Think-tank for action on social change

# The Ireland We Want

## TASC Policy Brief Series

## Towards a fair recovery: supporting firms and employment

Robert Sweeney

June 2020

## Towards a fair recovery: supporting firms and employment

The Irish economy has undergone a massive contraction as of June 2020. While necessary to halt the spread of Covid-19, the effective lockdown of major parts of the economy has led to sharp increases in unemployment, and sharp reductions in output. The gradual lifting of restrictions is already beginning the process of economic recovery, but given the scale of the contraction, a simple return to normal is unlikely to be sufficient to ensure a maximal recovery. This brief outlines some policies and business supports that can help kick-start the Irish economy.

It finds that the measures supporting households and which indirectly support firms have been effective in achieving their stated aims. The raft of measures aimed at assisting businesses, however, have been less comprehensive and need to be scaled-up, as is recognised. Firms and SMEs in particular have urgent liquidity needs and require state assistance. The government should expand the level of credit guarantees to incentivise banks to increase lending. The state should also use equity or equity-type investments as it takes a greater role in firm finance. In the case of larger firms, it should also use debt which is convertible into equity. Such measures would support employment and firm growth, while ensuring public value for money.

In terms of the layout, we first look at the scale of the economic shock to the economy. The next section examines some of the measures that have been introduced so far. The brief then asks whether the policies implemented have been sufficient. The penultimate section examines how to improve on the current framework. The final section concludes.

### The macroeconomic shock

It is widely agreed that the Irish economy is set to undergo a severe contraction in 2020. The unprecedented nature of the pandemic and the ever-evolving political-economic context subject forecasts to unusually high levels of uncertainty. The table below brings together output and employment projections for the Irish economy.

**Economic projections for 2020**[1]

| | DoF | ESRI | IBEC |
|---|---|---|---|
| GDP growth | -9.4 | -12.4 | -11.1 |
| GNI* growth | -15.5 | -9.5* | - |
| Unemployment | 13.9 | 17.4 | 18.7 |

Note: *Based on author's calculation. Growth figures are for nominal rates.

As can be seen, most forecasts predict that output or income will fall by at least 9%. The Department of Finance predicts that GNI*, the more relevant measure of national income in an Irish context, will fall by 15.5%. The bulk of this adjustment will come from a sharp decline in consumer spending and an even larger decline in investment, which comprises a smaller share of GDP/GNI*. All forecasters expect unemployment for 2020 to be well into the double-digit figures. IBEC predicts the unemployment rate to be 18.7% for 2020.

As the economy continues to open up, activity will resume. In addition, many individuals and households have been postponing spending and accumulating savings during the lockdown, savings which will be spent. The opening up and the drawing down of savings will boost the economy during its recovery. However, the extent of the current decline in economic activity is likely to do lasting damage to the Irish economy. Further interventions are necessary to assist the economy in its recovery.

This raises legitimate questions about the sustainability of public finances. The Department of Finance forecasts a deficit of 7.4% of GDP or 13.3% of GNI*. ESRI projections are somewhat higher. This would leave the level of national debt at 69.1% of GDP or 125.1% of GNI*. Again, ESRI projections are a little higher, though not by much. Both the size of the deficit and the level of government debt are set to be high by historical standards. The size of the debt and deficit are often pointed to as a reason to reduce government spending or, less frequently, increase taxes. The idea is that public finances need to be balanced if we are to live within our means. EU fiscal rules make this a legal requirement.

