Marc Coleman

An Economic Response to COVID-19

April 2020

Integrated Thinking

OCTAVIAN *ECONOMICS*

ACKNOWLEDGEMENTS
The Author would like to acknowledge permission from the ESRI, KBC Bank and Central Bank to replicate in this report data from their publications and, also, contributions from the SME Recovery initiative, Isme and others, including Richard Curtin for timely assistance

The author would like to thank Ciarán Downey of One House Communications and Jeremy Murphy of JM Editing & Literary Agency for their essential contribution.

Particular thanks are recorded to the Embassy of New Zealand for its specific contribution in relation to measures taken in that country to combat the economic impact of Covid-19.

Contributions do not automatically constitute agreement with opinions contained in this report. Preliminary outlines of the report were shared with key policy stakeholders in the interest of information sharing and transparency.

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7 KEY TAKE AWAYS

1. Policy must aim - as far as possible – for a "V-shaped" and not a "U-shaped" recovery

Despite rapid external recovery in the last crisis, an emphasis on tax rate rises and lack of SME funding delayed domestic recovery by 3 years. To make recovery as "V-shaped" as possible SMEs need extensive funding to survive post lockdown and tax cuts must stimulate demand.

2. Two Budgets – specifically targeting SMEs/Taxpayers and Housing – are needed this year

We must hope for the best but prepare for the worst. As well as a welcome 2 per cent of GNI* announced to help tide business over the lockdown period, another 4 per cent of GNI* should be injected in a June 2020 budget to recapitalise SMEs and stimulate demand. SME funding and Central Bank liquidity measures are essential but insufficient. Demand "pull" must match liquidity "push". New Zealand's response provides a useful template of a balanced response.

An October 2020 budget, funded by borrowing, should devote 4 per of GNI* to housing investment. Given the urgency of recovery and housing, separate focused budgets are needed.

3. Fiscal strategy needs to prioritise a more vulnerable private sector with a focus on tax cuts

For every 1 euro of net tax cut between 2015 and 2020 government spending rose by 26 euro. With an external recovery less guaranteed now than in the last crisis, so to bolster business confidence in recovery domestic demand must be stimulated. Evidence from the last crisis suggest that signalling an end to tax rate rises stabilises tax revenues and aids recovery.

4. Our Government Debt levels remain a serious obstacle to recovery

At 100 per cent of GNI* Ireland's General Government Debt is some 15 per higher than would otherwise be the case had the Single Resolution Mechanism existed before the bank bail out. Given the need to stimulate demand, recapitalise the SME sector and invest in housing, Ireland needs more upward room for manoeuvre. The Central Bank forecasts that the crisis may push debt to 112 per cent of GNI* of its own volition. Government should negotiate with the EU a pragmatic resolution of this constraint (as well as flexibility to exceed deficit targets).

5. The Multinational – SME cooperation has a strong role to play in the recovery

The multinational sector has both contributed to and benefitted significantly from Ireland's economy. As well as to assist with the coming economic challenge, deepening the MNC sector's integration with the indigenous economy can broaden and help to immunise its fiscal employment and supply chain footprint and reduce fiscal vulnerability to the BEPs process.

6. Global coordination – particularly between fiscal and monetary policy – must improve

Just as the health fallout of Covid-19 would benefit from global coordination, so tackling economic impacts will benefit from global coordination of fiscal and monetary responses

7. Policy making must be diverse and proportionately reflect SME & Private sector experience

SMEs and private sector workers will bear the brunt of job and income losses in this crisis. Sustaining confidence in the fairness and balance of policy making and politics means policy makers whose decisions affecting them must come from diverse backgrounds. SME policy research and advocacy must be well resourced to ensure fair balanced narrative and debate.

Executive Summary

Chapter 1 Is a V-Shaped recovery possible?

To be as short in duration as possible, economic recoveries should give equal access to forces driving growth by maintaining broadly similar rates of taxation and spending priority.

The disparity in the last crisis between the rapid – almost "V-shaped" - recovery in higher value added multinational sector and the indigenous sector, more affected by tax increases – was marked.

The disparity between current expenditure, which actually increased over the 2008 and 2014 period and capital spending which decreased, was also marked and a key feature in failure to construct badly needed housing and retain tens of thousands of construction workers.

The current crisis sees the Indigenous Non-Sheltered sector in the most vulnerable position in terms of job security and earnings. This sector contributes the bulk of tax receipts to the exchequer.

A failure to help domestic SMEs and taxpayers delayed the recovery in the domestic economy during the last crisis. To make the next recovery as "V-shaped" as possible SMEs need immediate and extensive funding to sustain post lockdown activity in the face of global shocks and taxpayers need stimulus to restore confidence and spending. Funding supports alone without stimulus are of limited value.

Chapter 2 Setting the Scene

Compared to the last crisis Ireland's private indebtedness is significantly lower with total lending significantly below total deposits. Employment and exports and overall growth are also more diversified compared with 2008, when growth and employment were overdependent on domestic credit, construction and real estate.

A comparison with the impact of SARS on the Hong Kong economy (one with which Ireland shares significant similarities) suggests that rapid recovery on country "stand alone basis" is possible. However as a much more significant and globally widespread crisis, Covid-19 will have a greater and more lasting impact on the Irish economy.

The key barrier to adjusting fiscal policy compared to 2008 is that in 2008 Government Debt was 28.5 per cent of GNI* whereas it currently stands at 104.3 per cent. With forecasts (see Chapter 3) likely to raise this debt level by 10 per centage points or more under "no policy change" substantive policy action of the magnitude needed (see Chapter 6) could bring the debt to GNI* ratio up to or over the critical threshold of 120 per cent.

Both the impact of state injections to the banking system between 2008 and 2011 and subsequently crystallised into Ireland's National Debt by the liquidation in February 2013 of the Irish Bank Resolution Corporation (IBRC) and account for approximately 15 percentage points of GNI*, is a significant factor. The European Parliament ratification of the Single Resolution Mechanism in September 2013 – half a year after the liquidation of the IBRC - recognised the need to avoid taxpayer bank bail outs in future.

Even a partial retrospective application of this principle to Ireland's bank bail out could, if agreed, give significant room for fiscal manoeuvre in this crisis, enabling fiscal policy to action while containing Government debt to the 100 to 110 per cent GNI* region.

The magnitude of the bank bail out – over €30 billion – is considerably larger than measures proposed to assist the SME sector in Chapter 6 below. The latter are arguably more socially and economically needed.

A clear distinction is needed between responses to tackle "immediate" responses on one hand, and on the other to ensure a restoration of demand and activity in the medium to long-term.

Chapter 3 Public health responses and immediate economic impact

The response to Covid-19 has been characterised by a lack of global policy coordination with some countries, including Ireland, responding rapidly and decisively and others responding with ad hoc/adaptive approaches.

In countries with decisive responses – particularly with strongly technology and data analytic strategies – death rates are lower and there is some evidence of a possible peak in forthcoming two months. In countries with ad hoc/devolved approaches death rates are higher and uncertainty greater as regards peak time.

Ireland has a prospect of cases peaking in Q2 enabling an end to lockdown in that period. Even if this occurs however, differing responses in key trading partners could impart shocks to our economy in Q3 and Q4.

Immediate impacts already felt include

- An immediate rise in the de facto Unemployment total to 300,000 as approximately (at the time of writing) 300,000 registrants for the special pandemic payment join 200,000 on the Live Register.
- Job losses are occurring in those sectors where income is lowest and rose least during the recovery
- A dramatic fall in consumer confidence and exchequer revenues during March
- ESRI and Central Bank forecasts of GDP declines this year of 7 to 8 per cent
- ESRI and Central Bank forecasts of unemployment ranging between 10 and 11 per cent by end-year
- ESRI and Central Bank forecasts of a General Government Deficit of between €12 and €20 billion.
- A return of global stock markets to levels prevailing in late 2016 / early 2017

Analysis of the previous crisis, together with March 2020 exchequer returns and aforementioned forecasts suggest, in the author's opinion, a loss of €12 billion in taxes for 2020, give or take. This compares with a total loss between 2008 and 2010 inclusive of approximately €15 billion. This will result in a 2020 tax revenue take of approximately €47 billion which in the not too distant past would have been sufficient to meet public spending requirements while respecting Fiscal Treaty provisions.

The analysis above accounts for immediate impacts and data available to date and will require udpating. The situation may change in Q2 as the situation unfolds, either adversely or positively.

Chapter 4 Economic response: Dimension and Duration

At the outset a clear distinction is needed between four broad types of policy responses to this crisis:

- "Bridging" measures to preserve employment and cover additional unemployment payments
- Monetary accommodation by Central Banks
- SME recapitalisation measures
- Fiscal stimulus measures

Ireland's more globalised and open economy and the exposure to potential external shocks discussed above means that welcome "bridging" measures, while tiding us over the next quarter, will not address the high risk of falling global demand for our exports, not to mention the pressures of Brexit.

Nor will such measures recapitalise the SME sector – a sector already facing funding difficulties before Covid-19 – during a period of collapsed demand in which many non-labour costs must continue to be covered. Nor can monetary policy actions in themselves restore demand (they can certainly accommodate a restoration of demand) unless EU and Irish governments signals clear measures to restore domestic demand.

A comparison of other country responses show that monetary action is complemented by a comprehensive mix of not only "bridging" but also recapitalisation and fiscal stimulus measures. New Zealand provides a good illustration (see Inset on New Zealand section 4.3). While welcome, Irish measures recapitalise small business are significantly smaller than in other key peer countries. In addition to the need to recapitalise small businesses and stimulate demand, Ireland needs to address a housing crisis.

Ireland should therefore adopt a 2 budget approach in 2020:

- A June 2020 budget – should focus an aggregate 6 per cent GNI* package including the 2 per cent already mentioned (€4 billion on unemployment and employer supports) and complementing these with a further 4 per cent of GNI* aimed at recapitalising small business (2 to 2.5 per cent GNI* - see Chapter 6) and stimulating demand (1.5 to 2.0 per cent GNI*).

- An October 2020 budget should – funded by capital borrowing as negotiated with our European partners – provide for a further 4 per cent of GNI* (approximately €8 billion) investment in housing through a mix of public, cooperative and tax incentivised private provision.
- The budgetary and debt implications of the June 2020 budget as proposed are discussed in Chapter 6. The debt implications of the October 2020 budget should be resolved through negotiation with the EU and this is discussed in Chapter 7
- Both budget should be seen as "Emergency phase" (2020) measures that will speed up the arrival of the "Recovery phase" (2021) and "Normalisation phase" (see Figure 4.3.1)

Chapter 5 Economic responses: Design and Delivery

Analysis of fiscal policy during the 2008-2014 period suggests that initial attempts to raise revenue through tax rate increases were at best limited in success and possibly counterproductive. Analysis in particular of developments in 2010 suggest that the signalling of an end to tax increases in December 2009 led to a tax overshoot, rising consumer expectations and a stabilisation of the unemployment rate.

These positive trends in the first half of 2010 were reversed and in the ensuing year tax underperformed against expectations, consumer expectations declined and unemployed resumed its rise. Contrary to popular narratives, the recovery was not characterised by tax reductions in net terms. Compared to a €16 billion rise in government spending over 2015 to 2020 net tax reductions as measured by successive Budget day documents was just €0.7 billion. Thus for every euro of net tax cuts, spending rose by 26 euro in spite of parties winning a plurality of vote in 2011 and 2016 general elections promising a 1:1 ratio i

In line with popular narratives, the multinational recovery was much stronger than the indigenous recovery. Compared to a 205 per cent in net exports between 2015 and 2018 and a 66.3 per cent increase in GDP, for instance, Household consumption rose by just 20.4 per cent.

Given that a key factor limiting enterprise growth is the outlook for the domestic economy, the above points to a clear conclusion: Budgetary priority should achieve a retrospective rebalancing of fiscal policy in a manner that, as suggested strongly by evidence during the crisis, restores demand and confidence

Chapter 6 A Budget for SMEs and Households

As evidenced by the lesser growth in earnings and activity not to mention the challenges of funding and Brexit facing the SME sector , both households and SMEs are already facing significant challenges even aside from Covid-19. As shown by last year's Seanad report on the SME sector, it accounts for 99.8 per cent of active enterprises and is 93.6 per cent Irish owned with high representation in Covid-19 exposed sectors.

While some welcome supports are available they are difficult to navigate. And as a planned event for 30 January 2020 showed, the policy making system's understanding of what the SME sector needs is often determined and decided without adequate representation to the sector.

To tackle these and new challenges a "Budget for Households and SMEs" should take place in June 2020 so that both urgent recapitalisation measures can be channelled to the sector once the lockdown ends and that the domestic demand essential to give business the confidence to invest can be secured and signalled in time to facilitate in time for Q3 the investment decisions needed to preserve employment and business viability. The budget add 4 per cent of GNI* to measures taken so far and be split between recapitalisation and stimulus. In relation to SME recapitalisation this should target

- Recapitalisation measures extending significantly the role of the SBCI (in line with the extension of the role of the Kreditanstalt fuer Wiederaufbau) with €4 billion in funding for a "Business Reactivation Funding Scheme"
- This should enable unsecured loans for up to €500,000 with no repayments 12 months and interest only payments for a further 12 months (through "emergency" & "recovery" phases (Ch 5)
- In addition, there should be cost flexing of certain costs and measures to facilitate staff redeployment during the crisis as a means of assisting the preservation of jobs
- The relaxation of EU state aid rules should encompass as far as possible a "Buy Irish" procurement strategy so that additional health spending has the maximum positive economic ipact

In relation to economic stimulus this should constate a range of tax reductions to both rebalance the lack of net tax reduction despite the recent recovery but also to stimulate domestic demand and tax revenue growth. The potential for Income Tax cuts, mortgage interest relief restoration (to tackle also the housing crisis), cuts to Employer's PRSI, VAT, CAT and others should be assessed on an evidence-based approach. By stimulating demand in sectors left behind by the recovery these may be partly self financing

Chapter 7 A Budget for the Housing Sector

As well as a looming demand crisis, Ireland must address a housing crisis. It is important that both receive specific and targeted attention in two separate budgets, so that policy responses are effective and focused. The "Budget for Housing" is equally important but not as urgent as responding to Covid-19 and so should be the focus of the October Budget. It should be financed

Chapter 8 Conclusion

The crisis will hit worst those sectors of Ireland's economy that

- Are arguably the most underrepresented in policy narratives and debates
- Suffered the most during the last crisis
- Benefitted the least from the recent recovery and arguably from fiscal policy during recovery
- Are most essential to overall job creation, tax revenues and regional economic well-being

As well as rectifying recent policy imbalance, a focus on stimulating Households and recapitalising Ireland's SME sector will help to secure not just confidence in the economy, but confidence in the fairness and relevance of a policy making system that has tended to underrepresent the voice of taxpayers and SMEs who are too busy surviving and creating jobs – and too underfunded – to defend themselves. There must be a permanent improvement and resourcing of SME policy advocacy.

In line with successful gender diversity strategies a similar far greater inclusion in the senior echelons of policy making, in media representation and amongst membership of Oireachtas to rebalance policy making

Chapter 1

Is a V-shaped recovery possible?

This book must commence with a caveat: Assessing the impact of Covid-19 on the global economy is a daunting one to which this publication can only constitute a preliminary but hopefully useful contribution. Further research – and more data – is needed to understand the full implications. But while saving lives is a far higher priority than containing economic damage saving livelihoods and economic well-being matter also.

Negativity deepens an economic crisis and incorrect policy response and inflexible responses prolong it. The function of the paper is practical and both one-page digest of Key Take Aways and a three-page Executive Summary enables the reader to quickly digest its key conclusions. Finally, this report is not a forecast – under the circumstances of urgency and time pressure the author deems it wiser to leave this task to official institutions such as the ESRI and Central Bank so as to avoid duplication. Rather the report aims to make constructive complementary use of forecasts published to date in setting out scenarios. The author intends to update it in June as more data becomes available. Necessarily strategic, the report does not address several pressing issues facing the economy (insurance costs) and gives generic outlines of others (funding). It is intended to be an immediate strategic response on which to base later, more focused and tactical research and more detailed policy proposals. But by giving a strategic overview it will hopefully assist policy formation in time for the formation of a government and help to prioritise subsequent policy analysis and action.

Compared to prolonged nature of the last recession the national objective must be to ensure the coming recession, the development of the Covid-19 crisis permitting, is as short and symmetrical as possible. The last recession took seven years to complete. Perfectly symmetrical recoveries are non-existent. But a faster recovery of domestic demand was possible. Under benign conditions the worst aspects of the forthcoming crisis could in theory subside or be substantially ameliorated within a two year period, with a further year of normalisation. The "V" aspect of this that, while the recovery will take longer than did the initial decline, there would at least be no relapse after activity resumes, global conditions permitting.

1. Due to the rapidly changing situation in relation to Covid-19 cases and deaths, data for this (Figure 3.1.2) is reported up to a later date of 5th April 2020.

As chapter 2 explains, Ireland's multinational sector experienced this aspect of a "V-shaped" recovery. But the domestic economy did not. Understanding why and rectifying this is central to overcoming the Covid-19 challenge to the economy.

Compared to the multinational sector, which apart from a brief respite in chemical and pharmaceutical exports in 2013 did not look back once the corner had been turned in the second half of 2009, the domestic and particularly the more vulnerable service sectors of the economy suffered significantly longer.

The ensuring part of this chapter compares and contrasts the very divergent experiences of different sectors of the economy between 2008 and 2014 and, noting the recent election, highlights the need to ensure a more balanced and evenly spread burden of correction and strategy for recovery.

This publication does not ignore immediate and pressing challenges that are more microeconomic if not managerial in nature, but which are of utmost importance in determining macroeconomic outcomes.

For as long as the lockdown persist, macroeconomic activity will be held down. Therefore, as fast an end to the lockdown as is possible without compromising public health is imperative.

As Chapter 2 discusses, Ireland and key trading partners are likely to have divergent peaks of Covid-19 incidence and this will result in different timings of economic shocks in export demand and financial market impacts.

The latter is already impacting on asset valuations through recent share price declines. Further secondary asset price impacts on housing markets, company and bank balance sheet valuations will also have profound impacts. For this reason the importance of coordination not only in handling the forthcoming economic challenge but the more immediate challenge of coordinating and resourcing testing, analysing test data with data analytics and reducing contagion – and ensuring adequate treatment – are important not just for overriding human, but also pressing economic, reasons:

Without a speedy resolution of the medical crisis, the lockdown will lengthen with more damaging economic consequences.

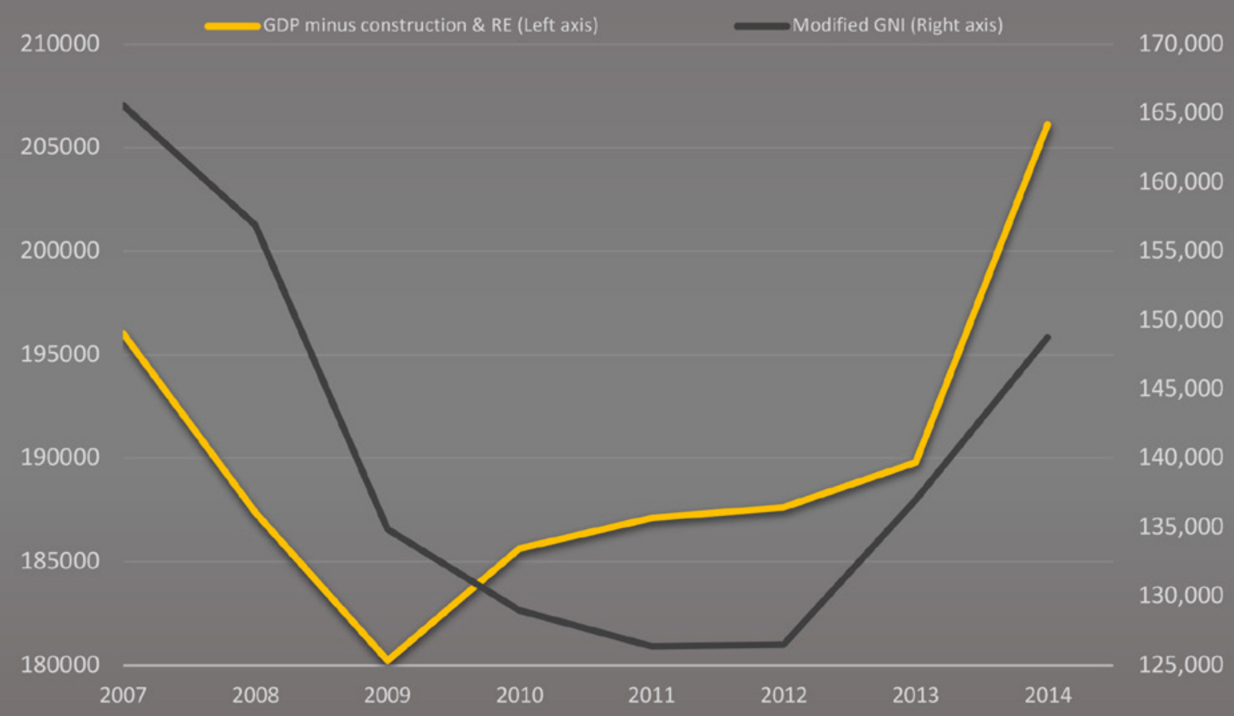
Sadly, we are in an age of less policy coordination than was the case when the 2008 crisis struck. The government can use to use Ireland's reputation as a – still - stable and cohesive political economy to appeal for enhanced policy coordination on a global crisis to call for increased EU and global coordination on both medical and economic aspects of the crisis.

V versus U shaped recoveries

Recessions are, over the long term, inevitable. When they happen, they are never welcome. But when they happen policy makers should work to ensure they are as short-lived as possible, and that recovery restores as much economic activity to as many affected sectors as possible as quickly as possible.

Figure 1 shows clearly that this was not the experience during Ireland's last recession. However, this figure also shows how a "V shaped" recovery was, in theory, possible.

Figure 1.1 V versus U-shaped recovery



By contrasting GDP excluding the distressed construction and real estate sector – which reflects the success of the multinational sector in rebounding quickly on the back of export growth from 2009 onwards – with a more domestic measure of economic output, Gross National Income, the divergence between the performance of Ireland's multinational driven economy on one hand and more domestic economy is starkly revealed.

As the yellow curve shows, the former achieved something close to a "V" shaped pattern, with output rising quickly from 2010. By contrast after a brief and limited false dawn in 2010, GNI fell back and remained depressed until 2013. This outcome was not necessary and fiscal policy could have prevented this outcome in two ways. Firstly, spending policy could have been targeted at more employment enhancing activity.

