# To Infinity and Beyond - a critique of P&R's Green Paper for post-lockdown

**Paper to Deputies, Fergus Dunlop 30th June 2020**


**Summary**

This note examines the Green Paper to inject state aid into Guernsey's economy, following the elimination of the COVID-19 virus locally, and asks whether it is necessary and safe.

The States of Guernsey's Policy and Resources Committee ('P&R') is inclined to borrow and spend very large new sums in response to the economic set-back – maybe £600m. To progress this, P&R has published a Green Paper, 'Revive and Thrive'[1] ('R&T'). However, the case for such spending is missing. Readers will find no model among the 110 pages of warm sentiments and the 25 pretty pictures, although '*economic modelling based on several recovery scenarios*' is mentioned.

Four aspects of Guernsey's current status are lacking from the Green Paper:

- our early elimination of COVID-19,
- the proportion of our economy which successfully worked from home,
- our balance of payments in tourism, and
- our past record in 'timing' the capital markets.

Other factors will be missing too. However, these four aspects alone suggest that a huge Keynesian push post-lockdown is unnecessary, in which case it will be harmful.

If Deputies succumb to the mood music of borrow-and-spend, they will make over-spending more likely. By blessing the 'Covid-19 Response Advisory Group' ('CRAG') as a sub-committee of P&R, they endorse a change with big ramifications for their control of business.


**Background**

On 20th March the States approved a Policy Letter published that day, 2020/58[2], releasing to P&R '*a maximum cost of £30million, to be funded from the General Revenue Account Reserve*" (para. 2.8, page 5 of 8) for a Payroll Co-funding Scheme, grants to small businesses and the self-employed, and a Lending Guarantee Scheme with the banks. Further money demands were expected.

On 22nd April P&R issued Policy Letter P2020/91[3] to be debated on the 24th. On top of the £30m from the General Revenue Account Reserve, P&R wanted access to Guernsey's Core Investment Reserve, also known as the rainy day fund, for up to £100m (para. 3.16, page 8 of 19). A further request for up to £500m in long-term debt raised eyebrows.

Prior to the debate, the Chairman of the Civil Contingencies Authority ('CCA'), easily changing hats to speak as President of P&R, stated on BBC Radio Guernsey that £600m might be too little. P&R read the mood and debate was delayed to the 29th. Nevertheless, several normally prudent Deputies then supported the proposal, saying 'in for a penny, in for a pound'. A short-term debt of £250m was approved, with a further £50m long-term 'Guernsey Together' bond, to be raised partly from local residents. Any more than this would need to be considered in the light of a P&R strategy document.

On 11th the draft strategy arrived, 'Revive & Thrive', P2020/106[1], with a letter of support from CRAG. Prefaced with threats of a possible 18% economic collapse in 2020, and soothing phrases about 'frameworks', 'working collaboratively' etc., the booklet and strategy will be debated on 1st July.

R&T proposes massive spending on:

- Transport connectivity,
- Digital infrastructure,
- Built environment,
- Workforce skills.

The spending would come on top of the £172m-£190m identified in P2020/91 for 'immediate financial pressure' in 2020 (see Appendix 1). It would aim to put Guernsey back where it might have been in three years' time, had the pandemic not struck (para 4.3). Without such expenditure, the central R&T forecast is that Guernsey would require up to decade to regain its pre-COVID level of Gross Value Added ('GVA') (page 8 of 24 of the booklet).

R&T is silent about magnitudes. So P2020/93's borrowing up to £500m, plus drawing up to £100m from the rainy day fund, plus that £30m from the General Reserve, is still the reference point. CRAG flagged noted already budgeted spending, now that '*commitments to short-term economic actions based on work streams already approved by the States, have been included'* (page 39 of 110). But the threat of a greatly expanded debt has not gone away.
So the questions are:

- Is R&T necessary? What model lies behind the R&T justification, and is it out of date?
- Is R&T safe? Would splashing out up to £630m do more harm than good?

