Séanadh
Is í an Oifig Buiséid Pharlaiminteach (OBP) a d’ullmhaigh an doiciméad seo de réir na feidhmeanna atá leagtha síos san Acht um Chomisiún Thithe an Oireachtais, 2003 (mar a leasalodh), mar áis do Chomhaltaí Thithe an Oireachtais ina gcuid duálgaí parlaiminteach. Féadfaidh an OBP aon fhaisnéis atá ann a bhaint as ná a leasú aon tráth gan fógra roimh ré. Níl an OBP freagrach as aon tagairtí d’aon fhaisnéis atá á cothabháil ag triú páirtithe nó naísc chuig aon fhaisnéis den sórt sin ná as ábhar aon fhaisnéise den sórt sin. Tá baill foirne an OBP ar fáil chun ábhar na bpáipéar seo a phlé le Comhaltaí agus lena gcuid foirne ach ní féidir leo dul i mbun plé leis an móphobal nó le heagraíochtaí seachtracha.

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Contents

Key Messages 2
Overview of Government Debt 3
Debt in an Economic and Monetary Union 5
Gross Debt v Net Debt 7
Interest Rate 9
Combined Debt 13
EU Fiscal Rules 15
The Relationship between Interest Rates and Economic Growth 16
Risks of a High Level of Debt 17
An International Perspective 19
Conclusion 20
The COVID-19 pandemic will cause a slowdown in the economy and extra Government spending will be needed to tackle the crisis. This will cause the Government Debt to rise.

Government Debt is currently high in historical and international terms.

The government can currently borrow at low interest rates. These interest rates may fall further due to the additional monetary stimulus provided by the ECB in response to the pandemic. All key sectors of the economy are now heavily indebted, including households, non-financial corporations and the financial sector.

Despite low interest rates, Ireland’s repayments on its debt are relatively high. In 2018, Ireland’s interest payments were 6.4% of government revenue. This was the fourth highest in the EU. If interest payments were as high as was expected in Budget 2015, interest payments would be 10.3% of government revenue.
Overview of Government Debt

In March 2020, the Government announced two fiscal packages allocating €6.7 billion to tackle the economic consequences of the COVID-19 pandemic. It is likely that there will need to be further fiscal packages. Their size will depend on the duration and severity of the pandemic and how quickly the economy and consumer confidence rebounds. This means the Government will run a Budget deficit in 2020 and they will need to borrow additional funds. The pandemic started to have economic and fiscal consequences in March 2020, therefore there is no annual budgetary data on its impact.

This paper looks at the debt level before the COVID-19 pandemic occurred. Governments borrow money for several different reasons. It can be used to fund tax cuts and spending (e.g. health, education, social welfare). It can also be used to finance investment in infrastructure. In certain circumstances it can benefit the economy as it can support long-term infrastructure projects or a fiscal expansion during a recession. However, a high level of debt can pose substantial risks for a country.

As larger economies can generally sustain a higher level of debt than small countries, debt is measured as a percentage of GDP. This also makes it easier to compare debt levels across countries. Ireland’s debt-to-GDP ratio is currently 59%. This is below the EU average and the 60% threshold set by the Stability and Growth Pact. However, using a more appropriate measure of economic activity for Ireland (GNI*), the debt-to-GNI* ratio is 100.2%, significantly higher than the EU average.

Ireland was not always a highly indebted country. In 2006 the debt-to-GDP ratio reached a record low of 23.6%, which was the sixth lowest in the EU. However, the level of public debt in Ireland rose dramatically during the financial and economic crisis of 2008. The public debt rose to approximately €215 billion and the government debt-to-GDP ratio peaked at 120% in 2012. Since then, the economy has recovered and the debt ratio has improved. However, Government Debt is still high in historical and international terms and will rise further in 2020 as Ireland runs a deficit, and as GDP is likely to fall.

Assessing Ireland’s level of public indebtedness in an international context, Ireland has been above the interquartile range¹ of Government debt of EU Member States since 2008 (Figure 1). While still above this range in 2018, there has been a significant improvement.

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¹ The IQR is the difference between the first quartile (which holds 25% of the EU MS’s debt-to-GDP values) and third quartile (holding 75% of the EU MS’s debt-to-GDP values). The IQR of EU (28) countries is 27 EU countries debt to GDP ratio and Ireland’s debt to GNI* ratio.
Figure 1: Government debt in an international context

Source: AMECO for EU Member States and CSO for Ireland.
Debt in an Economic and Monetary Union

The fiscal capacity to address macroeconomic and financial vulnerabilities is even more important in a monetary union, as monetary policy is centralised. For a member state, there may be times when a country-specific counter cyclical fiscal policy is needed to tackle issues such as overheating in an expansive monetary policy setting (i.e. low interest rates).

