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ECONOMIC RECOVERY

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BUDGET 2022:

Ensuring a strong business voice

Plus:

- **National Economic Dialogue & NPHET**
- **Covid-19 cases & related deaths stabilise**

A Strong Voice for Business

After a year of pandemic supports Budget 2022 will present tough choices for government. How soon to withdraw business supports? Raise taxes or cut spending? How to ensure a jobs led recovery? Since publishing Ireland's first Covid recovery agenda in April 2020 – the first to recommend a July Stimulus (which occurred) - we went on to help shape regional and sectoral recovery in partnership with valued clients. And we have learned one thing: If you don't ask, you don't get. Since March 2020 our weekly briefing – also world's first – has kept business abreast of the key issues in this crisis.

This week we begin to focus on next October's budget. Already we are receiving strong signals about what lies ahead: Government is holding fast to our low corporation tax regime, holding out on signing an OECD global tax deal.

The pressure for tax increases will therefore fall on taxes that have a detrimental effect on our domestic economy. Already reeling from NPHET's bombshell this week, the domestic business sector's frustration with a perceived lack of coordination, communication and consultation.

In our work we have been a constant support for small business groups in making their case to government. The conclusion of the National Economic Dialogue this week shows that work is more necessary than ever. While addressing useful topics from economic resilience, job creation, housing and climate action, policy making remains dominated by academic rather than business focused research and the voice of small business remains outnumbered, fragmented and poorly resourced. Ensuring business voice is heard in Budget 2022 – and by the Commission on Tax and Welfare – will require focused research, publication, social media and advocacy skills of the kind we combine.

It won't be easy. The cabinet's decision to restore public pay to 2008 levels for higher earners shows the strong emphasis on spending priorities. That emphasis saw spending rise by €16 billion between 2015 and 2019 at the expense of easing the tax burden created by the last crisis. With those legacy taxes still burdening the small business sector, effective representation coming up to Budget 2022 is more vital than ever. Contact us on info@octavian.ie to find out more.

Marc Coleman BA M Econ Sci ASP MBA **Founder, Octavian Economics**

Disclaimer

This report has been produced on a voluntary basis by Octavian Economics to assist the public's understanding of the economic crisis created by official and commercial responses to contain the spread of Covid-19. It does not constitute advice offered or solicited for the purposes of making investments or informing commercial or personal financial gain. The impetus of timely response necessary involves some abbreviation of detail. Views contained in Guest articles are not necessarily those of Octavian and vice-versa.

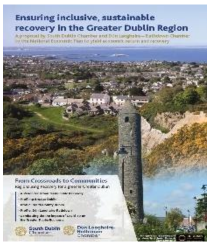
BUDGET 2022: EFFECTIVE BUSINESS REPRESENTATION

Several sectors of our economy have a built in advantage in terms of default access to government thinking. At the National Economic Dialogue, for instance, the academic sector was strongly represented in position papers setting a context for higher spending and taxation decisions. But will this be good for business recovery?

The design of Budget 2022 will be critical to its success or failure. The intentions of the Dialogue – a resilient, inclusive recovery, are all positive. But effective business representation and advocacy will be needed to correct misperceptions and incomplete narratives as well as to ensure that budgetary policy measures, once agreed, are communicated and implemented effectively.

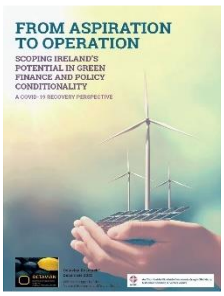
This is where Octavian blend of policy and public affairs capacity can help your business and sector to make its voice heard in time.

In April 2021 our publication *"An Economic Response to Covid-19"* successfully called for a July Stimulus package, which occurred once the government was formed while subsequent publications have led policy thinking in several key areas including:



- Regional recovery (*"Ensuring a Sustainable Recovery in the Greater Dublin Region", Nov 2021)*
- Town and village centred recovery (*"Designing a Lasting Localised Recovery", Feb 2021)*
- Recovery in sectors particularly affected by both Brexit and Covid (*"Saving Seafood and Harnessing our Ocean Wealth", April)*
- Environmentally sustainable recovery and ESG *("From Aspiration to Operation – Scoping Ireland's Green Finance Potential).*

Our Founder has also in previous roles (Economics Editor Irish Times, Sunday Independent columnist, Newstalk presenter, Author) contributed to both public awareness and government decision making on tax policies including in relation to income tax bands and thresholds, Household Carer's allowance, VAT, Capital Gains Tax, Stamp Duty and tax reliefs.