[1] https://www.gov.ie/en/publication/43a6dd-stability-programme-update-2020/ &
https://www.esri.ie/publications/quarterly-economic-commentary-summer-2020 &

**Table 1: Public finance projections for 2020**[2]

| | Deficit % GDP | Deficit % GNI* | Debt % GDP | Debt % GNI* |
|---|---|---|---|---|
| DoF | 7.4 | 13.3 | 69.1 | 125.1 |
| ESRI | 9 | 15* | 76 | 127* |

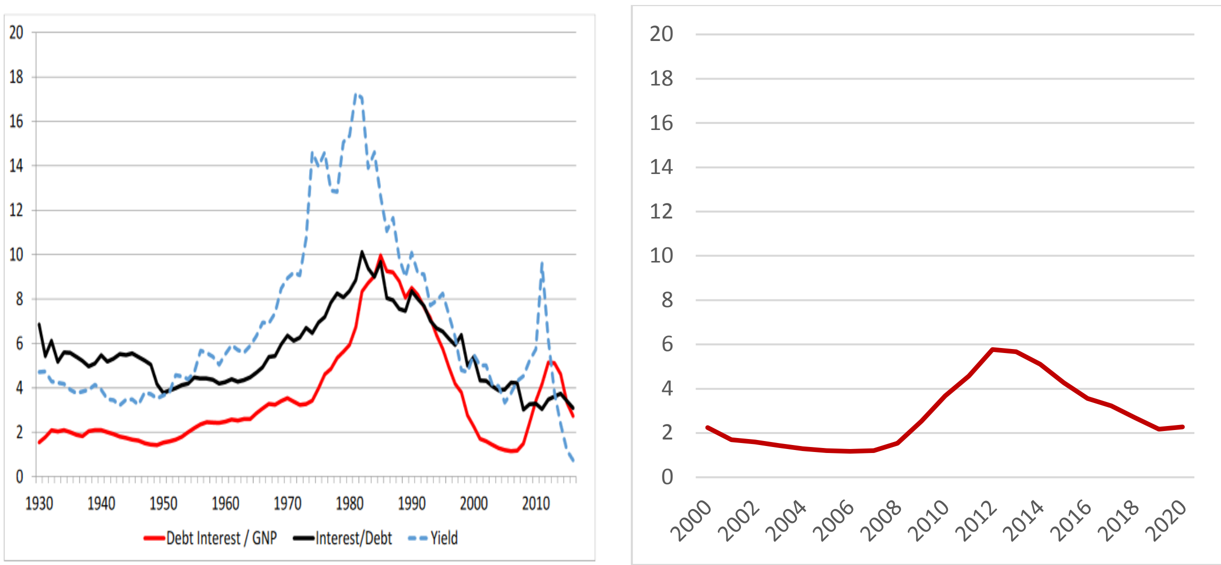
Note: *Based on author's calculations.

The fiscal rules have been suspended, so that legal constraints do not prevent Ireland from engaging in macroeconomic stimulus. As regard to the economic argument, to the extent that debt and deficits impose a burden on the Irish economy, it is not through their respective levels, but rather it is servicing those debts through interest repayments. Repayments of principal can be 'rolled over', serviced by new borrowings. Though this may sound like an inadvisable accumulation of more borrowing to pay existing borrowing, it is only a problem if it unduly increases the repayment burden. A sharp and unexpected increase in interest rates on government borrowing would increase the costs of rolling over debt. However, unless Ireland is subject to a country specific-shock that increases its riskiness from an international lender perspective, this appears unlikely as long as its growth prospects are low – ECB interventions are likely to keep borrowing costs low for all countries as the Eurozone struggles. This brings the analysis back to the importance of looking at the debt servicing burden, or interest repayments on national debt. The figures below provide some context by examining the evolution of debt servicing costs historically.

---

https://www.ibec.ie/influencing-for-business/economy-and-tax/quarterly-economic-outlook-q2-2020

**Figure 1: Interest burden (% GNI or GNI*)[3]**




Note: RHS is interest repayments % of GNI*.

Looking at the left hand graph first, the red line shows the variable of interest, debt repayments relative to national income. For most of Ireland's history, the burden of repayments hovered at around 2% of national income. In the latter part of the 1990s, when Ireland's economy was booming, interest costs were around 3%. As shown in the right hand graph, interest payments fell in the 2000s, rose sharply during the crisis, and represented 2.2% of national income in 2019. This is projected to increase to 2.3% for 2020. In other words, Ireland is around historical trend and despite the fact that the national deficit is set to balloon this year, the extra burden of servicing that debt is almost undetectable. The reason, as alluded to above, is that the ECB is deliberately keeping interest rates on government debt low through it Pandemic Emergency Purchase Programme. Targeted public spending programs are therefore justified so long as borrowing remains cheap and the economy is operating at below capacity.

