9th June 2020

ISME thanks the members of the Oireachtas Special Committee on Covid–19 Response for your invitation to address.

Summary and Opening Address

ISME first issued guidance to members and the public on the Covd-19 threat on 12th February.[1] We have maintained a low-key, information-based and data-driven approach to it since then.

The likely impacts of the pandemic on SMEs were clearly evident to us in early March. We set out three priorities at the start of the Covid-19 Pandemic:

- Immediate working-capital liquidity for SMEs, beyond debt finance,
- Affordable access to an amended examinership regime for SMEs for those firms that would inevitably get into trouble, and
- An operational plan for rebooting businesses post lock-down, which included:
    - Rational and reasonable health, safety, and hygiene measures
    - Clarity on the phases of return and reopening
    - Assistance for direct costs incurred such as PPE, consumables, cleaning

The average small business owes €78,000 in trade credit to other small businesses. Without a workable liquidity solution, large amounts of this inter-company debt will go bad, with terrible implications for business and personal insolvencies

We have been consistent and clear about these requirements in our communications with the Taoiseach, the Minister for Public Expenditure, and the Minister for Business and Enterprise. We have worked with others to amplify the voice of the small enterprise sector, and I am delighted to note you have accepted submissions from the SME Recovery Plan and the Local Jobs Alliance.

The voice of the SME sector has not been heard throughout this pandemic. Some fault lies with among the SME sector themselves: voices are disparate and fragmented; representatives find it difficult to coalesce around agreed policies and themes. ISME is working to address this issue.

However, the greater fault lies with a State apparatus and an industrial policy that is fixated on the Foreign Multinational Corporation sector. We have no issues with FMCs, which are some of the best customers for our SMEs. But our indigenous industrial policy must be fit for purpose, and focussed on those areas of greatest systemic importance to the Irish economy, to society, and to the Exchequer.

This issue is particularly important in the context of Government response to the Covid-19 pandemic, because many of the missteps with the Pandemic Unemployment Payment (PUP), the Temporary Wage Subsidy Scheme (TWSS), the Trading Online Voucher Scheme, and the Return to Work Safely Protocol, could all have been avoided if there was a formal liaison between Government and small businesses. Unfortunately, SMEs continue to be a blind-spot for Government.

[1] https://isme.ie/pr-coronavirus-no-cause-for-concern-but-time-to-prepare/

It is hard to say why this is the case, but our interactions with the upper reaches of our public service and Executive leave little doubt of their perception that big business is good, small business is bad. Big corporations pay their taxes, while small business owners fiddle their expenses. The figures in Appendix I tell a different story.

This is not merely anecdotal. I have personally heard it said to me by a senior trade union official and by a senior civil servant, that the lower tax credit available to the self-employed, and the USC surcharge imposed on high-income self-employed are justified by their ability to fiddle expenses. This is baseless and unsustainable, and we set out below a means to rectify these issues while repairing the State finances.

Finally, while many of you may be overwhelmed by the enormous challenges presented by the pandemic, this is a great time to be a legislator. Great turmoil brings great opportunity: to address and repair problems that were ignored when times are good. We wish you every success in doing so.

Committee Questions regarding Budgetary Issues:

What is the likelihood that the General Government Deficit will go beyond €30bn this year?

We are not against the build-up of a deficit at this time, since it is the function of a prudent government to spend counter-cyclically. Our greater issue has been the Government's ongoing failure to control spending in the last number of years, when the current account swallowed all additional Exchequer revenues. This is unsustainable.

In its baseline scenario, the ESRI's recent report said the deficit is expected to be over €27bn, or 9 per cent of GDP in 2020. There is a strong likelihood that it could exceed €30bn. If the reopening road map proceeds as planned, with two-metre social distancing, the COVID unemployment payments will have to be extended beyond the end of June, as early re-employment will be curtailed and business activity will recover on a more gradual curve.

What would the fiscal implications be of any additional periods of economic shut-down?

The fiscal implications of any additional periods of economic shutdown would be grave. It is apparent that many people in the country, including senior civil servants in DPER and DFIN, as well as some cabinet members, do not understand the systemic importance of the SME sector to the economy and to the Exchequer.

The Revenue's 2019 figures are shown in Appendix I. In summary, SMEs generate more than half of PAYE and USC in the productive economy, 58% of PRSI, 62% of total earnings, 63% of VAT, and 74% of total employment. The SME sector is simply too big to be allowed to fail.

In terms of per capita contribution, each SME job therefore generates an average of:

- €703 in USC
- €941 in Corporation Tax
- €2,504 in PRSI
- €3,238 in PAYE
- €3,640 in VAT

Contrast these recoveries from each SME worker with the €10,556 in Jobseeker's Allowance they would qualify for if they lost that job. The cost-benefit analysis of maintaining SME employment is quite transparent, and needs no further explanation or qualification.