Figure 2 shows two decades of economic growth for the eleven founding European Monetary Union states (EMU). Ireland has followed roughly the same cycle as other Euro states (i.e. the Irish economy grows and contracts at the same time as other members). However, Ireland generally experienced faster growth when economies were growing and much deeper recessions. This ‘boom bust’ cycle of the Irish economy is an issue for managing public finances as the common monetary policy is more aligned to less volatile economies.

Figure 2: Nominal economic growth for founding EMU states

Source: Eurostat for other EMU states and CSO for Ireland.

Note: GDP growth rate for founding EMU states and Modified GNI growth rate for Ireland. The GDP calculation is the output approach and the Modified GNI is at current market prices.

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2 The founding countries of the European and Monetary Union in 1999 are Belgium, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Spain, Portugal, Austria and Finland.

3 https://www.irishtimes.com/business/economy/does-ireland-s-roaring-economy-have-a-soft-centre-1.4113679
One of the functions of a central bank is to prevent overheating, in other words, “to take away the punch bowl just as the party gets going”⁴. This may not happen to Ireland, in fact, the opposite could happen, where the central bank could stimulate overheating in the Irish economy in this asymmetric monetary union.

In terms of the Convid-19 pandemic, this is not likely to be an asymmetric economic issue as the virus is in every member state of the EU. The co-ordination response from the European Commission in terms of fiscal rules and other supports and the rapid monetary expansion by the European Central Bank (ECB) suggests that this response is more co-ordinated than the initial response to the Global Financial Crisis of 2008.

The ECB’s monetary expansion includes making available €3 trillion in refinancing operations. The ECB has also announced a new Pandemic Emergency Purchase Programme of €870 billion. This equates to 7.3% of euro area GDP. In addition, European banking supervisors have enabled an extra €120 billion of capital for banks to mobilise.⁵ These funds will mitigate some of the negative effects of the pandemic and the associated uncertainty.

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⁴ Authors, J. (2011) “The punch bowl has to go but the timing is key” https://www.ft.com/content/97565b48-5ca3-11e0-ab7c-00144feab49a

Government debt can be assessed in terms of **gross debt and net debt**. Gross debt refers to the Maastricht debt definition. Gross debt consists of the stock of the following financial liabilities: currency and deposits; securities other than shares excluding financial derivatives; and loans. However, it excludes several important liabilities such as pension liabilities, insurance technical reserves and other accounts payable. On the other hand, net debt is defined as gross financial liabilities minus financial assets.

Net financial wealth can be used as a proxy for net debt. Figure 3 shows net financial wealth across the EU expressed as a percentage of GDP. While all countries hold debt, they also have a stock of financial assets. For countries that hold a significant stock of assets, net debt may present a more accurate picture. For example, Finland has a relatively high debt to GDP ratio, but it has positive net financial wealth (i.e. its stock of assets is greater than its debt). While Ireland holds assets (such as its investment in commercial banks by the state as a result of the 2008 financial crisis), its financial net wealth is still below the EU average. It has the ninth lowest net wealth in the EU expressed as a percentage of GDP and the seventh lowest expressed as a percentage of GNI*.

However, using net wealth as a metric has limitations. For instance, the Comptroller and Auditor General has questioned how likely it would be to recover the investment made in the three commercial banks. The value of the bank investment would be influenced by timing, in terms of how much are the shares worth when they are sold.

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Figure 3: Financial net worth

Source: Eurostat.
The various quantitative easing programmes have resulted in low interest rates. This means that governments can borrow at low interest rates. While interest rates have been low for almost a decade, this low interest rate environment is very unusual. For most of the twentieth century, there was a high or medium level of interest rates (see figure 4).

Figure 4: Money Market Rate


The National Treasury Management Agency (NTMA) manages public assets and liabilities. In response to the low interest rate environment, the NTMA has adopted a strategy of ‘locking-in’ low interest rates, lengthening the average maturity of the debt and reducing the share of variable rate instruments. This strategy has resulted in lower interest payments by the state. For example, in the 2016 Budget documentation, interest payments in 2019 were expected to be €6.66 billion. However, the actual cost of debt servicing was €4.68 billion.

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8 A quantitative easing programme is when a central bank buys government bonds or other financial assets. This increases the money supply and bank liquidity. This should increase investment and consumption, which stimulates economic growth. It is usually undertaken when interest rates are approaching zero and can’t be relied upon to boost the economy.