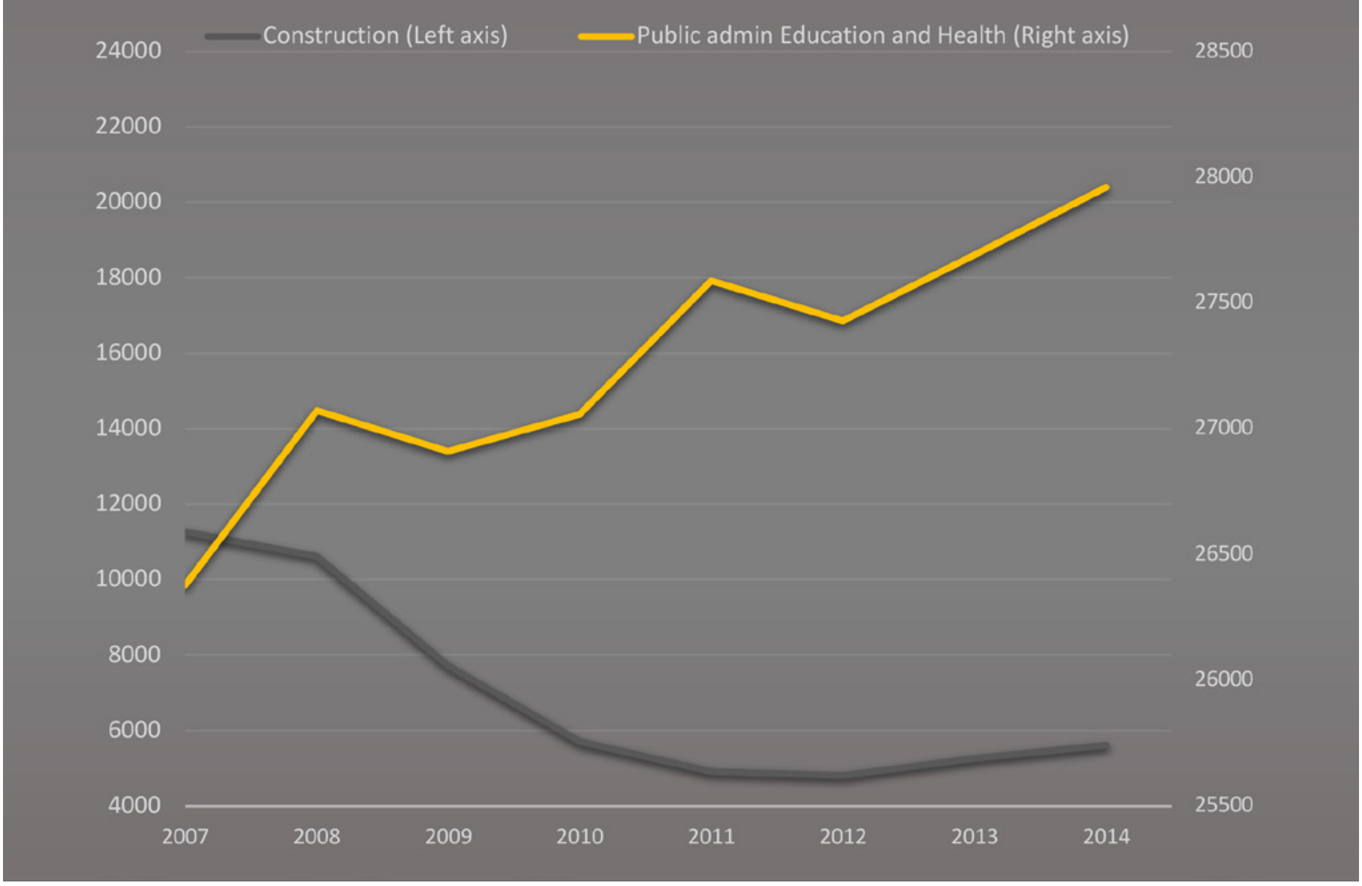
Secondly the balance of tax and spending could have been more supportive of vulnerable sectors of the economy. These two points are of crucial importance to the current crisis – and to its interaction with Ireland's housing crisis (see chapter 6) – and are discussed below:

Divergence in the non-traded sector

As Figure 2 makes clear, in terms of fiscal policy priorities, a policy of prioritizing capital over current spending to fund long-term planning and investment in housing and construction - as was advocated at the time (Coleman, 2009) – could have led to a more even distribution of impacts within the non-traded sectors of the economy. Of the two non-traded sectors most influenced by fiscal policies – Public Administration

Education & Health and Construction, vast difference in performance between the former actually grew by 6 per cent over the period of recession while activity in Construction fell by a staggering 50 per cent.

Figure 1.2 Public Administration and Construction sectors



From just under €10 billion in 2008, or 5.3% of GDP, the level of Government Investment in the economy fell to just over €4 billion in 2014 and has still not recovered to 2008 levels despite a chronic housing crisis.

The fact that average annual earnings in the construction sector over the 2008-2014 period (€36,376.57) were on average 28 per cent below average earnings in the sector sustained directly by current government spending (Public Administration Defence and compulsory social security (€46,440)) implies that greater capital relative to current spending would have been more employment friendly by a factor of over one quarter.

The magnitude of the collapse in construction sector activity and the failure to counteract it until recently is – apart from being a key cause of the housing crisis – is instructive in terms of illustrating the impact of policy choices on the sectoral distribution and employment impacts of this crisis.

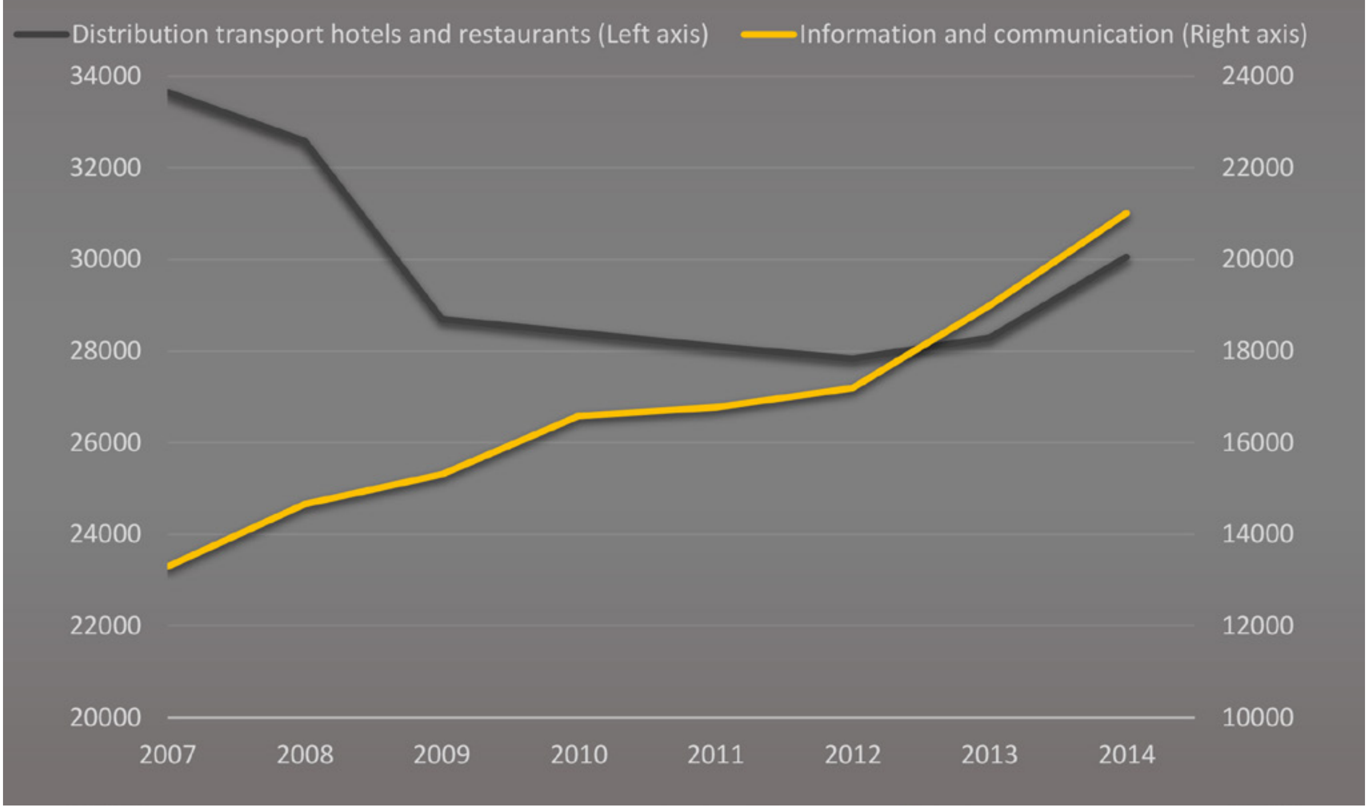
It might be noted that with a lag of a decade, this policy decision has impacted with profound consequences at the last general election as the housing crisis disrupted and has possibly destroyed forever a model of political representation that has dominated the state for over a century.

The result of that disruption is that the stability of policy making itself if affected in ways that feed back into the economy. Between 2008 and 2014 there were at least government's with strong majorities – Fianna Fáil from 2008 to 2011 and Fine Gael and Labour from 2011 to 2016. That even these majoritarian government could not grasp the long-term importance of housing investment, not to mention the immediate need to preserve jobs in the construction sector, is worrying.

Public expenditure, contrary to widespread understanding, actually grew in overall terms between 2008 and 2014. Significant improvements in efficiency in public spending were achieved (Coleman & Ralf, Ireland and Germany Partners in European Recovery, 2013). Both efficiency and effectiveness issues persist as shown in the case of the recent Children's Hospital. By contrast cost control and rapid efficiency and effectiveness drives are already been undertaken as part of the private sector's reaction to the Covid-19 crisis. Even with announced government measures to date, severe austerity is a reality for the private sector and for some sectors of the private sector remained so even during the recent recovery.

Divergence in Traded sector

Figure 1.3 Domestic & Multinational sectors



The divergence between the multinational and indigenous traded sectors during the crisis was also significant. The largely indigenous "Distribution, transport, hotels and restaurants" sector – the sector most immediately impacted by the current crisis – also saw a prolonged "U-shaped" recession lasting from 2008 until 2014 and was one of the last sectors to finally emerge from recession.

By contrast the more multinational "Information and Communication" sector saw constant growth during the crisis.

In fact, it is interesting to note the diametrically opposed impacts of the recession on this latter sector on one hand, where activity grew by 58% between 2007 and 2014, and on the other Construction where activity declined by 50%.

Just as divergent demographic experiences in relation to the housing market impacted on the recent general election, significant sectoral divergences of the coming crisis could impact severely on politics and policy making capacity.

Policy responses and their impact

Most economies have announced some package of measures to counter the crisis. Likewise, central banks and other international bodies have announced policy responses. Given the urgency of the crisis these are likely to focus on specific constituencies and sectors with less of a consideration on their macroeconomic adequacy.

The longer the duration of the crisis, the more likely the impact on the economy will spread beyond short-term sectoral impacts and into the macroeconomy at large. If the crisis persists into Q2 more consideration will have to be given to impacts beyond necessary fine tuning of sectoral reactions (small business sector, retail and travel and so on), and more on whether initial policy impact is adequate to stave off a significant slowdown in the second half of this year.

Here the case for taking a "pre-emptive" rather than a "wait and see" approach to fiscal policy needs to be examined. Consideration is also needed in relation to the coordination between monetary and fiscal policy. Without market anticipation of a sufficient fiscal effort, monetary policy measures may under assumptions of rational expectations fail to have a significant impact.

That their room for manoeuvre has been lessened by a failure to recalibrate monetary policy during recent years of recovery also bears referring to. And in times of growing political fragmentation, political economy considerations are now paramount: Policy stances which fail to distribute the burden of adjustment fairly may lead to political effects that in the medium to long term – and possibly the short term – worsen a political economy that in much of the western world is already distressed by the fallout from the last crisis. This book will examine the extent to which Irish policy making has been sufficiently diverse.

Key disparities between Multinationals and Indigenous and Sheltered and Non-sheltered Indigenous sectors

Two strong characteristics of the Irish economy must be noted going into the crisis.

Firstly, the relatively much higher profitability, value added and low tax intensity (compared to share of exports) of the multinational sector.

Secondly, the relatively high levels of income in the sheltered compared to non-sheltered sections of the indigenous economy. These are illustrated below in turn.

Multinationals and Indigenous sectors

The disparity in Ireland's GDP growth between 2015 and 2019 inclusive, some 62 per cent, and a still respectable but much lower 36.7 per cent growth for GNI* over the same period underlies the disparity between the multinational and indigenous economies of Ireland.

As noted by (Siedschlag I, 2017) "Among all EU countries Ireland stands out with respect to the contribution of affiliates of multinational firms who, in comparison to indigenous firms and in general, are more innovative, more profitable, have far greater access to funding, pay higher wages and salaries and are clustered around urban centres. As noted in Chapter 6 (section 6.1) the indigenous SME sector is in many respects in the opposite position, with less capacity to innovate in the face of change, less profitable, poor access to funding, lower wages and salaries and a significant presence in rural Ireland which depends upon it for employment.

Figure 3.2.2.C (Chapter 3) shows how average earnings in two of the more multinational sectors in 2018 (Information and Communication at €52,263 and Professional, Scientific and Technical sector at €44,269) were well above more indigenous sectors. This study also notes that Ireland's share of multinational contribution to Gross Value Added, 56.2 per cent, is the highest in Europe.

However, the share of employment as noted by the IDA, 21 per cent, is significantly less than this. Likewise, while constituting a very significant share of corporation tax receipts, the multinational sector's fiscal and employment contribution might be said to be low compared to its much larger share of output, value added and exports.

This is not to advocate any increase in the rate of corporation tax. But rather to highlight the need to look at the opportunity to integrate the multinational sector more closely into the indigenous SME sector so as to increase the indirect supply chain contribution to overall employment in the economy, to widen the impact – again through the same indirect channels – widen and consolidate the stability of its fiscal contribution.

As Figure 1.4 illustrates while the entirety of the multinational contribution to Ireland is welcome, the gap between the 11 per cent employment share and 56 per cent share of Gross Value Added is a wide one the closing of which could both normalise the profile of the multinational sector's contribution to – and deepen its roots in the economy.

In doing this it could in turn reduce the vulnerability of the overall tax take to the multinational sector moving to reduce dependence on potentially volatile multinational corporation tax receipts. This would address a potential short fall estimated by the Irish Fiscal Advisory Council to lie between €2 billion and €6 billion in annual revenues).

Figure 1.4 Profile of Multinational sector contribution to the economy

Current market values	**Growth between 2015 and 2018 inclusive (% change)**
Share of Employment	11 %
Share Income tax and USC	21%
Share corporation tax	80%
Share of Gross Value Added	56%
Spend in Irish Economy	€21.5 billion (11% GNI*)
of which Payroll	€13.3 billion
of which Materials	€ 2.6 billion
of which Services	€ 5.6 billion

Sources: IDA, Department of Finance, ESRI, Pre-2020 Pre-Budget 2020 Parliamentary Budget Office Commentary

Sheltered and Non-Sheltered indigenous sectors

The Parliamentary Budget Office's pre 2020 budget analysis notes the rising burden of spending on sheltered sectors of the economy on the Budget (and also refers to the unwelcome bias in favour of capital spending mentioned above). In Chapter 3 and specifically Figure 3.2.2.C it is made clear the Non-sheltered sectors of the economy which have already been severely affected by this crisis are ones in which incomes are significantly below average, well below those in the sheltered sectors of the economy and saw little growth, if any, during the recovery.

Annual average earnings in the Accommodation and Food Services sector, for instance, at €17,768 in 2018 was 0.6 per cent lower than in 2008. Likewise, earnings in Arts Entertainment and Recreation, at €24,312 in 2018, was 3.0 per cent lower than in 2018. By contrast, even including social welfare earnings, Public Administration and Defence and Compulsory Social Welfare earnings were at least €47,308 and higher if social welfare is adjusted for. Chapter 6 advocates a reduction in the VAT rate on the hotels and restaurants sector for the duration of the crisis and, thereafter, the restoration of the lower 9 per cent rate which was successfully introduced during the crisis. The foregoing analysis shows that this would help effect a socially just redistribution towards helping jobs in a lower income more vulnerable sector of the economy.

Austerity is already a reality in the private sector where hundreds of thousands of jobs have disappeared within the space of less than a month. Many of these jobs may not be restored, regardless of the policy measures taken to counter the crisis. But the extent to which jobs can be restored will be dictated by the ability of the private sector to "flex" its costs downwards to cater for decreasing demand. Taxation pressures both direct and indirect a huge element employer's PRSI local authority rates are a significant cost input.

Figure 1.5

	Sheltered	Multinational	Indigenous Non-Sheltered
Income level	Above average	Above average	**Below average**
Fiscal status	Net recipient of tax revenue	**Net contributor to tax revenues**	**Net contributor to tax revenues**
Vulnerability to job loss, income loss	Low or non-existent	High	**Very high and immediate**

Finally, Figure 1.5 summarises the situation facing these three sectors of the economy. In the sheltered sector incomes are above average (according to CSO data), the sector is a net recipient of tax revenue and vulnerability to job or income loss is low or non-existent. In the multinational sector incomes are above average. There is a vulnerability to job loss but this is likely to be far less immediate given the larger size and financial resources noted in (Siedschlag I, 2017). And this sector is a significant net contributor to the exchequer as noted above although it's employment intensity is lower than its export share). By contrast the indigenous Non-Sheltered economy contributes the bulk of the non-Corporation tax take and is a significant net contributor to the exchequer, has below average earnings and a high vulnerability to the crisis with already a very high rate of attrition in terms of job losses and business closure. In the its response to the crisis, policy must take account of these marked differences.

i This figure is likely to be understated in terms of averages wages in the public sector given the inclusion of social security payments. An adjusted, higher figure – beyond the scope of this report - would likely result in a higher average for Public Administration and Defence and consequently, a lower employment intensity of current government spending relative to capital government spending.

Chapter 2

Setting the Scene

2.1 Battle ready? The Irish Economy now compared to pre-2008 crisis

Compared to the onset of the last crisis in 2008, the preparedness of the Irish economy for a crisis is mixed. The obvious challenge is a significantly higher level of debt as a share of the overall economy as shown in Figure 1 (expressed as a share of Modified Gross National Income).

Figure 2.1 Ireland's pre-crisis "battle-readiness", now and 2008 compared

	2007	**2018**	**Change**	**% Change**
Economy and Government Finances				
GDP	197,202	324,038	126,836	64.3%
GNI*	165,560	197,460	31,900	19.3%
Government debt % GNI*	28.5%	104.3%		
Government deficit % GDP	0.3%	0.1%		
Private sector credit				
Total lending to private sector	148,136	89,948	-58,188	-39.3%
of which for House purchase	123,722	75,722	-48,000	-38.8%
of which for other pers. use	24,414	13,993	-10,421	-42.7%
Total Deposits	78,687	98,083	19,396	24.6%
Lending as % Deposits	157.2%	77.2%		
Structure of economy & external balance				
Personal consumption % GNP	55.5%	42.3%		
CA Bal % GNP	-6.5%	10.6%		
Net X-M % GNP	9.6%	42.4%		
Net govt current spend % GNI*	17.3%	16.3%		
Labour Market				
Employment	2,233,900	2,361,200	127,300	5.7%
of which Part time	415,300	492,000	76,700	18.5%

Source: CSO, Central Bank 2018 data is used to enable consistent comparison of full year data except for Labour market

* Data for Labour market statistics taken for Q4 2007 and 2019.
Private sector credit data for Dec 2007 & Dec 2018

By contrast private sector indebtedness is significantly lower now than compared to 2007. As a share of bank deposits (which have risen €20 billion or 24 per cent since 2007), total lending to the private sector has halved from 157% to 77%, a fall of €48 billion.

Personal lending (non-mortgage) is down €10 billion, a fall of 42.7%. Overall, therefore, the private sector starts the crisis in a better financial position to withstand the crisis but is likely to face a more serious challenge in terms of the extent of job loss and while the economy is now far less dependent than in 2008 on domestic credit growth, this situation may alter rapidly as debts accumulate during the period of lockdown and beyond.

The economy is also less dependent on domestic consumption and more dependent on external demand. From just 9.6 per cent the balance of exports over imports, 9.6 per cent of GNP, has risen to 42.4 per cent reflecting the increasing success of Ireland's export oriented economic model in recent years. (Note that GNP rather than Modified Gross National Income (GNI*) is used as the base to facilitate comparison with external (net export and current account balance) data. Using GNI* would alters the position somewhat in showing more modest declines in personal consumption and net government spending).

Notwithstanding the higher level of government indebtedness, net government spending plays a modestly lower role in the economy now than in 2008, accounting for 16.3 per cent of GNI* compared to 17.3 per cent in 2008. This is in spite of significant increases (see Chapter 5) in government spending during the recovery and may relate to the design of public spending (see Chapter 1)

Combined with the low level of public investment and the need for housing, this would suggest a strong case for stimulating the economy through greater public investment (public investment has yet to be restored to levels prevailing in 2008 and remains well below the 5% of GDP level sustained in the years leading up to the last crisis). The higher level of public indebtedness would seem to present an obstacle.

Here it must be remembered that a key reason for this was the assumption in February 2013 of €38 billion debt of the Irish Bank Resolution Corporation, relating to the bail out of corporate bondholders via the Exceptional Liquidity Assistance lending facility to Ireland's banks (see Annex II)

The subsequent agreement by the European Council to the Single Resolution Mechanism recognised the principle of "bailing in " of bondholder debts. But this was not retrospectively applied to Ireland's bail out.

Confronted now with mass unemployment on a scale experienced during the last crisis (see chapter 3), the labour market at least began this crisis with 127,000 more people employed in the economy. Thus, the rise of approximately 300,000 in the numbers unemployed during end March and early April notwithstanding, there still remain approximately 2 million people in working for a population of 5 million, a ratio of 40 per cent employed.

The last recession saw a significant rise in the numbers in part time employment and this recession may see a similar trend. This presents obvious challenges in the longer term, given recent signals from the last general election in relation to access to the housing market.

2.2 Hong Kong 2003: A case study relevant to Ireland

The Covid-19 pandemic is significantly greater than the SARS crisis of 2003. The latter resulted in 8,422 cases and 916 deaths (Hanna, 2004) while at the time of writing the Covid-19 pandemic is heading for a half a million cases and between 20,000 and 25,000 deaths.

However key similarities between Ireland and Hong Kong economies make an analysis of the impact on SARS informative. Theses impacts have been analysed by several studies for example (Siu & Wong, 2004), (Hanna, 2004) and (Warwick, 2004).

The fact that the SARS crisis was more concentrated in the Guangdong and Hong Kong "Greater Bay Area" makes the differences in the number of cases less of an obstacle to meaningful comparison: At the time of writing the number of cases in Ireland is still comparable to the total number of SARS cases recorded in Hong Kong (Hanna, 2004).

In addition, the duration of the crisis, from an initial identification of the SARS virus in Guangdong in February 2003 to the declaration by the WHO that the spread of the disease had peaked the following July, looks like a plausible scenario for Ireland, assuming containment measures are successful.

We need to be clear however that the economic impacts of Covid-19 are significantly more serious. SARS impacted merely 29 countries and resulted in a total number of 8,422 cases and 916 deaths (Siu & Wong, 2004). At the time of writing the number of deaths worldwide from Covid-19 is already more than double the total number of SARS cases recorded for the duration of the crisis.