**Problems for P&R's Model**

*Reaching Phase 5 early*
Guernsey has had an extraordinary ride. In mid-April we suffered one of the highest per-capita infection rates of COVID-19 in the world[4]. Yet the virus was eliminated in the Bailiwick six weeks later. From lockdown to the recovery of the last known active case, took just over 8 weeks.

So lockdown was not for 13 weeks, as P2020/91 assumed (para 4.2, page 8 of 19). At the start of Week 5, 25th April, low-risk outdoor workers such as gardeners and window cleaners could go back to work. A significant turning point came in Week 10, when private schools returned, followed by the state system in Week 11, on 8th June. The mental health benefits for the children were huge, as were the educational positives.

However, the economic gains were bigger still. Parents who had been home-schooling could now focus on their jobs. Employment jumped. The State's 'Guernsey Unemployment Bulletin[5]' found vacancies at the Job Centre recovering strongly. As of 18th June, vacancies open during that month were already double the whole of May, and eight times April (page 8). The culmination came on 19th June, still in Week 12, with the end of social distancing. Guernsey was the first place in the British Isles to achieve this, and one of the first in the West.

The speed of our turnaround was unanticipated. CCA members and the Director of Public Health have freely admitted they were astonished. P&R's models cannot be blamed for being overtaken by events. Even the 'Alternative Accelerated transition' (sic) foreseen in R&T (page 5 of the booklet) would be out of date. No Treasury official would dare factor-in how well Guernsey's sealed borders and small population would helped contact-tracing under lockdown.

Just as the second half of a period of self-isolation does more mental damage than the first half[6], so the second-half of a lockdown does more economic damage than the first. Savings run out, clients lose interest, productive ways of working are forgotten. The hope of a V-shaped recovery melts into the despair of an L-shaped one. Reaching Phase Five early made a big difference.

Such evidence needs to be incorporated into the Treasury model, before Deputies set the spending steam-roller trundling towards the cliffs.

*Successfully Working from Home*

A lock-down tests which sectors of an economy can work from home.

Of the twenty economic sectors listed in standard national income statements, the most vulnerable to a regime of forced Working from Home ('WFH') are:

- Construction
- Accommodation and food services (called in Guernsey Facts and Figures 'Hostelry')
- Manufacturing
- Transport and storage

The main defensive ones will be:

- Finance
- Professional, business, scientific and technical
- Public administration
- Administrative and support services
- Information and communication

The remaining eleven sectors will experience mixed results. For example, Retail divides between Non-food Retail, which has had a hard time, and Food and On-line Retail which may have done well.

The point is that Guernsey was fortunate to have an economy more than two-thirds weighted towards an ability work from home. The vulnerable but highly visible sectors comprise less than a tenth of our economy. This is in contrast to, say, Germany, where the vulnerable sectors outweigh the stable ones (see Table 1, below).

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*Table 1: Percent contribution to Gross Value Added of vulnerable and stable sectors in Guernsey (2018), the UK (2017), the USA (2019) and Germany (2017):*

| Vulnerable sectors | Guernsey[7] | UK[8] | USA[9] | Germany[10] |
|---|---|---|---|---|
| Construction | 3.6% | 6.1% | 4.4% | 4.9% |
| Hostelry (Accommodation and food services) | 1.8% | 2.8% | 3.2% | 1.6% |
| Transport and storage | 1.6% | 4.1% | 3.4% | 4.6% |
| Manufacturing | 1.0% | 10.1% | 16.6% | 23.4% |
| **Total** | **7.9%** | **23.1%** | **27.5%** | **34.4%** |
| Stable sectors | | | | |
| Finance | 42.0% | 7.3% | 8.4% | 3.8% |
| Professional, Business, scientific and technical | 11.2% | 7.6% | 8.4% | 5.8% |
| Public administration (excl. education) | 8.8% | 4.9% | 10.9% | 6.0% |
| Administrative and support services | 4.0% | 5.2% | 2.7% | 5.0% |
| Information and communication | 2.2% | 6.8% | 5.1% | 4.6% |
| Electricity, gas, steam and air conditioning | 0.5% | 1.4% | 1.3% | 1.6% |
| Water, sewerage, waste and remediation | 0.1% | 1.3% | 0.3% | 1.0% |
| **Total** | **68.8%** | **33.0%** | **37.1%** | **27.9%** |

