Saying No to the Bond – Note to Deputies, Fergus Dunlop 28th April 2020

The Civil Contingencies Authority team is doing a great job.

The request to launch a huge national debt does not come from them.

Proposition P.2020/91[1] comes from P&R. It seeks a free hand to 1) spend £100m from reserves and 2) issue a bond borrowing up to £500m.

When the Law Officers began work on P.2020/91, P&R was facing a health catastrophe locally, a June 2020 general election, much pending legislation due for debate in between, and little contact with Deputies because of the lock-down. It must have seemed wise to move at breakneck speed.

But things have changed.

- The health emergency has not happened. The PEH Intensive Care Unit stands empty.
- The election has been postponed a year.

Only the communication with Deputies still suffers. And so the bond marches on in a vacuum.

By coincidence, several countries around the world, from Hungary to Hong Kong to Togo, have seen strongmen take advantage of the crisis to grab power from their parliaments.

That is not what has happened here. This was over-caution and over-thinking on the part of P&R. They genuinely expected to be swamped, from several directions. Nevertheless, by initially giving Deputies only 24 hours to prepare, the proposers of P.2020/91 seemed to be seeking a capitulation.

We can now see that P&R's Proposition 2, the one asking for a £500m bond, is:

- **unnecessary**,
- short on **Guernsey characteristics**, and
- presented as the only option, where in fact there are **other possibilities**.

1) <u>Unnecessary</u>

   The lock-down has worked. Our testing levels are running at a weekly average of 64 per day, and often exceeded 100 per day. Per capita that is treble Germany's, and many times the UK's.

   On reasonable assumptions (see below and Appendix 1), Guernsey will be Covid-19 free by the time the States meets on 20th May.

   This projection is based on the daily data from the States' website, and assumes:

   - an average 17-day lag between first detection of the virus and a patient's return to virus-free status, if they do not die,
   - a mild second wave of new cases this week, with the last new case found on 3rd May,
   - sample testing of those with symptoms to continue indefinitely at or near the current average per day, along with contact tracing where appropriate,
   - incoming visitor numbers to be matched to / limited by the availability of testers, reagent chemical and contact tracing resources, and
   - such visitors to be quarantined for 14 days, whether or not they show symptoms, until such time as a safe vaccine is widely available.

[1] A line-by-line commentary on P.2020/91 is provided in Appendix 2

Lifting the internal lock-down at the end of Week Seven, rather than Week Thirteen, will help reduce the projected costs and loss of revenue to the States. At the same time, the damage to the economy will be reduced disproportionately in Guernsey's favour.

Secondly, Guernsey's experience of Covid-19 will differ favourably from our large European neighbours', due to the shape of our economy. For example, electricity usage could tell us whether our slow-down has been less than in Germany, France or the UK. Deputies should ask.

In particular, a projection of our economic weakness should consider:
- the proportion of our GDP that is earned by the finance sector,
- whether Covid-19 has changed the finance sector's costs and productivity,
- the sector's proportion of revenues from recurring fees, rather than transaction fees,
- whether other professions' earnings have behaved similarly (lawyers, liquidators, etc.).

Anecdotal answers to these questions suggest that the Guernsey finance sector has performed well, that contingency plans have worked and that sufficient warning of lock-down was given to protect revenues in the primary driver of our GDP. According to my contacts, they barely missed a beat. Pay cuts or redundancies in this part of the economy are unlikely. Valuable experience has been gained. For all the pressure, particularly on young colleagues, teams and skills are stronger.

The private sector pain will be felt most in those businesses initially recognised by the States at its meeting on 18th March, namely hospitality and tourism; passenger transport and travel; rental and leasing of cars and recreational goods; recreation and entertainment; event management and event services; personal service activities such as hairdressers, beauticians and animal boarding; commercial fishing; private extra-curricular education such as dance and riding schools; non-food and non-pharmacy retail; advertising and marketing; construction; and manufacturing.

Some businesses in these sectors will bounce back, some will take a long time to recover, some will sadly never return. However, lifting the internal lock-down in mid May, twice as fast as Proposition P.2020/91 foresees, will make a disproportionately positive difference to their futures. The main point is that the bread-winner that feeds many of them, the finance sector, will have money to spend as before, and together with the early lifting, makes the bond unnecessary.

Nor should one forget that Guernsey has received a medium-term economic boost from the Bank of England cutting rates to suit its own cloth, which is probably too much, i.e. too low, by Guernsey standards.

Accordingly, we should 'wait and see' before jumping into Proposition 2, on the basis that we face a UK-scale or Italian-style primary, private sector economic emergency.