## Main supports so far

In response to the pandemic and the lockdown it created, the government introduced a range of supports aimed at households and firms. One of the first measures introduced was the

[2]Ibid.
[3]http://www.ssisi.ie/SSISI-20182019-01-Fitzgerald-Kenny-Century-of-Debt.pdf, & CSO. 2020 data based on https://www.gov.ie/en/publication/43a6dd-stability-programme-update-2020/

Pandemic Unemployment Payment (PUP), which increased unemployment payments to €350 per week for those who lost their jobs due to Covid-19. This was later reduced to €203 for those who were earning below €200 per week. The government also introduced an enhanced and expedited system of sick pay.

The Temporary Wage Subsidy Scheme (TWSS), which took effect from March 26th, has supported households and indirectly supported firms, as it applies to businesses adversely affected by the crisis. Originally the state agreed to pay 70% of the wages up to a maximum of €410 per week if the business agreed to retain the worker on their payroll. This was later amended to 85% for lower paid workers and a range of payments for workers earning more, again with upper limits depending on the income bracket. As of June 11th, the cumulative value of disbursements from TWSS was €1.5 billion.[4] As of June 5th, the total value of payments made under the PUP was €1.9 billion. The actual cost of PUP may be smaller as the €1.9 billion figure does not appear to account for the fact that absent PUP other, less generous supports would have been paid.[5] At the time of writing both the TWSS and PUP will be in place until August.

The government also introduced a suite of measures to directly support businesses, worth up to €6.5 billion.[6] Probably the most important is the Credit Guarantee Scheme (CGS), which is worth up to €2 billion. Under the CGS, the government provides a guarantee for 80% of a loan granted to SMEs. However, banks can only claim 80% losses from the government on 50% of its loan portfolio, which could shrink the guarantee to 40%. The term of the bank loan ranges from three months to six years, with lending facilities between €10,000 and €1 million. The interest rate charged on the loan is to be the banks' SME lending rate, plus a premium of 0.5% (which could increase). Because a major portion of the losses are guaranteed, lending rates are below market rates. It is to be made available to all SMEs and supports SMEs ongoing liquidity needs.

As distinct from guarantees, the government has introduced several grant and lending schemes. Under the Working Capital Scheme (WCS), the Strategic Banking Corporation of Ireland (SBCI) sets aside €450 million to provide short-term liquidity to businesses at a rate of no more than 4%. Loans range from €25,000 to €1.5 million and are intended for growing, innovative, and research-intensive firms. Eligible businesses must have fewer than 250 employees, and turnover of no more than €50 million. Also administered through the SBCI,

[4] https://www.revenue.ie/ga/corporate/documents/statistics/registrations/wage-subsidy-scheme-statistics-11-june-2020.pdf

[5] https://merrionstreet.ie/en/News-Room/News/Minister_Doherty_Announces_Pandemic_Unemployment_Payment_to_Continue.html

[6] https://www.irishtimes.com/business/economy/broad-support-for-government-s-6-5bn-package-for-businesses-1.4243788

€500m has been allocated to the Future Growth Loan Scheme. It provides longer term finance through loans ranging from €100,000 to €3 million. The eligibility requirements are similar to WCS, except that the loans would be used for capital investment. The maximum interest rate is 4.5%. The Restart Grant has been created to assist small businesses in re-opening, and is worth up to €250million. Eligible business must have no more than 50 employees, turnover of no more than €5million, and have suffered a fall in turnover of at least 25%. Under the scheme companies receive a rebate on commercial rates paid in 2019, up to a maximum of €10,000.