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Some businesses in WFH-friendly sectors will have experienced problems. However, the lock-down date in Guernsey, 25th March, was relatively late. China locked down cities from 23rd January, Italy on 9th March, Norway on 12th, Spain on 14th, Switzerland on 17th, Gibraltar on 22nd, even the UK on 24th March, so businesses in Guernsey certainly had time to prepare. At least one large financial services company here had moved all staff to working from home before Guernsey locked down, having learned from its offices in the Far East and Europe.

This explains why the Guernsey Finance sector did not miss a beat. Income tax from this source will be unaffected. Does the model recognise this?

The Scrutiny Committee is asking the right question. What data do we have? For example, preliminary figures from Guernsey Electricity[11] suggest that power use on a weather-and-bank-holiday-adjusted basis was flat across the period compared to 2019. (In Germany consumption fell 10% on the same basis, compared to the previous 4-year average.[12]) But will they be too late?

Consensus Economics forecasts that European economies will suffer between 5.8% (Sweden) and 10.5% (Italy) contractions in GDP in 2020[13] followed by partial recovery in 2021. Yet despite our short lockdown and WFH success, the R&T Green Paper makes its central assumption that Guernsey GVA will fall by 8% (page 3 of 24) and unemployment in Guernsey rise to 10%.

The Guernsey Unemployment Bulletin[5] put the mid-June unemployment rate at 5.2%, and thought it overstated:

> '*It is expected that levels of unemployment will fall in June as more businesses are able to reopen. The figures for May are likely to also include some who have already found work but are yet to receive their first wages and will therefore still be included in the statistics'* (5th para., page 5 of 10).

Let us try to imagine how R&T reaches that number of 10% unemployment, when only 18% of Guernsey jobs are in vulnerable sectors[15]? Even assuming 2% job losses in stable sectors, and 5% losses in 'others' it would still need 36% job losses in vulnerable sectors, on top of the 1.1% wholly unemployed on 21st March 2020, to reach 10% overall. This would imply a much worse recession for the outside world than the OECD and others are modelling in a 'double-hit scenario'[15 16]. In what model can we expect a much worse outcome for the world than most, yet plan to be back on track ourselves in three years? P&R must show the assumptions behind their recovery scenarios.

Other facts and figures could be helpful here. For example, Guernsey low proportion of adults in the working age-range[17] reduces the impact of unemployment; and a very high proportion of our exports comes from stable sectors, perhaps 95%. This has a trickle-down within the economy. Does the model reflect such advantages? We don't know.

*A staycation haven*

Some countries have a net positive balance of trade in tourism. For example tourism is New Zealand's largest economic sector. Micro-jurisdictions tend to be particularly exposed. Of the fifteen countries with the highest proportion of GDP coming from tourism, ranging from Macau at 50.2% to Belize at 15.5%, ten are Caribbean islands[18]. However, Guernsey is different.

Like several large north European countries, we spend more on holidaying abroad than is spent by visitors here. Germans spend three times as much on foreign holidays as all Europeans together spend on holidays to Germany. The Dutch, Norwegians, Belgians, Icelanders and Swedes also spend significantly more abroad than they take in[19].

This is the category in which Guernsey finds itself. Spending by visitors on-island, excluding travel to and from the Bailiwick, was worth £80m in 2019[20]. However, Guernsey households spent twice that on overseas holidays (it was already £153m in 2012-3, which is our most recent data [21 21 23]), in other words just over 10% of average household income. Let's acknowledge that in 2020 some of our holiday spending money will be saved until the next opportunity. However, with a successful Guernsey Together staycation campaign, the boost to the Island's tourist economy from households unwilling to travel abroad can exceed the loss of visitor on-Island spending.

Is this taken into P&R's thinking? Again, without seeing the model we cannot know.