Figure 5 shows the various projections of general government interest expenditure from the last 5 budgets (2016-2020). There is a consistent revision downwards of the cost of servicing the debt, attributed to the low interest rate environment generated by the European Central Bank. The quantitative easing policy by the central banks is a significant assistance to the Irish government in managing the public finances over the last few years.

**Figure 5: General Government Interest Expenditure**

![Graph showing general government interest expenditure from 2016 to 2020.](#)

*Source: Department of Finance.*

Figure 6 shows the maturity profile of government debt till the middle of this century at present. In 2018, Ireland issued over €17 billion in benchmark bonds with a weighted average maturity at issuance of 7 years, and a weighted average yield at issuance of 1.06%\(^\text{10}\). Thus, the cost of servicing the existing debt will not change significantly in the short to medium term.

The favourable maturity profile of the debt is evidenced in the credit rating by the major rating agencies. There is an ‘A’ credit rating from all three major rating agencies and this supports Ireland’s favourable market access.

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<tr>
<th>Rating Agencies</th>
<th>Long-Term</th>
<th>Outlook</th>
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<tr>
<td>S&amp;P Global</td>
<td>AA-</td>
<td>Stable</td>
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<tr>
<td>Fitch Rating</td>
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<td>Stable</td>
</tr>
<tr>
<td>Moody</td>
<td>A2</td>
<td>Stable</td>
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While this rating might look impressive, there are four levels above A+, which are: AA-, AA, AA+, and AAA. Germany has a debt rating of AAA from all three main rating agencies which could result in lower debt servicing. The rating before the crisis for Ireland was a rating of AAA from all three main rating agencies\(^\text{11}\).
Generally, countries with a high level of debt pay higher interest rates as lenders consider that there is a risk of non-payment by the country’s government, so the cost of new borrowing will be higher than for countries with more fiscal credibility. While Ireland’s debt to GDP ratio is below the EU average, when expressed as a proportion of GNI*, Ireland has a very high level of debt in relation to the size of its economy (see Figure 7). However, in 2018 Ireland paid a relatively low rate of interest on this debt compared to other countries. No country with a higher debt to GDP ratio than Ireland (measured as a proportion of GNI*) pays a lower interest rate. At the same time there are ten countries with a lower debt ratio that pay a higher rate of interest on their debt.

In terms of the Covid-19 pandemic, the closing of non-essential sectors, the restrictions on peoples’ movement and the rise in unemployment will have a detrimental effect on the Irish economy. The IMF estimates that for each month that non-essential sectors remain closed, there will be a 3 percent drop in annual GDP. The negative effects of higher budgetary deficits will be mitigated by the increased quantitative easing by the European Central Bank (ECB). Following the ECB’s announcement, Government 10 year bond yields fell, which will result in lower borrowing costs for the Irish state.

In addition, the European Stability Mechanism (ESM) has an available lending capacity of €410 billion, equal to 3.4 percent of GDP of the Euro area. Furthermore, the ESM has a precautionary credit line to respond to the economic challenges arising from the COVID-19 virus, in particular, the Enhanced Conditions Credit Line. The funds made available could amount to up to 2 percent of the member state’s GDP.

Source: Eurostat, CSO for Modified GNI*.
Government debt must also be examined in the context of the prevailing private debt in the economy, specifically household debt, non-financial corporation debt and financial debt. The combination of debt might be an important driver of macro vulnerability to a global economic shock. In terms of the Irish economy, all key sectors of the economy are now heavily indebted, measured as a percentage of GDP.

The four graphs below illustrate the debt in the government and the private sectors, including household and corporation sectors from 2002 to 2017. A comparison with Germany is provided, as an economy that is more in line with the Fiscal and Stability Growth Pact/Maastricht Treaty. These graphs show the dramatic growth in Irish debt, especially in comparison to the steady state of debt in Germany.

The EU has a surveillance framework called the Macroeconomic Imbalance Procedure (MIP) scoreboard\(^\text{14}\). This aims to identify emerging imbalances in the economies of the Member States and encourage Member States to tackle these economic risks. The MIP scoreboard has a private sector consolidated debt-to-GDP threshold of 133 per cent\(^\text{15}\).

The graphs below show that Ireland is significantly above this threshold. However, this is driven by the debt of multinational companies. These companies have few links to the domestic financial system and thus, are not a significant risk to the domestic banking system. The corporate debt figure could give an inaccurate picture of the level of debt that Ireland would ultimately be responsible for.

