Opening Statement to the Special Committee on Covid-19 Response

Economic and Social Research Institute

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Introduction

I'd like to begin by thanking the Chair and the Committee for the invitation to speak to you today. I am Alan Barrett, the Director of the ESRI and I am joined by my colleagues Dr. Karina Doorley and Dr. Barra Roantree. The Institute has undertaken much work on the Covid crisis since March, including our inputs into the work of NPHET, analyses of topics such as childcare and working from home and the work which we will focus on today, namely, the fiscal impact with particular reference to social protection expenditure.

Macroeconomic impacts

In the recent *Quarterly Economic Commentary* – authored by our colleagues Kieran McQuinn, Conor O'Toole, Matthew Allen-Coghlan and Cathal Coffey, three scenarios for the Irish economy in 2020 were presented.

In the Baseline Scenario the lockdown restrictions are gradually lifted until August in line with the original government guidelines. After this point the economy enters a recovery phase which lasts to the end of the year. Under this scenario real GDP is forecast to decline by over 12 per cent this year. Private consumption expenditure is expected to fall by around 13 per cent this year. The fall in investment is even more significant, declining by about 28 per cent. International trade will also decline significantly with imports falling by 12 per cent and exports falling by 8 per cent.

In the Severe Scenario the economic shock is even more stark with a second wave of the virus resulting in the country being back into lockdown in Q4. In this case real GDP is forecast to decline by over 17 per cent in 2020. The final scenario is the Benign Scenario. This is the most optimistic scenario based on a situation in which the pandemic is suppressed so effectively over the latter half of the year that the economy returns to normal 'pre-covid' conditions in Q4. Under this scenario the economy is forecast to decline by about 9 per cent this year.

The impact of the crisis on the labour market can already be seen clearly. Including those on the Pandemic Unemployment Payment, the unemployment rate reached over 28 per cent in April. Work by Beirne et al. (2020)[1] and Roantree (2020)[2] has shown that the pandemic has had an asymmetric impact across the labour market with some sectors and demographic groups impacted more significantly than others. In our Baseline Scenario the unemployment rate is expected to average 17 per cent for the year.

No matter which scenario we find ourselves in, there will be significant repercussions for the public finances in 2020. In our Winter 2019 *Commentary* we had forecast the a modest deficit of 0.3 per cent of GDP this year - this has been revised down to a 9 per cent deficit under our baseline scenario. In nominal terms this is a deficit of about €28bn.

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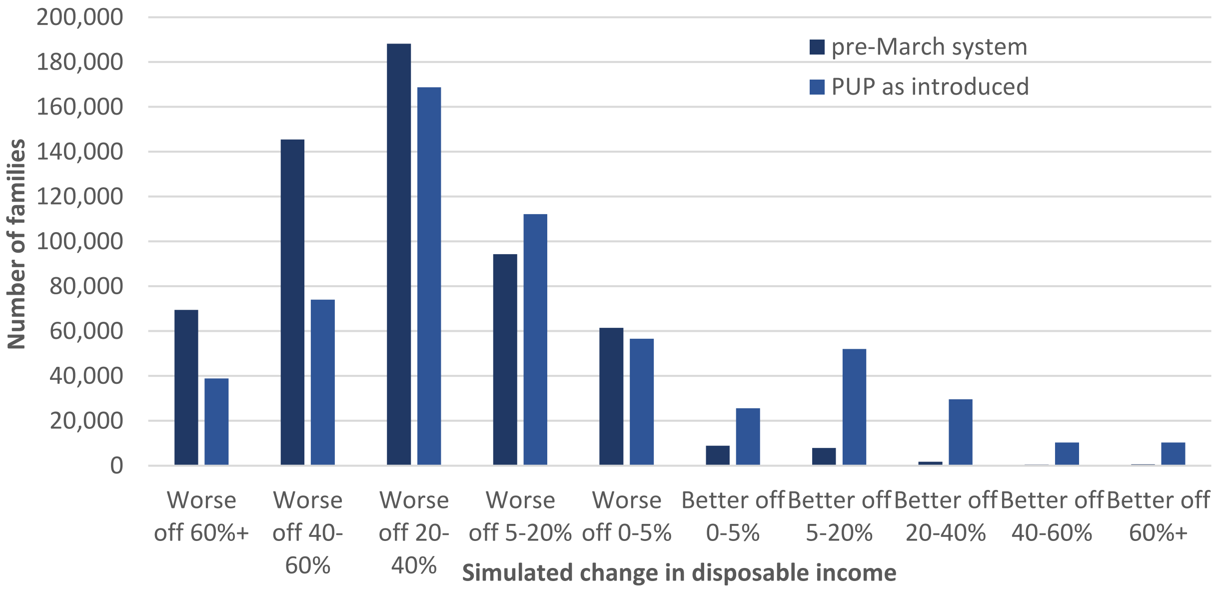
[1] Beirne K., K. Doorley, M. Regan, B. Roantree and D. Tuda (2020). 'The potential costs and distributional effect of COVID-19 related unemployment in Ireland'. Budget Perspectives 2021, Paper 1, April. Economic and Social Research Institute (ESRI).
[2] Roantree, B (2020) 'Job Loss Distribution'. *Quarterly Economic Commentary, Summer2020 (ESRI)*