Many businesses across the SME sector would simply not survive a longer shutdown. The recession would be prolonged and eventual recovery pushed further down the road. This would further undermine tax receipts related to employment and consumer spending and keep upward pressure on social protection expenditure. The only way to stop the fiscal deficit rising is through re-igniting growth. Economic recovery will increase tax receipts and dampen government expenditure. The current reopening road map is already ponderously slow for business and the economy. Any addition period of economic shutdown would be disastrous for business and the economy.

ISME twice surveyed business mortality during the Covid-19 shutdown. While we are delighted to report that sentiment regarding mortality improved from mid-April to the end of May (Appendix II), the number of SMEs 6% believe they will cease trading in a month, 22% in three months, and 44% in six months. It is imperative that these figures do not actually materialise.

How likely is it that conditions in the bond market may become less favourable to Ireland?

Ireland's 10-year bond yield is now at 0.11%. Global bond yields are very low due to bond buying (QE) by Central Banks. Greece is at 1.47% and Italy at 1.53%. This shows that Ireland is not deemed a sovereign risk by markets. However, this could change. Ireland at the end of this year could have a debt/GNI* ratio of 127%.

It is vital not to allow this economic crisis to morph into a banking crisis. Hence the need to give financial support to business and households to prevent a bad debt problem from escalating. It is important that the ECB continues to buy bonds to keep sovereign borrowing costs down. As long as the ECB and the EU stands ready to do whatever it takes, Ireland will endure. Any diminution of this support could prompt the markets to look much more critically at high debt and low growth countries.

That is why it is important to support business during lockdown and for a period thereafter, in order to re-engage the unemployed. Without viable businesses it will not be possible to re-ignite the economy; in this case Ireland's debt levels would frighten the markets. Economic recovery as quickly as possible is essential.

Conditions remain favourable at present, and in the short term there is little likelihood of a ratings downgrade from any of the three main agencies; S&P recently reaffirmed Ireland's rating. The quantum of response from the EU/ECB has provided effective risk mitigation to the initial COVID downturn.

If there is a risk, it is linked to Brexit and the degree to which a hard Brexit disrupts trade between the UK and Ireland. The rating agencies and international bond markets do recognise the extent to which Ireland is exposed to a tumultuous exit but also understand that we have an open economy and we can react quickly.

Similarly, we may face some risk as the US Presidential election ramps up and the rhetoric relating to repatriation of FDI-related businesses becomes elevated. This will mainly be an issue for Big Pharma, Life Sciences and Big Tech. However, this too is a known risk.

What is the impact for Ireland of the ECB's current asset purchasing levels?

We benefit as all EU Sovereigns do, in so far as our government debt is purchased as part of the program.

The Franco-German proposals for a €750bn grant fund is more closely aligned with what ISME has sought than the mainly debt-based solutions proposed by the Irish Government. These have demonstrably failed to attract drawdown from the SME sector. Lending support schemes all weigh negatively on the debt metrics of peripheral nations and ultimately form a negative feedback loop; if continued, they culminate in ratings downgrades. Grants are effectively a mutualisation of debt, and a more efficient tool as they allow firms to grow cash flow rather than have it siphoned off to pay interest.

The current window will likely be exhausted by early October. It will be necessary to extend it out to the middle of 2021. This support is vital for the eurozone and for Ireland, as without it bond yields would rise and the financing of the big government deficits would become too onerous for countries such as Ireland with a large debt legacy.

Are there potential "low hanging fruit" policy options that could increase revenue without negating economic growth in the short term?

We suggest the following measures, which would affect the real economy, and would make Ireland a better place to live in:

1. Reduce the PAYE credit to €1,500. This would only cost workers €2.88 per week, but would raise approximately €150m annually.
2. Apply a 3% USC solidarity surcharge to all PAYE income above €100k per annum. This would raise about €300m annually.
3. Apply an open market valuation test to all public service pensions, and tax pension pots valued above the Standard Fund Threshold[2] of €2m at the pensioner's marginal rate.
4. Apply an open market valuation test to the imputed contribution by the State to public service pensions, and tax the difference between the imputed contribution and the Additional Superannuation Contribution[3] at the employee's marginal rate.
5. Move all public-service pensions to an auto-enrolment defined contribution model, and standardise for all citizens to ensure tax equity.
6. Establish a standing Public Service Pay Commission, guided by recruitment and retention needs in individual areas of the public service, and with a medium-term goal to reduce the differential between public and private sector pay. The Q4 2019 differential between average public and private sector earnings is 37%.[4] For the same period in the UK, the average private sector worker is paid 0.3% more than the public sector worker.[5]
7. There is an inverse relationship between rate and yield for CGT, and we have moved higher than the 'sweet spot.' A rate of circa 25% would probably increase yield by €100m.
8. Stop 'studying' things and start 'doing' things. We have embarked on the Sláintecare[6] process without thought to previous comprehensive work done in the healthcare area such as the Hanly Report.[7] The 'Organisation of Hospital Services' section of this has been ignored.
9. A comprehensive spending review and value-for-money audit must form part of large projects such as Sláintecare. What gets measured gets managed. It is easier to save a euro in spending than raise a new one in taxation.
10. There is no reason to treat aviation fuels differently to other transportation fuels in terms of carbon taxes. A move to normalise taxation treatment would be good for the Exchequer and the environment.
11. Further rationalise our local authorities network.
12. Rationalise by up to 50% our estate of Institutes of Technology. We have over 20 separate 3rd level campuses (with other satellites) for a population of 4.9m. In view of the level of course duplication, we do not need 7 full universities either.
13. Digitise as much of the work of the Courts Service as possible, per the recommendations of the Chief Justice.

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[2] Irish Life Standard Fund Thresholds at Retirement
[3] https://pssc.gov.ie/wp-content/uploads/DPER-Circular-21-2018.pdf
[4] https://www.cso.ie/en/releasesandpublications/er/elcq/earningsandlabourcostsq32019finalq42019preliminaryestimates/
[5] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/ashe1997to2015selectedestimates
[6] https://data.oireachtas.ie/ie/oireachtas/committee/dail/32/committee_on_the_future_of_healthcare/reports/2017/2017-05-30_slaintecare-report_en.pdf
[7] https://assets.gov.ie/39348/634e7cea7b764923957698865ea66003.pdf

14. Liquidate the State's bank shareholdings within 18 months.
15. Cut any charity funding not linked to essential service provision.
16. Sell non-core State enterprises such as RTE, TG4, 2RN, Horse Racing Ireland, Bord na gCon, VHI, and Arramara Teoranta.
17. Institute a radical cull of quangos, and consolidate or merge those that remain onto fewer boards for like purposes. A recent list from the IPA is available here.[8]
18. DO NOT attempt to liquidate the National Training Fund surplus to address the fiscal deficit. The Training Levy is charged to employers to pay for much-needed upskilling, and ISME believes it should be used to fund a Level 6 Diploma in Business Management, incentivised in the same manner as the farmers' Green Cert.

Committee Questions regarding Social Protection Issues:

How sustainable are these payments beyond Quarter 2 2020?

It is likely that these supports will be required until work levels return to 80% or more of pre-covid levels. Ending them before then will trigger a substantial wave of redundancies, increased social protection spend, and reducing payroll taxes.

One compromise which should follow the lifting of the bar on employees claiming redundancy is the reintroduction of the Statutory Redundancy Rebate.

The Government reduced the rebate on Statutory Redundancy in 2012, and eliminated it in 2013. This was wrong. Employers always had liability for a proportion of Statutory Redundancy payments, but the State provided an 'insurance policy' via the social fund to pay the balance. The employers' contribution to this fund was set at 0.5% (recovered via PRSI) in the Redundancy Payments Acts 1979. This contribution was not terminated when the rebate ended.

The employers' payments to the redundancy fund generated a substantial surplus over the fund's outgoings. In 2002, the then Department of Social Welfare paid a dividend of €635m to the Exchequer. The removal of a rebate which employers were paying for was wrong, even though done in the teeth of the last recession. The Statutory Redundancy Rebate should be reinstated at its 2012 level (60%). Failing this, the requirement to pay statutory redundancy should be eliminated, or employers' PRSI should be reduced by 0.5% in lieu.

What is the anticipated Supplementary Estimate that will be required under Vote 37 in 2020?

"When the battle drum beats, it's too late to sharpen your sword." ISME can only guess what Vote 37 will require this year, but it will be substantial. This issue for us is not what Vote 37 will look like in the middle of a pandemic-induced unemployment crisis. The far bigger issue for us is why Vote 37 declined by just 19% between 2012 and 2018, when unemployment reduced from 15% to 5.3%. The fact is that the overall social protection spend has remained static for a decade because reduced unemployment has produced no social dividend. This

[8] IPA State Agencies Review

means Ireland is constantly borrowing to cover increasing social protection payments, and the unfunded liability on social fund pensions is in the region of €335bn (2015).[9]

How will the special employment and unemployment supports be tapered back to the levels of "regular" support payments?