2) <u>Short on Guernsey characteristics</u>

Under the P.2020/91 (2), the proceeds of the bond would be available for current spending. This breaks a well-established convention. Indeed it sets a dangerous political and social precedent.

- It tramples a hard-fought States principle (see Section 7 of the Policy Letter).
- It discards a Guernsey tradition that friends and neighbours, not big government, help out.
- It plays roulette with our independence as a jurisdiction. The recession P&R is trying to avoid is nothing like the recession the Bailiwick will suffer if our jurisdiction one day cannot pay its debts and we become a backwater of the UK, like the Scilly Isles (viz. Turks & Cacos 2009).

A £500m bond might have been dreamed up by someone who had never been to Guernsey, or who imagines that the Guernsey Pound is really Guernsey's. It screams 'big-government'.

In fact Guernsey enjoys:

- a flat society. Citizens have received equal access to justice at the hands of their elected peers (jurats) for at least 800 years, and maybe since Roman times (*Le Patourel, OUP, 1937*).
- a related culture of self-sufficiency and stubbornness, also from knowing hardship.
- a tradition of not inheriting national debt from our parents, or bequeathing it to our kids.
- self-discipline. Hey, we are halting an epidemic in its tracks, with minimal policing.
- island frontiers. We can close ourselves to disease, while letting physical supplies through.
- a talented, imaginative electorate. With fewer people than a mid-sized English town, we run a jurisdiction. We punch above our weight in sport, and we earn a high GDP per capita.

What we cannot do, however, is borrow like bigger jurisdictions. Lacking a Central Bank not only means Guernsey cannot print its way out of trouble if need be. It also stops us capping interest rates below inflation, or forcing locals to buy our bonds through exchange controls, or pegging our exchange rate to other currencies, or rationing bank lending, or the other tools needed for a jurisdiction to enforce negative interest rates long enough to fleece investors who hold its debt.

If Proposition 2 of P.2020/91 passes,

- what should Guernsey do when the next crisis hits? Borrow even more?
- how should we to pay it back? Borrow again? But what if interest rates are higher then?

Migration is particularly interesting in this context. The population debate has often been about immigration. It briefly became about sustaining the current headcount. Whatever may happen to the finance industry, a declining population would not be good for tax revenues.

Today markets are signalling deflation. Just because institutions would like a Guernsey bond, does not mean we should sell them one. Bond market conditions are not "better". Indeed the downside risks are clearer than ever. Who are Deputies to bet against the professionals a second time, having already got it so wrong once (see comment on Item 1.7, page 7, below)?

If P.2020/91 (2) passes, how many of today's Deputies will stand for office in 2029 or 2037 to pick up the pieces of our mistake? Borrowing now may help re-election prospects next summer. But is that the limit of our horizon?

A line-by-line commentary on P.2020/91 is attached at Appendix 2. As might be imagined, given how rushed the P&R authors were, my critique is not all compliments, although I manage some.

3) <u>Other possibilities</u>

Before calling for this alien licence to borrow money, P&R should look at solutions which match Guernsey's characteristics. The rainy day fund is not insignificant beside the actual problem we face, and beyond that, Section 6 outlines some £1.3bn of assets in various other pockets.

Our bench of talent will produce innovative ideas, if asked. And even I have one, albeit obvious: to use Guernsey's record-breaking voluntary sector.

With as many charities as there are days of the year, our third sector is unique. Some existing volunteers in it would be delighted to contribute to getting Guernsey back on its feet.

More importantly, I would expect that a similar number of new volunteers would enjoy helping businesses, if they could be matched to operations which interested them, and which would treat them fairly.

Engaging such volunteers' time, ideas, and manpower would uphold Guernsey's traditions of equality and neighbourliness, and have beneficial social and business network effects.

4) Wider considerations

With an ageing population, Guernsey cannot seek 'herd immunity' to Covid-19. It is anyway unclear whether or for how long a recovered Covid-19 patient is immune. Or whether the virus will mutate. Or when other countries will be safe to travel to, or accept visitors from.

Until such time as a safe and reliable vaccine is available, which must be many months away, Islanders will effectively be trapped 'on the rock', or leave and face a 14 day quarantine when they return. Likewise, business visitors and tourists will be unable to come here freely. This is not sustainable in the medium term, not even for the VPN-savvy, video-conferencing finance sector. However it can work for a year or two.

We should also be aware that the UK Treasury, or indeed the GFSC, may take a less lenient view on the substance and tax implications of non-Guernsey directors phoning-in from the UK to board meetings in Guernsey. At the moment there are no questions, but this may not last.

