An Roinn Airgeadais
Department of Finance
Oifig an Aire
Office of the Minister

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2nd ~~July~~, 2020

Mr Sebastian Barnes,
Acting Chair,
Irish Fiscal Advisory Council,
Whitaker Square (ESRI Building),
Sir John Rogerson's Quay,
Dublin 2.

Dear Sebastian

I refer to the Irish Fiscal Advisory Council's *Fiscal Assessment Report, May 2020* as published on 26th May 2020.

This response, set out in the appendix to this letter, follows the same format as that adopted in the previous replies that have issued to the Council's *Fiscal Assessment Reports.* It is my intention to publish this letter on my Department's website.

Yours sincerely

Paschal Donohoe T.D.
Minister for Finance

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Appendix 1

Firstly, let me begin by thanking the Council once again for its work in producing the *Fiscal Assessment Report (FAR)* and its thorough analysis of the *Stability Programme Update*.

Clearly we are in exceptional times and, while the re-opening of the economy has now begun, the pandemic will leave a legacy of higher public and private indebtedness, higher unemployment and the exit of firms whose business model is no longer viable in the new environment. The role of budgetary policy in these circumstances is to minimise these impacts and the previous Government provided support along these lines; supports with a direct fiscal cost of 7½ per cent of GNI* have been implemented while other supports – such as guaranteed loans – have no direct cost but significant benefit for the private sector. I note the Council's view that this level of support has been appropriate.

I will now respond to some of the main points highlighted in the *FAR* by addressing each Chapter in turn.

Chapter 1

In relation to the fiscal rules, I note the Council's view that "exceptional circumstances" as defined in the *Fiscal Responsibility Act 2012* now apply in 2020, as a result of the pandemic.

The economic and fiscal costs of closing many sectors of the economy will be large but unavoidable. It is worth stressing that our economic and fiscal starting points were good: few if any serious imbalances were evident prior to the pandemic.

My Department is forecasting that GDP will contract by 10.5 per cent this year with a deficit of 7.4 per cent of GDP (the equivalent of €23 billion); we have also said that if recovery is delayed the budget deficit could be up to €30 billion. The data that have subsequently been published broadly confirm these assessments.

The Council has also recommended a temporary and targeted fiscal stimulus during the recovery phase. The *Programme for Government* provides for a macroeconomic stimulus in July as well as additional budgetary measures in *Budget 2021*. The main objective in this recovery phase will be to get as many people back to work as quickly as possible and to maximise the survival rate of firms.

Government will also set out in October a medium-term budgetary strategy to restore fiscal balance.

Chapter 2

I welcome the Council's endorsement of my Department's macroeconomic forecasts as set out in the *Stability Programme, April 2020 Update*.

Short-term macroeconomic forecasting in such an unprecedented environment presents significant challenges; the numbers have so far stood the test of time and we will update our assessment in the autumn as is normally the case. My Department has also complemented its forecasts with the publication of ultra-high frequency data; these are more up-to-date than official data although they are, by definition, somewhat experimental. Nevertheless, these data do give an indication regarding the direction of travel for the economy.

Chapter 3 - Assessment of Budgetary Forecasts

Turning to the fiscal forecasts, I share the Council's view on the high degree of uncertainty around projected deficit levels and I note the three medium-term fiscal scenarios described in this chapter.

The Council notes how quickly the situation is evolving. The Government is committed to providing support to individuals, employees and employers in order to support aggregate demand in the short-term and to minimise 'scarring effects' over the medium-term. The trade-off in providing such supports is the uncertainty with respect to the fiscal projections. This is a price worth paying. The Government will continue to do whatever is necessary in these extraordinary times.

The Council outlines the significant suite of measures introduced by Government since March. Additional supports were announced in early May and, in the interests of transparency, my Department has published the definitive list on its website. Of course, interventions of this magnitude come with a significant long-term cost. I fully agree with the Council that following phase two (recovery phase) the national debt burden may be near record highs. It is essential that after phase two fiscal policy pivots towards putting the debt-income ratio on a downward trajectory.

Finally, I note the Council's views and research on corporation tax receipts. I remain cognisant of developments in this important tax head and my Department, as you are aware, has published several pieces in this regard over the past year. This work has highlighted some of the risks around corporation tax and I have spoken on the potential for this tax to decline in the future. Prior to the Covid-19 pandemic, we had built up fiscal buffers, including setting up a Rainy Day Fund and returning the public finances to budgetary surpluses. The *Programme for Government* mandates continued implementation of the Roadmap on Corporation Tax Reform. It also recognises that taxation policy needs to reflect a changing digital economy, and that this work is best done through the OECD. In the context of Budget 2021, my Department will update our future projections on Corporation Tax revenues.

Chapter 4 - Assessment of Compliance with Fiscal Rules

I welcome the Council's view that Ireland complied with the fiscal rules in 2019, a point also echoed by the European Commission. As is documented, the "general escape clause" of the *Stability and Growth Pact* has been activated for 2020, allowing an ambitious counter-cyclical budgetary response across the European Union. While an 'article 126(3) report' has been issued for Ireland regarding the planned breach of the 3 per cent deficit threshold, this is a legal obligation with no formal consequences. Recognising the difficulties facing Member States as a result of the pandemic, the Commission has stated that now is not the right time to decide on the opening of *Excessive Deficit Procedures* (EDPs). Although, it remains possible that an *EDP* will be launched later in the year, it is important to stress that Ireland is not alone in facing these challenges, with every EU Member State planning a deficit above 3 per cent of GDP this year. Furthermore, the European Commission has specifically recommended that Ireland "take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery."

Conclusion

To conclude, I would like to thank the Council for its assessment and for the important role it continues to play in Ireland's budgetary architecture. As we move from lockdown to re-opening, budgetary policy will need to adjust and, over time, it will be necessary to exit the unprecedented budgetary support. In the short-term, however, the priority will be to support households and firms, to limit the medium-term damage to the economy and to lay the ground for recovery. Setting out a medium-term trajectory for restoring fiscal balance can help to limit the trade-off between economic growth and the unwinding of extraordinary fiscal measures by providing certainty to economic agents. This is what Government intends to do.