*Borrowing didn't work last time*

Guernsey politicians have a poor track record when it comes to the capital markets. The £330m States of Guernsey $3^3/_8$% 2046 bond currently trades around £141, with a yield of 1.5% (Appendix 2). It is nominally worth £100 per bond ('par'), and was sold at £97. In other words, it would cost £460m (excluding break fees) today to buy back the debt we sold for £330m, which raised £320m.

The money available from the 2014 Guernsey Bond is loaned on at about 4%, to cover our costs. This interest rate is so far above the current price of money to well-secured businesses, which is below 2%, that responsible boards cannot be arm-twisted into taking it. Indeed a case of negligence might be made against anyone who did so.

When Guernsey politicians want to borrow, they argue that 'there will never be a better time'. It happened in 2009, when the proposal was defeated. And it happened in 2014. Such statements show an ignorance of how money is priced. At any point in time, there is a 50/50 balance of views, for every optimist there is a pessimist. In this case, pessimism is about deflation, falling house prices, falling commodity prices; in fact, ironically, the scenario Policy Letter 2020/91 apparently modelled.

The Scrutiny Committee enquiry into the 2014 Guernsey Bond was told, 'all the experts advised that it was a good time to borrow'. If you believe that, you have been captured by just one side of the argument. Check your advisors' motives, and why you are being shielded from the other viewpoint. Currently, this other view sees strong central banks around the world, Japan, Switzerland, Sweden, Norway, actively engaged in lending at negative interest rates. The European Central Bank has a base rate of -0.5% and last week opened a window for member states' commercial banks to borrow from it at -1%. Much Euro-denominated debt currently trades at negative interest rates.

Negative interest rates are publicly discussed by the US Chairman of the US Federal Reserve. Should the Fed take such a step, the Bank of England (base rate, +0.1%) can follow. Where would that leave us? Guernsey has £330m (notionally £460m) of debt from 2014. Add to that what P&R seems to be seeking, (is it £550m? let's say £500m), and repeat the market movement of the last six years. Under these parameters, we'd need £1.33bn, plus break fees, to redeem our debt early, say in 2026.

What if States' Treasury unearths new, pre-COVID financial liabilities? What if the Guernsey economy starts to shrink? House prices fall, a brain drain, capital flight? What about a trade conflict, or worse? What if, when the time comes to repay the debt, we can't? Could we re-finance it – in other words borrow again, to repay? Possibly, but only at now usurious interest rates.

As the printing-press option is not available to us, we would have to turn to whoever's currency we use, presumably the UK, to bail us out. And the price of that would be our freedom. It has happened before, as long ago as 1707 in Scotland with the Act of Union, following the Darien Bubble; and as recently as 2009 with The Crown suspending parliament in the Turks & Cacos Islands.

**Would splashing the cash do more harm than good?**

Apart from whether Guernsey needs it, or can afford it, the consequences of a State spending spree in a relatively healthy economy are well known. The UK's 'Barber Boom' in 1972-3 was an example.

- The Conservatives reaped a short-term boost in popularity, but lost the next election,
- Tax cuts were paid for by debt, only to suck in imports as productivity failed to keep up,
- Inflation expectations rose and 'moral hazard' was created, better known as complacency,
- Government finances lost wiggle-room for the first Oil Crisis, which hit a year later.

Guernsey in 2020 is not the UK in 1972. Nevertheless, parallels can be seen. Borrowed money is easily spent, and Island-wide elections will make it more tempting to savvy Deputies. Populists make poor industrial bets. No society is immune from moral hazard when the State intervenes excessively. Discouraged from importing labour and services, local suppliers temper demand by raising prices.

Nor is Guernsey Germany in 2020. That country, with an economy more vulnerable to WFH, has dropped its 'Schwarze Null' (black zero) budgetary discipline, for a EUR 1.3tn rescue and EUR 130bn stimulus package. Does that justify a copy-cat policy here?

Indeed major economies, with their own fiat currencies and central banks, are doing the job for us, hence the strong stock markets. The UK has taken government debt above 100% of GDP. The EU has waived its fiscal rules. The Fed and ECB buy corporate bonds for the first time. Guernsey's Core Investment Reserve stands high again - cue expert advice to hang on in a rising market, no doubt.

