will become unnecessary and a normal fiscal path restored. The Government has already made fiscal commitments which would be extraordinary in ordinary times. But these are far from ordinary times. Further significant measures will need to be taken over the coming months to ensure balance sheet and liquidity issues do not impact on the speed of the recovery.

The State, at the time of writing, has introduced measures which in total will be equivalent to 4.6% of GDP. These measures include business supports which, when leveraged by private finance and before they are repaid, induce liquidity worth an additional 2.2% of national income to support the Irish economy. Even assuming some significant, long-term default rates over the coming years these measures are likely to cost the Exchequer in the region of 0.5% of GDP. This has supplemented Exchequer spending on income and health supports totally around 2.4% of national income. The average scale of national direct fiscal measures (excluding health measures) is 7.1% of GDP across developed countries. Many of these direct measures have been supplemented by large scale public loan schemes and guarantees.

As recently outlined by the IMF in their 'Fiscal Monitor' publication - the full cost of most budgetary "above-the-line" measures, such as additional health spending, income supports, and direct grants will add to the debt and deficit in the short term (minus the economic return on those policy measures). However, their impact on the deficit will fade as the crisis winds down and some, such as tax deferrals, will only have a temporary impact because they will be repaid in the future.

On the other hand, "below-the-line" policy measures such as loan guarantees or equity create both assets and liabilities for the Exchequer balance sheet but do not immediately add to the deficit. If repaid in full, the Exchequer will extend liquidity to the economy without incurring a long-term cost on either the debt or deficit. While the total leveraged finance supported by Government schemes introduced thus far is around €7 billion (2.2% of GDP) the total Exchequer cost is likely to be around €1.3 billion, with the remaining risk either borne by companies themselves or by on-lenders in the financial system. The design of expanded schemes, if optimal, can provide significant liquidity to business.

Table 2: Measures already introduced (€ million)

	Liquidity to the economy/health system	*Exchequer cost*	*Leveraged funding from on-lenders*	*Repaid in future*
SBCI Brexit/Covid schemes expansion	450	40	410	.
Sustaining enterprise fund	180	180	.	.
Restart grant	250	250	.	.
Pandemic Stabilisation and Recovery Fund (assume 5% loss)	2,000	100	.	1,900
Credit guarantee scheme (assumed 15% NPL)	2,000	200	1,800	.
Tax 'Warehousing' (assume 15% NPL)	2,000	300	.	1,700
Commercial rates waiver	250	250	.	.
Covid online retail scheme	2	2	.	.
Microfinance loan scheme	20	.	.	20
Total business supports	7,152	1,322	2,210	3,620
Health spending	2,000	2,000	.	.
Income supports for households (Ibec estimate to end August)	5,500	5,500	.	.
Total household income and health supports	7,500	7,500	.	.
Total, nominal €	14,652	8,822	2,210	3,620
Total, % of GDP	4.6%	2.8%	0.7%	1.1%
Business supports, % of GDP	2.2%	0.4%	0.7%	1.1%

Household and health supports, % of GDP	2.4%	2.4%	0.0%	0.0%
Lost tax revenue in 2020 (April Stability Programme Update)	-	16,125	.	.
Total including lost tax revenue, % of GDP		7.9%		

4.2 Phased policy actions for fiscal policy

We believe fiscal policy action should take place in three phases as outlined below:

Phase 1 actions required in the next 100 days

1. **Government must do whatever it takes to offset the significant economic shock of COVID-19:** For every percentage point lost in growth in 2020 and 2021 the State should expand its primary deficit in kind.

2. **Substantially increase and improve measures to address the liquidity crisis:** A further large-scale bridging liquidity package will be needed to keep firms functioning through the remaining months of the COVID-19 containment measures.

3. **Implement an immediate reboot package for the economy:** This must include measures aimed at consumer confidence, business investment, and returning the worst impacted sectors to normality. It should be set out on a multiannual basis for fiscal years through to 2022 to support sectors which will take time to recover.