Figure 2.2.1 Comparison of pre virus crisis economic performance Ireland (2019) and Hong Kong (2002)

	Ireland 2019	**Hong Kong 2002**
GDP growth (real)	4.1%	2.3%
Domestic demand	3.8%	-1.3%
Government deficit % GDP	0.0%	-4.9%
Unemployment	5.4%	7.3%
Revenue as % GDP	26.0%	14.0%
Current account balance	7.9%	17.5%

Source: IMF Article IV Staff report, Dec 2019

Compared to Hong Kong in 2002 before the SARS crisis struck, Ireland's economy compares favourably with that of Hong Kong as Figure 1.2.1 shows.

Ireland's GDP growth significantly higher, robust domestic demand growth and a balanced budget compared to Hong Kong's deficit (consolidated government balance) at the time of 4.9 per cent of GDP.

Government revenue as a share of GDP in Ireland is also significantly higher at 26.0 per cent, indicating a greater capacity to divert spending to support the domestic economy. While not as strongly in surplus, Ireland's Current Account Balance is healthy.

Several authors (Hanna, 2004) (Siu & Wong, 2004) note the importance of key variables in determining the relative speed with which SARS was transmitted in Asia during 2003. These were favourable factors in enabling Hong Kong to quickly tackle the crisis and included:

- Level of GDP per capita
- Quality of Healthcare and Sanitation by international standards
- Quality of public governance (rapid action to contain the spread of virus)
- Population density
- Degree of travel and tourism

As Figure 1.2.2 shows Ireland shares Hong Kong's favourable characteristics and has the added advantage that compared to Hong Kong's very high (even by Asian Standards) population density (8 million people in an area the size of county Dublin) Ireland has a very low population density. And while Ireland has a high rate of visitors (an estimated 11.2 million in 2019) this is significantly less than the 66.4 million visitors to Hong Kong in 2019. And like Hong Kong in 2003 (and unlike some European countries) Ireland has acted quickly to contain the virus.

Figure 2.2.2 Comparison of economic models, Ireland and Hong Kong

	Ireland	**Hong Kong**
GDP per capita	Very High	Very High
Exchange rate	Fixed	Pegged
Openness of Economy	Very High	Very High
Degree of travel & tourism	High	Extremely High
Language of business	English	English
Legal system	Common Law	Common Law
Foreign Direct Inv % exports	Very High	Very High
Quality of Healthcare Sanitation & Governance	Very High	Very High
Population density	Very Low	Very High

The key channels through which the SARS epidemic impacted on the Kong Kong economy included the following (Hanna, 2004)

- A reduction in retail sales over Q2 (10 per cent) and Q3 (5 per cent) of 2003
- A reduction in FDI of 30 per cent in Q2 2003
- A fall in exports of 5 per cent in Q2 2003 and 10 per cent in Q3
- A rise in government spending of 7% in both Q2 and Q3

In the main, the impact was sectorally concentrated in retailing, inward tourism and restaurant and some temporary impact on foreign investment, mainly due to delays.

Stock market impacts were limited in size and duration and had largely subsided by Q3, by which time the WHO had declared that the SARS epidemic had peaked.
In all studies surveyed the final impact on GDP – a reduction of 0.5 per cent – was significantly lower than forecast at the time.

Hong Kong's highly open, flexible, low tax adaptable economy ensured a "V-shaped outcome" with GDP actually growing by the end of 2003, up more than 3 per cent on the year previously (although slightly lower than it would have been in the absence of the epidemic).

Conclusions

Key differences with 2003 must be noted at the outset.

Firstly, the Covid-19 epidemic is significantly greater in extent than SARS. Were it not – or if the pandemic can be quickly contained in countries with which we trade and do business - the evidence above suggests that Ireland could potentially confine impacts to the immediately impacted sectors, limiting any macroeconomic damage.

As it is global macroeconomic impacts are not just likely but inevitable and the only question is the magnitude of their duration. These and their capacity to turn immediate localised and sectoral effects on job loss and consumption into a more widespread and self-sustaining slowdown are the subject of chapters 2, 3 and 5.

The risk of this is medium to high at present and this risk level needs to be assessed at regular intervals so that the need for action supplementary to action taken already (as outlined in Chapter 3) can be assessed in terms of desirable timing and magnitude.

Secondly the extent of the lockdown in Ireland is far more substantive and with a much more far reaching sectoral impact than measures taken by the Special Administrative Region in Hong Kong.

Thirdly, as noted by (Siu & Wong, 2004) 2003 was an era of strong global policy coordination. While Ireland's economy is more diversified and open now than then, and while there is significantly more international travel now than then, global policy coordination is significantly weaker.

Fourthly compared to 2008 major world economies have significantly less fiscal room for manoeuvre due to the legacy impacts of the last crisis and, due to a failure to recalibrate monetary policy interest rates, less monetary policy room for manoeuvre.

These facts accentuate the likely impact a prolonged medical crisis will have on the world economy. In Hong Kong in 2003, the worst of the contagion was over within two months of reportage.

This report has been published in mid-April. The evolution of the virus and public policy responses to contain it over the coming months will be decisive in determining the level of challenge we face from then on.

2.3 Impact time horizons: Immediate, secondary (medium term) and third round (long-term) effects

Before moving on to the next chapter, a conceptual differentiation is needed between the immediate impact of the crisis and more medium to long term decisions.

This differentiation is key to grasping (a) how government decisions to limit the human impact of the spread of Covid-19 are impacting on the economy (b) how the duration of those decisions influence the transition from impacts that are largely microeconomic, sector-specific and reversible with relative speed on the one hand and, on the other, more durable, macroeconomic and systemic effects that require larger scale responses.

The content of the next chapter and the final concluding sentence of this chapter is probably the most important statement in the entire book: The design and duration of the strategy to contain the medical impact of Covid-19 will determine the length of the lockdown, the impact on the economy, and the economic and social consequences to come afterwards.

Chapter 3

Public health response and immediate economic impact

3.1 Design and duration of Responses

The crucial importance to the economy of Ireland in ensuring that crisis measures are as short in duration cannot be overstated. Like recessions, virus pandemics should meet with swift, professional and thorough responses.

Unfortunately although there is a greater understanding of the need for prompt action in relation to policy action to stem economic effects – as evidenced below by the number of countries that have announced decisive early stage fiscal interventions and as evidenced by the quick reactions of the world's leading central banks – the medical response to the crisis has not been as coordinated or consistent.

In the limited time available to conduct an analysis of responses globally, stylized facts from five selected countries representing a spectrum of rigorous response – with China at one end and Italy at the other – are presented below in Figure 3.1.1 in terms of two key dimension of policy response.

One dimension relates to the duration of the pandemic from first detection to wind-down (and only one country, China, has reached wind-down stage). The other relates to the rigour of response by governments.

The duration is broken down into four rough stages 1. "Detection" – the period between the first case detected by the WHO and the formulation of a government response; 2. "Policy response" – the formulation of policy response; 3. "Policy implementation" and 4. "Wind-down".

The rigour of government response is characterised according to whether it can be described as "Early" (implying a detection period of no longer than 4 weeks); "Mandatory" implying the use of compulsory rather than discretionary travel and movement restrictions and "Decision level" indicating whether policy is clearly articulated and maintained at national level or devolved to regional or prefecture level.

In the latter case an adaptive strategy – starting with regional action and moving to national action – is suggestive of policy making following rather than leading the crisis.

As well as running the risk of delaying effective response such an approach, if combined with a lack of mandatory measures and a lack of comprehensive centralised tracking of analytical data, runs the risk a partial or illusory recovery in which the virus lays undetected only to re-emerge requiring more stringent measures early on. Like the V-shaped recovery in the economy referred to in the introduction to this book,

Note that these descriptions are necessarily stylized and open to some interpretation.

They will, however, help to underpin the importance of early action and also the need for economic policy makers to analyse and coordinate the extent of health policy coordination in key trading partners to assess the extent to which trade and travel can be resumed once more.

In terms of the decisiveness of government action and the likely duration and ending of the crisis, the contrast between one end of this conceptual spectrum and the other could not be clearer.

China's approach – while pragmatically based in terms of being regional rather than national (although covering an area of 50 million people) was decisive and data and technology driven. According to one recent report "In China the peak adverse impact on output is already past, with some shutdown measures now being eased". (OECD, 2020)

The approach in Italy was delayed, unclear and has only recently culminated in lockdown measures of the kind that in China were introduced and consolidated well within a month of the crisis becoming widely known.

In Ireland despite being an island nation with low population density and being remote from high centres of population, Ireland's open economy and relatively large travel flows have warranted a strong approach.

If not as stringent as China, the Irish government moved quickly – with strong public support and cooperation – to achieve a legislatively supported lockdown within three weeks of the first case being detected. Somewhere in the middle of the spectrum is Japan. There the government has not implemented a lockdown but used a mixed strategy of banning travel from affected Chinese regions and from certain Cruise liners with a strategy that does not aim to prevent the spread from individual to individual but rather monitor and prevent the growth in a number of clusters.

Guidelines issued by a central government expert group to regional prefectures are the key tool of implementation. At least in Japan, however, there is broad consistency between national and regional approaches, with the latter taking clear direction from the former. At the other end of the spectrum lies the US and Italy. In the US policy response began with travel restrictions at Federal level imposed first on China, then Iran and then Europe and, finally Mexico and Canada. In relation to support for a lockdown, there has been tension in policy response between State level responses in urban areas and Federal government responses. The US Federal government policy announced the intention to resume economic activity by Easter in the interests of the economy.

Figure 3.1.1 Comparing a spectrum of country approaches to containment

	China	**Ireland**	**Japan**	**USA**	**Italy**
Early action?	Yes	Yes	No	No	No
Mandatory?	Yes	Mostly	No	No	Partly
Decision level	Regional government	Central Government	Central guidance. Regional implementation	State level. Federal restrictions on travel	Regional at first. Then National.
Principal feature of government policy	Stringent lockdown in affected regions. Centralised tracking and analysis of data using QR codes Good coordination between regions and with industry	Strong legislative action to enforce lockdown Clear communication. Early testing bottlenecks	Initial focus on containing "clusters" rather than stopping individual transference. No lockdown. Complaints of inability to access tests.	Different approach of Federal versus State Govt. Federal emphasis on travel and visa restrictions but no lockdown.	Initial difference in approach of national and regional Govt. National emphasis on monitoring clusters. Travel and visa restrictions but no lockdown. Eventual national lockdown
Timeline of detection and government action					
Dec 2019	Original identification & Detection				
Jan 2020	Spread Policy response begins: Travel suspension		Detection Policy response begins: Part travel suspension	Detection and ban of travel from China	Detection and ban of travel from China
Feb 2020	Lockdown in affected regions	Detection in late February	Guidelines drafted & issued to regional govt	Ban of travel from Iran, Europe	Emergence of regional clusters. Regional lockdown
March 2020	Loosening of lockdown	Mandatory national lockdown and travel restrictions		Ban travel from Canada, Mexico. Schools & Universities closed.	National lockdown. Bars and Restaurants closed early March. Factories closed late March
April 2020	End of lockdown expected 9 April	End of lockdown unknown	End of lockdown unknown	US Federal Govt aims to end lockdown for Economic not health reasons	End of lockdown unlikely

Figure 3.1.2 Trends in cases and deaths as of 10th April and 17th April 2020

		Global	US	China	Italy	Spain	Ireland	UK
10 April	Cases	1,521,252	425,889	83,305	143,626	152,446	7,393	65,081
	Deaths	92,798	14,665	3,345	18,281	15,238	263	7,978
17 April	Cases	2,074,529	632,781	84,149	168,941	182,816	13,271	103,097
	Deaths	139,378	28,221	4,642	22,172	19,130	486	13,729
% change	Cases	36%	49%	1%	18%	20%	80%	58%
	Deaths	50%	92%	39%	21%	26%	85%	72%
17 April	% Deaths	6.7%	4.5%	5.5%	13.1%	10.5%	3.7%	13.3%

Source: World Health Organisation Situation reports [81 and 88]

Figure 3.1.2 examines information on cases and deaths at the data cut off point of April 17th (this page is an update of the originally published version in the report of 7th April) as reported to the World Health Organisation and published in their Situation reports numbers 81 and 88. It must be noted here that the accuracy of this table, and related comment, depends upon the veracity of data as reported to the World Health Organisation. Ireland's prompt action has resulted in a significant slowdown in the growth rate of cases in recent weeks. From a weekly increase of 633 per cent recorded on 28th March the number of cases – which still significantly higher was at least rising at the time of writing at a much decelerated (albeit still high) weekly rate of increase of 85 per cent. Likewise, weekly growth rates in both cases and deaths have occurred in the US (from 460 per cent and 518 per cent weekly growth in cases and deaths to respective rates of 49 per cent and 92 per cent), Italy (from 84 per cent and 127 per cent weekly growth in cases and deaths to respective rates of 18 per cent and 21 per cent), Spain (from 221 per cent and 385 per cent weekly growth in cases and deaths to respective rates of 20 per cent and 26 per cent) and the UK (from 265 per cent and 329 per cent weekly growth in cases and deaths to respective rates of 58 per cent and 72 per cent). In China the reported rate of case increase remains very low at 1 per cent however the rate of increases in deaths has accelerated, rising by 39 per cent between 10th and 17th April after a period of low growth. While slowing down in growth terms, however, deaths now constitute a higher share of cases than previously as, the growth in deaths, while slower than previous growth rates in deaths, are now increasing faster than case growth rates. From an average global death rate of 4.6 per cent of cases recorded on 28th March the global death rate was 6.7 per cent as of 17th April. Rates in the UK and Italy are significantly higher, at 13.1 and 13.3 per cent, respectively. German and Irish death rates, at 2.9 per cent and 3.7 per cent, are significantly lower than the global rate. Differences in Figure 3.1.2 arise not only from differences in approach to combatting the virus. Italy and Spain, for instance, have relatively high tourism visits all year round and relatively older populations. Population density – noted in Chapter 2 above (Hanna, 2004) in relation to Asia – is also important.

In Ireland, where the reported death rate remains – at the time of writing – still below the global average, the vigilance of government policy is supporting the advantages of a young population and a low population density in a country with a high reputation for food standards, clean air and a fresh climate.

The US, Japan and Italy are included not just as examples of particular approaches to policy containment, however.

They are also highly economically significant: The US as the world's leading economic power and Italy, as evidenced during the Euro zone crisis, is a critical point of pressure in the Euro zone economy due to its high ratio of government debt which amounts to 135 per cent of GDP (while this metric of comparison is not used for Ireland in Chapter 1 it is more relevant for Italy and more conducive to cross country comparisons).

Thus, policies adopted towards the spread of Covid-19 in the US, Japan and Italy are not just relevant for public health in those countries: They could have a profound impact on the course of Covid-19's economic impact on the global and European economy.

3.2 Immediate economic impacts

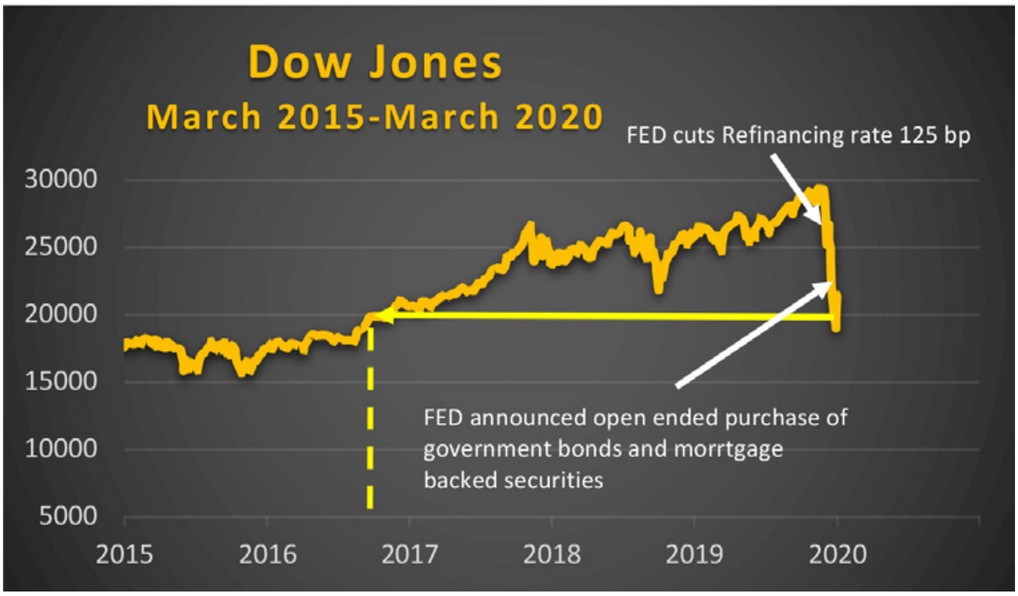
3.2.1 Financial market reactions

While a comprehensive overview of global financial market reactions is beyond the scope of this book, a comparison of stock market reactions is instructive.

Taking the Dow Jones and Nikkei to assess the global impact on share prices of Covid-19 (movements in the FTSE 100 are affected by Brexit and therefore not a good benchmark), Figure 3.2.1.A shows that, in broad terms, three years of stock market gains have been wiped off the value of both major stock markets up to the end of March.

This notwithstanding, it should be added that between 2009 and 2020 stock markets witnessed the longest uninterrupted run of gains since the Second World War and did so against the backdrop of an unprecedented degree of monetary policy accommodation.

Figure 3.2.1.A Stock market impact Covid-19



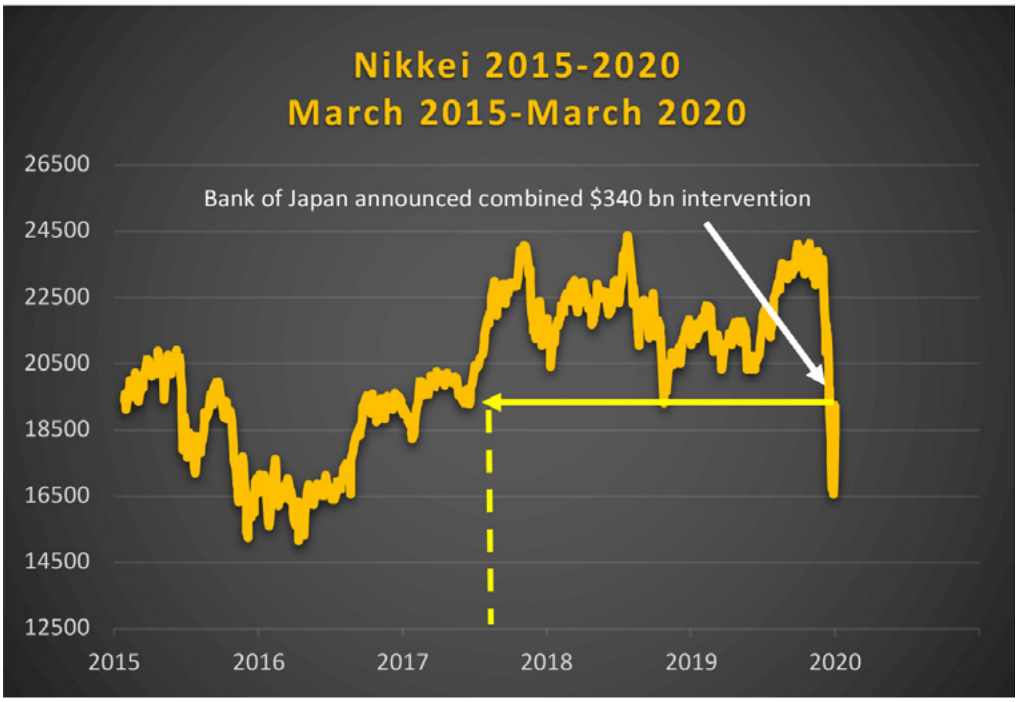


Figure 3.1.2.A shows not only the pronounced nature of the stock market declines in response to the Covid-19 crisis, but its intensity. In a period of under one month the Dow Jones lost one third of its value, bringing it back to a level last seen in late 2016.

Decisive intervention by the US Federal Reserve – a 125 basis point cut in the Refinancing facility rate on March 3rd and the announcement two weeks later of the open-ended purchase of both bonds and mortgage backed securities did between the 23 and 26 March effect a rally but downward momentum resumed towards the end of March as news emerged that the number of Coronavirus cases in the US has now overtaken the number of cases in China.

This is despite news towards the end of March that both Houses of Congress have passed a $ 2 trillion stimulus package to counter the economic impact of the virus.

In Japan by contrast this news was a key factor in the Nikkei rallying strongly towards the end of March.

News that in China the virus appears to have peaked may have supported positive sentiment (Japan's number of cases remains relatively low compared to its population and debate exists as to whether this is the result of cultural inhibitions in or whether the full extent of the virus has yet to be reported.

In Ireland the extent of stock market falls was proportionately more significant than in major stock markets, taking the value of the Iseq back to levels unseen since a decade ago.

As the next illustration shows, however, Ireland's small open economy makes it particularly prone to volatile share price movements during crisis periods.

As shown in Figure 3.2.1.B, for example, the Iseq lost almost 80 per cent of its value from the decline from its pre 2008 crisis peak in May 2007 to its subsequent trough in March 2009.

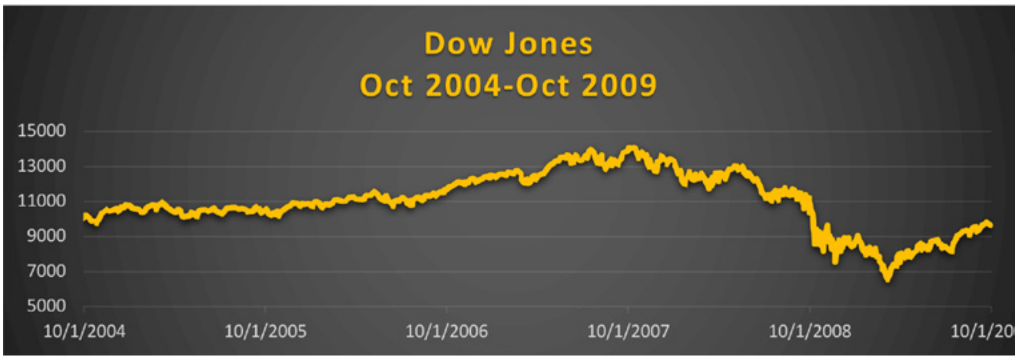
This compares with the Dow Jones and Nikkei losing approximately half their value during the same period.

The proportionately greater falls in the Iseq in recent weeks compared to other stock markets is therefore likely a normal feature of Irish stock markets during a crisis.

The clear difference between the reactive nature of the 2008-2014 and the proactive policy driven current crisis is reflected in the more gradual decline in stock markets in the last compared to the present crisis.