Helpfully, for several years, even before the Brexit referendum, Guernsey's funds industry has been in a pseudo-lock-down of its own (I say 'helpfully' through gritted teeth, as might be imagined). New sponsors choose Luxembourg or London, or indeed Jersey. Existing sponsors are still opening vehicles here as we speak, and will continue to if they can, because it is convenient. However, the days when new potential IPO clients flew in daily are a fading memory. The truth is that eighteen months of border lock-down will not lose us much business we would otherwise have won. That is a non-Covid-19 problem, one P.2020/91 does not purport to address.

Should Guernsey relax its border controls too early, and suffer a subsequent wave or waves of the pandemic, calls for a bond will come back. Then we may have to square up to the threat of long-term States' borrowing, and debate whether a temporary Covid Solidarity Tax (CST), for example, would be preferable. Wealthier residents with strong supportive feelings towards the island might be willing to contribute financially if the sunset clause was cast-iron, and the spending controlled. Or they might vote with their feet. But that debate is not yet here.

Conclusion

Thanks to an unexpected adaptability of the finance sector, the timely lock-down on 25th March, some brilliant staff-work and a self-disciplined implementation, the position does not yet require us to increase the national debt. The crisis is grave, but the answer can be a combination of other measures, conventional and innovative. Guernsey's supercharged voluntary sector can help. Given accurate evidence upon which to base decisions, cooler and wiser heads than mine can find a better solution than P.2020/91 (2). The State's debate on Proposition 2 should be delayed until more evidence is available in May.

Fergus Dunlop, 28th April 2020

Appendix 1

Guernsey Coronavirus Cases - history and projection, 25th March - 21st May 2020

Colour code:

Day of Lock-down	NB data from States website and own calcs	FD added from States website	FD added/ computed from States/ NB data	FD forecast

Date	Week	Cum cases	Daily cases	Cum deaths	Daily deaths	Daily presumed deaths	Cum recovered	Cum cases - died - recovered	Active Cases	Cum Tested	Daily tested	5-day avergage test per day
25-Mar-20												
26-Mar-20												
27-Mar-20	1											
28-Mar-20												
29-Mar-20		45		0	0		0	45		537		
30-Mar-20		60	15	0	0		0	60		591	54	
31-Mar-20		78	18	1	1		0	77		708	117	
01-Apr-20		91	13	1	0		0	90		749	41	
02-Apr-20		91	13	1	0		0	90		749	-	
03-Apr-20		114	23	2	1		0	112		910	161	74.60
04-Apr-20	2	136	22	2	0		15	119		991	81	80.00
05-Apr-20		no data			0							
06-Apr-20		154		3	2		27	124		1109		72.00
07-Apr-20		no data										
08-Apr-20		181		7	2	2	38	138		1287		75.40
09-Apr-20		191	10	7	0	0	40	144		1497	210	101.20
10-Apr-20		no data										
11-Apr-20	3	200		9	1	1	42	150		1578		93.80
12-Apr-20		218	18	9	0	0	48	161		1719	141	
13-Apr-20		no data			0	0						
14-Apr-20		223		10	1		53	160		1,835		67.60
15-Apr-20		228	5									
16-Apr-20		234	6									
17-Apr-20		236	2	13								
18-Apr-20		239	3	13	0					2,320		
19-Apr-20	4	239	0	13	0					2,447	127	122.40
20-Apr-20		239	0	14	0	1	98	127		2,491	44	
21-Apr-20		241	2	14	0	0	123	118		2,566	75	
22-Apr-20		243	2	14	0	0	136	107		2,635	69	
23-Apr-20		245	2	14	0	0	139	106	95	2,727	92	81.40
24-Apr-20		245	0	15	1	0	155	90	78	2,796	69	69.80
25-Apr-20		245	0	16	1	0	167		67	2,864	68	74.60
26-Apr-20		247	2	17	1	0	171		62	2,941	77	75.00
27-Apr-20		247	0	17	0	0	182		51	2,998	57	72.60
28-Apr-20	5	247	0	17	0	0	191		42	3,014	16	57.40
29-Apr-20		248	1	17	0	0	201		30			
30-Apr-20		250	2	17	0	0	no data		no data			
01-May-20		251	1	17	0	0	206		28			
02-May-20		251	0	17	0	0	211		23			
03-May-20		252	1	17	0	0	217		18			
04-May-20		252	0	17	0	0	219		16			
05-May-20	6	252	0	17	0	0	222		13			
06-May-20		252	0	17	0	0	222		13			
07-May-20		252	0	17	0	0	222		13			
08-May-20		252	0	17	0	0	224		11			
09-May-20		252	0	17	0	0	226		9			
10-May-20		252	0	17	0	0	228		7			
11-May-20		252	0	17	0	0	228		7			
12-May-20		252	0	17	0	0	228		7			
13-May-20	7	252	0	17	0	0	230		5			
14-May-20		252	0	17	0	0	230		5			
15-May-20		252	0	17	0	0	230		5			
16-May-20		252	0	17	0	0	231		4			
17-May-20		252	0	17	0	0	233		2			
18-May-20		252	0	17	0	0	234		1			
19-May-20		252	0	17	0	0	234		1			
20-May-20		252	0	17	0	0	235		0			
21-May-20		252	0	17	0	0	235		0			