A range of supports is also available to larger businesses. Most important is the €2 billion Pandemic Stabilisation and Recovery Fund (PSRF). Managed through the Ireland Strategic Investment Fund, the money will invest in businesses employing more than 250 people, and with turnover in excess of €50 million. The fund can invest in companies through a variety of instruments including taking shares, buying debt, and hybrid instruments. Companies must demonstrate they were commercially viable prior to the crisis, and investments are to be made in companies that are deemed of 'substantial scale and of significant importance at national or regional level'. No guidance is given in terms of how adversely affected a business has been to be eligible, though investments are anticipated to be in the region of €10 million and upwards.

These measures are in addition to broader tax measures that support SMEs and firms. Most notably SMEs and, upon request, larger firms can avail of VAT and payroll tax 'warehousing'. As businesses were unable to trade as a result of the restrictions, the payment of taxation can be deferred for twelve months without charge. The taxation period relates to March until two months after restrictions are lifted. Commercial rates have also been waived for a three month period. Finally, a range of other supports have been announced, often targeted at specific sectors.[7]

**Has the response been adequate?**

The TWSS has been an effective policy in that it has provided income supports to a range of workers while also retaining the contractual link between employees and employers. According to the latest figures, 527,000 employees have received the payment, and 400,000 are currently availing of it.[8] The PUP has similarly been an effective tool, in this case mitigating the fall in income arising from being laid-off. At the height of the lockdown, 602,000 people were in receipt of the payment, which compares to 499,000 people at the time of writing.[9] As the

[7] https://dbei.gov.ie/en/Publications/Publication-files/Supports-for-businesses-impacted-by-COVID-19.pdf
[8] https://www.revenue.ie/ga/corporate/documents/statistics/registrations/wage-subsidy-scheme-statistics-11-june-2020.pdf
[9] https://www.cso.ie/en/statistics/labourmarket/liveregister/detailedcovid-19incomesupportandliveregistertables/

restrictions have been eased, more workers have been transitioning out of the two schemes, as designed. The measures have also been progressive from a distributional standpoint, notwithstanding some coverage issues from the hastily-designed measures.[10] In terms of what policy tools are required in the coming period, we therefore focus attention on SMEs and businesses.

The effect of the crisis on business has been severe, and the measures adopted so far less comprehensive. The suspension of trading has led to a collapse in business income, without a commensurate fall in obligations. Without cash injections, many businesses will fail. An IBEC survey released in May found that three quarters of the respondent companies did not have cash reserves extending beyond six months.[11] The longer-term viability of firms appears to be stronger, however. The same survey reports that 72% of businesses expect to return to pre-Covid levels of demand within a year of restrictions ending. The situation has, of course, changed since May, and so it may well be the case that fewer firms now expect to return to normal. International evidence suggests that Irish business is more pessimistic.[12]

The crisis has been particularly challenging for smaller businesses. 81% of companies with fewer than 50 employees have reserves that extend beyond six months, and 51% have reserves for less than three months. In contrast, 64% of firms with more than 500 employees have reserves for less than six months, and 41% have reserves of less than three months.[13] The precarious situation of SMEs appears to be more tied to immediate liquidity or cashflow problems than it does fundamental profitability. The profitability impact of Covid-19 has been felt evenly across businesses of different sizes.[14]

The liquidity needs of SMEs over a three-month period based on non-personnel costs for the sector has been estimated to be between €2.4 and €5.7 billion.[15] In terms of liquidity need, some sectors are obviously more exposed than others, given the effects of the lockdown and the extent to which the state has already provided liquidity through wage supports. Some of these needs can, as above, be met temporarily through cash reserves or drawing down unused credit lines with banks. As many SMEs have no debt or lending relationship with banks, alternative sources of funding will be necessary. Moreover, given the highly uncertain economic outlook, banks are unlikely to lend at a level sufficient to meet the needs of those who do have access to credit. Lack of collateral and an inability to demonstrate creditworthiness through