The data cut-off points for these charts was end March for publication deadline reasons. Since then, a partial rally occurred in most stock markets followed by a partial relapse (offsetting approximately one half of the rally). The situation at the time of writing can be characterised as one in which, for the time being, a floor has been put under further declines as a result of prompt central bank action. As with the 2008-2014 crisis, however (see Annex) subsequent macroeconomic, fiscal and bond market developments may have further impacts, potentially significant ones, on asset prices in coming quarters.

Figure 3.2.1.B Financial market impact 2008-2014 Crisis



From peak to trough, adjustment in stock markets from a previous overvaluation – induced by weaker than appropriate monetary policy – took 15 months to materialize before stock markets began to recover in March 2009.

It might be noted that 11 year period marks the longest period of sustained increases in share prices in living memory.

This record "bull run" has occurred against the backdrop of an unprecedented degree of monetary accommodation, an accommodation originally designed to restore economic confidence and activity in the wake of the last crisis, but which was continued indefinitely into a period in which the global economy had recovered.

The extent to which recent declines in share prices are a reaction to the Covid-19 virus and the government policy and economic activity it triggered, as opposed to a long overdue correction, is still unclear. It does beg the question whether Covid-19 is a cause or a catalyst of stock market decline, or both.

The impact of declines on corporate balance sheets and household wealth, not to mention pensions, and the knock on effects on consumption may, if sustained, be severe.

On the other hand, it can be noted that levels attained by stock prices during late 2016 – levels to which stock markets have broadly returned - were better than expected some years before.

It should be considered whether the return to these levels constitutes a "reset" and, if so, over what period of time a recovery can be realistically envisaged.

A more immediate task is to read the signals from the stock market in relation to the efficacy of monetary policy responses to the crisis.

The weakness of stock markets in the US at the time of writing - despite significant policy announcements by the Federal Reserve - may suggest that markets remain unconvinced that monetary policy alone can sustain pre crisis asset prices. This may be true whether the Covid-19 virus is successfully contained or not.

As discussed in the next chapter real economy policy responses – fiscal and supply side measures that have the correct magnitude, duration design and delivery strategy – will be instrumental in delivering a safe exit from this crisis, an exit that monetary policy can merely accommodate but not on its own guarantee.

The significant falls in German 10-year bond yields and the rise in spreads between Italian and German yields, as well as the rise in the prices of safe haven assets, such as gold, suggest that markets are now at an inflection point: What will determine the direction of movement from that inflection point will be a combination of three things:

Firstly, the ability of governments to quickly and decisively implement public health measures that effectively contain the spread of Covid-19.

Secondly, their ability to adopt strategies consistent with those measures and which are of a sufficient magnitude, duration and of an appropriate design to compensate for their economic impact.

Thirdly, their ability to coordinate with each other, both in relation to reducing the divergence in approaches both to public health (containment) measures but also to fiscal / monetary policy coordination challenges: Given the aforementioned differences in policy approaches to containing the virus discussed above, this impact is likely to be spread over several quarters as the crisis peaks in different trading partners.

The timing of economic impacts from different economies may not be simultaneously timed and some economies may recovery more quickly than other. The likely scheduling of these differing impulses should be assessed in designing – as far as possible – a coordinated response at G20 level.

The impacts discussed below constitute the “first wave” of domestically induced impacts. This chapter ends by briefly outlining both the second and third round impacts of the crisis, transmitted through both real economy and financial channels.

3.2.2 Real Economy impacts

Economic growth: ESRI and Central Bank forecasts compared

Forecasts of the impact of Covid-19 on the economy at this early stage are highly unlikely to be accurate. They are, nonetheless, useful in shining some light on a dark situation. If not precise outcomes, then at least approximately scenarios can be envisaged and – complemented by analysis of the previous crisis – give policy makers useful guidance. Insets 1 and 2 on the following page summarise, respectively, the Central Bank of Ireland’s (CBI) latest (published April 3, 2020) forecasts and the Economic and Social Research Institute’s (ESRI) latest (published 27 March 2020) outcome. The former is based on a macroeconomic model. The latter, as indicated by the authors is more a scenario than an forecast. Both assume that lockdown restrictions remain in place for one quarter.

The CBI predict an 8.3 per cent decline in GDP and a rise to 14.5 per cent in the rate of unemployment by the end of the year, with a peak rate of 24.5 per cent being attained at the end of Q2. It further predicts a decline of 24.3 per cent in underlying investment.

The ESRI (see inset 2) "scenarios" a 7.1 per cent decline in GDP and an 8.1 per cent decline in GNP. Assuming a relatively "benign" scenario in which the lockdown is over by the end of Q2 and assuming additional expenditure of approximately €4.8 billion as a result of government measures including the Pandemic Unemployment Benefit and Employer Refund Scheme and a 7 per cent fall in government revenues – modestly more optimistic than the "medium-term" scenario above, it predicts a General Government Deficit of €12.7 billion, or 4.3 per cent of GDP.

Inset 1: Central Bank Forecasts, 2 April 2020*

Using a macroeconomic model cross checked against a sectoral approach, the Central Bank of Ireland (CBI) predicts the following:

Summary table of CBI forecasts outcomes

	Q2	**2020**
GDP	4.1%	-8.3%
Underlying investment	3.8%	-24.3
Unemployment	0.0%	349,350
Unemployment	24.7% peak	10.5% end year
Gen Govt Def	26.0%	€19.9bn
Current account balance	7.9%	17.5%

Source: CBI

*Note: These forecasts are replicated with the kind permission of the Central Bank of Ireland (CBI) and do not necessarily imply agreement by the CBI with conclusions drawn in this report.

Inset 2: ESRI Analysis 26 March 2020*

Authors: Kieran McQuinn, Conor O'Toole, Matthew Allen-Coughlan and Cathal Coffey

In its first publication relating to the crisis the ESRI has conducted a "scenario analysis" rather than a forecast, giving the following results for the economy in 2020:

Summary table of ESRI scenario outcomes

	Q2	**2020**
GDP	4.1%	-7.1%
Underlying investment	3.8%	-8.1%
Unemployment	0.0%	307,000
Unemployment	18% peak	11% by end year
Gen Govt Def	26.0%	€12.7 bn
Current account balance	7.9%	17.5%

Source: ESRI

*Note: These are replicated with the kind permission of the Economic and Social Research Institute (ESRI) and do not necessarily imply agreement by the ESRI with conclusions drawn in this report.

Unemployment

Figure 3.2.2.A Unemployment 2008-2014

	2008	2009	2010	2011
Employment	2,100	1,929	1,848	1,810
Unemployment (000s)	141	259	292	304
Unemployment (%)	6.3	11.8	13.6	14.4

Source: CSO

During the last crisis from a level of 141,000 unemployment more than doubled to over 300,000 by 2011, that is over a three-year period.

The ESRI (see inset below) predicted at end March that a similar level of unemployment, some 307,000, will be reached by the second quarter of this year representing an unemployment rate of 18 per cent. It further predicted that approximately half of this increase will be reversed by the end of the year on the assumption that the worst of the crisis subsides by Q3.

According to figures released by the CSO on April 2nd some 283,037 were in receipt of the Pandemic Unemployment Payment. Given the high level of part time employment in the economy – almost half a million - (see Figure 2.1) this number is unsurprising.

The Live Register does not measure unemployment (it includes part time workers) but movements in it do parallel movements in unemployment and it assists in the estimation of monthly unemployment trends. Its level rose in March by 24,400 to an unadjusted level of 205,209.

So, already, the numbers in receipt of employment related welfare assistance – standard assistance and pandemic payments combined - now exceeds half a million.

Given complications in relation to interpreting these statistics and complexities relating to who is on the Live Register, the CSO has deferred publication of the monthly unemployment estimates.

Given the level of unemployment of 120,100 reported by the CSO in February 2020 and on the strength of Pandemic Unemployment Payment numbers but lower increase in the Live Register, two conclusions might be tentatively – and subject to revision as more information emerges – drawn.

Firstly, the rate of Pandemic Unemployment Payment suggests that a level of unemployment somewhere between 300,000 and 400,000 will be reached by the end of Q2, assuming the end of lockdown during that period.

This reflects a gap of about 70,000 between the end February unemployment and Live Register level and the likelihood of some fallback in the numbers currently availing of the Pandemic payment as economic activity resumes.

Secondly, even assuming the lockdown is ended before the end of Q2, a significant number of people will remain unemployed after the lockdown due to asymmetric effects: Simply put, businesses that close do not always automatically re-open, even under circumstances where employer labour costs are supported by state payments. Therefore, policy implications, in so far as they can be drawn at this early stage, suggest that within the space of three months a rise in unemployment will be affected that took three years to unfold between 2008 and 2011.

As a tried and tested format, the Action Plan for Jobs will therefore need to be renewed and adapted to new circumstances (the design and detail of which is beyond the scope of this report).

Fiscal

End March 2020 Exchequer returns show a 22 per cent decline year-on-year in tax revenues. As the crisis affected the second half of March, this would imply a full month decline of approximately 40 per cent in tax revenues for each full month in which the lockdown continues. Given total tax revenues of €59 billion in 2019 the following "immediate" scenarios can be envisaged for the tax take in 2020 in Figure 3.2.2.B.[2]

Figure 3.2.2.B Tax Revenue losses under 3 different scenarios

	Lockdown duration	Revenue loss
Best case lockdown	1 month: mid-March to mid-April	€1.5 billion
Medium case lockdown	3 months: mid-March to mid-June	€5.4 billion
Worst case lockdown	6 months: mid-March to mid-Sept	€11.0 billion
Tax revenue loss 2008-2011 inclusive		€15.5 billion

Source: Department of Finance

However, these assumptions merely extend the immediate effect of the lockdown, principally VAT and income taxes, and do not account for second and third round fiscal impacts arising from declining export demand – yet to be channelled into the exchequer via Corporation tax receipts (which are mostly received at end year) –. the impact of asset price movements on Capital Gains and Capital Acquisition Taxes, the impact of declining property market and asset market activity on Stamp duty.

Earnings

As shown in Figure 3.2.2.C below - that of those sectors most immediately struck by the crisis – the hospitality, arts and entertainment, wholesale and retail sector – are sectors which have seen the least growth in total annual earnings since 2008.

In spite of an economy that has grown by one half since then in GNI terms (one fifth in modified GNI terms), several of these sectors have seen low single digit increases in earnings since then. Compared to an overall increase in annual earnings of 5.3 per cent, earnings in the Hotels and Restaurant sector (Accommodation and Food Services) has actually fallen by 0.6 per cent as have earnings in the Arts, Entertainment and Recreation services, by 3 per cent.

2. This applies the relevant monthly share of total tax revenues received for the relevant months in the middle column and applies a factor of 40 per cent.

Average annual earnings in Accommodation and Food Services (€17,768), Arts Entertainment and Recreation (€24,312) and Wholesale, retail and repair (€28,152) are below or just above half the earnings levels in sectors where employment is more secure.

Given the dramatic outcome of the last general election, the greater vulnerability to this crisis of groups that have benefitted so little from the recovery and have relatively low incomes and security could have profound consequences for political and social stability.

As well as political stability, the disparity in earnings growth raises fundamental questions about differences in both access to recovery but also differences in job security in different sectors of the economy. These narratives were a strong feature of public discussion during the last recession and are likely to be even stronger narratives in the coming recession.

Figure 3.2.2.C Annual earnings growth during the recession

	2008	2018	% Change
All NACE economic sectors	34,826	36,664	5.3%
Accommodation & Food services	17,880	17,768	-0.6%
Arts Entertainment, Recreation	25,074	24,312	-3.0%
Admin and support services	24,716	27,702	12.1%
Wholesale, retail & repair	25,445	28,152	10.6%
Health and Social Work	36,507	35,675	-2.3%
Construction (F)	38,234	39,661	3.7%
Transportation and storage (H)	38,112	39,843	4.5%
Industry (B to E)	38,997	43,407	11.3%
Education (P)	44,054	43,589	-1.1%
Prof. Scientific & Technical	40,459	44,269	9.4%
Public Admin & Defence & Compulsory Social Welfare	46,886	47,308	0.9%
Information and communication (J)	46,193	52,263	13.1%

Source: CSO

3.2.3 Business confidence and retail sector closure

In addition to their obvious employment impacts business and retail outlets closures will impact on the commercial rental sector, on local government rates and central government revenues and also to community morale and interaction.

A discussion of these impacts is beyond the scope of this report. However, these impacts will impact profoundly on local government service provision capacity, on the real estate sector and on community life in general.

3.2.4 Full year tax revenue impacts

The ESRI (see above) have predicted a loss amounting to 7 per cent of government revenue in 2020. In the previous crisis the revenue loss was far more substantial as indicated below.

As Figure 3.2.4.A shows tax revenue declined by one third between 2008 and 2011 inclusive.

This was partly due to overreliance of the economy on the construction sector. As noted in Chapter 2, the Irish economy is now more broadly based than before.

However strong corporation tax receipts from the multinational sector have been a feature of recent exchequer returns and a marked global slowdown could replicate in this sector the revenue impact channelled by the domestic construction sector during the last crisis.

Below two approaches are taken to estimate full year tax impacts, a “lower-bound” and “upper-bound” scenario.

Lower bound scenario:

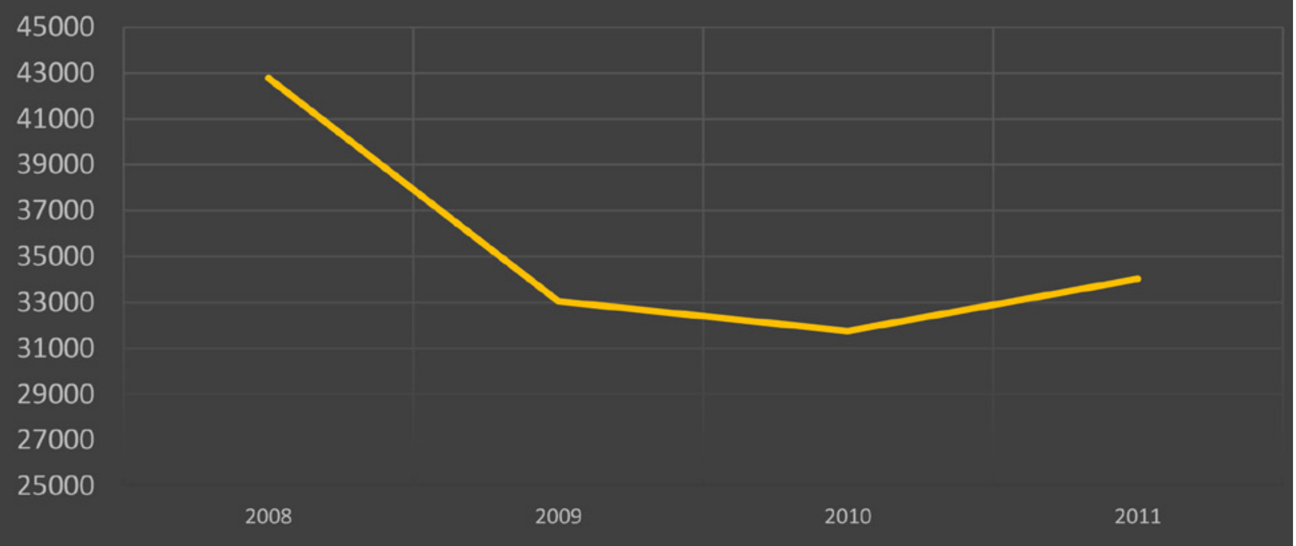
The fall in one third of tax revenues between 2008 and 2011 (see Figures 3.2.4.A and 3.2.4.B) corresponded to a decline in GDP and GNP of approximately 12 per cent. Assuming the ESRI is correct in its estimate of a 7 per cent GDP decline, this would suggest – abstracting from the impact of changes in tax policy since the last crisis (which requires more analysis than the urgency of this paper’s production allows) – that a decline in tax revenue of just under 20 per cent. The latest March 2020 Exchequer returns imply that, even before second and third round impacts are accounted for, tax revenues are falling at a rate of 20 per cent in each full month of the lockdown (see above)

Making a rough assumption that beyond the end of the lockdown external economy impacts the persistence of lower employment and consumption will exert continued, albeit somewhat less severe, downward pressure on tax returns and that any mitigation arising from the end of lockdown will be at least partly offset as external economy impacts begin to kick in, the continuation of a 15 per cent fall in annual tax revenues seems prudent.

This approximates to a decline in tax revenues in the region of €9 billion to a level of €50 billion. It might be noted that – if it materialises - this level of tax revenue is €3 billion higher than recorded at the peak of the last boom (€47 billion) and much higher than the €31.7 billion tax revenues recorded at the trough of the last recession (2010).

As Figure 3.2.4.B below shows this equates in magnitude (but not in share of economic activity) to fall in revenues seen during the last crisis, a reduction of some €15 billion. The difference being that the latter was spread over a 3-year period.

Figure 3.2.4.A Tax Revenues 2008-2011



Upper bound scenario:
As noted above, exchequer indications reveal a fall in 22 per cent in March 2020 tax revenues year-on-year.

Noting that the crisis only began to impact from mid-March, this would suggest a full monthly impact of 40 per cent tax revenue decline for the duration of the lockdown.

Assuming the lockdown prevails for a six-month period – a "worst case lockdown" - this would imply the loss – as a result of the lockdown – of equal to roughly one fifth of tax revenues by end 2020.

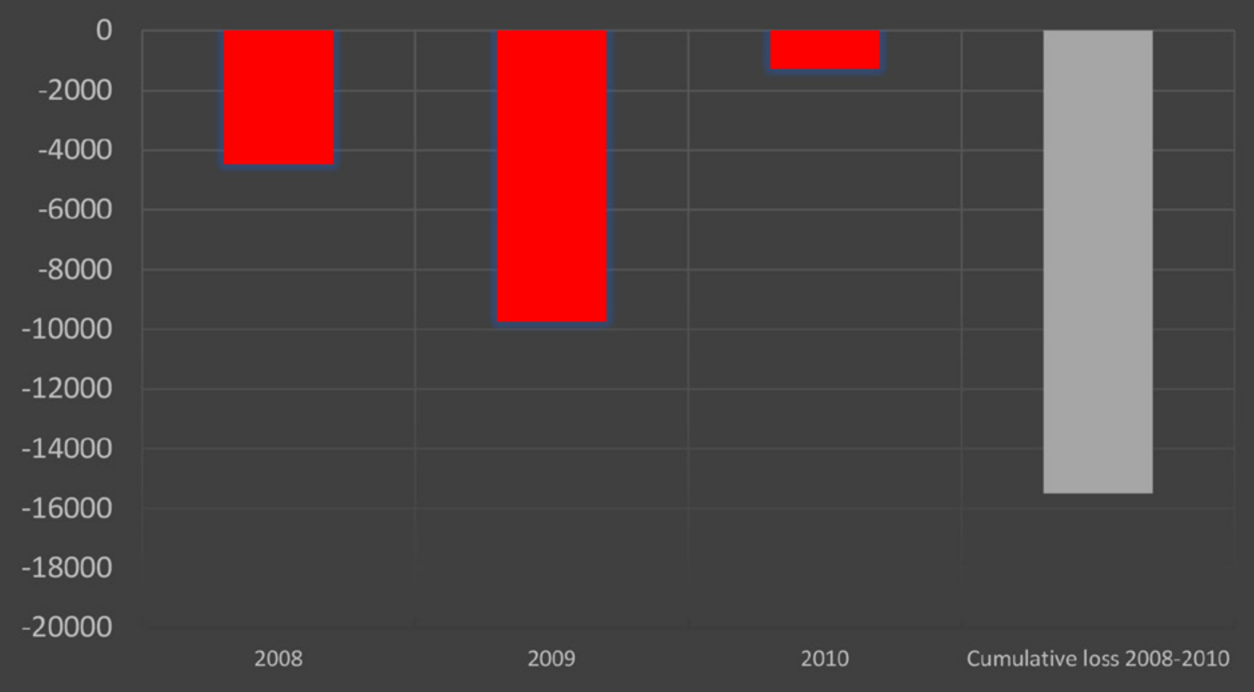
This lockdown scenario is pessimistic. However, a medium-term lockdown scenario extending to 3 months – will see tax revenues suffer beyond the lockdown as international trade impacts on the Irish economy. That consideration must in turn be mitigated by the observation made by the CBI in its forecasts (see above) that net trade impacts may be positive as imports fall by more than exports, as well as the fact that a decline in export activity, being less employment intensive (see Chapter 6) and lower tax rich, tends to have less of a fiscal impact.

Overall, then, the loss of one fifth of tax revenues in 2020 – around €12 billion - is most likely an upper bound scenario. Thus, the tax revenue decline in 2020 – assuming no policy change – is likely to be between €9 and €12 billion and more data for the second quarter is needed to be more precise.

To points are made in conclusion on this topic. Fiscal reactions must be more immediate and "real time" to try and stimulate demand in the domestic economy and so as to compensate. The European Commission has already signalled flexibility in terms of the application of the Fiscal Treaty. This flexibility must not just apply to enabling fiscal balances to be exceeded: It must also alter the "rear view mirror" approach to fiscal rules interpretation towards a more forward looking and pre-emptive approach that enables a significant deficit to be incurred to offset the worst effects of the crisis before it is too late, rather than merely retrospectively permitting flexibility once the damage is done. This brings us to an essential point: The ECB has taken adequate stimulus measures. But it cannot be stressed enough that these monetary policy measures can accommodate a continuation of borrowing and lending to support the real economy but without demand side measures cannot in themselves ensure demand.

If economic actors do not have confidence in the recovery of the demand side of the economy towards the end of 2020, they will be unlikely to avail of easier credit. Without this confidence in the level of future demand in the real economy, the impact of monetary policy will be severely limited. Thus, if fiscal and monetary policy coordination was desirable during the last crisis, it is an absolute imperative now, not just at national but at EU and as far as possible global level. If implemented in time and correctly implemented, a fiscal stimulus to prompt a successful recovery that is partly (but not fully) self-financing. Which leads to the second point:

Figure 3.2.4.B Tax revenue losses 2008-2010



Secondly, the prevailing narrative to date has been that tax revenues rise when tax rates rise. As both the foregoing and forthcoming analysis (in Chapter 5) shows, there is significant evidence to the contrary.