From inception, the TWSS had the control mechanism built in that it could not be used to pay workers more than their pre-covid income. This was absent in the PUP. Both will need to be tapered back. The PUP should immediately revert to a 'no-greater than before' basis. Tapering the TWSS will be more difficult if large-scale redundancies are to be avoided. The Oireachtas could consider some control measures to reduce the TWSS, such as:

- Setting a sunset date for the overall scheme. This would be a crude methodology, that would discriminate against those businesses, especially B2C, still affected by social distancing.
- Setting sunset dates by employment sector. This would be difficult to do but may be required for the worst-affected sectors.
- Setting a rate of unemployment at which the TWSS would end. This would be crude but public and objective. Some sectors may need more time to adjust.
- Progressively reducing the rate of wage coverage while maintaining the scheme. This may also require sector-specific arrangements.

Are there targeted, sector-specific supports that might continue the PUP and TWSS have ceased?

Most businesses in the tourism, hospitality, and leisure sectors were forced to close early on March 16th and will also be among the slowest to resume. Most of these have suffered a 100% loss of revenue while closed. These sectors require special mention and attention. Similarly, non-grocery retail, hair, beauty and wellness, aviation and dentistry, will all experience difficulties for some time into the future. They may require specialised sectoral treatment for their employees.

Are these payments, in certain sectors/cases, acting as perverse incentives and discouraging a return to work?

The fact that the PUP was not related to pre-covid income is highly problematic. It is in the area of part-time employment that this has been particularly evident. There is no reason the PUP could not have had a similar rules base as the TWSS, and no one should earn more on the PUP than they did in their part-time employment. For this reason, the two-band structure for the PUP announced last week should be amended, and those who previously earned between €203 and €350 per week should only be able to claim a maximum of their previous weekly earnings, and NOT the full €350 per week payment. There is no justification for the two-band structure as proposed by Government.

One of the legacies of the State response to the covid pandemic will be its exposure of the fact that our 'social insurance' system is nothing of the sort: it is a branch of the taxation system and nothing more. It is noteworthy that at the introduction of the TWSS, higher

[9] KPMG Actuarial Review of the Social Insurance Fund 2015

earning workers were offered nothing at all by way of wage supplement, forcing employers to either keep them on at normal wages, reduce their wages, or let them go.

Yet lower earning workers, contributing less into the social protection system, were covered up to 70% of their previous net earnings. It must be remembered that there used to be an income ceiling on employee PRSI contributions. This was because social protection benefits are capped. The ceiling of €75k was removed on the recommendation of the 2009 Commission on Taxation, which noted that our PRSI system was "complex," has "certain characteristics of a tax" and “contains a number of anomalies.” The system has demonstrably worsened since then, and is very far removed from the Scandinavian exemplars of social protection systems often cited in this House such as the Danish system[10], where workers can claim up to 90% of their income in an unemployment situation.

Will similar measures be implemented should any additional periods of lockdown be required?

Yes.

What will be the requirement in additional expenditure to address increased unemployment in 2021?

It is very difficult to predict how large and sustained will be the rate of unemployment created by the pandemic, as it dissimilar in nature to the Great Recession. However, by way of comparison, the Social Protection vote climbed from €7.2bn in 2006, to €10.5bn in 2009, and hit a peak of €13.9bn in 2012, almost double the pre-recession level. The 2012 vote reflected peak unemployment of 15%.

[10] Denmark Unemployment Benefit: EU Commission

Appendix I

	Companies returns	Total CT Liable	Employees	Earnings	Income Tax	USC	Employer PRSI	VAT
	Number	€m	Number	€m	€m	€m	€m	€m
All Enterprises	164,201	8,105	2,120,485	52,393	9,303	1,990	6,748	9,081
FMCs Only	5,925	6,258	468,731	17,540	3,770	793	2,484	3,210
Irish MNCs	362	373	84,911	2,460	459	96	340	167
SMEs	**157,914**	**1,474**	**1,566,843**	**32,394**	**5,074**	**1,101**	**3,924**	**5,704**
FMCs Only	4%	77%	22%	33%	41%	40%	37%	35%
Irish MNCs	0.2%	4.6%	4.0%	4.7%	4.9%	4.8%	5.0%	1.8%
SMEs	96%	18%	74%	62%	55%	55%	58%	63%
Contribution per employee (€)		**941**		**20,675**	**3,238**	**703**	**2,504**	**3,640**

Appendix II

As things stand in the Covid19 pandemic, my business can continue as a viable going concern for:

		Cumulative Mortality
My business will cease trading	2.9%	
Up to 1 month	3.6%	6.4%
1 to 3 months	15.4%	21.8%
3 to 6 months	22.1%	43.9%
6 to 9 months	16.0%	59.9%
More than 9 months	40.1%	