---

[10] https://www.esri.ie/system/files/publications/BP202101.pdf
[11] https://www.ibec.ie/connect-and-learn/media/2020/05/11/ibec-launches-major-new-reboot-and-reimagine-campaign
[12] https://www.irishtimes.com/business/irish-business-leaders-most-pessimistic-on-covid-recovery-1.4280918
[13] Ibid (p35).
[14] Ibid (p36).
[15] https://centralbank.ie/docs/default-source/publications/financial-stability-notes/no-2-sme-liquidity-needs-during-the-covid-19-shock-(mcgeever-mcquinn-and-myers).pdf?sfvrsn=4

standardised accounts are well-known barriers to financing SMEs. In times of crisis, such constraints are magnified.

At the same time that SMEs are in urgent need of liquidity injections, both the scale and the uptake of the supports announced so far have been inadequate. In principal, the raft of measures introduced totaling some €6.5 billion may appear sufficient to meet a liquidity need of €2.4 to €5.7 billion, but a number of factors need to be considered. At least €2 billion of the announced supports is likely to flow to larger businesses. Moreover, the CGS needs legislation to become operational, which in turn requires the formation of a new government. The €2 billion of guarantees are to be allocated over the entire course of 2020, which amounts to €500 million every three months. In terms of the size of the credit guarantee relative to national income, €2 billion represents just 0.97% of GNI*, though in reality the guarantee is lower as banks cannot not reclaim losses on all loans. This compares to guarantee programs of 8% of GDP in Spain, 12.4% of GDP in France, and 14.6% of GDP in Germany, where the latter can rise as is necessary.[16] Given the short-term liquidity needs of SMEs, more funding will be needed to ensure they can meet their short-term obligations, as has been recognised by the government.

In terms of uptake, of the total liquidity supports available to SMEs, only €95 million has been released to SMEs at the time of writing.[17] Given SMEs account for 68% of business employment and 41% of value-added, the economic implications are obvious.[18] Business groups have reported on the number and complexity of arrangements as barriers to releasing funds. Less than 10% of applications had been approved from the WCS.[19] Interest rates of up to 4% may also be a barrier. The €10,000 limit of the grants available under the Restart Grant are such that they are likely to be quickly used up. For the CGS, what amounts to a 40% guarantee of bank lending is well below that of other countries. This provides a strong disincentive for banks to grant loans. In Spain guarantees range between 70-80%, in France 90%, in Germany 100%, while a similar scheme in the UK provides 80-100% coverage.[20] In addition to requiring more funds, mechanisms need to be put in place to ensure that the allocated resources are made available to those that require them.

---

[16] http://www.irisheconomy.ie/index.php/2020/05/11/irelands-credit-guarantee-scheme-for-covid-19-sme-lending/

[17] https://www.irishtimes.com/business/economy/ibec-warns-of-mass-business-closures-unless-government-acts-1.4285719

[18] https://www.cso.ie/en/releasesandpublications/ep/p-syi/statisticalyearbookofireland2019/bus/businessinireland/

[19] https://www.irishtimes.com/business/innovation/liquidity-liquidity-liquidity-it-s-what-matters-to-smes-exiting-pandemic-1.4273413

[20] http://www.irisheconomy.ie/index.php/2020/05/11/irelands-credit-guarantee-scheme-for-covid-19-sme-lending/

**Towards a fair recovery**

The challenge for society in the coming years is to get people back to work without unduly jeopardising workers' health and safety. The immediate economic challenge is to provide liquidity and other supports to SMEs so that as restrictions continue to be eased, the economy is primed to resume activity at whatever capacity it can now operate at. Policymakers have a range of options at their disposal, which emphasise different goals and which need to be considered not only in terms of their employment impacts, but in the value for money they provide to the state.

