

The Irish Economy – Recovery from Covid and Beyond - Speech by Paschal Donohoe, T.D. Minister for Finance to the Institute of Directors in Ireland

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Check against Delivery

26th May 2021

Introduction

Good morning and let me begin by thanking you for the invitation to speak with you today.

In my remarks, I would like to discuss prospective economic developments, including our near-term recovery prospects from the coronavirus pandemic.

I will also focus my remarks on the economic challenges and opportunities that lie ahead over the coming years and beyond.

Where we are now

As we are all aware, the pandemic had a severe impact on the domestic economy last year.

During the first lockdown in the second quarter of last year, Modified Domestic Demand, the best metric for domestic economic activity, fell by just under 15 per cent, the largest quarterly fall on record.

Despite a partial recovery in the second half of the year, Modified Domestic Demand fell by around 5 ½ per cent for last year as whole, the second largest annual fall on record.

While the re-introduction of restrictions at the very end of last year likely led to a contraction in economic activity in the first quarter of this year, the outlook has since improved.

Notably, while the level of stringency of restrictions since the turn of the year is in line with that of the first lockdown in the spring last year, many indicators including retail sales and business confidence indicators suggest that the fall in activity has not been as severe as during the first lockdown.

This points to a weakening in the relationship between stringency and economic activity and reflects adaptation and innovation by firms and consumers.

We have all gotten used to online shopping, click and collect and dine at home meals over the past year. It is unlikely we will unlearn all of these habits.

On the public health situation, Covid-19 infection case numbers, hospital and ICU admissions, and fatalities have fallen by over 90 per cent from the peak in January.

The incidence among all age groups has declined and is one of the lowest in Europe.

Approximately 45 per cent of the eligible population have received a first dose of a vaccination with vulnerable groups largely fully vaccinated at this point.

Encouragingly, the HSE has said that 300,000 vaccine doses were administered last week and that a similar number is expected this week.

This acceleration of the vaccination programme in recent weeks and the efforts of the Irish people have allowed for a gradual easing of restrictions.

Recovering from the crisis

Looking ahead, my Department published updated macroeconomic forecasts as part of the Stability Programme Update in April.

These forecasts were based on assumptions regarding the speed at which restrictions were likely to be lifted.

Specifically, it was assumed that the vaccine roll-out will accelerate over the second quarter, and thereafter in line with the Governments projection that around four-fifths of the adult population will be partly inoculated by late June / early July.

Under these assumptions, GDP growth of 4 ½ per cent was forecast for this year, with growth of 5 per cent in prospect next year.

This will be supported by the release of pent-up demand alongside an unwinding of a portion of the roughly €11 billion in ‘excess’ household savings built up during the pandemic.

The unemployment rate should fall from the current high rates in excess of 20 per cent to around 11 per cent by the end of the year.

However, the evolution of the virus remains difficult to predict and downside risks dominate the outlook.

In particular, the emergence of vaccine-resistant variants, domestically or abroad, could hamper the economic recovery.

Government response to Coronavirus

Our overall budgetary strategy remains one of providing counter-cyclical budgetary support to the economy.

To date, we have deployed the public sector balance sheet to the tune of approximately €38 billion – or nearly one-fifth of national income.

Over €14 billion of this has been spent on the three main support schemes – the Pandemic Unemployment Payment, the Employer Wage Subsidy Scheme and the Covid Restrictions Support Scheme.

The Wage Subsidy Schemes have been a central pillar of Government's response to the pandemic, supporting businesses, encouraging employment and helping to maintain the link between employers and employees.

This level of support remains the correct approach: the pandemic is the classic 'force majeure' event which led to supply and demand shocks for the private sector.

Decisions on the form of such support will take account of emerging circumstances and economic conditions as they become clearer.

Removing them at this late stage would be akin to falling at the final hurdle. And until we reopen, we have no clear picture of how demand will recover.

Consumer behaviour may have fundamentally changed even after public health restrictions are removed.

I note for example research last week from Edelman that found nervousness about a return to life as normal, even after vaccination, with 65% of people describing themselves as still being in a "pandemic mindset".

Concretely, that meant that only 16% felt safe flying commercial airlines, 23% staying in hotels and 28% dining indoors in restaurants.

In each case, those tallies rose only slightly among those who had been fully vaccinated.

As such, while we can be hopeful that the worst days of the public health crisis may be behind us, we are likely to face significant challenges as we begin to navigate the post-pandemic world.

It is on this basis that I believe that continued support could be necessary out to the end of 2021 to help maintain viable businesses and employment and to provide businesses with certainty to the maximum extent possible.

However, while there is no cliff-edge, there must be an end to them at the right point.

Last year, a general government deficit of €18½ billion was recorded– this is the equivalent of nearly 9 per cent of national income, or 5 per cent GDP.

For this year, a deficit, before any extension or additional policy is agreed upon, is projected at around €18 billion – the equivalent of 8½ per cent of national income, or 4.7 per cent of GDP.

As a share of GDP, Ireland’s deficit remains within the ‘norm’ and a keystone of our fiscal strategy over the past year has been ‘staying in the pack’ of EU Member States.

When we have emerged from the pandemic, it will be imperative that we place the public finances on a sustainable trajectory.

The ongoing negotiations of changes to the international tax regime reinforce the nature of this risk: my Department estimates a reduction in the order of €2 billion in corporation tax receipts by 2025 as a result of international tax changes.

When the virus has been brought under control, it is expected that economic recovery will do much of the ‘heavy lifting’ in restoring the public finances.