In this article we

- Recap on key features of Budget 2021
- Look at the economic parameters facing government in Budget 2022
- Outline broad policy challenges
- Identify key priorities for business

Budget 2021: A Recap

Last October's budget was the first since the beginning of the pandemic. In the wake of a targeted package business stimulus package the previous July – which our 2020 publication "*An Economic Response to Covid-19"* had called for the previous April – Budget 2021 had the following features:

- The budget was dominated by an additional allocation of €6.4 billion to the Departments of Health and Social welfare in relation to, respectively, PPE and Testing and Tracing (Department of Health) and extending the Emergency Wage Subsidy Scheme (EWSS).
- A €2.1 contingency fund was provided along with a €3.4 recovery fund to allocate over 2021 as the need arises.
- Tax warehousing for the self-employed was extended for up to 5 years
- A Covid Restrictions Support Scheme paying €5,000 a week to eligible businesses
- A temporary reduction in VAT on the hospitality sector from 13.5% to 9%
- An equity fund to investment in high innovation enterprises and the extension of the Knowledge Development Box
- A set of measures to promote climate action including
    - An increase in the per tonne carbon tax by €7.50 per annum
    - A €286 million retrofit programme
    - Accelerated capital allowances for energy efficient buildings
- On taxation there were no changes to personal income tax or USC but some modest changes to PRSI (a rise in the higher employer's PRSI threshold)
- The extension of the Help to Buy scheme giving 10% of a house price up to €300,000
- The announcement of a "Corporation Tax roadmap" and some modest changes to film relief, tax credits for the gaming sector and the tax treatment of intangible assets

Macro-economic aspects of Budget 2021

In broad macroeconomic terms the measures above raised national debt – as measured by Gross National Income modified (GNI*) from 95.6 to a projected 2021 level of 114.7 per cent. Generally a level over 100 per cent creates a risk of future interest rate rises burdening government with large debt repayments.

Above 120 per cent, debt can become unsustainable and self-increasing as tax rises reduce the size of the economy, as happened in the 1980s.

	2019	**2021f***
Trade Balance	+12.3	+34.8
Gross Debt	95.6	114.7
Unemployment	5.0	10.3

** Forecast. Source: Department of Finance*

An interesting – and positive - feature of the change in the economy between 2019 and 2021 is the dramatic improvement in an already a strong trade surplus (12.3 per cent) to a staggering 34.8 per cent. This corresponds to another interesting – and also positive feature: The fact that as measured by GDP rather than GNI* the share of national debt is just 66 per cent, only modestly above the European Fiscal Treaty benchmark threshold of 60 per cent. The reason for using two very different economic measures in government forecasts is that the former (GNI*) is seen as a more reliable measure of the economy's capacity to generate tax to support debt repayments.

Two Macro-economic challenges facing budgetary policy

As well as many tactical policy challenges, there are two key big broad macroeconomic challenges facing budgetary policy in the years ahead. The first is an "inter-sectoral" challenge – the challenge of balancing fiscal adjustment between the multinational and domestic sectors of the economy.

The second is an "inter-temporal" fiscal policy problem namely balancing the legacy of adjustment to the previous crisis with the forthcoming adjustment of budgetary policy.

The first of these relates to the reason differing measures of debt used above brings us to first of the major the heart of the dual challenge facing the Irish economy as it adjusts to the pandemic: The ongoing resilience of an export generating multinational sector on one hand – a sector that is attracted to and benefits from Ireland's successful low corporation tax rate - and the far greater vulnerability of the domestic economy which is more exposed to higher rates of taxation on income, purchases and capital transactions.

The challenge is achieving fiscal sustainability where a domestic economy already more vulnerable to pandemic is more affected by tax rises also. A key conclusion of the National Economic Dialogue (NED) is that the tax burden would be much higher in ten years' time.

The Economic and Social Research Institute (ESRI) examined the case for higher taxes in May. The government's tough stance in refusing to sign an OECD international tax agreement shows a welcome commitment to retaining our successful low tax FDI model.

But this implies that the vulnerable domestic sector will bear more of the brunt of tax rises. Our analysis last year showed how our low tax multinational sector recovered much more quickly than the domestic sector of the economy during the previous crisis. Are we in for a repeat of this?

The second challenge relates to the legacy of the previous recession. Spending austerity was more than fully reversed in the subsequent 5 years between 2015 and 2019 with a €16 billion per annum rise in public spending.

