Box J: Net debt and contingent liabilities

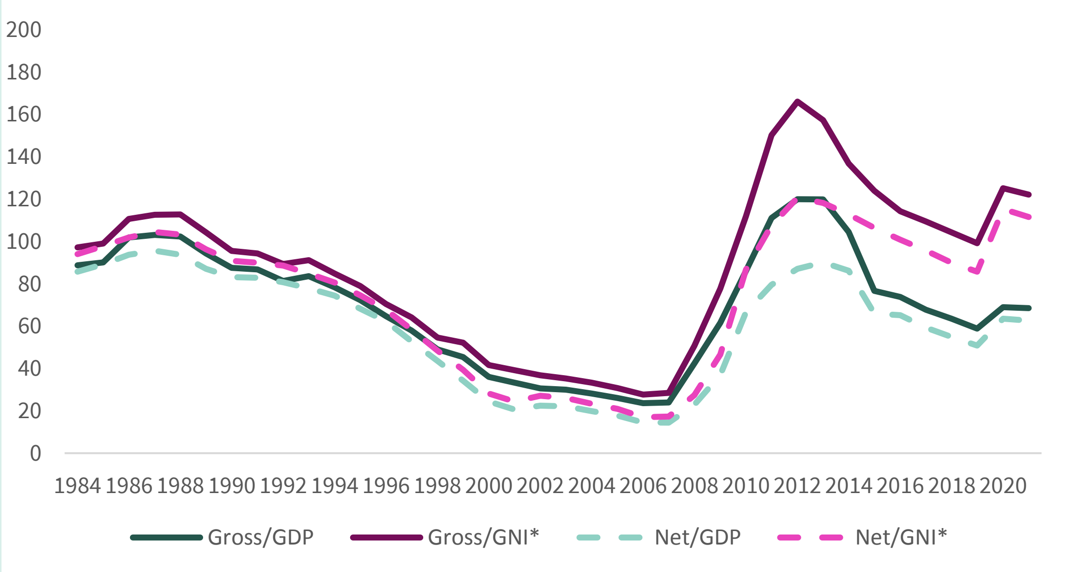
This box examines the relationship between net debt and gross debt in a historical context and also assesses the extent to which government guarantees may affect the government's debt position in the future.

Gross debt is defined as financial liabilities of loans, currency and deposits, and securities (excluding shares and financial derivatives).[47] Net debt is defined as gross debt minus financial assets corresponding to debt instruments. These measures do not take into account physical capital, such as infrastructure, that are part of government net worth.

Net debt is a more appropriate measure of the government's debt burden as it takes into account liquid assets that can be either used to fund a deficit or to further roll-over debt. Historically there can be substantial differences between the two series. This often arises during crisis periods due to the precautionary holding of cash balances.

Figure J.1 shows the gross and net debt ratios as a per cent of both GDP and GNI* from 1984-2021. In 1987 gross debt peaked at 113 per cent of GNI*, while net debt peaked at 103 per cent of GNI*. As a result of the financial crisis, gross debt peaked at 166 per cent of GNI* in 2012. However, net debt only peaked at 121 per cent of GNI*. This gap reflected a large amount of cash reserves that the NTMA had maintained as a precautionary measure (see Fitzgerald & Kenny, 2018).

Figure J.1: Debt ratios 1984-2021



Sources: CSO; Department of Finance; IMF; Fitzgerald & Kenny (2018); and Fiscal Council workings.
Note: CSO data is used for GDP, GNI* and gross debt from 1995-2018. Gross debt from 1984-1994 is from Fitzgerald & Kenny (2018). CSO data for Net debt is used from 2000-2019. The general government balance is used as a proxy for the change in net debt from 1984-1999 (the change in net debt tracks the general government balance closely. Discrepancies arise between the two due to debt adjustment effects and statistical discrepancies). Data from the IMF April 2017 WEO is used for the general government balance from 1984-1995.