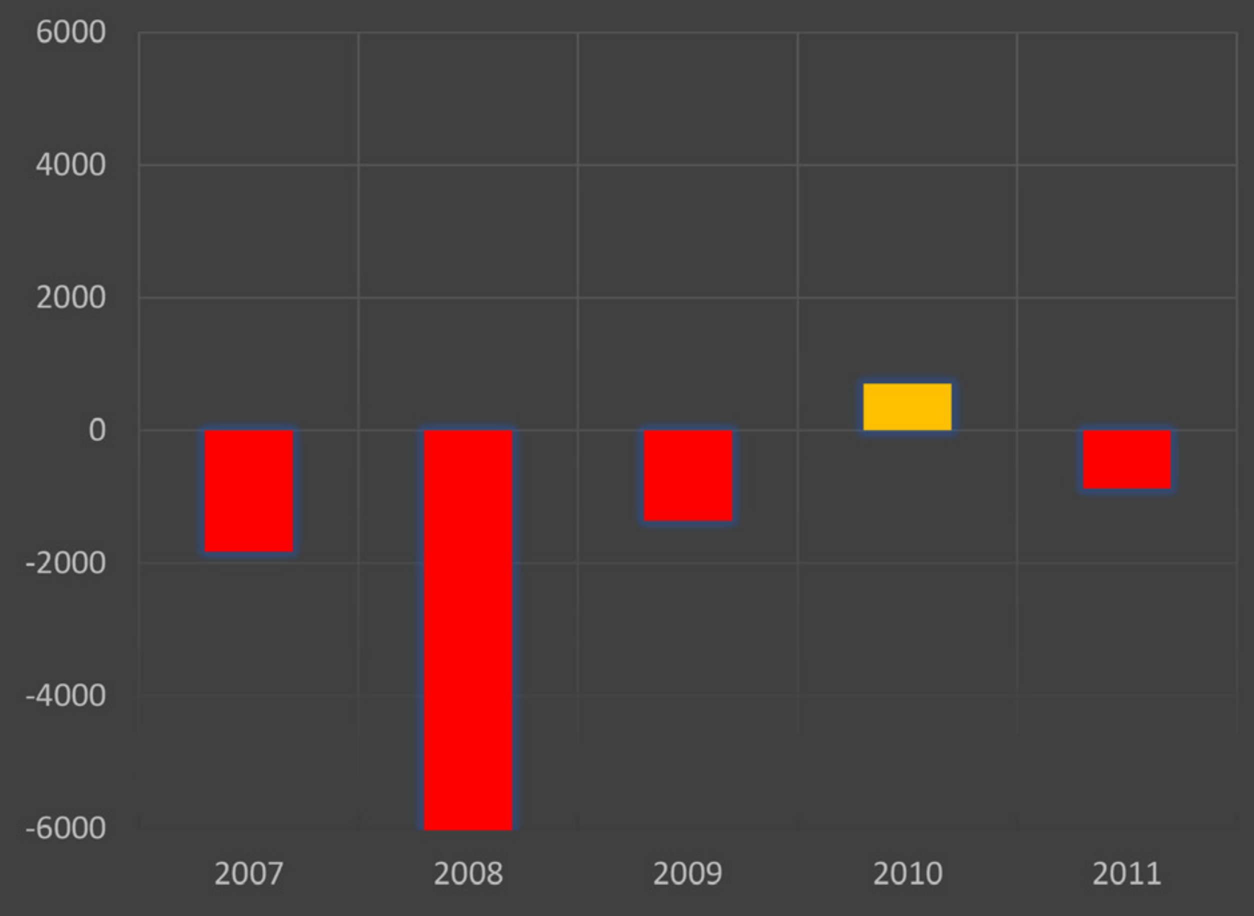
As shown in Figure 3.2.4.B tax revenues declined sharply during years in which the emphasis on tax rate increases was most intense.

And as Figure 3.2.4.C - comparing tax revenue outturns for the years most affected by the recession are contrasted with the relevant tax forecast made in the preceding Budget - in all but one case, that of 2010, the revenue outcome was worse than expected.

The exception, year outturn in 2010, is worth noting for the very different fiscal approach adopted in December 2009 Budget that affected fiscal outcomes in that year.

A strategy that produced not only higher than expected tax revenues, but also a cessation in the rise of unemployment – albeit temporarily – and a rise in business and consumer confidence and business investment.

Figure 3.2.4.C Tax outturn -v- Forecast



This will be elaborated in the next chapter when the optimal design of a fiscal policy response to the crisis is discussed in more detail.

3.3 "Second" and "Third" round effects

Towards the end of Q2 and into Q3 and beyond, depending on the duration of the crisis, subsequent second round domestic and international effects will be transmitted to our economy via the "knock-on" impact of job loss and company closure on consumer and business to business demand (and subsequent second wave job losses), the transmission of the global slowdown through our current account. Added to this are likely "third-round" financial market effects.

These latter will take various forms.

Firstly, a slowdown in investment will affect private sector demand for goods and services.

Secondly, as the fiscal impact of the crisis pushes already struggling Eurozone countries into significant fiscal deficits and rising debts, this will manifest itself in rising bond yields that may lead to financial contagion once the fiscal impacts discussed above being to impact on government bond issuance, bond prices and market confidence in sovereign debt.

Thirdly, the financial performance of domestic businesses – especially SMEs – and households are deteriorating rapidly in the immediate term with knock on consequences for business and household credit ratings, liquidity and solvency in the medium term if macroeconomic conditions do not normalise in Q3.

These issues are assessed in subsequent chapters. The design and delivery – sectoral and regional – of assistance to the Irish economy will be decisive in ensuring whether those who most need assistance will receive it. Not only the macroeconomic size and impact of policy needs to be considered, but its fine tuning and the alignment with it of credit, government aid and other policies.

Chapter 4

Economic response: Dimension and Duration

4.1 Ireland: Key trading partners

The design and delivery of policy response, as noted in the last chapter, crucial. But before design and delivery, the dimensions and duration must be adequate. Prompt, welcome government actions– outlined below – will limit income losses for households for the duration of the lockdown. However, they offer no guarantee of a resumption of demand beyond then.

As noted above, different public health responses to Covid-19 around the world will produce differing peak impacts. The OECD in a recent report has suggested that in China, for instance, the peak has already passed (OECD, 2020). In other major economies, however, it is yet to arrive. For that reason, the magnitude of the government's response needs to be considered, not only in terms of its immediate impact, but also in light of the best available forecasts for the medium-term economic impact and with other economic response programmes elsewhere.

Figures 4.1.1 and 4.1.2 provide an overview of Ireland's key service and merchandise trade partners below. Subsequent analysis takes a key subset of these to compare and contrast the size of government intervention in Ireland with other responses. This is done for two reasons:

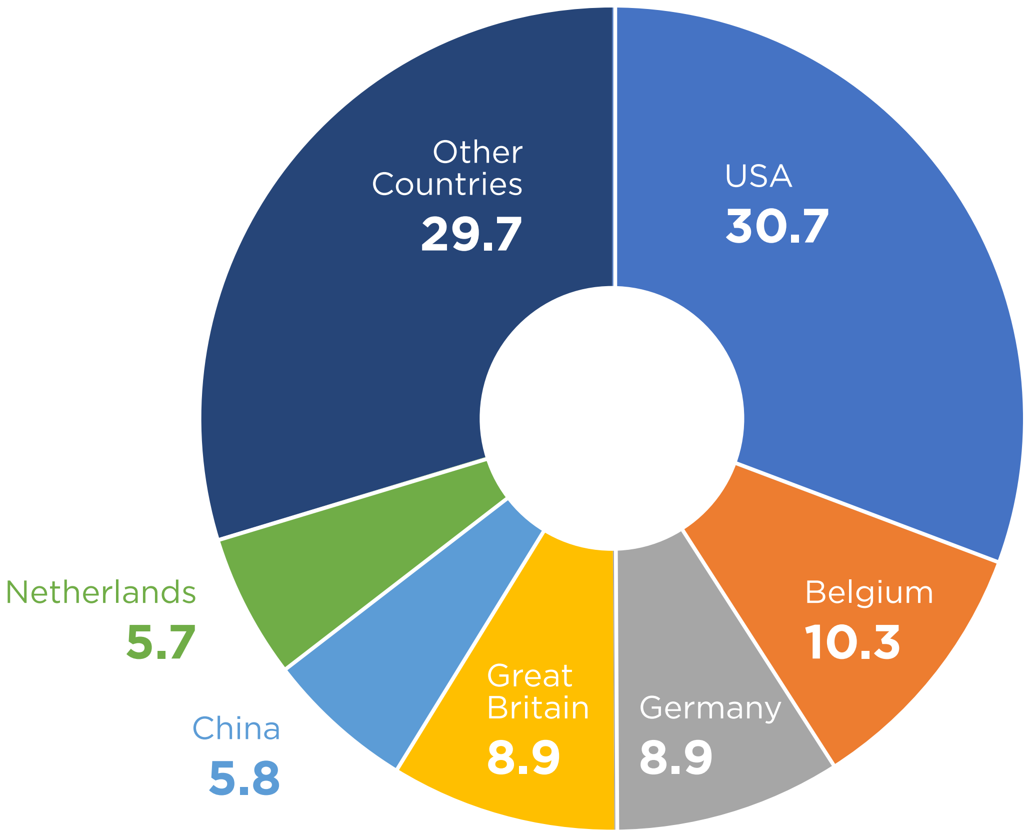
Firstly, to benchmark Ireland's response to date as is done in the next section. Secondly, to underline the point made in Chapter 2 about the uncertainty of both health outcomes and economic response in our key trading partners and the need to prepare for a contingency budget as proposed in Chapter 6. The following analysis preserves a conceptual difference between temporary stabilisation measures – "holding operations" – and longer-term stimulus.

Figure 4.1.1 Ireland's key Service trade partners

	Exports	Imports	Net
Total	180,077	185,647	5,570
US	20,908	47,125	26,217
Germany	13,475	4,434	- 9,041
UK	28,282	17,832	- 10,450
Netherlands	5,871	25,814	19,943

Source: CSO (2018 data)

Figure 4.1.2 Ireland's Merchandise Exports by destination



Source: CSO (2019 data)

4.2 Irish government (fiscal) and EU (monetary) responses so far

Figure 4.2.1 and 4.2.2 present, respectively, an overview of the Irish government's response to date (see also figure 6.2.1) and the key monetary responses of the Central Bank of Ireland, ECB and US Federal reserve measures announced in the period March 18th to the publication of this report on 6th April (closing data from 3rd April).

The immediate point to note is that the magnitude of measures deemed necessary to put floor under household incomes – a pandemic payment of 350 per week (claimed at the time of writing by approximately 300,000 claimants), together with a wage subsidy and other measures - amount approximately to between 4 and 5 billion euro, or 2 per cent of GNI*. As a "holding operation" this is a helpful and timely intervention that will preserve the viability of many businesses and jobs in "deep freeze" for the next three months.

Additional measures on health spending are aimed at addressing the medical crisis and as such are not classified as stabilisation and stimulus measures given that there is no indication of the extent to which they will benefit the Irish economy. However, if targeted as far as possible at the indigenous SME sector – and the EU has established a precedent in other respects in relaxing state aid (see Figure 6.2.1) – these expenditures could be regarded as economic stimulus to a significant degree (see Figure 6.2.2).

Figure 4.2.1 Irish Government Fiscal Responses as of end March 2020

Institution	Description
Government overall package of approximately €4.4 billion (2.2 % GNI*). Last week government announced a package of measures amounting to approximately 2 per cent of GNI to tackle immediate challenges of the crisis.	Last week government announced a package of measures amounting to approximately **2 per cent of GNI** to tackle immediate challenges of the crisis. These include: (a) The introduction of pandemic unemployment benefit payment. (b) The introduction of the Covid-19 Wage Subsidy scheme (c) A €200m SBCI Working Capital scheme (d) €200m in Enterprise support including rescue and restructuring (e) An increase in the loan available from Microfinance (f) A Finance in Focus grant for consultancy support

With the value of the Iseq down dramatically, with between 300,000 and 400,000 workers have thus far signed up for the Irish government's pandemic unemployment payment, tens of thousands of businesses have closed, preparation must now begin for the possibility of an extended downturn in Q3 and beyond as global impacts make themselves felt.

Comparing recent government measures announced on Tuesday 24th March with a subsequently published ESRI and Central Bank of Ireland forecasts (see section 3.2.2), suggests that these measures announced by government make a significant contribution to tackling the domestic demand fallout for the duration of the lockdown. Preparation must begin now to complete the picture by preparing for the medium to long-term impacts, either due to the possibility that the lockdown continues into Q3 and/or due to global shocks in that quarter and beyond.

Before discussing the precise size of the fiscal effort required under different scenarios, a remark might be entered about the size and efficacy of central bank responses. A key feature of the last crisis was the observation that in the absence of an EU fiscal policy, fiscal and monetary policies could not be effectively coordinated.

Figure 4.2.2 ECB and US Federal Reserve Monetary policy responses

Monetary response	Description
Central Bank of Ireland, BPFI	• Introduction of 3-month payment breaks on mortgages, personal loans and business loans for those affected by Covid-19 • Reduction of the Counter Cyclical Capital Buffer from 1 to 0 per cent by 2 April 2020
European Central Bank	• (ECB) €750 billion intervention in markets
US Federal Reserve	• (US Fed) Cut in 125 basis points in Fed Fund rate • (US Fed) Announcement of open-ended commitment to purchase commercial bonds and mortgage backed securities

The stringent operation of the Stability Pact in a retrospective manner – waiting until severe recession had occurred before permitting the EU Commission to sanction fiscal measures large enough to prevent it – effectively resulted in a situation where the stable door was closed after the horse had bolted.

Despite significant action by the Central Bank of Ireland, the European Central Bank and US Federal Reserve (see Figure 4.1.2 below), stock markets have not responded in a proportionately positive way.

Besides continued uncertainty about the cohesion and efficacy of public health response in the US, a key reason for this – as noted above – is uncertainty in relation to demand conditions in the second half of 2020.

Monetary policy at near zero interest rates can merely accommodate and not stimulate and unless complementary fiscal action is taken.

Furthermore, for monetary policy actions to produce the desired impact, policy makers must signal their intention to engage in the necessary fiscal stimulus at time periods that are in the vicinity of monetary policy actions. Here the need for coordination between monetary and fiscal policy cannot be stressed enough.

The small size of the EU budget in relation to the significance of the ECB's policy action needs to be noted. In that respect Ireland can help to support better coordination between the larger EU economies in the implementation of their already announced fiscal responses (see below).

4.3 A comparative assessment of country responses

Taking together both loan supports to business and direct spending interventions the overall size of interventions are presented below. Chapter 5 presents a more detailed analysis of specific instruments within these overall packages.

The aim here is to assess their size in terms of the likely impact not just as a share of GDP (and GNI* for Ireland) but also in terms of the OECD's latest forecasts for the impact of the virus on GDP levels (here GDP must be used for Ireland and other countries).

Figure 4.3.1. summarises this analysis for the UK, Germany, US and UK – and in terms of a comparator country of similar size, New Zealand, arising from result of the lockdown.

Figure 4.3.1 Cross country comparisons in Covid-19 economic responses & forecast GDP declines**

	GDP	Fiscal	% GDP***	Funding	% GDP***	Total	% GDP
UK	2808.6	38.8	1.4%	376.2	13.4%	415.0	14.8%
Germany	3785.1	156.0	4.1%	978.0	25.8%	1134.0	30.0%
US	20450.7	1053.7	5.2%	815.6	4.0%	1869.3	9.1%
NZ	203.7	8.7	4.3%	3.4	1.7%	12.1	5.9%
Ireland***	376.2	4.0	2.0%	0.4	0.2%	4.4	1.2%

IMF (2020) "Policy Responses to Covid-19 https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#I

OECD (2020) https://read.oecd-ilibrary.org/view/?ref=126_126496-evgsi2gmqj&title=Evaluating_the_initial_impact_of_COVID- 19_containment_measures_on_economic_activity
and various national authorities (country measures)

* Overall impact depends on duration of lockdown with an estimated average adverse monthly impact of 2 per cent of GDP.

** Health spending measures are excluded. Focus is on measures to help households, small businesses and excludes monetary policy measures by ECB, Bank of England, US Federal Reserve or the Reserve Bank of New Zealand

*** GNI* is used as the base for Ireland.

Assuming a 2 per cent impact on a country's GDP from a single month of lockdown, the OECD's approach underlies the importance of timely action to contain the virus. Ireland's prompt action has resulted in an amount less in GDP terms but is broadly comparable in GNI* terms.

With the impact if not the duration of the lockdown likely to persist for longer than a single month, OECD data on the magnitude of fallout in key trading partners shown above imply that second and third round impacts will only then beginning to make themselves felt on our economy if economic impacts continue to affect key trading partners and as financial market and asset market impacts make themselves felt.

Here a comparison of Irish measures with the extent of trading partners is helpful but must be interpreted with care.

Firstly, as leading global economies the US, German and UK economies have a more significant responsibility and a greater impact in ensuring global demand recovers. Similar magnitudes of intervention should not be expected of smaller economies like Ireland.

Secondly, Ireland has (see inset below) compared to New Zealand a more open economy. New Zealand's greater reliance on domestic demand and in particular its even stronger reliance on the aviation sector means direct comparison needs to be undertaken with some perspective.

These points having been made, the lack of funding support for SME's in measures announced to date could greatly aggravate the recession. New Zealand has achieved a far greater greater balance between income supports on one side and, on the other, tax measures and the magnitude of funding measures for business.

Even if matching New Zealand in the entirety of the size of its response is not warranted, doing so in relation to providing much greater assistance to small business funding measures seems essential

This point is also borne out by Figure 4.2.1 above: There is a greater balance between SME funding support and fiscal measures in other countries. Ireland's share of GNI* dedicated to funding supports thus far is just 0.2 per cent (0.1 per cent of GDP).

In the table above, Ireland is alone in being the only country not to provide substantial funding supports for SME supports. As noted above, however, over 99 per cent of employment in Ireland is provided for by the SME sector.

New Zealand's response to the Covid-19 crisis

Ireland	New Zealand
Population (Republic): 4.9 million	Population: 4.8 million
Trade as % GDP: 211%	Trade as % GDP: 56.4% *(World Bank, 2018)*
Trade as % GNI*: 129% *(World Bank, 2018)*	

Monetary response	Description
Macro-economic features	• **Just under (excluding health measures) NZ$16 billion / €8.7 billion** • **5.2 % GDP (excluding health measures)** • **"Cashflow and confidence" theme**
Tax package	**A €1.5 billion tax package** to increase business cashflow and stimulate investment mainly through: • tax deductions for new and existing commercial buildings • immediate tax deductions for low-value assets in the year of purchase, • easing requirements on small businesses to pay provisional tax (doubling the exemption thresholds) and lowering compliance costs • giving Inland Revenue Department given new powers to waive interest on late tax payments for those taxpayers that have been significantly adversely affected by COVID-19

Wages subsidies and Income support	**A €4.7 billion package of wage subsidies** key provisions of which are: • Support of $585.80 per week for a full-time employee (20 hours or more) and $350 per week for a part time employee. • Payment to be made as a lump sum for an initial 12-week period. **A €1.5 billion package of income supports** key provisions of which are • $480 million of additional funds allocated towards doubling the Winter Energy Payment to support beneficiaries and superannuitants. The rates for 2020 will be $40.91 per week (single people) and $63.64 per week (couples or people with dependents). This change is temporary. • $2.4 billion will be provided over the next four years to increase 'main benefits' in line with wage growth (indexation) AND then by an additional $25 per week (a permanent change). Families with children who are not receiving a main benefit and have some level of employment income each week will no longer need to meet an hours (means) test
Funding and Aviation support	**Up to €3.2 billion in loan support to New Zealand businesses through the 'Business Finance Guarantee Scheme'** **A €330 million package of supports for the airline sector.**

4.4 Duration and the need for a "2020 5-5 2-Budget" approach

In conclusion, while Ireland should not target the size of measures contemplated in larger or less open economies, a response beyond that announced to date is very likely to be needed.

To quote OECD General Secretary Angel Gurria on the OECD's latest analysis of the crisis, "Our analysis further underpins the need for sharper action to absorb the shock and a more coordinated response by governments to maintain a lifeline to people, and a private sector that will emerge in a very fragile state when the health crisis past".

The immediate magnitude of GDP decline forecast by the OECD – while not to be confused with the overall growth performance of the economy as a whole this year – speaks, together with the ESRI estimate – of the government's need to significantly augment its welcome initial measures announced on 24th March.

These measures approximate to approximately 2 per cent GNI – establishing a welcome base on which to tide the economy over during the month of lockdown – the government must now countenance a plan of action over a 3-year time horizon to do three things:

Firstly, during an "Emergency phase" (2020) stabilise and pre-emptively stimulate economy to speed recovery

Secondly, during a "Recovery phase" (2021) continue to stabilise and adapt economic and fiscal policy

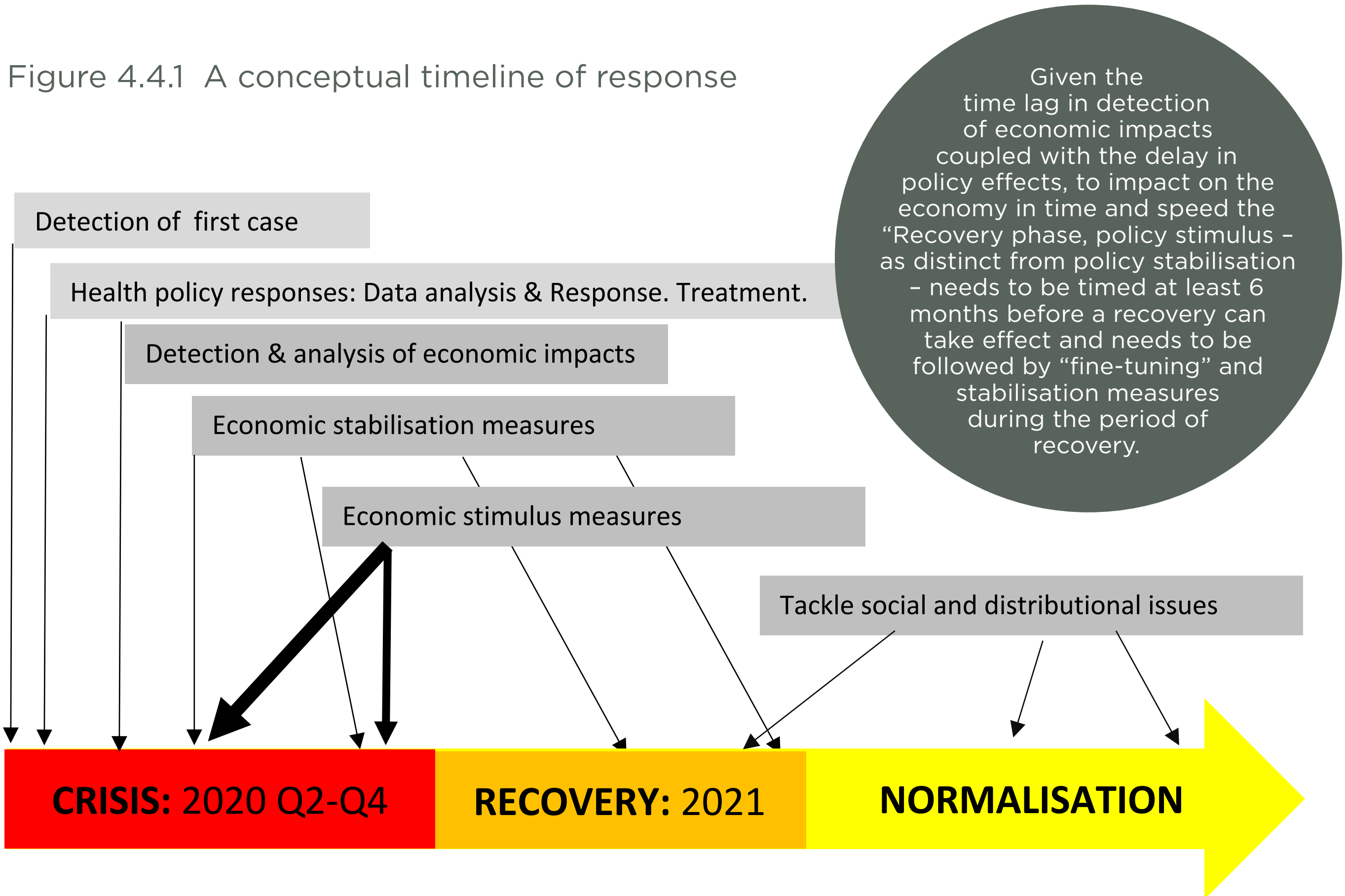
Thirdly, during a "normalisation" phase (2022) deal with social and distributional fallout of the crisis

During the "Emergency phase" a crucial "micro" element will be ensuring small businesses do not just maintain employment as assisted by already existing measures but are also recapitalised SMEs (see Chapter 6). Additionally, urgently addressing bottlenecks in testing, correctly using data analysis to contain and react to clusters of cases and addressing bottlenecks in treatment are all necessary managerial challenges that – by speeding the possible end of the lockdown – can accelerate transition from crisis to recovery.