By contrast of over €10 billion in tax increases levied during the 2009 to 2018 period, barely one tenth of these were reversed. The logic of this was relates to the dilemma above: As a share of GDP, our tax revenues were deemed too low by EU standard.

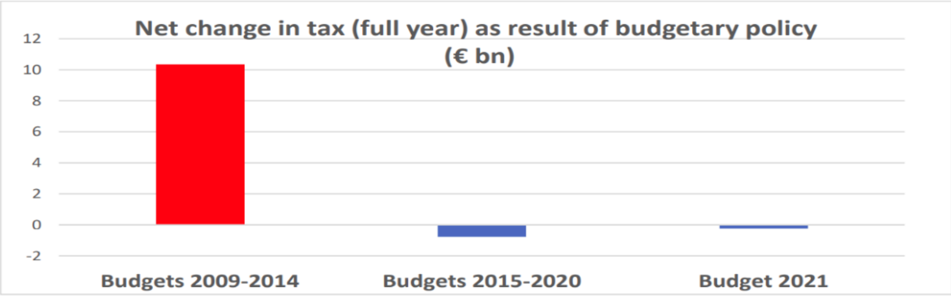
However this apparently low burden is due to GDP being relatively larger than the EU average due to our lower corporation tax bringing in FDI activity.

Ironically, this success of a low tax FDI model is prompting academics to conclude that taxes should be increased on a domestic sector already suffering from the legacy of higher domestic tax rates imposed in the last crisis.

This policy logic is therefore perversely inflicting punishment on the domestic sector for the success of our FDI sector.

A Key legacy issue: Tax rises from 2009-14 period remain largely in place

(Red indicates net tax increases, blue indicates net tax reductions)



Economic parameters of Budget 2022

The economic parameters of Budget 2022 are set out in the April Stability update as mandated by the EU Fiscal Treaty.

As the table shows below, General Government spending – as a measure of our domestic (GNI*) economy measure – was over one half in 2020. This means that government spending now dominates the economy.

However the impact of pandemic supports – while the tipping point – is far from the dominant aspect of public spending. Compared to pre-Covid planned spending, an additional €17 billion was allocated to Budget 2021 due to the pandemic and of this €7.2 billion went towards Pandemic Unemployment and Employment Wage Subsidy reports with a further €14 billion in other supports. The vast bulk of the €104.1 billion spent by General Government goes not to the private sector but on public pay and social welfare.

	2020	**2021**
General Government Spending (€ billion)	104.1*	103.4
Gross National Income, modified (GNI*) (€ billion)	206.7	214.1
Gen. Govt Spending (% of GNI*)	**50.4%**	**48.3%**

*Source: Department of Finance * Some €87.8 billion of which is Voted Expenditure.*

Budget 2022: The Macroeconomic issues

Despite dominating government spending increases business supports remain a minority of overall spending. But because they are more recent and unusual, the focus of Budget 2022 will be the extent to which spending on business supports can be reduced, rather than on conducting a fundamental review of over all public spending.

This differs from most household and business budgeting response to the crisis in which all items of expenditure are thoroughly reviewed. By contrast the dialogue surrounding NED was on discussing the pace and extent of reducing business supports and the case for raising the tax burden. NED breakout papers do discuss the importance of implementing the public spending code and also better performance budgeting and public service performance monitoring.

There will be pressure to achieve efficiency in current spending. The question is what metrics will be used to target effort: The educational sector is an interesting case in point: The political realities are such that, with a cabinet Minister defending the third level sector and given the third level sector's strong role in both the National Economic Dialogue and policy making generally it is hard to see significant effort being targeted here.

By contrast Ireland's status as having among the worst primary pupil teacher ratios in the EU suggests that this sector is politically weaker and that cuts, if they come, will – as was the case in the previous recession – be directed at politically weaker areas of public spending rather than at areas of significant waste and duplication. How the Non-Government Organisation sector will fare is also a case in point. The debate on housing has ignored the fact that Ireland has over 500 housing agencies, most of whom do excellent work. But a question begs asking as to whether there is a case for consolidation and efficiencies in the nearly €6 billion spent on these NGOs.

Unlike the NGO sector which can draw on tax funding to advocate for more tax funding, small business representative bodies do not have sufficient resources to make their case for continued budgetary support. Here is where Octavian's policy and public affairs service has provided effective business representation to key business sectors. We can ensure your message gets heard and is responded to in an open and accountable manner.

