Opening Statement of the Minister for Finance

Mr. Paschal Donohoe T.D.

to the Budget Oversight Committee

1st October 2020

INTRODUCTION

Chair, Members of the Committee: good afternoon and thank you for the invitation to meet with you today in advance of *Budget 2021* which I will present to *Dáil Éireann* – alongside with my cabinet colleague, Minister McGrath – on Tuesday October 13th.

I would like to begin by congratulating you, Deputy Hourigan, on your appointment as Chair of this Committee, and you, Deputy Farrell, on your appointment as Vice-Chair. I wish you both well in your new roles.

I understand the Committee would like to discuss a range of topics – the Budget forecasts and priorities, debt sustainability, Brexit, pandemic-related support from the EU, and international corporate tax reform. I am, of course, happy to address these issues, but I would like to begin by putting the choices facing us in the Budget in some context.

ECONOMIC CONTEXT

Firstly, is the economic backdrop to the Budget. As everyone is aware, the pandemic has triggered a severe recession in almost all countries. Ireland is no exception – our economy has experienced a severe shock, unprecedented in both speed and scale. We will, I suspect, be dealing with the economic, fiscal and other legacies of this pandemic for some time to come.

The lockdown triggered by the first wave of the virus resulted in an 18 per cent peak-to-trough decline in Modified Domestic Demand, our preferred measure of economic activity in Ireland. While there was some rebound in the third quarter, the latest indications are that momentum has slowed – though not gone into reverse – since the uptick in the infection rate which began around mid-August.

For this year as a whole, my Department is forecasting that Modified Domestic Demand will fall by 6½ per cent this year, with the unemployment rate averaging nearly 16 per cent. These are truly horrific figures – this time last year we had an economy that was virtually at 'full employment'.

FISCAL POLICY RESPONSE

The Government has responded rapidly and forcefully to mitigate the impact of the pandemic. Broadly speaking, a three-pronged strategy has characterised our approach:

- Firstly: ramping up healthcare capacity;
- Secondly: cushioning household incomes;
- Thirdly: providing life-lines to micro-sized firms and to SMEs.

The value of total supports announced to-date amounts to €24½bn or 14 per cent of national income. Put simply, this is an enormous amount of counter-cyclical support and, I would add, compares favourably with that provided in other jurisdictions. It is built on the back of market confidence in our approach, the Government's approach of sustainable, prudent management of the public finances in the years leading up to the crisis, as well as the supportive monetary policy adopted by the European Central Bank.

It is also worth making the point that a large part of Government borrowing is being financed by increased domestic savings by the private sector, especially the household sector. This is an important difference between the situation now and that of a decade-or-so ago. It means that the nation as a whole is not increasing its liabilities to non-residents: it is more sustainable.

Of course, this doesn't mean that we can go on like this forever – the pandemic will leave a large quantum of public debt in its wake; but as I've said before, a temporary increase in public debt is the appropriate strategy and the best way to absorb the shock to the economy.

But what we will need to do is to demonstrate that – once the worst of the pandemic has passed – we are committed to balancing the books over the medium-term. This can be done in a timely manner, consistent with the dual needs of supporting the economy as well as ensuring fiscal sustainability.

BREXIT

To compound matters is the very real prospect of a disorderly end to the so-called 'transition period'.

Chair, as every member of this committee will aware, the UK formally exited the European Union at the end of January this year, with *status quo* arrangements governing bilateral trade between the two jurisdictions at present. This transition period will come to a close at the end of this year and, in the absence of agreement, bilateral trade between the UK and all EU Member States – including Ireland – will be undertaken on *World Trade Organisation* terms from the beginning of January.

This will involve tariffs – essentially taxes on imports and exports – on traded goods, ranging from near-zero in some cases to in excess of 50 per cent in other cases. This would be enormously disruptive – and possibly compounded by non-tariff barriers and disruptions to cross-border supply chains, many of which are 'just-in-time'.

Last month, the Government published the *Brexit Readiness Action Plan* which supports the necessary preparations for the substantial changes which will arise at the end of the transition period. The Government is urging businesses, no matter how small, to take immediate steps to understand the impacts any new rules or processes will have on their operations.

Government has decided that the forthcoming Budget will be based on the assumption of a disorderly end to the transition period. My Department estimates that this would reduce the GDP growth rate by around 3 percentage points next year, although the lack of historical precedent makes these estimates uncertain. Quite clearly, the consequences would be most severe for the agriculture, food and traditional manufacturing sectors.

ECONOMIC OUTLOOK

The combined effects of the pandemic and trade disruption will have a significant bearing on our near-term economic prospects.

At this point in time, there is no line of sight for a vaccine. This means that our economic trajectory is highly intertwined with the trajectory of the virus: where the virus goes, the economy goes. It seems inevitable that there will be peaks-and-troughs in the infection rate, at least in the near-term. This means that economic rebounds followed by setbacks will be an unfortunate feature of our lives.

For next year, my Department is projecting GDP growth of just 1½ per cent while Modified Domestic Demand will increase by around 4 per cent. These figures mean that the level of economic activity next year will still be below last year's peak. Earlier this week, these forecasts were endorsed by the *Irish Fiscal Advisory Council* – a legal requirement for all euro area Member States at this stage in the budgetary cycle.

BUDGETARY STANCE

So, in terms of framing Budget 2021, the macro-economic backdrop is exceptionally difficult. The Government is planning on the basis of co-existence with the virus next year as well as the assumption that bilateral trade between the UK and the EU takes place on WTO terms.

A key plank of *Budget 2021* will be the *Recovery Fund,* as provided for in the *Programme for Government*. This will provide for targeted, time-bound counter-cyclical support – further helping to cushion the impact on people's incomes and employment.

At the same time, however, a key challenge in framing the Budget is to find the appropriate balance between continued support for the economy and staying 'within the pack' of EU Member States. As we are all too aware in this country, market sentiment can turn rapidly – so we must not be an outlier. Irish public debt is already one of the highest in the developed world at 125 per cent of national income. As such, while *Budget 2021* will provide for deficit-financed spending to continue in the short-term, as well as targeting an improvement in the headline fiscal position.

CONCLUSION

In conclusion, Chair, we have never seen a challenge like this in modern times; but equally we have not seen a response like this either. Our job is to minimise the damage – economic and social – and to lay the foundations for recovery which will come. The forthcoming budget will be the next phase in the Government's response.

I look forward to Members' questions and to a productive discussion.