During the "Recovery phase" the economic impact of stimulus measures should kick in. Here the distinction between fiscal stabilisation and monetary accommodation on the one hand and fiscal stimulus on the other must be noted. The importance of policy time lags must also be noted: To effect a recovery from the beginning of 2021, stimulus must begin in mid-2020.

Finally, during the "Normalisation phase" emphasis must shift towards the social and distributional aspects of recovery. As chapter 5 notes, the crisis will have very different sectoral impacts with some feeling the full brunt and others

Figure 4.4.1 A conceptual timeline of response



Conclusions

While tentative and open to constructive criticism, the author is of the view that the following concrete steps need to be taken in the coming six months:

- A June 2020 Budget targeting specifically the SME sector and Household sector to simultaneously recapitalise the former and stimulate demand in the former. Given the foregoing analysis this should aim for fiscal injection that, together with recent stabilisation measures announced in March, amount to approximately 6 per cent of GNI*. The additional 4 per cent – beyond existing measures – should be balanced evenly between recapitalising SMEs and stimulating household demand (see chapter 7)
- An October 2020 supplementary "Housing Budget" which, focussing on capital borrowing and once negotiations with the EU Commission on fiscal flexibility and a discussion of the possibility of a review of Ireland's Bank Bail out is concluded, will secure an additional 4 per cent of GNI* investment in the housing market. As this will create long-term infrastructure that will enhance productivity lower housing costs and generate tax revenues it should be exempt from the application of standard budgetary rules as discussed in Chapter 7.
- The magnitudes above are broadly consistent with the ESRI's "benign" scenario for the economy's decline this year (7.1 per cent GDP or 8.1 per cent GNP (implying a broadly similar growth outlook for GNI*) and being prudent in terms of not pushing the national debt ratio significantly above the crucial ratio of 120 per cent of GNI* (Budget 2020 forecasts are for General Government Debt to turn out at 100.2 per cent GNI* were to fall marginally below that to 97.4 per cent this year.
- In addition to the impact of a fiscal stimulus on this ration must be considered the impact of both tax revenue losses that could amount to between 7 and 15 per cent of GNI*. Chapter below strongly makes the case that if designed properly, fiscal intervention can mitigate and partly reverse tax revenue losses, as occurred in the 2009 budget and during the "Tallaght Strategy" years between 1988 and 1992.
- The government must avoid using its entire ammunition in one go and should allocate roughly one half to a "pre-emptive strike" in June of this year and the remaining half to a "fine-tuning" operation, if needed, during the normal month of October, by which time the economic impact will be much.

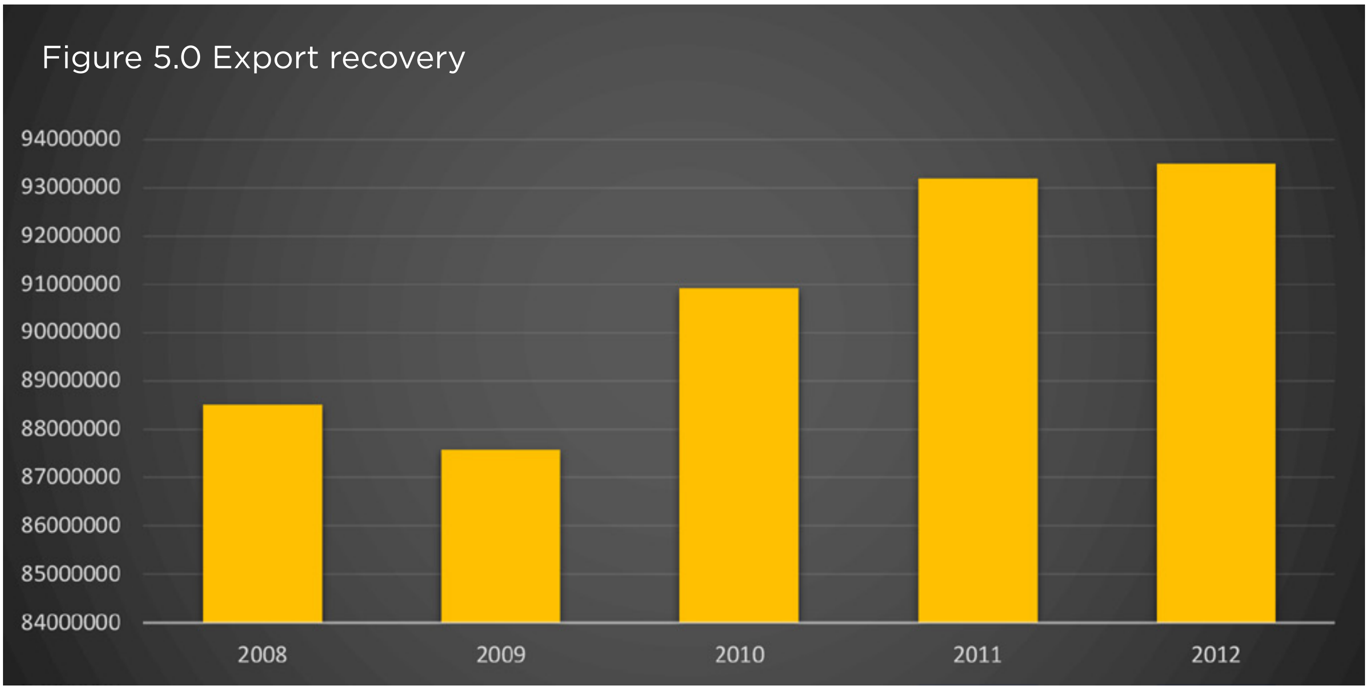
Chapter 5

Economic (micro) response: Design and Delivery

Perfect "V-shaped" recoveries are non-existent in most economies (although the experience of Hong Kong discussed in Chapter 2 did reflect a rapid recovery). Approximate V-shaped recoveries, however, are as demonstrated in Chapter 1 possible although in Ireland's case different sectors of the economy experienced very different recovery profiles during the last recession, the reasons for which are relevant to the preparation for the coming crisis. A crucial factor is confidence in the future – both confidence in investors that consumer demand will exist to justify risk taking today and also consumer confidence in income prospects to justify consumer spending.

The divergence between the approximate "V-shaped" recovery that broadly characterised the international economy on the one hand and the prolonged "U-shaped" recovery in more domestic sectors began from the year 2009 onwards. As shown in Figure 5.0 exports recovered strongly from 2009 onwards . As global export demand continued to grow strongly, multinational confidence in Ireland's growth-oriented policies towards foreign direct investment, supported (but by no means exclusively reliant on) a corporation tax rate of 12.5 per cent. The decision of successive governments to retain this relatively low tax advantage was critical to Ireland's continued export and Foreign Investment success beyond 2009. Tax policy developments as they impacted on domestic demand evolved in a very different manner.

As the subsequent section 5.2 shows, the sectoral impact of recovery was not shared by all sectors of the economy. Before elaborating on this point an analysis is conducted below of how Fiscal policy responded to the 2008 crisis.



5.1 Fiscal policy design: Issues

As Figure 5.1.1 shows, budgetary response began with a strong emphasis on tax increases which constituted nearly nine tenths of budgetary response in the first crisis budget of October 2008. This fell to seven tenths the following year in an emergency budget in April 2009. Both of these budgets impacted tax revenues in the fiscal year 2009 and in that year, revenues fell by €9.7 billion compared to the previous year and were €6.1 billion below forecast.

This implies not only the downward effect of macroeconomic trends – particularly a collapse in tax revenues related to the property market such as Stamp duties and Capital Gains tax– but additionally significant falls in those categories of taxation in which tax rate increases had been sanctioned in the two budgets impacting on that year such as Income taxes and excise duties.

In the subsequent year, however, something very different occurred (see also Figure 3.2.4C above). The December 2009 budget – impacting on the fiscal year 2010 – did not increase tax rates (except for carbon taxes and restrictions on certain income tax reliefs). Tax revenues in the ensuing year fell but due to economic reasons.

Besides this, key features of the economic outturn 2010 were noticeable:

- Tax revenues were €700 million above levels forecasted in the December 2009 budget
- Unemployment plateaued (see Figure 5.1.2 below) until March 2010. In that month agreement of government to the Cork Park Agreement signalled a policy shift making future tax increases and/or public sector job losses more necessary.
- Consumer expectations recovered markedly (see Figure 5.1.3 below) as measured by the KBC-ESRI consumer expectations index)

Figure 5.1.1 Balance of tax increases over spending cuts

Budget	**Intended fiscal adjustment (€bn)**	**Attempted tax revenue increase (€bn)**	**Tax revenue impact in fiscal year of impact**	**Dependence on tax increases**	**Tax yield relative to forecast in fiscal year of impact**
Oct 2008	2.6	2.30	-9.7	88% tax rate increases	1,826m **below** fcst
April 2009	3.9	2.70		69% tax rate increases	6,127m **below** fcst
Dec 2009	3.2	0.10	-1.3	3.1% tax rate increases	1,357m **below** fcst
Dec 2010	5.6	2.40	+2.2	52% tax rate increases	703m **above** fcst
Dec 2011	3.2	1.60	+2.6	50 tax rate increases	873m **below** fcst
Dec 2012	3.5	1.65	+1.1	47% tax rate increases	144m **above** fcst
Oct 2013	2.5	0.90	+3.5	36% tax rate increases	1,266m **above** fcst
Total	**23.5**	**11.65**		**50%**	**Tot. 7,537 below fcst***

Source: Revenue Commissioner (Exchequer Returns data)

In overall terms – looking at the sweep of budgetary policy from 2008 to 2014 – the performance of budgetary policy can be characterised by a both deterioration of the domestic economy with a brief respite in tax performance, unemployment and consumer expectations, before a relapse after 2010 when, in spite of a strong recovery in external demand, the domestic economy remained subdued until 2014.

This conclusion is supported by a contrast between budgetary policy between 1983 and 1987 inclusive, when budgetary policy strongly emphasised tax increases and a subsequent strategy of avoiding tax increases or cutting taxes between 1988 and 1992 inclusive.

During the former period, GDP growth averaged 0.3 per cent per annum and unemployment rose persistently to peak at 18 per cent and tax revenues underperformed. During the latter, GDP growth averaged 3.2 per cent and unemployment began to stabilise.

More importantly, tax revenues increased significantly in the latter compared to the former period. It should be noted that global economic conditions during the latter period were, if anything, more adverse due to the 1991 global recession, whereas the mid-1980s were a period of strong economic performance in Ireland's key trading partners at the time, the US, UK and Germany.

While and exchange rate adjustment was an element in this transition (enabling a helpful lower and more stable interest rate environment in the latter period) that in itself was underpinned by confidence in a commitment to a model of fiscal stability based on declining tax rates and increasing tax revenues.

Figure 5.1.2 Unemployment April 2009 – Dec 2010

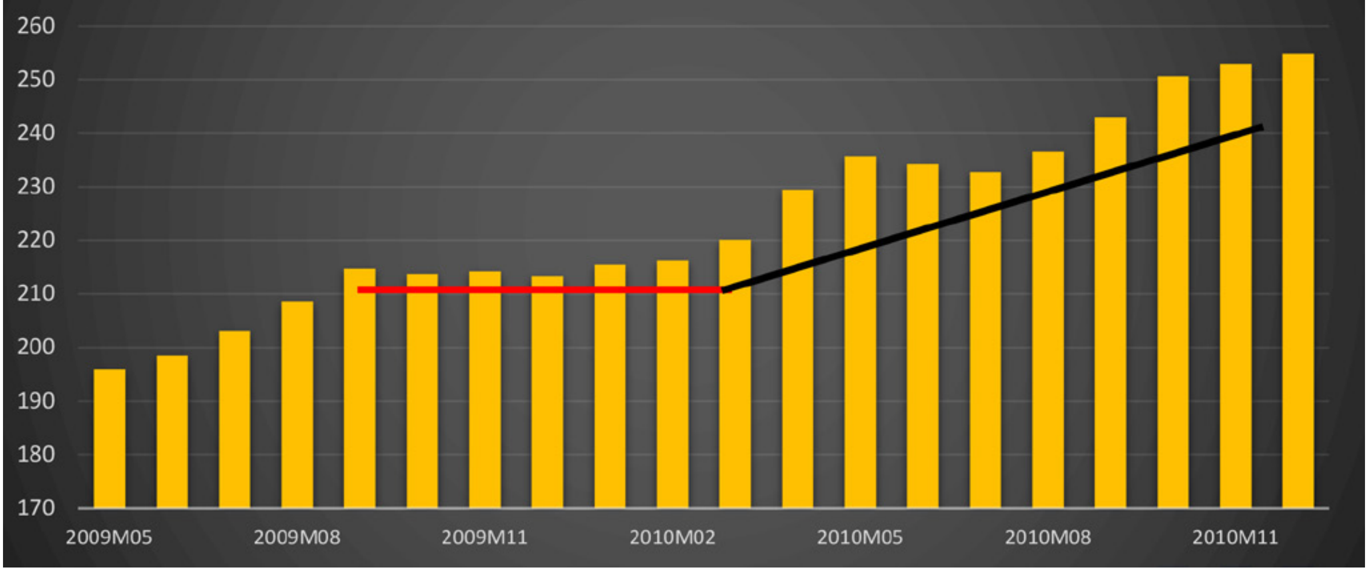
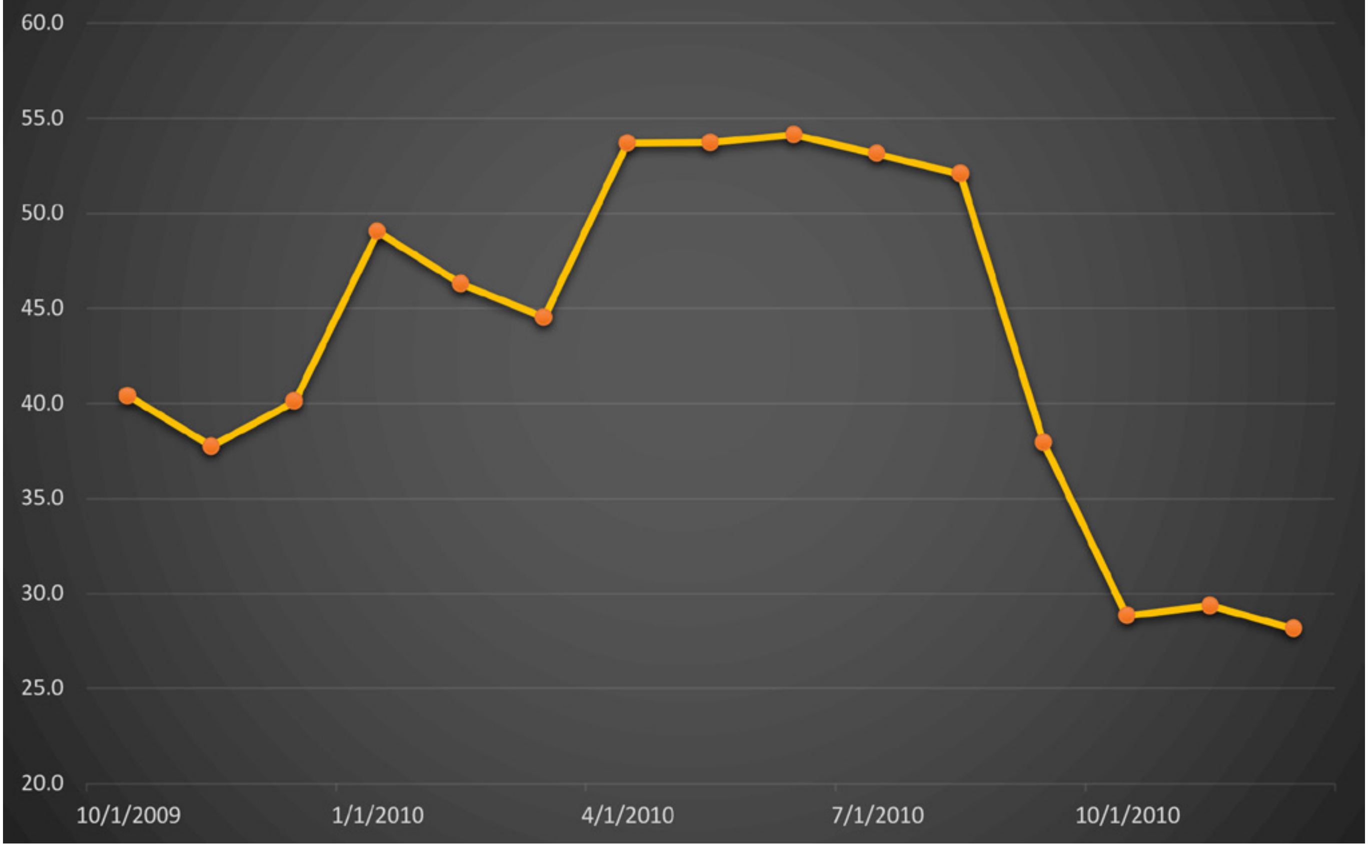


Figure 5.1.3 Consumer Expectations in the wake of December 2009 budget



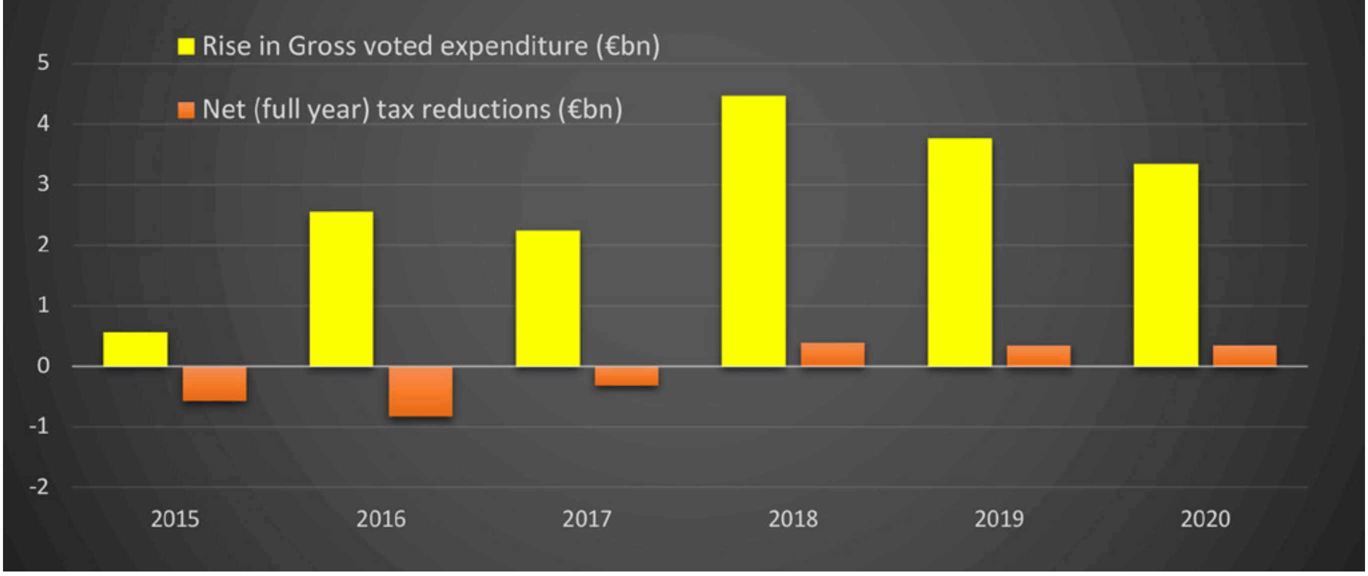
Whereas the immediate response to the last crisis emphasised tax increases as a policy response, fiscal policy during the recovery has heavily emphasised increase in public spending.

Contrary to some perceptions and narratives in net terms – once increases in other tax rates are balanced against reductions in direct tax rates and the Universal Social Charge – there has been relatively little reduction in the overall tax burden despite five years in which the economy recovered so significantly.

In every fiscal year since 2015 public spending has been increased, slowly at first but significantly to the point where projected Gross voted expenditure for 2020, some €70 billion euro, now stands 32 per cent higher than in 2014, the year in which recovery began in earnest. In total this represents an increase in expenditure of some €16 billion over a five-year period.