With many competing priorities the newly-established Commission on Taxation and Welfare will examine how the State can best support economic activity while ensuring that we have the resources available to fund public services.

European response to covid crisis

Of course, Ireland is not alone in facing these economic and policy response challenges.

In this regard, the potential for an incomplete and uneven recovery across Europe emphasises the continued importance of a strong and coordinated response to ensure a resilient future pathway at national and EU levels.

However, the EU Recovery and Resilience Fund or ‘RRF’ is geared towards raising investment and growth in the medium-term. So we have different instruments and goals.

Second, there is a balancing act in our measures.

We remain committed to avoiding withdrawing policy support too early as opposed to too late.

We do need a sustainable economic recovery as opposed to just a temporary rebound. The former will help to limit scarring effects from the crisis, such as long-term unemployment.

The RRF is a huge achievement – a year or so ago, the idea of it would have been unimaginable. So I think that needs to be fully appreciated.

What I am doing as President of the Eurogroup is looking at what is the appropriate budgetary stance for the euro area.

On the fiscal rules, it is too early to get into a discussion on any changes. We will need to see how the review of the economic governance framework proceeds. I look forward to being involved in these discussions and pushing forward the euro-area specific elements but the rules themselves sit within ECOFIN's remit.

The role I see for Eurogroup now and when the fiscal rules are under review is as a forum for political discussions, for ministers to share their experiences, and to find consensus and agreement on our budgetary stance.

The Eurogroup has reaffirmed our commitment to supporting the economy until recovery takes hold. At the same time, we cannot ignore the issue of debt sustainability. When we look at growth paths and interest rates, it is clear that we are in an exceptional period, and in time, we will need to pursue more sustainable public finance trajectories.

Challenges and Opportunities beyond covid

Looking beyond the pandemic, Ireland also faces other longer-term economic challenges and opportunities.

As a small open and adaptable economy, our resilience and strength comes from being one that remains open to trade and investment.

This has been proven to be the strength of the Irish economy over recent decades and will continue to be our strength in the future.

While there are many opportunities for a small open economy like ours, there are also significant challenges to be managed.

Principal amongst these include a decline of corporate taxes as a result of international reforms and the need to address climate change.

This year will be a critical year for international tax as we seek agreement at the OECD on addressing the tax challenges of digitalisation, although we must consider these discussions now in the context of the broader challenges we will be facing as we emerge from the pandemic.

At the European Council recently, EU Leaders re-iterated their strong preference for and commitment to a global solution on international digital taxation and will strive to reach a consensus-based solution by mid-2021 within the framework of the OECD.

Ireland has long maintained that aggressive tax planning is a global problem and is best solved by global cooperation at the OECD.

A multilateral approach is the best way in which to ensure that the international tax framework meets the needs of the globalised economy and Ireland believes that the OECD BEPS Inclusive Framework is the most effective forum where consensus is likely to be achieved.

Ireland is in favour of an agreement at the OECD which can bring stability to the international tax framework, which will be critical as we emerge from the pandemic.

An agreement which continues to support innovation and growth, provides certainty, guards against abusive practices, facilitates healthy but appropriate and acceptable tax competition aligned to key principles such as substance, and ultimately an outcome that is a fair and balanced compromise by all countries in the OECD Inclusive Framework.

The renewed engagement by the United States at the OECD is welcome.

However, it is important to remember that there remain substantial issues to resolve before a consensus can be reached.

Political discussions on the key policy issues have not yet taken place. Key principles still need to be agreed.

Looking forward

The response to COVID-19 illustrated our ability to take urgent and decisive action, at both national and international level.

The pandemic has also progressed our understanding of the delicate relationship between the natural environment and the resilience of our societies.

This has refocused minds on the need to embed sustainability, including climate change action in policy design.

As Finance Minister, my priorities are to ensure that Ireland has the right economic, fiscal and financial services policies to support our climate ambition and, on the international stage, the right policies to support climate action, resilience and adaptation in the developing world.

The Programme for Government significantly amplifies the Government's renewed focus on climate action. This is illustrated by the Programme for Government's commitment to an average 7 per cent per annum reduction in overall greenhouse gas emissions from 2021 to 2030, a 51 per cent reduction over the decade.

To support delivery of this ambition, the process of drawing up an updated Climate Action Plan to reflect these increased targets is underway and will identify and set out the far reaching policy changes across every sector to deliver the necessary emissions reductions.

This plan will have a strong focus on implementation, including actions with specific timelines and steps needed to achieve each action, assigning clear lines of responsibility for delivery.

Its preparation will involve extensive and ongoing collaboration with Departments and Bodies right across the Government system and consultation with the public, which will inform key elements of the overall approach.

Related to this work, the Climate Action Bill which is currently progressing through the Oireachtas will significantly strengthen the governance structure for climate action in Ireland, especially by putting the 2050 net zero target into law and establishing a series of five year carbon budgets and related sectoral ceilings.

This is a pioneering development for Ireland and puts us at the forefront of climate ambition globally.

In parallel, we are finalising our National Recovery and Resilience Plan under the EU's Recovery and Resilience Facility. Our plan will set out an ambitious but targeted programme of impactful, mature investments and reforms up to 2026, with an important emphasis on advancing the green transition.

Conclusion

Ladies and gentlemen, my objective today was to give you an overview of my and my Department's thinking on the challenges and opportunities facing our economy.

We are living in an increasingly complex and interconnected world where events such as a pandemic can have severe economic consequences around the globe.

While it is essential that we deal with this enormous challenge, we must not lose sight of the longer-term challenges and opportunities that we face.

I hope I have achieved my objective. Thank you and I wish you a pleasant day.