An example of such a trade-off is to what extent SME supports should rely on cash grants versus loans and credit guarantees. Grants can in principal get funds to all businesses at will and in a timely manner. They are, however, the least cost-effective tool from the perspective of the state. The money is irretrievable and if the grant is too large, it can have adverse incentive effects. For instance, it may reduce the willingness of employers to negotiate on reductions in rent payments with their landlords, landlords who can afford rent reductions. This could lead to a net cash transfer to commercial property owners.[21] Our view is that cash grants should be relied on sparingly, and less so when other supports are more firmly in place. A precondition for receiving funds should be that businesses continue to respect minimum wage legislation and other labour rights.

Credit guarantees and other forms of subsidised lending are less costly, not least because they are loans. Moreover, because the credit is channeled through the banking system the funds are disbursed by institutions that have experience is assessing the creditworthiness of borrowers. This is likely to reduce losses. There is, however, a trade-off to be made. Guarantees that are too low do not incentivise banks to lend at the required level, as discussed. Guarantees that cover all or a large share of the lending increase the cost to the state and reduce the incentive for banks to properly screen borrowers.

A somewhat different argument against the use of lending is that SMEs in particular are often reluctant to take on debt, and when they do the consequences may be undesirable. In addition to banks' reluctance to lend, SMEs may be reluctant to borrow because of insufficient collateral other than personal assets and a general reluctance to use external finance to expand. When SMEs have debt on their balance sheets, they have been found to be less likely to invest and hire, even when the business outlook is strong.[22] Despite these shortcomings, however, credit guarantees have been used effectively in other countries. The UK Bounce Back

[21] See note 13
[22] https://www.esri.ie/system/files/media/file-uploads/2016-03/JACB201549.pdf

Loan Scheme, which provides a 100% guarantee to SMEs, has accounted for two thirds of the £31.3 billion in liquidity supports provided to British business.[23] Even when the larger size of the UK economy is factored in, this represents a much more successful channeling of supports to affected firms than has been done in Ireland.

There are several options available to policymakers to increase the incentives to lend to SMEs, and increase the take-up of credit by the firms themselves. The level of guarantee provided by the Irish government under CGS is clearly low. Within the framework of the CGS, the government could increase the level of the guarantee to 80% without restrictions. The government could also increase the guarantee beyond this and assess whether, say, a 90-98% guarantee continues to provide an incentive for banks to screen lenders. The size of the fund could also be increased, to €6 billion+ for 2020. To mitigate the economic effects of high levels of firm indebtedness, SMEs could have the option of converting debt into equity. For instance, instead of the loan being repayable to the bank, an SME could exercise an option so that the government now becomes the SME creditor. Repayment would be a percentage of profits, which could be a 5% surcharge annually. In effect the state would take on the obligations of the loan and be remunerated by firms paying higher future taxes once they return to profit. Of course, the state would still incur losses as many business go bust. Moreover, safeguards would need to be implemented. For instance, the government should not be liable for debts incurred by the firm to the bank previous to Covid-19. Guarantees should be phased out as the economy recovers and similar strings should be attached regarding minimum wages and labour rights.[24]

Other forms of equity or equity-type investments are also available to the government. For SMEs, an alternative or complementary option would be to use equity-type investments from the outset. For instance, a tax-based grant system is one in which the government provides grants but repayments are based on profits.[25] Similar to the debt to equity/tax conversion above, funds would be repaid only after firms return to profitability. Like other forms of finance, firms would have to demonstrate they were commercially viable prior to the crisis. Funds could be channeled through existing networks such as through the Revenue or through the SBCI.

Finally, regarding how to support larger enterprises Ireland has comparatively few large companies, and larger firms have more stable cash buffers than SMEs. Nevertheless, a significant number are likely to need an injection of funds and, as outlined above, the state has