Assumptions: Daily Presumed Deaths are not included in the Cumulative Cases.
Average 17-day lag between virus identification and full recovery.
Full testing and contact tracing program continues.

Source: Historic data was sourced on a best-efforts basis from daily States website updates.
It is self-evidently incomplete, and may have been mis-copied or mis-interpreted.

Appendix 2

A commentary on Proposition 2020/91

The Proposition is dated 22nd April 2020. As I understand, it was on the States' agenda to be debated the next day, 23rd April.

This was rushed. Indeed it would have been a joke, had the topic been less serious.

The Proposition (sheet 1 of 19 – the document on gov.gg has unnumbered pages)

> **Proposition 1** on page 1 seeks up to £100million to support Guernsey businesses, to be '*funded from the Core Investment Reserve*'. Item 6.3 on sheet 14 notes that this Core Investment Reserve totals £185m. So 55% of it is proposed to be spent. Reserves are for rainy days, and today is undoubtedly one of them.
>
> **Proposition 2** on the next sheet gives P&R licence '*to enter into external borrowing facilities of an amount not exceeding £500,000,000, on such terms and conditions as the said Committee shall deem appropriate.'* Expectations for the next 17 pages are high…
>
> However, sheet 2 ends by noting that the Procureur has not yet been able to comment on the constitutionality of Propositions 1 and 2. This rather knocks the wind out of the reader. How often, one wonders, are States Deputies sprung upon to vote on a matter without knowing if it would be constitutional? Happily the debate was postponed by three whole working days, to Wednesday this week. And lot can happen in three days.

The supporting Policy Letter (sheets 2 to 19)

> In the **Executive Summary** on sheet 2, Paragraph 1.2 quotes a guidance paper from the IMF published this month, and provides a link. The implication is that the IMF supports the huge borrowing which the authors propose, and that the paper is mentioned in the Summary because it will be discussed elsewhere in the Policy Letter.
>
> This is not the case. The IMF is not mentioned again. Opening the link, the IMF paper proves more cautious about debt than the quote suggests. Rather, it focusses on differences between:
>
> - large, developed economies such as the US and Germany,
> - large, growing economies like China and India,
> - intermediate economies such as Mexico and Saudi Arabia, dependent on oil,
> - large, poor economies such as Chad, Moldova and Nicaragua (page 12), and
> - countries which are both poor *and* oil-based, like Angola and Gabon (page 20).
>
> It does not discuss developed micro-states without their own central banks, or the risks involved when such states borrow in foreign currencies. Such a discussion is much-needed.
>
> Paragraph 1.2 belongs as a footnote to a deeper 'Background' briefing (i.e. in Section 2).

Paragraphs 1.3, 1.4 and 1.5 admit that the amount of money to be given away by P&R is uncertain. Item 1.4 manages to be both vague and spuriously accurate in the same phrase, claiming '*an immediate requirement for up to £172-190 million'*.

Paragraph 1.6 stakes out a central role for the States in the coming years. With no word of justification, the public sector is assumed to be more efficient than Guernsey's private or charitable sectors. Furthermore the money is said to be needed *to 'fund the longer-term implications of Covid-19 on States' finances'*, in other words it can go on States' current expenditure, including, yes, pay rises, chief officers' bonuses and Deputies' pensions.

Paragraph 1.7 mourns the 11% decline in the State's investment portfolio due to '*the falling market*', and says this is the wrong time to '*crystalise losses'*. The statement has four flaws:

- The 11% decline follows years of rises. It takes gains back to 2019 levels.
- No one knows if the market is mispriced, and certainly not P&R. Judging by the stratospheric rise of the 2014 Guernsey bond since T&R said it was 'the right time to borrow', their market timing is a contra-indicator. Ask them…
- Fears of '*crystalising losses'* are either false pride (losses would tend to occur on individual positions most recently purchased), or muddled thinking about capital gains tax which does not apply.
- Investment managers have an interest to advise against selling half the portfolio, as they are paid on a percentage of assets under management.