The Pandemic Unemployment Payment (PUP)

In Beirne et al. (2020), we estimate the exchequer impact of job losses in three scenarios. The 'medium' job loss scenario (600,000) with the PUP in place is estimated to cost the exchequer €4.9 billion per quarter, around €800 million more than a situation in which the existing system of welfare supports remained unchanged.

We find that the introduction of the PUP did much to cushion incomes from COVID-19 related job losses. Figure 1 plots the number of families we estimate are affected by a job loss in our medium unemployment scenario, grouped by the size of the change in their disposable income (after taxes and benefits). The number of families who lose more than 20% of their disposable income is reduced by around a third with the introduction of the PUP. The number who lose more than 60% is reduced by almost a half.

Figure 1: estimated number of families by change in disposable income after job loss



Source: Source: authors' calculations using EUROMOD run on 2017 EU-SILC data uprated to 2020 terms using reported average earnings growth from CSO, assuming no growth between 2019 and 2020. Excludes families simulated to be unaffected by job losses.

That the PUP leaves some families with more disposable income out-of-work than they had in-work raises the question of how the payment affects financial incentives to work. Although these may be of little importance while public health measures are in place, our simulations suggest careful consideration should be given to how these supports will be scaled back.

The Temporary Wage Subsidy Scheme (TWSS)

In addition to the PUP, the government also introduced the Temporary Wage Subsidy Scheme (TWSS). Beirne et al. (2020) examined the impact of the initial version of this scheme on the exchequer and households. This version of the scheme was less generous to lower-paid employees than the revised scheme and excluded some higher earning workers from eligibility.

The exchequer cost of the TWSS was found to be potentially lower than the cost of the PUP as many workers are entitled to less than €350 per week under the TWSS and many receive a top-up payment from their employer. This conclusion will remain true for the revised scheme. We estimate that if half of those who lose their job in our ‘medium’ unemployment scenario were to instead remain in work and receive the TWSS alongside the maximum employer top-up allowed, the net impact on the exchequer would be €360 million less per quarter than the PUP. This equates to approximately €120 million per quarter less for every 100,000 who transfer from the PUP to the TWSS with a full-top up paid by the employer.

We also find that there would be substantially fewer families worse off by more than 20% of their previous disposable income in such a scenario: around 170,000 compared to 280,000 and 400,000 respectively if all claimed the PUP or received the benefits they would have been entitled to before the PUP was introduced.

If those claiming the TWSS would be made unemployed (and claim the PUP) in the absence of the scheme, the TWSS does not add to the cost of the policy response as most employees will receive no more under this scheme than they would through PUP, and some will receive less. This feature of the TWSS may, however, have provided a financial incentive for some employees to seek unemployment.

There may also be more deadweight associated with the TWSS as it allows employers to claim a subsidy for all their employees – including those working – so long as their business has been affected by the pandemic in accordance with Revenue guidelines. This may ultimately lead to a greater exchequer cost than paying the PUP to just those who would have been laid-off in the absence of the TWSS. However, it will help retain greater links between employees and employers for when business picks up after the crisis, a central aim of the TWSS scheme.

Conclusion

We will end with the following points.

The ESRI in its macroeconomic forecasting work has not yet attempted to provide forecasts for 2021. We judged that there was simply too much uncertainty for such an exercise to be undertaken. However, like other forecasting agencies we expect a fiscal deficit to remain in 2021 even in the context of a likely recovery. From a policy perspective, on-going borrowing to fund such a deficit will be the correct option. The key consideration here is that borrowing is appropriate in the context of a temporary deficit which is likely to be closed as the economy grows.

It will also be advisable to borrow for investment under a stimulus package. With interest rates close to zero, such a course would help to reboot the economy while also tackling some of the infrastructural needs which are well-understood.

However, much has been written about a possible expanded role for the state in a post-Covid society covering issues such as health, childcare and basic incomes. While borrowing is the appropriate response where a deficit is cyclical, an enhanced role for the state will have to mean higher taxes. Though the precise source and structure of those taxes is an open question, an increase in the total tax take is likely to be needed.