

Box B: Fiscal supports cushion the economic impact of Covid-19

Since the outbreak of Covid-19 in Ireland, the Government has introduced substantial budgetary supports. These are not a conventional fiscal stimulus; rather, they are primarily intended to sustain companies and workers while containment measures slow the transmission of the virus. The supports should help to ensure that businesses have resources to weather the containment period and to retain staff. This box looks at some of the key supports introduced and tries to model their impact on economic growth.

A large number of fiscal measures have been introduced

The two key measures that the Government introduced to respond to the Covid-19 shock are (1) an enhanced unemployment payment; and (2) a temporary wage subsidy for companies whose revenues are hit, but which opt to retain employees. Together they have an estimated fiscal cost of €4.5 billion. Importantly, this cost estimate may overstate the true policy cost, as standard unemployment benefits would likely have been paid to many recipients anyway as a result of the downturn. These income supports are particularly important to low-income and vulnerable households, with Beirne *et al.* (2020) noting that about one-third fewer families would have income losses beyond 20 per cent due to the supports.

Another key measure we consider is the increase in health spending, which will boost government consumption. This is primarily intended to improve the capacity of the health system, including by increasing staffing and paying for overtime costs. The estimated cost of these health measures is a further €2 billion.

There are a large number of additional government supports that we do not consider here (see Box F). These include a mix of loans, tax deferrals (for VAT and business rates), transfers, grants, and other government spending increases that have also been introduced but are relatively smaller in scale.

Table B.1 shows the main measures that we have modelled in our simulation.

Table B.1: Fiscal supports introduced

	Estimated cost €m
Pandemic Unemployment Payment + Temporary Wage Subsidy	4,500
Health spending	2,000
Extension to Fuel Allowance & Working Family Payment	75

Sources: Department of Finance; and Fiscal Council workings.

Note: We assume the payments are only made for twelve weeks in Q2 of 2020. The four-week extension to the Fuel Allowance and to the Working Family Payment eligibility is estimated to cost €70–80 million (Beirne *et al.*, 2020).

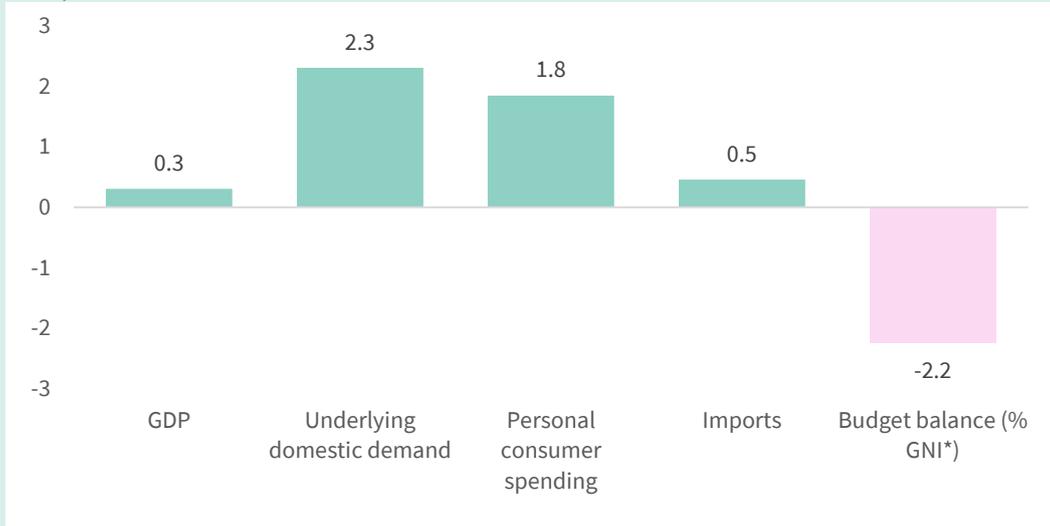
We use the Council's suite of forecasting models (Conroy and Casey, 2017) to estimate the gross impacts of the policy measures and to also allow for import leakages. Using these, we develop a counterfactual forecast where the income supports had not been provided. Comparing this counterfactual forecast with the baseline allows us to make an estimate of the impact that the supports are likely to have. Specifically, we use model estimates based on the historical relationship between consumer spending and incomes and based on the relationship between final demand and imports.

The comparison with a counterfactual scenario suggests that the measures introduced may have offset 2.3 percentage points of the decline in underlying domestic demand in 2020. This is primarily achieved by sustaining consumer spending through income supports and by raising government spending (Figure B.1). The impact on GDP is smaller, especially given the artificially high level of GDP due to distortions from multinational enterprises, but also given

the offset from higher imports. In terms of the fiscal impacts, we estimate that the general government balance will weaken by 2.2 percentage points of GNI* due to these supports.

Figure B.1: Fiscal supports boost underlying domestic demand but widen the deficit

% impact in volumes, unless otherwise stated



Sources: Fiscal Council workings.

Notes: Estimates of the impact of fiscal supports are calculated using the Council's suite of forecasting models (Conroy and Casey, 2017).

Given the exceptional nature of the downturn, these estimates are highly uncertain. Avoiding widespread collapse of firms in the business sector or the impact on vulnerable families is hard to assess. There are three further caveats worth noting:

First, the ultimate cost of the Pandemic Unemployment Payments and Temporary Wage Subsidy Scheme could be very different from the assumptions made here. The schemes could be availed of by more people or extended beyond twelve weeks. This would further boost underlying domestic demand, while worsening the government budget balance. Yet, this scenario would likely only occur in a situation where transmission of the virus and economic impacts were also more adverse. By contrast, the schemes might also end up costing less if the initial cost estimates prove to be too conservative.

Second, liquidity constraints will likely be significantly higher among the recipients of social transfers than those on average incomes. As a result, the elasticity of consumption to income may be higher than suggested by the historical relationship based on nationwide incomes. This would boost the impact on personal consumption spending relative to the estimate in Figure B.1.

Third, in cases where output is falling, unemployment is rising, and the policy rate is at the zero-lower bound, fiscal multipliers may be temporarily higher than usual. For example, Auerbach and Gorodnichenko (2012) estimate spending multipliers to be close to zero in US expansions and as high as 2 or 3 in recessions. This suggests that the fiscal supports might boost economic activity more than our estimates suggest, posing upside risks to the outlook. However, fiscal policy will not fully shield the dramatic shock posed by the crisis.