The **Background** section of the Paper (Section 2, sheets 4 and 5), summarises the £30m spending authorised by the States on 18th March. The main purpose (hence the only text in bold throughout the document) is revealed in paragraph 2.3: reminding the reader that P&R warned then, that '*further policy letter(s) will be submitted to request additional funding*'.

Section 3 (sheets 5 to 8) summaries the **Financial Support Measures for Business**, which compensate companies for being forced to reduce or cease activity in the lock-down. The tone of the section is measured and articulate. 3.4 mentions in passing that tax and social security contributions will continue to be collected on the Payroll Co-funding Scheme - it remains unclear whether this has been included in the modelling. 3.7 has a typo.

The section concludes by proposing that £100m be made available from the Core Investment Reserve. However, since the Proposition then says that this support is likely to cost £50m (Section 4.3, first bullet point), presumably the £100m covers other spending too.

Section 4 (sheets 8 to 12) looks at the **2020 States Funding Requirement**. It foresees a full Guernsey lock-down lasting 13 weeks (Paragraph 4.2). Evidently this pre-dates the Civil Contingencies Authority's plan for a multi-phase lock-down release, the first phase of which happened early on Saturday morning, 25th April.

Since the Proposition was published on the 22nd April, the Bailiwick has found only four Covid-19 cases, possibly all related to care homes, out of 432 tests over that time. And none in the past four days, out of 271, with twenty nine pending. With continued testing and contact tracing, we are on track to have zero known cases by mid May (Week Seven, see Appendix 1, above). Thereafter, quarantining air/sea link visitors can prevent a second wave.

The thirteen-week assumption, which underpins much of P.202/91, is too pessimistic. Deputies should delay debating Proposition 2 until the May States' meeting.

Section 4 continues on sheet 9 with a table of '*immediate financial pressures in 2020*', divided by '*Lower range'*, and '*Higher range*'.

The first item, £50m for cost of business support, has the same lower range as upper range, although it has been made clear (3.9 and 3.10) that £50m is a conservative guess.

The third item in the table, '*Increase in States' expenditure*' of £6m, is likewise unchanging in both columns. However, perhaps tellingly, P&R makes no off-setting allowance for

- savings from the '*other sources of funding mentioned*' which it discusses in 4.5,
- the freeze on recruitment and '*service development*' mentioned in 4.6, or
- the other reductions in States expenditure detailed at length in 4.7.

The **Total States Funding Requirement,** Section 5 (from sheet 13) confuses 'nice-to-have', with 'requirements' in a borrow-and-spend fantasy. Paragraph 5.3 splashes a further £250m in the sweet-shop of government spending dreams, '*supporting and encouraging connectivity, both within the island and with the wider world in order to promote our competitiveness, including in areas such as data connectivity and transport links*.'

This is the point at which teenagers would ask Gran to cut up her credit cards.

In a search for allies, 5.5 assures us that P&R will discuss what to do with the extra £250m with the Committee *for* Economic Development.

Section 6 is called **Borrowing Requirement** (from sheet 14). It outlines the whereabouts of more than £1.5bn in various States pockets, and emphasises that this is not enough. Again, the word 'requirement' seems out of place.

Section 7 notes that the borrowing rules (**Fiscal Framework**) which the States set itself only in January would be trampled by Proposition 2. The authors clearly feel the rules were a mistake. States net debt which stands at 13% of GDP, and is capped by law at 15%, is compared with the UK's 2020 debt forecast of 95.7% of GDP. This idea is wholly spurious. Countries with their own central bank can (as a last resort) print money to inflate and depreciate their way out of a debt crisis. Guernsey cannot.

Section 8 notes that P.2020/91 (2) triggers Rule 4 of the **Procedures for the States of Deliberation and the Committees**, on the behaviour of PR regarding money matters.

The **Appendices** to the Policy Letter support Section 7, inviting the reader to compare Guernsey to the UK and other countries which borrow in their own currency. Look how little debt we have compared to them!

This is the slippery slope, the road to hell which takes us down, for all its good intentions. No mention of the pain of countries trying to turn back a national debt run up by an earlier generation of foolish or unscrupulous politicians, after it started to accelerate at this rate. No mention of the indebtedness of Bermuda, whose annual interest bill alone now exceeds USD 125m. Or of what happened in 2009 to the customers with more than EUR 100,000 in banks in Cyprus. Have we learned nothing from Argentina borrowing in US Dollars? Or Greece within the Euro? Do Liechtenstein or Monaco issue debt? Or even the British Virgin Islands?