The R&T Paper would not have us act as if we controlled our own currency and central bank (2020/106 para 3.9). Nevertheless it lards basic contradictions with apple-pie and Toy Story platitudes. The aspiration '*to set out a shared vision and the overall approach to recovery*' arises twice in the space of 100 words (page 5).

The R&T booklet itself does not say so, but CRAG will be the spending bulldozer, combining as it does the Presidents of the eight big spending departments as a sub-committee of P&R. CRAG has an enormous incentive. Whatever allocation the eight Presidents agree among themselves to 'recommend', we can be sure that the maximum pot available (£300m? £600m?) will be spent, and every member's own Committee will get many millions from the process.

CRAG's recommendations will sail through P&R and the States, because between them the eight Committees command a clear majority on both. If you can't justify a fibre network to every home, or a rebuilt Town front, or a longer runway, or a network of cycle paths, individually on economic grounds, drape yourself in the flag and call it a 'Recovery strategy for GuernseyTogether'. Anyone for a sewage works at Belgreve Bay? For examples of other islands' debt control problems, look at Bermuda – national debt: USD 3bn (2009, USD 500m) or the Bahamas - USD 9bn (2009 USD 3bn).

The saddest part of spending £600m plus is how common sense is jettisoned at the sight of so much money. £600m is £75m for each of the eight Committee Presidents sitting on CRAG, if split evenly. Back-benchers too may scoop a few million for their personal hobby horses. Who can resist?

**Conclusion**

So we conclude that R&T is unnecessary and dangerous.

- We reached Phase 5 earlier than modelled in the Green Paper, let alone in P2020/91,
- our main economic drivers were little damaged by lock-down,
- our potential stay-cation spend is greater than the visitor income foregone, and
- the politicians who want to borrow now, showed poor judgement in raising debt in 2014.

Other aspects will surely come to mind, but these four factors alone make it reasonable to ask for the details of P&R's modelling before signing up to R&T.

By blessing the existence of the Covid-19 Response Advisory Group as a sub-committee of P&R, Deputies endorse a change with far-reaching ramifications for their control of States' business.

Deputies need more than a Buzz Lightyear glimpse of the future before they join this mission To Infinity and Beyond.

Fergus Dunlop, 30th June 2020

Sources:

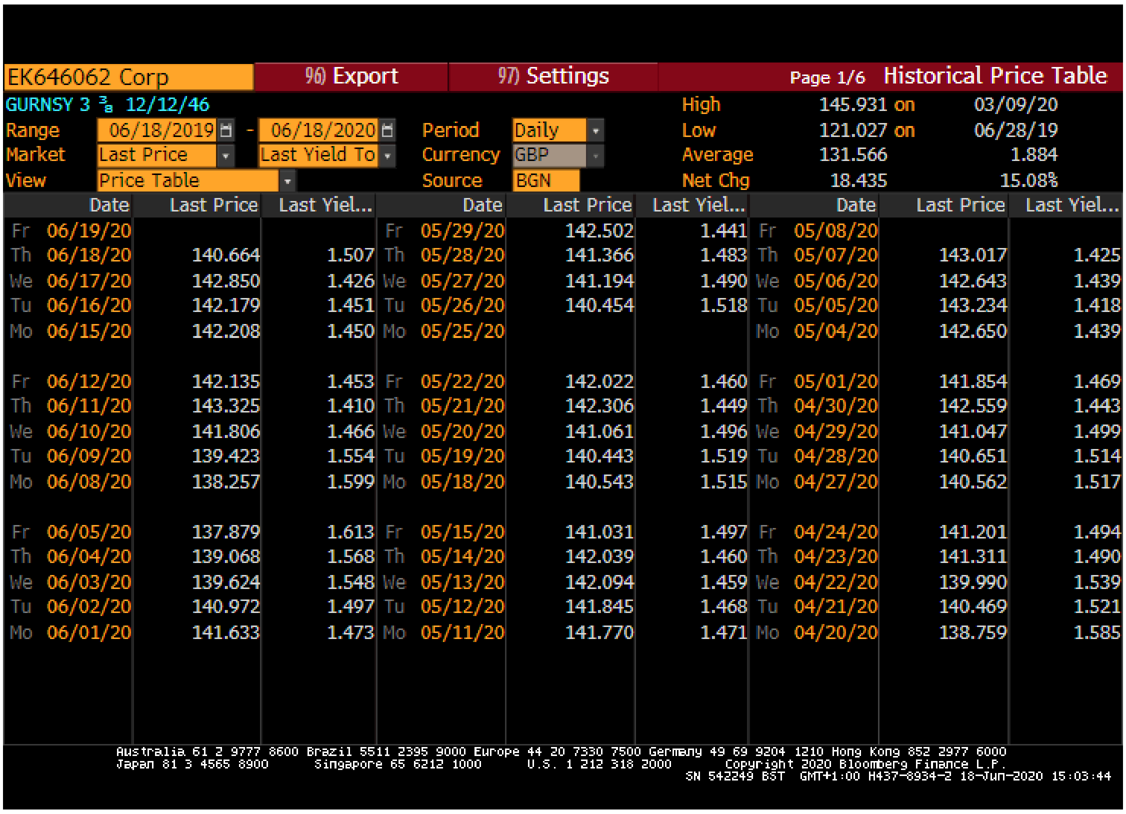
[1] https://www.gov.gg/CHttpHandler.ashx?id=126529&p=0 11th June 2020
[2] https://www.gov.gg/CHttpHandler.ashx?id=124161&p=0 20th March 2020
[3] https://www.gov.gg/CHttpHandler.ashx?id=124605&p=0 22nd April 2020
[4]Financial Times https://ig.ft.com/coronavirus-chart/?areas=usa&areas=gbr&areas=ggy&AreasRegional=usny&areasRegional=usnj&cumulative=0&logScale=1&perMillion=1&values=cases
[5]https://www.gov.gg/CHttpHandler.ashx?id=126980&p=0 23rd June 2020
[6] Dr. Nicola Brink, COVID-19 press conference, 19th June 2020
[7] Guernsey Facts and Figures 2019 (2018 data for this point.)
[8] UK Blue Book Chapter 2 (2019)
[9] US Bureau of Economic Analysis, (6th April 2020)
[10] Statistisches Bundesamt, Jahrbuch 2019 (2020)
[11] Guernsey Electricity daily demand Jan-June 2020 vs Jan-June 2019, preliminary chart
[12] www.teamconsult.net/news/files/Corona-Energy Market Radar_No.3_fv_engl.pdf
[13] https://www.ft.com/content/7ecd5ded-9b90-4052-b849-0e153f701e1f
[14] States of Guernsey, Facts and Figures, supplementary data 2019
[15] OECD Economic Outlook, Preliminary (June 2020)
[16]https://www.allianz.com/en/economic_research/publications/specials_fmo/17062020_Labormarket.html
[17] Guernsey Electronic Census, January 2020
[18] https://www.statista.com/statistics/1100368/countries-highest-gdp-travel-tourism/
[19] The Europeans, Ostergren (2012)
[20] States of Guernsey Visitor Spend Survey Report April-September 2019 (Feb 2020)
[21] States of Guernsey Annual Residential Property Stock Bulletin, December 2019 (March 2020)
[22] States of Guernsey 2012-2013 Household Expenditure Survey Report (Sept 2014)
[23] Publication of the results of the of the 2019 survey have been delayed by the lock-down
[24] Bloomberg (18th June 2020) – see Appendix 2

Appendix 1 – Extract from Policy Letter P2020/91 section 4.2 showing 'Immediate financial pressures requiring funding in 2020', which is proving to be exaggerated.