In terms of household debt, the total value of household debt amounts to €136.9 billion or around €28,000 per person in 2019\(^\text{16}\). This figure is on a downward trajectory from its peak during the Celtic Tiger era. For instance, household debt to Gross Disposable Income (GDI) was 126% in Q3 2018, a significant decrease from debt to GDI of 212.1% in 2009\(^\text{17}\). Despite this reduction, Ireland still has the fourth highest household debt-to-GDI in the EU.

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\(^{15}\) The 133 per cent threshold was set based on the 75th percentile of the private debt ratios of EU Member States over the period 1995-2007.


\(^{17}\) Department of Finance (2019) An analysis of Private Sector Debt in Ireland [https://assets.gov.ie/7079/dlc2bj3bfcfd4dofpoeosc29b0c00c3.pdf](https://assets.gov.ie/7079/dlc2bj3bfcfd4dofpoeosc29b0c0c3.pdf)
Figure 8: Comparing Combined Debt of Ireland and Germany 2002-2017

Private Debt (financial corporations, corporations and households) – % of GDP

Non-Financial Corporate Debt (all instruments) – % of GDP

Household Debt – % of GDP for Germany, % of GNI* for Ireland

Government Debt – % of GDP for Germany, % of GNI* for Ireland

Source: Eurostat.
The management of government debt is facilitated by the ability of the State to access international capital markets, roll debt over and refinance it. The government is required to pay interest on the debt, instead of funding other public spending. This can become a significant financial issue if both interest rates and government debt are high. This is what happened in Ireland during the 1980s. This meant that a substantial portion of government revenue was used to service the debt and was not spent on public services or counter cyclical tax reductions.18

The 2011 revision of the Stability and Growth Pact (SGP) resulted in a more stringent framework for EMU States to change their budget deficit and debt to a more stable and sustainable trajectory over the medium term. These EU Fiscal Rules, specifically the Expenditure Benchmark (EB), limit the net growth rate of government spending to the medium-term potential growth rate of the economy.19

The EU fiscal rules also state that if the debt ratio is above 60% of GDP, the excess over 60% must be reduced at an average annual rate of 1/20th. The average speed of debt reduction is assessed in a backward-looking and forward-looking manner, in the context of the economic cycle. This could potentially promote reducing the principal of debt (and thus interest payments).

There are two general indicators of the debt, firstly, the absolute value of the debt and secondly the value of debt relative to the size of the economy, as measured by GDP, modified GNI, or other measures. Ireland’s experience of the debt reduction rule highlights a measurement difficulty. In recent years, Irish debt as a measure of the size of the economy, would indicate a very significant debt reduction, whereas the absolute value of the debt is consistently around the €200 billion mark between 2014 to 2018.20 This discrepancy can lead to complacency regarding the risks associated with government debt.

It is important to note that in response to the Covid-19 virus outbreak, the European Commission has relaxed the fiscal rules for Member States. Specifically the Commission will exclude the budgetary effects of one-off fiscal measures taken to counter the effects of the COVID-19 pandemic. The Stability and Growth Pact allows for these exemptions.21

The stock of debt grows every year by the average interest rate paid on the debt. If GDP grows faster than the interest rate, the debt-to-GDP ratio will fall. Conversely, when interest rates are above the economic growth rate, the ratio will rise. This also places more pressure on the public finances for sustaining the level of debt and interest payments.

Since 1971, there were fifteen years where economic growth was lower than short term interest rates. This mostly occurred during the 1980s and the Financial Crisis (2008-2010), where the interest rate exceeded the economic growth rate. Economic growth rates were higher than short-term interest rates for 30 years during this period, including from 1994-2007 and from 2011 to 2018.

**Figure 9: Economic growth and Interest rates**

![Graph showing economic growth and interest rates from 1971 to 2017.]

- **Nominal GDP growth**
- **Nominal short-term interest rates**
- **Nominal long-term interest rates**

*Source: AMECO.*
There are several risks associated with a high level of debt. While countries do not usually pay back debt, if investors fear that a country would not be able to meet its obligations, they could refuse to roll it over and refinance it. This could trigger a default and cut countries off from capital markets.

Furthermore, while advanced countries generally do not repay debt, they do pay interest on the existing stock of debt. A high stock of debt means a government will have to pay back higher interest payments. To fund these additional payments, governments may have to increase taxes or cut spending. Despite low interest rates, Ireland’s repayments on its debt are relatively high. In 2018, Ireland’s interest payments were 6.4% of government revenue. This was the fourth highest in the EU, see Figure 10.

