

Opening Statement – Select Committee on Budgetary Oversight

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Introduction

Let me begin by thanking the Chairman for the invitation to the ESRI to appear before you today. I am Dr Adele Bergin and I am joined by my colleague Professor Kieran McQuinn who is head of Economics in the ESRI.

We have been asked to discuss a recent paper “Ireland and Brexit: Modelling the Impact of Deal and No-Deal Scenarios” which was published in the Spring 2019 *Quarterly Economic Commentary*. The paper attempts to quantify the macroeconomic impact of Brexit on the Irish economy. I will start by summarizing the range of scenarios considered and then outline some of the key findings for the macro economy, trade, the labour market, households, and the public finances.

Brexit Scenarios

Owing to the current heightened political uncertainty in the UK, we consider a range of Brexit scenarios. We also acknowledge the uncertainty around any assessment of the economic impact of Brexit, as there is no precedent of a country leaving a major and closely integrated trading block such as the EU.

The paper considers three scenarios which we describe as *Deal*, *No-Deal* and *Disorderly No-Deal*. To estimate the economic impact of each scenario, we compare them to a counterfactual scenario where the UK remains in the EU. In the *Deal* scenario, the UK makes an orderly agreed exit from the EU. This involves a transition period to the end of 2020, and a free trade agreement between the UK and the EU-27 being in place thereafter. In the *No-Deal* scenario, the UK exits the EU without a deal but there is an orderly period of adjustment for trade. Ultimately, WTO tariff arrangements will apply to goods trade, there will be non-tariff measures, and services trade will also be negatively impacted. In the *Disorderly No-Deal* scenario, the UK exits the EU without a deal and there is an additional disruption to trade in the short-run, above that considered in the *No-Deal* scenario.

The analysis focusses on the most well understood channels through which Brexit will affect Ireland, namely though lower trade, incorporating the impact of tariff and non-tariff measures, and the potentially positive impact of FDI diversion to Ireland. Our approach is to build up estimates of each of these channels from a range of recent Brexit micro-economic studies, so our estimates are anchored in the empirical literature. We then use these micro-estimates to calibrate macro

scenarios; specifically we generate alternative paths for the UK and international economy using the NiGEM global model of the National Institute of Economic and Social Research in the UK and assess the impact on Ireland using the ESRI's COSMO macro-econometric model.

The impact of each Brexit scenario is considerable and will have negative effects on the macro-economy and throughout the economy on trade, the labour market, the household sector, and the public finances. I will briefly outline the key impacts for each these.

Macroeconomic Impact

The macroeconomic effects of Brexit are significant and negative for the Irish economy. We find that GDP, the level of output in Ireland, in the longer term could be around 2.6% lower in a *Deal* scenario, 4.8% lower in a *No-Deal* scenario and 5.0% lower in a *Disorderly No-Deal* scenario, compared to a situation where the UK stays in the EU. While some of these effects may not appear substantial, it has to be borne in mind that these impacts will cumulate over a long period of time. In each scenario, the level of Irish output is below where it otherwise would have been. The negative impact on Irish output in the long run in the *Deal* scenario is approximately half that of the *No-Deal* scenario.

Although these are substantial relative reductions in the level of output over the long run, it is important to state that the Irish economy will continue to grow but at a slower pace as a consequence of Brexit. If we assume the Irish economy would grow by an average of 3% per annum over the long-run if the UK stayed in the EU, the impact of Brexit is roughly equivalent to a 0.3 percentage point reduction in the long-run growth rate in the *Deal* scenario and around 0.6 percentage points off the long-run growth rate in the *No-Deal* and *Disorderly No-Deal* scenarios.

There is more uncertainty about the short-run impact of Brexit as it depends on how smooth any transition to the future arrangements between the UK and EU is. Our results suggest that by 2020, the level of real output in the Irish economy would be 0.6%, 1.2% and 2.4% lower in the *Deal*, *No-Deal* and *Disorderly No-Deal* scenarios, respectively, compared to a situation where the UK remains in the EU.

Trade

Our results also indicate that firms will be negatively affected as a result of Brexit. The negative trade shock will reduce the demand for Irish exports and Irish firms will be affected by the depreciation in sterling which will reduce our competitiveness. Our results indicate that exports, in the long-run, will be 4.6% lower in a *Deal* scenario, 8.1% lower in a *No-Deal* scenario and 8.3% lower in a *Disorderly No-Deal* scenario, compared to a situation where the UK stays in the EU.

Labour Market

Lower output in the long-run compared to a situation where the UK remains in the EU will result in lower labour demand, which has knock-on impacts for employment and the unemployment rate. Our results indicate that employment, in the long-run, would be 1.8% lower in a *Deal* scenario, 3.2% lower in a *No-Deal* scenario and 3.4% lower in a *Disorderly No-Deal* scenario, compared to a situation where the UK stays in the EU. This represents around 40 thousand fewer jobs created in the long-run in a *Deal* scenario and around 80 thousand fewer jobs created in the long-run in the two no-deal scenarios. Again, it is important to state that employment will continue to grow in each scenario but at a slower pace than compared to a situation where the UK remains in the EU. In the long-run, the unemployment rate is 1 percentage point higher in the *Deal* scenario and roughly 2 percentage points higher in the two no-deal scenarios, compared to a situation where the UK stays in the EU.

Households

For households, the impact of Brexit will be severe. Our results indicate that real personal disposable income, in the long-run, would be 2.2% lower in a *Deal* scenario, 3.9% lower in a *No-Deal* scenario and 4.1% lower in a *Disorderly No-Deal* scenario, compared to a situation where the UK stays in the EU. This is driven by lower employment, lower wages and higher prices. As a result, consumption will be lower in the long-run. Furthermore, households will face higher prices as a result of the imposition of tariffs or other increases in trading costs could be passed on as increased prices for Irish consumers.

Public Finances

With both output and employment below where they otherwise would have been in the absence of Brexit, government revenue from taxes will be lower and the increase in the unemployment rate would lead to higher government spending on welfare payments. The net effect is a deterioration in the general government balance (GGB) (as a % of GDP); in the long-run this could reduce the GGB by around 0.5 percentage points in a *Deal* scenario and by around 0.9 percentage points in a *No-Deal* and *Disorderly No-Deal* scenario.

We have also looked at the short-term forecasts for the public finances from the Spring 2019 Quarterly Economy Commentary (QEC) and examined the implications of Brexit for the public finances in the short-run. The short-term forecasts for the public finances in the recent QEC are done on the basis of a no-Brexit scenario. They show a deficit on the GGB of 0.3% of GDP in 2019 and a

deficit of 0.4% of GDP in 2020; this is equivalent to €0.9 billion in 2019 and €1.5 billion in 2020. Our results suggest that for 2019 the impact of our *Deal* or *No-Deal* scenario is more limited on the GGB; however the deficit on the GGB (as a % of GDP) could be 0.2 percentage points higher (or €0.7bn) in the case of a *Disorderly No-Deal* scenario. In 2020, the deficit on the GGB could be around 0.1 percentage points higher in our *Deal* or *No-Deal* scenarios (or €0.2 and €0.4 bn respectively) and 0.3 percentage points higher (or €1.1 billion) in the *Disorderly No-Deal* scenario. In each of the scenarios, we assume there is no explicit fiscal policy response to the change in the economic environment.

Conclusion

Many thanks for your attention, my colleague and I would be delighted to take any questions you may have.