On the taxation side the two fundamental issues strategic relating to budgetary policy are the extent to which tax increases will affect the domestic over the international sector and the extent to which recognition will be given to the legacy of tax rises implemented between 2008 and 2014, most of which have not been reversed.

Echoing the approach of the previous crisis, there was no suggestion of increasing corporation tax, implying that the focus of adjustment will once more fall on taxes that disproportionately affect domestic demand. The incentivisation effects of this of the morale of small business owners and more vulnerable sectors remains to be seen. What is clear is that in terms of these priorities the narrative remains dominated by those for whom the economic impact of the crisis is either limited or zero, a fact that – unless business engages in constructive advocacy - is likely to have a profound impact on policy design in Budget 2022.

Budget 2022: The Microeconomic issues

The "microeconomic" issues facing business in Budget 2022 could be divided into three broad categories: Urgent and immediate, medium-term and longer-term.

More immediate and urgent issues include (far from exhaustive):

- **The pace and targeting of the withdrawal of EWSS, PUP, commercial rates waiver , tax debt warehousing the new Business resumption support scheme** A fine tuning of these measures is likely to be the key microeconomic priority of Budget 2022.

- **Certainty about re-opening.** Notwithstanding the primacy of public health in public policy making, the need for more communication, coordination and consistency between NPHET, HSE and Government is clear if the domestic economy is to have confidence to recover.
- **The low take up of business supports**. This has been commented on by Ministers of State with responsibility for business support policy. A key issue remains the design and implementation of these supports. While welcome, the vast majority of SMEs are micro-enterprises for whom the time and bureaucracy involved in applying for supports is often prohibitive against a backdrop of intense pressure to survive.

<u>More medium term issues include (again far from exhaustive):</u>

- **Budgetary incentives and compensation for climate action.** The design and implementation of climate action incentivisation and also "Just transition" measures to alleviate adverse impacts of climate action for some industries (e.g. Peat) will need attention over a two year period. Given the electoral consequences of climate transition in some industries, this is likely to feature more prominently in Budget 2022 than Budget 2021.
- **Improving linkages between domestic and multinational sides of the Irish economy**
In our publication "*An Economic Response to Covid-19"* in April 2020 we identified the need for greater multinational SME collaboration as a crucial priority for two reasons:
Firstly – at a tactical economic level - to improve the capacity of SMEs to benefit from the export resilience of FDI and secondly – at a strategic fiscal policy level – to improve the tax yield of multinational activity in a way that would not require us to raise our corporation tax rate. This was identified as a key issue above in determining public debt sustainability.

- **Effective management of regional and town and village centred recovery**. In contrast to the previous recovery, the more regional and rural focus of recovery has been a very welcome and needed development to which our consultancy has significantly contributed (see above). Shifting from a centralised to more regional and local methods of recovery investment will require change in budgetary thinking, structures and planning.

In the longer term budgetary policy challenges will include (again far from exhaustive)

- **Targeting key fiscal variables** such as the size of government spending as a share of GNI*, the level of debt, fiscal balances over the long-term and the mix of current and capital spending. A past failure to prioritise long-term thinking and commitment to infrastructure spending compared to current spending – and to favour politically stronger (University) over politically weaker but more deserving (primary school) public spending calls – has contributed significantly to our crisis in housing, primary education and inequality. But even if these are corrected it remains to be seen if that can be sustained over the political cycle.
- **Maintaining and mitigating climate action goals** After a strong start the government will aim to continue and pass on to the succeeding government a shared commitment to climate action and achieving Paris 2015 targets. The extent to which "Just Transition" implementation works will determine if this commitment survives the next election.

- **Achieving a fair social contract between public and private sectors** Against the backdrop of negative response to NPHET advice public pay increases are testing social Cohesion.
A much stronger private sector voice in future policy making may be needed to limit the political fallout of pandemic and ensure public confidence in the integrity of policy (see below).

National Economic Dialogue and NPHET

Against the backdrop of rising public concern about NPHET's advice to government on re-opening, the National Economic Dialogue (NED) completed a two day think-in on key topics:

The format was a traditional social partnership structure with Government Ministers chairing discussion – supported by prominent academics acting as Rapporteurs. Key topics included in breakout session briefings include:

- Delivering a resilient economic recovery
- Improving budgetary policy
- Supporting job creation and economic recovery
- Climate action and a low-carbon economy
- Employment, education and skills
- Specific sessions on Health, Agri-Food and Tourism

Key issues that received less focus or were not discussed included

- Narratives on public sector reform remain qualitative with little focus on the possibility of quantified analysis of the potential for productivity gain. This contrasts with highly quantified analysis of the scope for tax increases. The impact of public pay policy on budget sustainability and – through higher tax burdens and relative incentives – on entrepreneur morale would also be useful to include.