**Figure 10: Interest payments as % of revenue 2018**

![Bar chart showing interest payments as % of revenue for various countries in 2018]

*Source: Eurostat.*

It is important to note that these interest payments are lower than what was expected. For instance, in Budget 2016, the cost of servicing the debt in 2019 was expected to be €6,654 million. Whereas in Budget 2020, the cost was recorded as €4,678 million. This is a significant saving for the government. If interest payments were as high (in 2018) as was expected in Budget 2015, interest payments would be 10.3% of government revenue.
Table 2 shows a consistent reduction in the projected cost of general government interest expenditure in the last five budgets. In the past, this has allowed the Government additional flexibility, and enabled more fiscal space for the Budget. In an event of a significant rise in interest rates, higher than anticipated, this could place some limitations on the public finances.

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<td>2020 Budget Forecast</td>
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Source: Department of Finance. Bold numbers in the table indicate final outturn figures.

While interest rates are currently low and have a long maturity, **there is potential that interest rates could rise over the coming years.** This would cause interest payments as a proportion of revenue to increase significantly. The current low interest rate period is unusual by historical standards.

Governments’ can run into problems if they are not able to meet interest obligations. If it borrows money to meet these payments, the country could enter a debt interest spiral. This is where debt continues to increase and eventually becomes unsustainable.

**To avoid these risks, government could implement a debt reduction target.** In November the Minister for Finance announced it would implement an 85% debt to GNI* target by 2025. However, this would not involve paying down debt. The stock of debt would remain at its current level. The ratio would simply fall because GNI* is forecast to grow by 3.5-4% over the coming years. All else equal, this would leave interest payments at existing levels. In future, failing to reduce the stock of debt could leave Ireland exposed to swings in interest rates.
The vulnerability of national debt is further compounded by the high level of international debt. According to the International Monetary Fund, global debt accumulates to $188 trillion, historically an unprecedented figure. This means debt is over 230 percent of world output. The public sector makes up around one-third of the total debt level and the private sector, households and companies, make up almost two-thirds of total debt.

Similar to Ireland, a factor in the high level of international debt was the financial crisis of 2008. IMF research has identified that governments support to financial institutions amounted to $1.6 trillion during the 2008 crisis. The example of the Financial Crisis and the Sovereign Debt Crisis in the Eurozone clearly highlights how a sudden catastrophic event resulted in countries increasing debt and having to implement fiscal consolidation measures. States that are now highly indebted could be more fragile to any shock that initiates an international and sustained downturn, as seen in 2008.

While the international environment highlights the risks, experience from other countries can also highlight the solutions to public debt. This includes macroeconomic and structural policies to stimulate economic growth as well as fiscal adjustment policies that aim to generate primary budget surpluses. Research on European economies’ experience of debt reduction suggests that fiscal consolidation measures such as reducing expenditure appear to be more effective than tax increases or limited fiscal adjustments. In addition, during periods of economic expansion, governments should adopt a counter cyclical fiscal strategy and aim for budget consolidation rather than providing tax or other fiscal reductions. This thinking perhaps can be seen in the EU programme for Greece where there are primary budget surplus targets for the country, even after the end of the assistance programme.

Furthermore, an investigation by IMF researchers into the determinants of significant debt reduction identified the key role of strong economic growth and large and lasting fiscal consolidation efforts, in terms of reducing expenditure costs and a favourable external environment in terms of strong growth in international markets. The other factors which provide fiscal discipline and assist in debt reduction are the initial level of debt, the cost of debt servicing and if there are fiscal rules governing the budgetary process. This investigation into the factors that determine the probability of a large debt reduction used a data set that spans more than four decades for a large sample of developed and developing economies. For Ireland as a small open economy, the role of international markets is important for growth and development, which in turn drives relative debt reduction.

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The COVID-19 virus outbreak and the dramatic economic restrictions will have a significant effect on the public finances. Given the unprecedented scale of business closures to prevent the spread of the COVID-19 pandemic, extra spending will be needed to help mitigate the impacts on individuals affected. This additional spending will result in a budget deficit in 2020. Lower tax receipts (e.g. income tax, VAT and excise) will result in an even larger deficit. This will cause debt levels to rise and depending on the duration and scale of the COVID-19 pandemic, this could be by a substantial amount.

Ireland currently has a high level of Government debt (in both international and historical terms). This problem is compounded by the fact that the other key sectors of the economy are also heavily indebted, including households, non-financial corporations and the financial sector. However, the government can currently borrow at low interest rates. It benefits from an ‘A’ credit rating from all three major ratings agencies. The NTMA has adopted a strategy of ‘locking-in’ low interest rates, lengthening the average maturity of the debt and reducing the share of variable rate instruments, resulting in lower interest payments. Furthermore, recent monetary stimulus from the ECB should reduce borrowing costs further. This puts Ireland in a better position to deal with the COVID-19 pandemic.