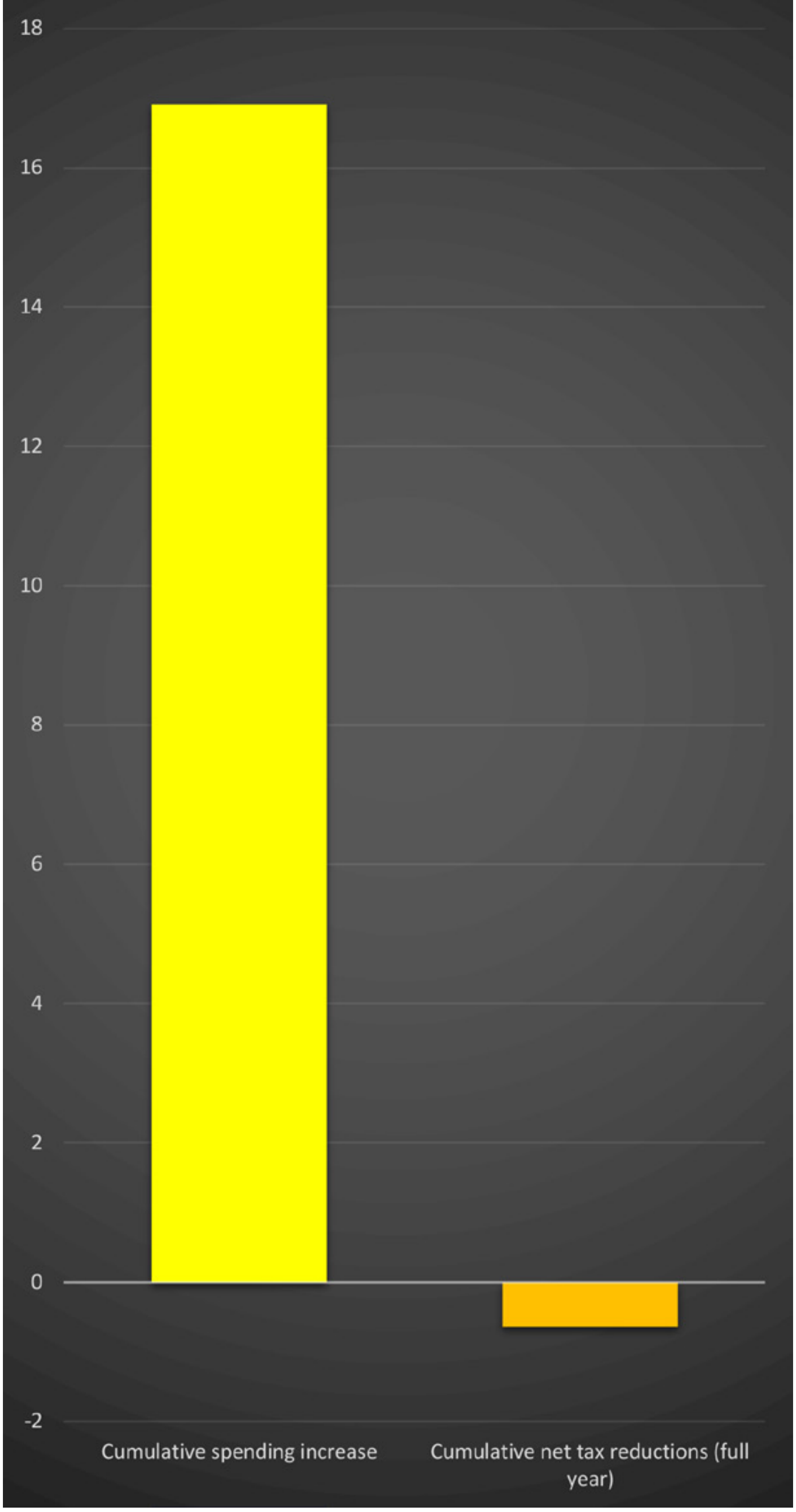
By contrast, while some net reduction in the austerity tax burden was seen during the first three full years of recovery this was followed in 2018 and 2019 by modest increases in the overall tax burden and a modest projected increase for 2020. This is shown in Figure 5.1.4 below.

Figure 5.1.4 Spending increases versus net tax cuts 2015-2020



Looking at the cumulative change in spending over tax reduction, the contrast is quite stark. Whereas over the period of crisis taxpayers bore approximately one half of the burden of intended fiscal adjustment (see Figure 5.1.1 above) and intended reductions in spending the other half, there has been no such balance in terms of sharing the gains of recovery.

Figure 5.1.5 Cumulative spending increases and net tax cuts (full year) €bn 2015-2020



Quite the contrary. As Figure 5.1.5 demonstrates, the cumulative impact of spending increases between 2015 and 2020 inclusive dwarfs the cumulative net impact of tax reductions by a factor of over 26 euro spending increase for every 1 euro of net tax reduction. It should be mentioned that during the two general elections in this period, the party that won the plurality of votes promised a ratio of 1 euro in tax cuts for 1 euro spending rises.

As for the foregoing analysis shows, the strongest driver of the recovery – the multinational sector – is the sector in which Ireland's relatively low (compared to its Gross Value Added) share of taxation is a key (but by no means the only) factor. For good reason the rate of corporation tax has been maintained in the national economic interest at 12.5 per cent. Implementation of the OECD initiatives to counter Base Erosion and Profit Sharing has resulted in an incremental reduction of corporation tax receipts of €500 million per annum last January by the Department of Finance. There is a strong contrast between Ireland's relatively low (one of the lowest in the world) rates of corporation and its relatively high rate of marginal personal taxation and social charges and insurance on incomes of €50,000 per annum – a gap of 40 percentage points –with mainland EU economies in which marginal income taxes and rates of social insurance on average or just above average incomes are more in line with corporation tax receipts.

5.2 Sectoral considerations revisited

The contrast between the performance of the domestic and external economies in over this period is stark. In the years for which full year national accounts data exist, 2015 to 2018 inclusive, Figure 5.2.1 shows how Household consumption rose by 20.4 per cent, compared to an increase in net exports ten times greater, 205.2 per cent (current market values are used to relate to the foregoing analysis of tax revenues.

Figure 5.2.1 Household Consumption and Net Export growth 2015-2018 inclusive

Current market values	Growth between 2015 and 2018 inclusive (% change)
Household consumption	20.4
Net exports	205.2
GDP	66.3

Source: CSO

Ireland's strong export performance is salutary. However, given both the decision to maintain Ireland's low corporation tax rates while maintaining significantly higher rates of marginal income taxation and the fact that as shown below the domestic and particularly low wage sectors of the economy are likely to be impacted most by the coming crisis, the challenge now is to consider how to achieve a greater balance during the coming crisis.

When asked by the Central Statistics Office in 2010 – the depth of the previous crisis – what factors were inhibiting the growth of their enterprises, business leaders were unambiguous in their response: 89.8 per cent responded that the economic outlook was the single most worrying factor. Given the particular sensitivity of demand in spending in retail, hotels, restaurants and other sectors most affected by the crisis, stimulating demand will be particularly important to restoring businesses and jobs.

Figure 5.2.2 Factors limiting growth of Enterprises in 2010

	Percentage of respondents
Economic outlook	**89.8**
Price competition	60.5
Local/domestic markets	53.7
High cost of labour	49.3
Market competition	47
Burdensome regulations	33.4
Not enough financing	25.4
Investment in equipment	12.1
Foreign markets	7
Technological competition	5.2

Products getting outdated	3.8
Availability of personnel	2.8
Loss of existing personnel	2.8
Access to information technology	1.6

Another feature of that year was the significant deterioration in businesses, particularly small businesses, able to access loan finance. From 93.2 per cent in 2007, only 66 per cent of businesses with between 10 and 49 employees were able to access loan finance in 2010. Clearly both issues go hand in hand. The government has taken welcome steps to enable small business to access funding. But if concerns about the future of the economy are not addressed, this will not be availed of to the extent necessary. Clearly action must be taken not just to facilitate recovery, but to stimulate it also.

Chapter 6

A Budget for SMEs and Households

Ireland must design a response based on its own specific economic challenges. It can, however, note approaches in other countries. While the full extent of consumer stimulus response implemented in New Zealand (see inset, Chapter 4) may not be needed given Ireland's lesser reliance on domestic demand, Ireland is likely to need to go further than it has and the "cashflow and confidence" theme of New Zealand's response is also a good one for the Irish economy. As explained in previous chapters some sectors of the economy in Ireland have not shared in the full extent of recovery and are now once again more vulnerable than others. Those sectors – households with income earners in less secure employment and in particular the risk takers and entrepreneurs – must now be to the fore.

6.1 An already challenged sector

As outlined from Chapter 1 and in subsequent chapters, Ireland's recent economic success has been strongly driven by the multinational sector. Even aside from the challenges of Covid-19 and the challenges of Brexit before then, the Small and Medium Sized (SME) enterprise sector has faced significant challenges in an economy where living costs, resultant wage pressures and relatively modest (compared to overall economic growth) growth in domestic demand mean recovery has not impacted on SMEs with the same force as on the externally driven economy.

Given the higher share SME employment in regional Ireland (shown in Figure 6.2 below for industry but largely true also for the Services sector) and the results of the recent general election, the prioritisation of SME policy in budgetary policy – to complement good initiatives in relation to export oriented and high-growth start-ups – was already overdue, particularly in the light of Brexit.

Welcome initiatives by the Department of Business Enterprise and Innovation, Enterprise Ireland and Local Enterprise Offices include a €300 million loan scheme, Enterprise Ireland's Brexit Advisory Clinics and a Brexit Mentoring Programme. Given the potential magnitude of Covid-19, even compared to Brexit, and the underlying problems facing the SME sector, a full budget is now required in June 2020 to address the needs outlined below. In May last year a consultation report was published by the Seanad providing critical insights into the SME challenge in Ireland. A summary of its findings and recommendations are presented below in Figure 6.1

Figure 6.1 Key Findings of the 2019 Seanad Public Consultation Committee Report on Small and Medium Sized Businesses in Ireland

Key Findings	Details
Employment share	99.8 per cent of total active enterprises are SMEs
Sectoral coverage	SMEs are 93.6% Irish owned and account for 65% of employment
Strategic focus	SMEs account for 31% of exports
	25% of persons engaged in SMEs are in highly Covid-19 exposed wholesale and retail
	37% of SMES are in rural areas with no cities
Key issues	Even before the onset of Brexit and Covid-19 financing and funding were key concerns of SMEs
	Ireland's high growth economy also presents challenges for recruiting and retaining talent
	The range of supports available, while appreciated, are difficult to navigate for SMEs
Key recommendations	Introduce a Minister of State for SMEs
	Embed entrepreneurial education in schools
	Establish a task force to create a coordinated strategy for SMEs in more traditional sectors

The key recommendations of the Seanad report included

- Establishment of a Minister of State portfolio for SMEs
- Review and improve Capital Gains Tax entrepreneur's relief by introducing a 12.5 per cent rate with no lifetime cap (threshold) on gains
- Review the Capital Gains Tax with a view to reducing the 33 per cent rate in line with international standards
- Evaluate and align SME supports with the diversity of SMEs in Ireland
- Promoting entrepreneurial education in Ireland
- Improved broadband provision
- Inventorise and share information on skills and talent as well as potential investors

Definitions of SMEs included three categories:

- Micro (fewer than 10 employees and less than €2 million turnover)
- Small (10 to 49 employees, turnover million or balance sheet not exceeding €43 million)
- Medium (50 to 249 employees, turnover not exceeding €50 million or balance sheet not exceeding €43 million)

The policy context and priorities driving policy heretofore, as noted in the above report, included

- Promoting innovative capacities of enterprise and targeting high-technology sectors as "clusters" of activity
- Driving exports (in a Brexit context)
- Scaling enterprises

It was already noted by the report's contributors that while laudable and understandable, these priorities failed to capture the diversity of the Irish SME sector, in particular the need to be more inclusive of SMEs outside of Dublin, both high-tech and traditional.

Starting from this point of departure and given the urgency of the Covid-19 challenge, this report regards these findings as a baton to be passed to government for action and acceleration.

6.2 New challenges

As with the housing crisis and the imbalance between growth in the multinational and domestic sectors of the Irish economy – problems that have been accumulating for years – the challenge facing the SME sector is one to which the Covid-19 crisis adds urgency.

Welcome measures taken by government so far include, with observations.

The key observations are that the measures taken by government thus far do not account for the forecasts made by the ESRI and Central Bank of Ireland. As well as adapting to these forecasts, contingency planning for much more substantial impacts on the Irish economy arising from the transmission of global shocks needs to be made.

Consequently, there is a need to provide for a "Budget for Small Business" to take place in June of this year. As well as policy timing impact – in order to stimulate re-investment and consumer spending in time to give an impetus for recovery in 2021, confidence and stimulus needs to be injected as soon as possible in the second quarter for policy to take effect, given transmission lags. The German government has extended the role of the Kreditanstalt fuer Wiederaufbau (KfW) in response to the crisis and that this proposal seeks to extend the work of its equivalent the Strategic Banking Corporation of Ireland (SBCI). It might be noted here that the establishment of the SBCI in October 2014 was foreshadowed a year earlier by the recommendation (Coleman & Ralf, Ireland and Germany Partners in European Recovery, 2013) that an equivalent to the KfW be established in Ireland. Thus the recommended extension of the SBCI's mandage here is consistent with the recent extension of the KfW's legal mandate under Germany's *Wirtschaftsstabilisierungsfondsgesetz "WStFG" Act* by the German government to tackle Covid-19.

The proposed magnitude should be evenly split and – inclusive of measures already announced (amounting to 2 per cent of GNI*) – should comprise of a total of 6 per cent of GNI* broken down as follows:

- **Stabilisation measures to date for immediate lockdown**
  €4 billion = 2 per cent GNI*
- **Small Business Recapitalisation measures**
  €4-5 billion = 2 – 2.5 per cent GNI*
- **Stimulation of consumer and business demand**
  €3-4 billion = 1.5-2.0 per cent GNI*

In total this amounts to an unforeseen (at time of last Budget) expenditure commitment of approximately €12 billion which, when added to a possible €12 billion loss in tax revenues (see Chapter 3) would, from a position of budgetary balance, imply a budget deficit in the region of 12 to 13 per cent, slightly lower than recorded in 2009. However, while the two budgets that impacted on the deficit in 2009 and which tried but failed to raise tax revenues by raising tax rates, the proposed strategy is targeted at those sectors most in need of and most likely to respond to stimulus. The first batch of measures are outlined in Figure 6.2.1 below:

Figure 6.2.1 Measures taken to date to support SMEs

Measure	Description	Observations
Covid-19 Wage subsidy scheme	Up to 70% of take-home pay up to €410 per week	Need to ensure criteria do not discriminate against more viable, durable firms
Covid-19 Working Capital scheme	€200 million loans available through the Strategic Banking Corporation of Ireland (SBCI)	Welcome as a temporary measure but , given subsequent forecasts (see Chapter 3) these now need significant expansion in ambition (see below).
Rescue and Restructuring scheme	€200 million package of enterprise supports through Enterprise Ireland	
MicroFinance Ireland Covid-19 Business Loans	Loans with six-month interest and repayment moratorium	
Revenue Commissioner support	Suspension of interest payments on late payment of VAT and PAYE liabilities. Debt enforcement activity suspended. Contract Tax rate review for subcontractors scheduled for March suspended.	
	70 per cent of per crisis childcare staff costs suspended. Government will reimburse childcare employers 30 per cent of pre-crisis staff costs with retention top up. 12-week duration.	

EU	Relaxation of State Aid rules to enable €800,000 grant to a company through direct grant or tax advantage	
European Investment Bank	€40 billion financing package towards bridging loans, credit holidays and other measures	

Measures to stimulate the Small Business Sector are summarised in Figure 6.2.2 below. Added to the welcome Government measures announced on March 24th they address issues of undercapitalisation of SMEs identified prior to the Covid-19 crisis as well as the challenges of Brexit not to mention the recommendations of last year's Seanad Consultation report on SMEs (see above). When compared to the magnitude of the bank bail out – see the Annex to this report, their overall size – some €4 billion to recapitalise SMEs - is modest. When account is taken of over €5 billion spent annually supporting Non-Government Organisations they are good value for money. As risk takers and employment creators the SME sector is asking for a significantly lesser amount. As illustrated in this report in the very same Annex, the European Council – in subsequently agreeing to the Single Resolution Mechanism – accepted the principle that henceforth taxpayers should not bail out banks.

Even a modest retrospective application of this principle to Ireland's bail out costs would be more than enough to fund the proposed recapitalisation of the SME sector.

In addition to the overall size of the proposed measure a key aspect of the design warrants mention: Cost Flexing. During the last crisis, the SME sector faced drastic demand reductions and huge competitive price pressures (see Figure 5.2.2). However, they were unable to weather the impact of this in relation to key overheads. We need a national conversation, as well as decisions from government, to ensure that the costs of adjustment are not just borne by the private SME sector, but that adequate pass-through is also possible. Social justice demands that the main risk takers in our economy – the entrepreneurs and those who work for them, the people who, in the process of risk-taking and working, generate tax revenue for the state - do not bear 100 per cent of the risk of this crisis. The risks need to be fairly distributed.

Figure 6.2.2 Desirable measures to support SME Recovery

Category	Description	Observations
Finance	Create, under the auspices of the SBCI a Business Reactivation Funding Scheme	€4- 5 billion should be allocated to this scheme to provide working capital to businesses that need to reactivate after the Covid-19 crisis.
		It should enable unsecured loans up to €500,000 with no repayments up to 12 months, interest only repayments for a further 12 months and the remaining balanced structured as a 3-year term loan. It should not incur personal guarantees

Cost Flexing	Find measures to enable small businesses to pass on impact of demand reduction to key overheads (rents, rates) in partnership discussion with national and local government	This touches on a key issue namely the extent to which the risks and burdens of adjustment of this crisis are going to be evenly distributed across the economy or whether the risk-taking sector will again the main brunt of adjustment. Social and political cohesion demands the former approach.
	To preserve employment, SMEs should have flexibility to temporarily re-allocate employees to work areas of greatest need within the company. viability.	This corresponds to the government's own redeployment of public servants during the crisis and is consistent with concepts of "Flexicurity" advocated by the trade union movement before the last crisis – a combination of protecting jobs while enabling flexible interpretation of work contracts
Other	Noting EU relaxation of state aid rules, Government should examine the feasibility of prioritising local suppliers in the SME sector in relation to additional health spending (approximately € 2 billion)	In assessing government response measures to support the economy this report has not included health spending, regarding it as rather a needed additional spending. If targeted at the SME sector, however, such spending could be regarded as stimulus to the economy.

6.3 Stimulating the Economy

Finally, as argued above there are very strong reasons for considering a stimulus to the economy.

Before elaborating them, it must be pointed out that measures announced to date – both government and Central Bank and European Central Bank measures – are not stimuli to the economy but rather constitute fiscal and monetary stabilisation measures.

Without adequate consumer demand in the future and credible anticipation of same, businesses – no matter how well capitalised and whether large or small – will not have the confidence to invest in recapitalisation.

As Chapter 5 demonstrated, increases in taxation were a heavy feature of the early part of the crisis, and not a successful one.

Moreover, the one crisis budget that signaled a change of direction in relation to tax cuts (December 2009), resulted in the ensuing year seeing consumer confidence rebound, a stabilisation of the unemployment rate and a tax take that was significantly above forecast.

The reversal of this policy was followed by a reversal of these positive trends in the domestic economy and a relapse to recession until early 2014.

Contrary to some narratives, the recovery has not seen any significant tax reduction in net terms, and, when some early partial reversals of crisis "tax-sterity" on personal taxation and the Universal Social Charge are offset by the impact of significant increases in other tax heads, the cumulative impact of budgetary tax measures between the years 2015 to 2020 inclusive amounts to a net tax reduction of between €600 million and €700 million over a period in which GDP increased by at least €80 billion and even GNI* increased by at least €40 billion euro.

When compared with the €16 billion increase in government spending over the period it is clear that for every €1 in net tax reduction intended by Budgetary policy between 2015 and 2020 successive budgets effective an increase in government spending of €26 euro.

Much of this increase was justified. For instance, the salutary work of healthcare professionals during the Covid-19 crisis is a clear illustration of the case for the restoration last year of crisis reductions to public sector pay.

What is less clear is why those risk takers – many of whom suffered job losses, dramatic income loss, loss of business and painful financial and personal re-adjustment, only to re-emerge to create jobs and generation tax revenues – were not similarly rewarded by a reversal in the very significant burdens of tax increases they bore during the crisis, burdens that were not compensated for by any job security or pension entitlements.

Together with the high cost of living in Ireland – in most counties house purchase on the average industrial wage is now impossible – the high marginal rates of taxation and high rates of indirect taxation are not just an obstacle to consumption growth. They are also a significant disincentive to entrepreneurial activity here.

Finally, government spending has not only been restored, but now exceeds pre-crisis levels. The tax burden, however, remains for many close to crisis levels.

To rectify this, and to rebalance budgetary policy towards a more even balance between spending growth and tax reduction, Figure 6.3.1 below outlines a range of possible tax reduction – and one spending measures that will restore fairness and stimulate demand at this vital time.

Figure 6.3.1 Desirable measures to Stimulate the Economy

Category	Suggested measures	Comment
VAT	Consideration for a zero rate of VAT for the duration of the crisis and thereafter a 9 per cent rate restored for sectors most affected by the crisis (Hotels and Food services (restaurants), Wholesale and Retail, Arts Entertainments, etc)	It might be noted that Hong Kong, with which Ireland was compared in relation to the SARS crisis of 2003 (see Chapter 2) does not have a VAT or sales tax. Hong Kong's indirect taxation system has long been regarded as a reason for its rapid ability to recover from economic shocks such as the SARS crisis and, before then, the Asian Financial Crisis of 1998/199.
Income Tax/PRSI	Consideration should be given to waiving PRSI in full during the duration of the crisis and also to reducing the top rate of tax to incentivise small business owners and stimulate demand	PRSI funds recorded a surplus of €1.4 billion in 2019
Universal Social Charge	Consideration given to further reductions	When introduced the USC was intended to be abolished once recovery had taken hold
Corporation Tax	Consideration to zero rating for the duration of the crisis. Consideration to property tax deductions for new and existing buildings, as in New Zealand	
Capital Gains Tax	Consideration to reducing the rate of CGT	The reduction of CGT may yield increased revenues.
National Training Fund	The National Training Fund should be fully used to fund employer led training to reskill workers affected by the crisis	The National Training Fund surplus is set to climb to €1 billion in 2020 and is funded by a levy on employers

As it is the prerogative of the income government – as a democratically elected government – to decide the precise allocation of budgetary policy Figure 6.3.1 sticks to suggesting broad outlines of policy direction.

6.4 Equity and confidence in policy making

A final comment should be made in relation to the narrative on taxation. Most commentators in favour of increased taxation are not from the SME sector. The voice of the SME sector within policy making is weak. The imbalance between SME and private sector taxpaying voices within media and government policy making processes on one hand and on the other the voices of those organisations representing tax funded entities – entities with a strong interest in bolstering and increasing the tax funding that secures their income and the pay and pensions of their staff – is very imbalanced.

For instance, at one recent event planned by government to discuss SME funding on 30th January of the 13 planned speakers, twelve were from publicly funded bodies and just one (7 per cent) actually represented the business sector affected by the topic of discussion. The same figure (7 per cent) applies to the share of recruits from the private sector to the top of the public sector in the last year (2017) for which data is available.

As Ireland digests the recent impact of an unprecedented general election this year and prepares for an equally if not more unprecedented disruption to the very core of its economic and social life, such imbalances can no longer be permitted. A policy of diversity – so rightly and assertively promoted in relation to securing more women in senior positions in the public sector and on state boards – must now be pursued with equal vigour in relation to ensuring that at the top of policy making structures in government and the public sector contain a fair and proportionate mix of those whose experience will assist the talented professionals already in the system to design policies that are fair and seen to be so by the private sector, Taxpayers and SME community.

Chapter 7

A Budget for the Housing sector

7.1 Ireland's lost decade of public investment 2008-2014

The Covid-19 crisis presents not only an opportunity, but a necessity, to address the housing crisis. This is true from an economic as well as a political point of view.

Economically, as shown in Chapter 1, housing investment is a relatively employment-friendly form of public spending and one that can be more regionally diffuse.

Politically, the message from the 2020 general election is that the political system is already buckling under pressure from a young population that feels alienated from the future.

Prompt action to correct this will help improve both confidence in the future of the economy but also confidence in the responsiveness of the political system at a crucial time.

Between 2008 to 2018 371,900 new citizens entered the state ,178,100 new families were formed and yet a mere 98,900 new dwellings were created over this period.