- While a paragraph was devoted to noting the OECD's commitment to seek an International Tax Agreement, there was no specific reference to this in background briefings other than a commitment to a blueprint from tax policy in the Commission on Taxation and Welfare.

- The cost environment facing Irish SMEs compared to peer small economies in the EU was not identified as an issue, despite the recent Eurostat report indicating that Ireland faces the second highest cost of living in the EU. There was an acknowledgement of energy costs in the context of climate action but no mention of insurance costs.

- The impact of multinational activity on SME operating conditions was not explicitly identified although the issue of the linkages between the multinational and SME sectors was identified as an important issue.

Arguably the deliberations of the NED did not receive the media attention they deserved, overshadowed as they were by the public and political response to NPHET's recommendation to delay the planned re-opening of key sectors of the economy. A notable feature of the dialogue was that while business representative bodies were consulted, the breakout session documents were drafted by government. This touches on a key challenge for recovery policy identified in "*An Economic Response to Covid-19"*, namely the significantly weaker policy advocacy and resultant voice of the private compared to the public sector.

While government has responded well to calls for increased resourcing of supports in macroeconomic terms, the design and implementation of those supports, in microeconomic terms, has left many schemes undersubscribed. The Pandemic Unemployment Payment and EWSS have been a success in saving many jobs. But they have saved jobs that were threatened by public policy edicts forced on business. And they are ultimately funded by business risk takers and entrepreneurs. As government makes choices in relation to continuing supports for the SME sector, a focus on the continued financial feasibility of continuing supports to other more sheltered parts of the economy - including those with a strong influence on public policy making – may test the capacity of the policy making system to act in the national interest.

Monthly deaths related to Covid-19 stabilise

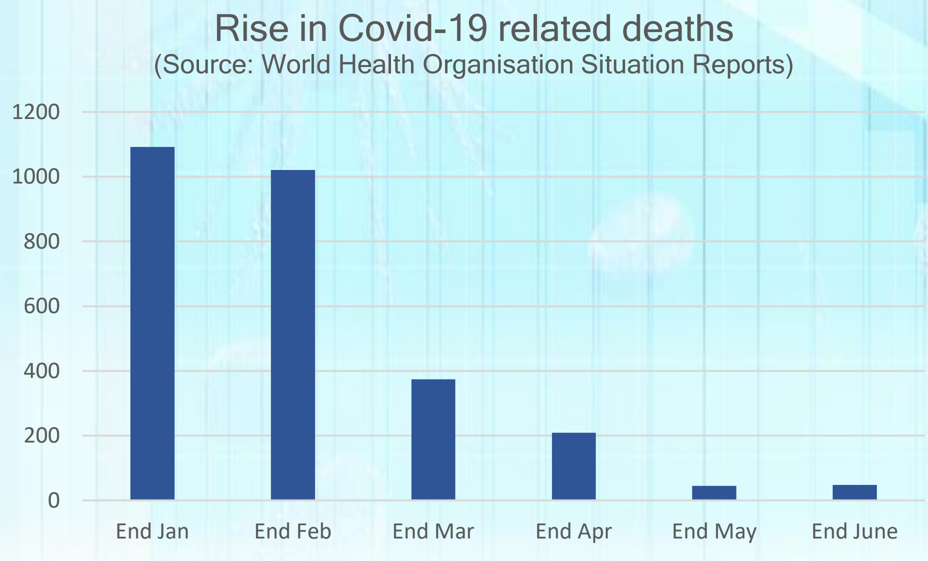
From a high of 109,909 new cases in the month of January, the number of new Covid-19 cases recorded has fallen to a monthly total of 10,774 in June. According to Chief Medical Officer Tony Holohan, the delta variant accounts for approximately 20 per cent of new Covid-19 cases observed in mid-June

The sharp fall in the number of monthly deaths related to Covid-19 continued to end May and stabilised in June.

Compared to a total of 1,092 new deaths recorded in January of this year and a total of 1,021 in February, the respective totals for March, April, May and June are 374, 209, 45 and 48. Compared with the profile of deaths in 2020, the numbers suggest some reoccurrence of a seasonal correlation (not necessarily a causation).

3.7 million vaccines have been administered to date with a rate of approximately 350,000 vaccines being administered each week.

**This analysis is updated once a month.*



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