The *SPU 2020* forecast for net debt is that it will peak at 115 per cent of GNI* in 2020, below the 2012 peak but above the 1987 peak. This is an increase of 29 percentage points in the net debt ratio in 2020 compared with 2019. In contrast, gross debt is forecast to increase by 26

[47] Maastricht definition. See *Measuring net government debt: theory and practice* (Eurostat, 2014): https://ec.europa.eu/eurostat/web/products-statistical-working-papers/-/KS-TC-14-005.

percentage points. The difference mostly relates to a planned run down in cash balances by the NTMA (see Figure 1.9 for details on how the exchequer deficit will be funded in 2020).

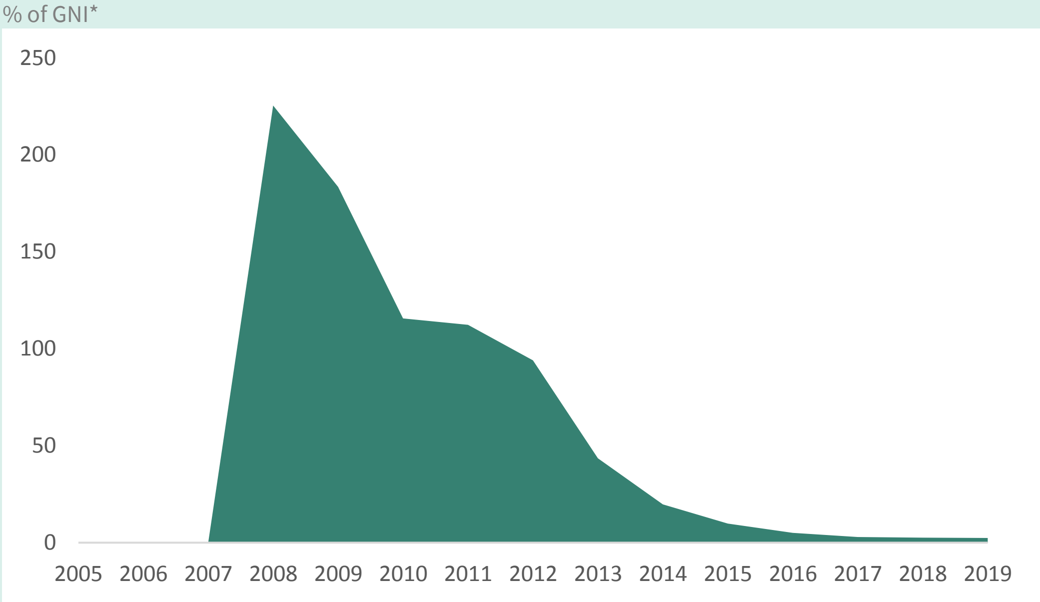
Contingent liabilities

Government guarantees are often used as a way of leveraging the government's balance sheet in order to provide support to the economy in a time of crisis. Shown in Figure J.2 is the general government contingent liabilities from 2005-2019 as a per cent of GNI*. This represents the maximum possible exposure to the Irish State of these liabilities.[48]

The banking guarantee scheme introduced in 2008, which covered €375 billion of banking liabilities, created a very large potential exposure for the government (Barnes & Smyth, 2013). As a result, the contingent liabilities peaked at 225 per cent of GNI* in 2008 but since then it has steadily declined and at the end of 2019 amounted to 2.5 per cent of GNI*.

In response to the Covid-19 pandemic, the Government has again turned to leveraging the government's balance sheet and has introduced a credit guarantee scheme of €2 billion (see Box F). As far as the Council is aware, this is the only new measure introduced by the Government in response to Covid-19 that creates a potential contingent liability for the State.[49] As a result, the potential cost the State may incur from contingent liabilities is not on a comparable scale to that arising from the financial crisis.

Figure J.2: The financial crisis led to a large increase in the government's contingent liabilities



Sources: CSO; and internal Fiscal Council workings.
Note: Contingent liabilities are presented in terms of their maximum possible exposure.

[48] Often, the probability of realising the cost on the contingent liabilities is low. While contingent liabilities are often expressed in terms of the maximum possible exposure, a more appropriate way to assess contingent liabilities would be on the basis of expected present discounted value.

[49] Up to 80 per cent of the loan is guaranteed, with a 50 per cent cap on a lender's portfolio. The scheme requires legislation, and the legislation will ultimately determine the amount of the contingent liability for the State.