| | Lower range £m | £m | Higher range £m | £m |
|---|---|---|---|---|
| <u>General Revenue</u> | | | | |
| Direct Financial Support Measures for Business | 50 | | 50 | |
| Reduction in States' revenues | 60 | | 70 | |
| Increase in States' expenditure | 6 | | 6 | |
| Reduction in States' operating income | 6 | | 6 | |
| | | 122 | | 132 |
| | | | 27 | |
| <u>Trading Assets</u> | | | 8 | 35 |
| Aurigny Group | 23 | | | |
| Unincorporated entities | 8 | | | |
| Total Trading Assets impact | | 31 | | |
| <u>Social Security Funds</u> | | | | |
| Additional benefit payments | | 3 | | 3 |
| Social Security Funds cash-flow impact provision | | 16 | | 20 |
| | | **172** | | **190** |

Appendix 2 – Guernsey's Bond – April 20th-June 18th 2020: It yields around 1.5% - less than half its coupon - and trades at around 140, which is 40% over par.

Source: Bloomberg, 18th June 2020.


EK646062 Corp | 96) Export | 97) Settings | Page 1/6 Historical Price Table

GURNSY 3 ⅜ 12/12/46

| | | | | | |
|---|---|---|---|---|---|
| Range | 06/18/2019 - 06/18/2020 | Period | Daily | High | 145.931 on 03/09/20 |
| Market | Last Price / Last Yield To | Currency | GBP | Low | 121.027 on 06/28/19 |
| View | Price Table | Source | BGN | Average | 131.566 / 1.884 |
| | | | | Net Chg | 18.435 / 15.08% |

| Date | Last Price | Last Yiel... | Date | Last Price | Last Yiel... | Date | Last Price | Last Yiel... |
|---|---|---|---|---|---|---|---|---|
| Fr 06/19/20 | | | Fr 05/29/20 | 142.502 | 1.441 | Fr 05/08/20 | | |
| Th 06/18/20 | 140.664 | 1.507 | Th 05/28/20 | 141.366 | 1.483 | Th 05/07/20 | 143.017 | 1.425 |
| We 06/17/20 | 142.850 | 1.426 | We 05/27/20 | 141.194 | 1.490 | We 05/06/20 | 142.643 | 1.439 |
| Tu 06/16/20 | 142.179 | 1.451 | Tu 05/26/20 | 140.454 | 1.518 | Tu 05/05/20 | 143.234 | 1.418 |
| Mo 06/15/20 | 142.208 | 1.450 | Mo 05/25/20 | | | Mo 05/04/20 | 142.650 | 1.439 |
| Fr 06/12/20 | 142.135 | 1.453 | Fr 05/22/20 | 142.022 | 1.460 | Fr 05/01/20 | 141.854 | 1.469 |
| Th 06/11/20 | 143.325 | 1.410 | Th 05/21/20 | 142.306 | 1.449 | Th 04/30/20 | 142.559 | 1.443 |
| We 06/10/20 | 141.806 | 1.466 | We 05/20/20 | 141.061 | 1.496 | We 04/29/20 | 141.047 | 1.499 |
| Tu 06/09/20 | 139.423 | 1.554 | Tu 05/19/20 | 140.443 | 1.519 | Tu 04/28/20 | 140.651 | 1.514 |
| Mo 06/08/20 | 138.257 | 1.599 | Mo 05/18/20 | 140.543 | 1.515 | Mo 04/27/20 | 140.562 | 1.517 |
| Fr 06/05/20 | 137.879 | 1.613 | Fr 05/15/20 | 141.031 | 1.497 | Fr 04/24/20 | 141.201 | 1.494 |
| Th 06/04/20 | 139.068 | 1.568 | Th 05/14/20 | 142.039 | 1.460 | Th 04/23/20 | 141.311 | 1.490 |
| We 06/03/20 | 139.624 | 1.548 | We 05/13/20 | 142.094 | 1.459 | We 04/22/20 | 139.990 | 1.539 |
| Tu 06/02/20 | 140.972 | 1.497 | Tu 05/12/20 | 141.845 | 1.468 | Tu 04/21/20 | 140.469 | 1.521 |
| Mo 06/01/20 | 141.633 | 1.473 | Mo 05/11/20 | 141.770 | 1.471 | Mo 04/20/20 | 138.759 | 1.585 |

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