4. **Allocate a further €15 billion to the reboot package**; For every one percent in output lost due to the crisis over those years, tax revenue and unemployment support changes will account for 0.3% of GDP. On top of this, another 0.7% of GDP should be spent on discretionary fiscal measures aimed at offsetting the economic impacts of the crisis.

   For example, if the total loss of GDP in 2020 amounts to 10%, then the total cost of lost revenue and higher unemployment spending would amount to 3% of GDP and the total of other discretionary policy measures should amount to 7% of GDP.

5. **Accelerate public capital spending:** Learn lessons from the last crises by committing to maintaining and bringing forward capital budgets in the coming years where projects are suitable. This will ensure that bottlenecks do not emerge as the economy recovers.

Phase 2 actions required by end 2020

1. **Convene a new Commission on Taxation:** With relevant expertise, to help plan a taxation system which is fit for purpose in the post-crisis world. Initial recommendations by the Commission should be published and responded to by Government in Q1 2021.

2. **Review and adjust crisis response measures**; All economic measures introduced in response to the crisis should be kept under ongoing review and amended where necessary to support their impact and ease of use.

Phase 3 actions required by end 2023

1. **Return a balanced current budget at an appropriate pace**: Begin an orderly return to normal fiscal policy by unwinding emergency support measures only when the economic situation recovers sufficiently. Review those emergency supports through a social dialogue process to understand which supports might be worth making part of broader economic, labour market or enterprise policy.

2. **Introduce an 'investment rule' into domestic fiscal rules:** Setting an explicit, multi-annual investment target compliance with which should be assessed under the 2012 Fiscal Responsibility Act.

3. **Increase the share of public spending for productivity enhancing measures:** Over the long-term a greater share of public spending should be allocated to infrastructure, skills, and R&D measures in order to boost the potential growth rate of the economy.

Annex 1: Cost of immediate economic measures proposed in Ibec Reboot & Re-Imagine campaign, (€ million)

	Stimulus measures (€ billion), gross cost in first twelve months	Net cost of measures after repayment (€ million)
Existing economic measures:		
SBCI Brexit/Covid schemes expansion	40	40
Sustaining enterprise fund	180	180
Restart grant	250	250
Pandemic Stabilisation and Recovery Fund (assume 5% loss)	2,000	100
Credit guarantee scheme (assumed 15% NPL)	200	200
Tax 'Warehousing' (assume 15% NPL)	2,000	300
Commercial rates waiver	250	250
Covid online retail scheme	2	2
Microfinance loan scheme	20	-
Income supports for households	3,860	3,860
Sub-total	**8,802**	**5,182**
New or supplementary Ibec proposals:		
Extend and gradually taper the WSS for sectors worst impacted	3,500	3,500
Accelerate public capital spending and bring forward maintenance programmes	2,000	2,000
Provide ongoing flexibility on tax compliance including debt forgiveness	1,100	1,100
Increase provisions for State credit guarantee measures	1,000	1,000
Ensure the restart grant scheme is fit for purpose	800	800
Enhanced labour market activation and short-time work	700	700
Allow employers to provide up to €2,000 in tax free vouchers	600	600
Re-introduce and expand the 9% VAT rate	600	600
Introduce a in-employment training voucher scheme	500	500
Bring forward urban and rural regenerations funds	475	475
Explore a binding mandatory arbitration model for disputes over commercial leases	400	400
Substantially increase funding and recapitalise higher education	400	400
Provide ongoing grant support for worst impacted sectors	375	375
Shared equity affordable housing scheme	350	-
Introduce tax measures to support business investment	330	150
Extend the six-month commercial rates exemption to six months	300	300
Significantly enhance the JobsPlus scheme	300	300
Roll out an ambitious national deep retrofit programme	300	300
Drive low carbon investment by increasing SSRH and other industry grants through SEAI	200	200
Town growth fund	200	200
Increase and extend the eWorking tax allowance to an annual equivalent of €1,500.	130	130
Introduce a State supported export credit insurance scheme	50	50
Incentivise industry to participate in Generation Apprenticeship	40	40
Sub-total	**14,650**	**14,120**
Total of all policy measures	23,452	19,302