---

[23] https://www.thetimes.co.uk/article/state-to-raise-credit-guarantee-cap-in-2bn-covid-19-loan-scheme-0k66x536c
[24] https://www.piie.com/system/files/documents/pb20-8.pdf
[25] https://notesonthefront.typepad.com/politicaleconomy/2020/05/from-each-business-according-to-its-ability-.html &
https://safe-frankfurt.de/fileadmin/user_upload/editor_common/Policy_Center/SAFE_Policy_Letter_No_81_final4.pdf

already pledged €2 billion through PSRF. We feel that low interest debt finance is the least likely to yield a fair return to the state. The primary reason is to assist or save firms which are of strategic importance. That being the case, it would be expected that many of the assisted firms will go on to experience future growth and profitability. Debt investing through the government purchasing bonds, for instance, is not cost effective because it simply returns the amount lent (plus interest) without sharing in the upside when the company returns to financial health. A better option in this case would be equity investment. With equity investment, as profits increase, share prices rise so that the value of the state's investment also increases – shares could then be sold at a higher price.

The downside with equity investment is that if the company goes bankrupt, equity holders are the first investors to take a loss as the firm is liquidated. A solution in this case is for the state to invest in firms through convertible debt. That is, the state lends to the company in need of funds by purchasing debt which is convertible into equity at a later date. If the company becomes insolvent the state, being a bondholder, is not the first to take a hit. In the event where the company returns to financial health, as would be expected, the state still experiences the upside as it can convert the face value of the debt into an equivalent or similar number of shares based on what the share price was plus premium when the firm sought assistance. For example, if the state loaned €1000 and the share price at the time of lending was €9, it could convert the €1000 into, say, 100 shares when the loan matures. If the share price had increased to, say, €15 by the time the loan is to be repaid, it makes a profit by as it purchases shares worth €15 for €10. Both equity and convertible debt should be favoured over conventional debt injections. Again, strings could be attached around labour rights and, especially for larger companies, around limits on CEO pay.

Outside of liquidity supports, there is a case for maintaining a version of TWSS for certain sectors. IBEC estimates that firms need, on average, 80% pre-Covid demand to break even.[26] With social distancing in place, many businesses will become unviable. According to restaurants, 80-90% will not be able operate without significant government support after restrictions are lifted.[27] The continuation of reduced levels of wage supports as businesses re-open is therefore justified. These can be gradually phased out as the economy continues to recover. While some businesses are likely to need further tax holidays, general tax reductions are unlikely to be as effective as wage supports in supporting employment. In particular, previous experience has shown VAT reductions tend to increase profit margins while in place, and increase prices when lifted.[28] For instance, the lifting of the reduced rate of VAT for

[26] https://www.ibec.ie/influencing-for-business/ibec-campaigns/reboot-and-reimagine

[27] https://www.rai.ie/wp-content/uploads/2020/06/A-PLAN-TO-STABILISE-AND-RE-BUILD-THE-IRISH-RESTAURANT-SECTOR-JUNE-2020.pdf

[28] https://www.oireachtas.ie/en/debates/debate/special_committee_on_covid-19_response/2020-06-16/4/

hospitality in 2019 caused a spike in prices in the restaurant sector.

**Conclusion**

This brief has explored how the government can craft a recovery plan that aids businesses in employment growth, but which is also fair and public value for money. The scale of the economic crisis in Ireland has been unprecedented, as have the effects on firms and employment. While measures supporting households have been effective, aid to firms have been less effective. Businesses and SMEs in particular have urgent liquidity needs, which need to be addressed. This should include expanding credit guarantees, and potentially using equity or equity-type investments. Such measures would alleviate the most pressing needs of business and help employment growth.

A related question asks what fiscal policy should look like more generally. Though a prolonged recession that characterised the previous crisis seems less likely this time around, it is becoming clear that this crisis is going to inflict lasting economic damage. A stimulus package in the range of 10% of GNI* or €20 billion, which implies €13 billion in additional measures has been mooted.[29] This would include decisions about potentially bringing proposals in the National Development Plan forward, or expanding the stock of public housing, among other measures. In the meantime, a variety of policies are available to government to support firms, get people back to work, and bring public value for money.

[29] https://www.oireachtas.ie/en/debates/debate/special_committee_on_covid-19_response/2020-06-16/4/

**www.tasc.ie**
contact@tasc.ie