From 21% in 2008, public investment fell to just 8% of total investment in 2018. The contrast between the rise in total investment in the economy, from €46 to €77 billion, and the fall in public investment from just under €10 to €6.3 billion is noteworthy.

In 2019 public investment recovered further, however it has yet to reach anything like its previous proportion of total investment in the economy. With the Covid-19 crisis likely to severely curtail private investment, a significantly higher proportion of public investment as a share of total should be targeted than was achieved in 2008.

Figure 7.1 Ireland's lost decade of public investment

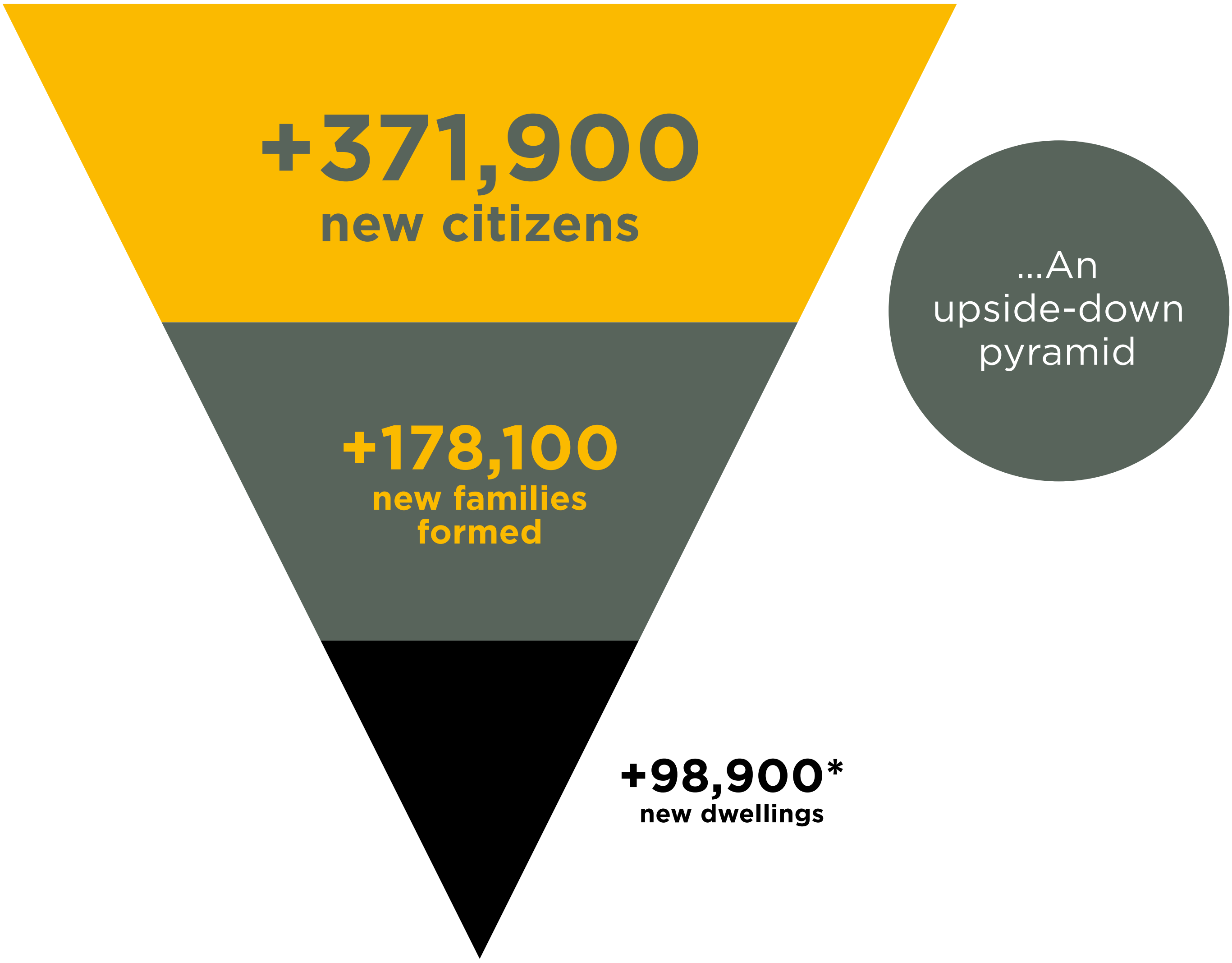
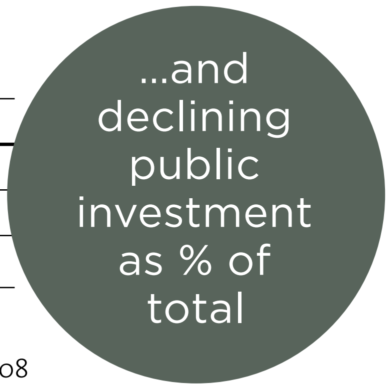


Figure 4.1.1 Ireland's key Service trade partners

	2008	2018	Change	% Change
Total investment	46.2bn	76.9bn	**+30.8bn**	**+67%**
Govt investment	9.9bn	6.3bn	**-3.5bn**	**-36%**
Govt % of total	21%	8%	-13 pp.	



Given our rates of growth in population (+8%) and family formation (+12%) since 2008 our rates of public investment (2.5% GNI, 1.9% of GDP) are relatively if not very low.

The 5% GDP share of public investment in 2008 is not just a credible benchmark but given subsequent population growth, an arguably conservative one.

To create the fiscal freedom to do so in terms of making the case to the EU Commission during Fiscal Treaty procedures, consideration must be given to the following key features of Ireland's economy:

- At 37.9 Ireland has the EU's youngest median age (EU average 43). As well as indicating a higher need for public investment this signals that a higher level of private sector indebtedness compared to the EU average is, to a certain degree, warranted.
- Younger countries tend to have greater needs to finance house purchase, car purchase and other personal investments compared to older countries whose citizens are more likely to have accumulated assets and paid off loans.
- At 6.8% (GDP for comparison with EU), Ireland had Europe's fastest rate of economic growth in 2018. While recession is now certain, the accumulated infrastructure deficit of several years of rapid growth relative to our peers still remains to be dealt with.
- Ireland has by far Europe's fastest rate of population growth over the last decade (8% between 2008 and 2018)

As the following table shows Ireland's public investment growth has not kept pace with the dramatic change in the economy. As well as the points noted above Figure 7.2 illustrates further striking facts:

- The number of dwellings completed annually has fallen from 51,724 per annum to 18,702
- While total annual investment in the economy has risen by €31 billion, investment in new dwellings is lower by over €7 billion per annum.
- Government investment as a share of GDP fell dramatically from 2008 to 2018, although it should be noted that it has since increased in 2019 (the reason for reporting 2018 figures below is to enable comparison with National Accounts data which is only available up to 2018 on a full year basis).
- The fall in government investment as a share of the economy contrasts with a broadly steady share of overall investment in the economy. As noted in Chapter 3 (section 3.2.2) above, however, the CBI expects underlying investment to contract severely by 24.3 per cent in 2020, strengthening the case for countervailing government action.

Figure 7.2 Ireland's lost decade of public investment

2008-2018: A LOST DECADE OF PUBLIC INVESTMENT

	2008	2018	Change	% Change
Population	4,485,100	4,857,000	**+371,900**	**+8%**
Family formation*	1,543,400	1,721,500	**+178,100**	**+12%**
Dwellings completed	51,724	18,702	**-33,022**	**-36%**
GNI* (current prices)	157bn	197bn	**+31,900**	**+19.3%**
GDP (current prices)	188bn	324bn	**+136bn**	**+72%**
Total Investment	46.2bn	77bn	**+31bn**	**+67%**
of which dwellings	14.5bn	7.1bn	**-7.4bn**	**-51%**
Govt Investment	9.9bn	6.3bn*	**(3.6m)**	**-36%**
Total investment %GDP	24.6%	23.8%	*Total Inv. steady as % GDP*	
Govt Investment %GDP	5.3%	1.9%	*Govt Inv. more than halves as % GDP*	
Govt Inv % Total Inv	21%	8.1%	*Govt share of Total Inv. fell 38% 2008-2018*	

7.2 Ireland's case for flexibility in relation to EU Fiscal rules

The EU Commission has proposed to the European Council to apply the full flexibility provided for in the EU fiscal framework to enable measures needed to contain the negative impacts of the Coronavirus.

As the foregoing analysis shows the case for housing investment clearly needs to be taken on a stand-alone basis for Ireland, quite aside from the pressures of Covid-19. Therefore it is important that this is recognised in addition to the Covid-19 crisis so that the application access to an "escape clause" can include spending on housing that, while it will significantly assist in countering the impact of Covid-19 on the economy, would be needed in any event.

An acceptable approach would be to regard the General Government Balance targets agreed with the Commission heretofore as current balance targets. Additionally, this approach would entail enabling our GGB to rise to 3% each year until 2025, which would - with simplifying assumptions for 2025[3] - enable an additional capital spend of €9 billion rising to €12 billion per annum, bringing total capital spending to between 5% and 7% of GDP out to 2025 (comparable to 2008).

Abstracting from the impact of the Covid-19 crisis, the impact on the fiscal balance as applied to Budget 2020 projections is laid out in Figure 7.3 below

Figure 7.3 The impact of applying EU fiscal rules to the Current, rather than General, Government Balance

	2020	**2021**	**2022**	**2023**	**2024**	**2025****
GGB*	-0.6	-0.2	0.1	0.4	0.7	0.7
GDP (euro bns)	351.3	365	380	396	412.5	412.5
Additional spending from Stability Pact reform (€ bns)	**8.4**	**10.2**	**11.8**	**13.5**	**15.3**	**15.3**
Gross capital spending*	9.3	10.8	11.1	11.4	12.0	12.0**
Adjusted capital spending	17.7	21.0	22.9	24.9	27.3	27.3
Adjusted capital spending % GDP	5%	6%	6%	7%	7%	7%

*Budget 2020 forecast
** Assume zero GDP growth 2025

A caveat is that as a share of GNI*, Ireland's public debt is now significantly higher than in 2008 (at 100 per cent of GNI*). Compared to the current spending reasons for rising debts in the previous crisis Ireland is now ironically constrained from making urgently needed capital investments.

3. Department of Finance forecasts for 2025 are not yet available. A prudent "zero growth" assumptions is made for 2025.

In that light consideration should be given to discussing the terms of the agreement reached at the EU summit of June 2012 on the Single Resolution Mechanism and whether a possible retrospective partial funding for Ireland's bank bail-out can be countenanced in the light of significant housing needs.

While not politically easy the urgent necessity of the current situation means that every avenue will need to be investigated and discussed in the light of recent political developments in Ireland and forthcoming economic challenges.

Chapter 8

Conclusions

In responding quickly to both the health challenges of the Covid-19 crisis and the need to provide support to maintain employment, the government and public policy system has performed well. The challenge now is to ensure that the medium to long term shocks that may be lying in wait are prepared for with a keen eye on the sectors most at risk from the current crisis.

In preparing for that some reflections may be helpful, reflections drawn from over a quarter century of monitoring, analysing and prescribing policy solutions for a range of economic challenges, through crisis and recovery.

Firstly, Ireland has recovered before and can and I believe will recover again. This was the central message that, with the endorsement of TK Whitaker, I conveyed in my first book predicting both crisis but also recovery and also in a subsequent book in 2009.

During that period the overwhelming pull of sensationalist negativity was hugely damaging. That negativity did not cause the crisis and in some cases was an understandable reaction – exasperation – resulting from failures to heed warnings that had been issued. Having warned clearly of the coming crisis in a series of articles in the Irish Times between July 2005 and most notably on July 6th 2006 – I can well understand that exasperation.

But it behoves all policy commentators to exercise judgement now. During the Second World War, the saying "Loose Talk costs Lives" urged citizens to avoid saying anything that might either demoralise compatriots or provide information to adversaries. Now the watchword should be "Loose talk costs livelihoods". The exhortation to caution is not an attempt to slience debate about the seriousness of the situation we are in. Rather it is to make the point that the situation is serious enough with out making it worse. If at the bedside of a loved one the night before they are facing a life saving serious operation with a 50 per cent likelihood of success and a 50 per cent likelihood of death, which would one choose to focus on? Exactly. In this crisis positivity might be too much to ask for. But stoic and informed determination is possible.

Secondly, a regrettable feature of global policy in the last 5 years has been the decline in global policy coordination. As discussed in Chapter 3, the lack of coordination in managing the health policy responses could have serious impacts on the global economy, as different peaks in Covid-19 result in differently timed shocks not to mention more uncertainty.

As well as global policy coordination, coordination between those injecting welcome monetary accommodation and those controlling the levers of fiscal policy is crucial. Without domestic demand, monetary stimulus is very limited in what it can do.

Thirdly, fiscal stimulus must – particularly in a crisis – be driven by the public interest and be evidence based. To ensure this debate between alternatives must be balanced. Here there is a paradox and a challenge. Policy making narratives in Ireland tend to reflect the views of those who, being recipients of tax funding and having job security, have the resources and security to make their case. Ironically the net contributors to the exchequer – those who take the most risks with their livelihoods and welfare of their families to create jobs for others - are often the last in the queue when policy decisions are being taken.

This is not by design, but by circumstance: Compared to well-funded representative bodies who favour ever more government spending, ever more taxation and ever more regulation – bodies whose funding often comes from the taxes raised by the very entrepreneurs they wish to subject to more taxes and regulation – the latter are too busy navigating the stormy waters of the private sector to defend their own interest. Or they are wary of making the case to the contrary for fear of incurring the displeasure of authorities.

This is where business representative bodies need to step up to the plate and achieve better results for those they represent. Government funded entities – Universities, Quasi Non-Government (but government funded) Organisations, trade unions with large public sector memberships and others – ensure there is a large number of groups who seek an increase in exchequer funding, funding on which they rely. There must be a counterbalancing force of those who are stressing the need not just for corporate taxes to remain low, but for direct and indirect taxation to be set at levels that compare reasonably with our peer competitors and which do not hamper recovery.

The last election has shown that more state spending on housing – capital spending – is crucially needed. As several bodies have noted, most recently the Parliamentary Budget Office, capital spending has been the line of least resistance when it comes to cutting back to fund current spending. The last general election suggests that this has been pushed too far.

Nor, as the Children's hospital saga showed, have underlying issues in public spending control been addressed. At a time when those in the private sector who must control costs on a daily basis are facing an existential threat to their livelihoods, a failure to tackle these issues could risk a loss of confidence by the indigenous and particularly small business sector in the system. Having already endured a seismic shock in the last general election, this is not something the body politic needs.

The next government will face the challenge of implementing policies that may – like recent measures announced – have profound implications for job loss and company closure. To maintain national solidarity it will need to ensure that those measures are in the national interest and seen to be.

There are clear signs that in this respect, there need to be fundamental changes. A single event which brings home this challenge is a particular event that – benignly intended and professionally put together no doubt – was planned last January 30th to discuss an issue that is absolutely central to the survival of SMEs in this crisis; the issue of SME funding. This topic was already identified by a seminal Seanad report last year as a crucial one and the event planned, which consisted of 13 speakers, was excellent in its design except for one key feature: Of the 13 speakers – all highly reputable - only one was from the small business sector and all others were from the policy making sector.

While not intentional, this reflects an approach to policy making that will need to change. The important goal of diversity – a watchword in both public and private sectors in terms of gender - must also apply to ensuring that the policy making system contains within those who have worked in the private – specifically the non tax funded private – sector as well as of course the many talented policy makers currently in the public sector. A mix of perspectives will enrich policy decision making, speed the recovery and ensure public confidence in the system is retained.

The strong leaning of fiscal policy towards increased spending over reductions in taxation in recent budgets also leave the impression that indigenous risk takers who worked hard to secure the recovery – and face rising living costs as a result of it – still face much of the taxation introduced during austerity. Many of them are now among the three hundred thousand casualties who have lost livelihoods - hopefully temporarily but alas in some cases not – and will attest that austerity is here and is a brutal reality. The question is whether that burden will be shared equally by all, or focused disproportionately on those who, once again, must start their businesses from scratch for a second time in a decade.

It might be suggested that the dominant narrative is against tax reductions of the kind proposed here. If so, this is an ironic consequence of the point made above: Having access to tax funding, those groups who advocate higher taxation are not only in a far stronger case to provide well researched arguments for their case, but also to fund and promote public representatives who support them and cultivate their voice in the media. Here is where business has a responsibility to ensure that those advocating alternative narratives are well funded and clearly focused on providing a healthy counterview. To be clear: The existence of representative bodies promoting increased taxation and spending is welcome, and in relation to the climate and housing challenges, very necessary.

But balanced discussion is essential to good policy decisions and there is huge room for improvement here. Without it, the seismic impact of the last general election in relation to the chronic need for housing may be replicated in relation to the crisis facing hundreds of thousands of workers and SMEs. Fortunately solutions to both – a clear programme of economic stimulus through housing investment, stimulating consumer demand and recapitalising the SME sector – is, with some flexibility and assistance from the EU (which Ireland has earned) – possible in time to avert the worst of this crisis and return the economy to growth by the end of next year. It has been done before. It can be done again.

Annex
Chronology of 2008-2014 crisis

2008

March 14/15	Bear Stearns goes bankrupt. George Bush addresses Economic Conference in New York on global economy.
September 15	Lehman brothers goes bankrupt. This begins a global liquidity crisis in which the interbank lending market ceases to function. The result is a funding crisis for banks.
September 18	Irish Financial Services Regulatory Authority introduces a ban on short selling of financial stocks.
September 30	Dáil Eireann enacts legislation guaranteeing deposits, loans and bonds worth €440 billion for six domestic financial institutions: Allied Irish Bank, Anglo Irish Bank, Bank of Ireland, Irish Life and Permanent, EBS and Irish Nationwide.
October 14	Normally held in December, Ireland's government brings forward the annual budget by two months in order to address the ensuing crisis and implements tax increases and spending reductions. A series of peaceful demonstrations ensued.
December 21	Government announced intention to inject €5.5 billion into three main lenders, Bank of Ireland, Allied Irish Banks and Anglo-Irish Bank.

2009

January 15	The Irish Government nationalises Anglos Irish Bank to prevent the institution's collapse
January	In emergency legislation the government introduces a levy on public servants to fund their pension entitlements.
February 11	The Irish Government announces intention to inject €7 billion into Bank of Ireland and Allied Irish Bank and receives a 25 per cent stake in both banks.

March	To facilitate lending to Anglo Irish Bank – whose collateral did not meet the standard for Euro system monetary operations – the Central Bank of Ireland agrees to provide "Exceptional Liquidity Assistance" (see Glossary). These loans were underwritten by the Irish government under the Credit Institutions Financial Stability Act and resulted in the state acquiring obligations
April 7	In the second emergency budget in just six months, the Irish government implements significant increases in taxation.
April	The government announces the intention to establish the National Asset Management Agency (NAMA), a vehicle designed to manage property loans from five financial institutions covered by the bank guarantee scheme enacted the previous September (see glossary of terms). NAMA is established the following September.
May 29	The Irish Government injects €4 billion into Anglo Irish Bank following rising losses at the institution.
December 9	In its third emergency budget in just 14 months, the Irish government implements cuts in public service pay and social welfare payments. The domestic economy in the following year shows a modest recovery in terms of Gross National Product (see chapter 4) which rises by 0.5 per cent year on year.

2010

February 19	The government takes its first direct stake in Bank of Ireland.
March	The government concludes the so-called "Croke Park Agreement" with public sector unions. This commits the unions to reforms and a pay freeze in return for a commitment to no further reductions in pay or pensions.
March 30	NAMA buys its first batch of property loans from Irish banks at a discount of 47 per cent. This higher discount requires affected banks to raise more capital than previously thought necessary.
	The Central Bank requires lenders to hold a minimum of 8 per cent Tier 1 capital by the end of the year.
	The government injects a further €8.3 billion into Anglo Irish Bank and takes control of Irish Nationwide.
March 31	Anglo Irish Bank reports the biggest corporate loss in Irish history (€12.7 billion)

May 13	The government takes a 18 per cent stake in Allied Irish Banks.
June 9	The state injects a further €3 billion into Bank of Ireland
August 25	Standard and Poor cut Ireland's long-term bond rating to AA-. This follows a cut in July by Moody's and is followed by further warnings of likely future downgrades.
September 30	The Central Bank of Ireland estimates that the final state injection into the banking system could be as high as €34.3 billion, considerably higher than previous estimates.
October	The Central Bank Reform Act creates a new reformed and fully integrated Central Bank of Ireland to oversee Ireland's financial and banking system. The Act also raises obligations on financial service providers to control lending and compliance and extends the powers of the Central Bank to police the banking system.
November	The government agrees to an €85 billion rescue package with the EU and IMF in return for a 4-year programme of tax increases and spending cuts.
December 7	Reversing the policy of the previous year, the Irish government implements a budget focusing on tax increases. The domestic economy as measured by GNP returns to negative growth in 2011 after a year of modest recovery

2011

February	A month after Dáil Eireann approves the Finance Bill enacting the previous December's budget, the government collapses and an election is held in which the main opposition "Fine Gael" party falls just short of a majority and a Fine Gael-Labour coalition is formed.
July 1	The Irish Bank Resolution Corporation is formed following a court order. This formalises the state's take-over of Anglo-Irish Bank and Irish Nationwide Building Society.
July	Moody's rating agency downgrades Ireland's debt rating.
July 2011	As part of a wider reform of public finances the government establishes the Irish Fiscal Advisory Council (IFAC) to monitor the Irish government's fiscal policy.
December	The Irish government introduces a budget balancing tax increases and spending cuts.

2012

June	Irish voters approve by a substantial majority to enshrine the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union into the Irish constitution.
December	The Irish government's budget pursues a policy of mixing tax increases with spending reductions. The government implements the Fiscal Responsibility Act to give statutory effect to the approval of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (see above).

2013

February	With ECB approval the Irish Bank Resolution Corporation (see above) is liquidated. Its debts are assumed by the Irish exchequer but on more favourable terms: The interest rate on debt is reduced and repayment of the principal of the debt is deferred from 2023 until 2053. This move results in significant savings to the Irish exchequer.
July	The IFAC (see above) is put on a financially independent footing to enhance its freedom and independence in commenting on budgetary policy.
September 19	The EU Bank Supervision System – and Single Resolution Mechanism which enables "bail ins" to avoid the need for taxpayer "bail-outs" – are ratified by the European Parliament. Official economic statistics confirm the return of GDP to growth in the second quarter of 2012.
October 15	In the first budget implemented under the terms of the Fiscal Responsibility Act the Irish government's forecasts are approved by IFAC. The balance in this budget shifts more clearly in the direction of reducing expenditure.
November 26	Official employment figures confirm a rise of 3.8 per cent in the numbers of full time employed in the economy. The figures also confirm that the rate of employment growth is increasing.
December 18	The Irish government publishes "A Strategy for Growth" aiming to attain full employment and reduce public debt by one quarter between 2014 and 2020.

Integrated Thinking

OCTAVIAN
ECONOMICS