# What Budget 2015 Tells Us About Tomorrow

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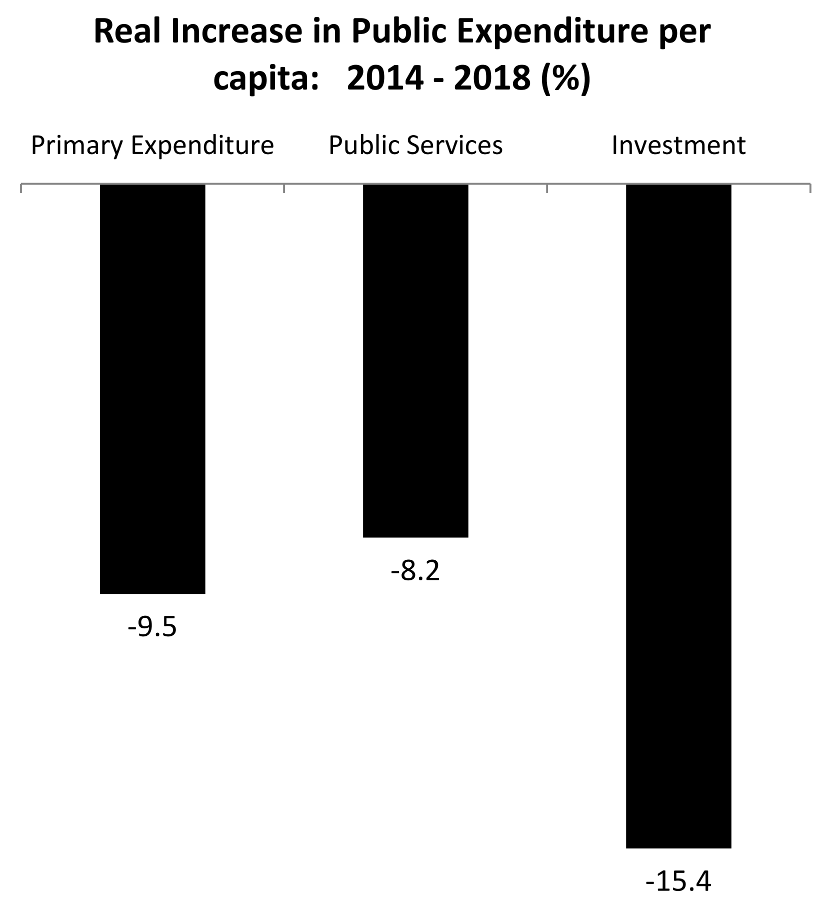
# 1: The New Phase of Austerity

- Contrary to declarations, austerity has not ended. It is entering into a new phase.
- The first phase of austerity has been nominal. It involved adjustments – expenditure reductions, tax increases – of over €30 billion.
- The second phase of austerity will be *real.* It will fall after inflation – or be cut in real terms. Public expenditure will not keep pace with inflation and therefore the value of social transfers, public services and investment will be eroded. We can measure this using the data produced by the Government in its budget papers.

# Real Cuts in Public Expenditure

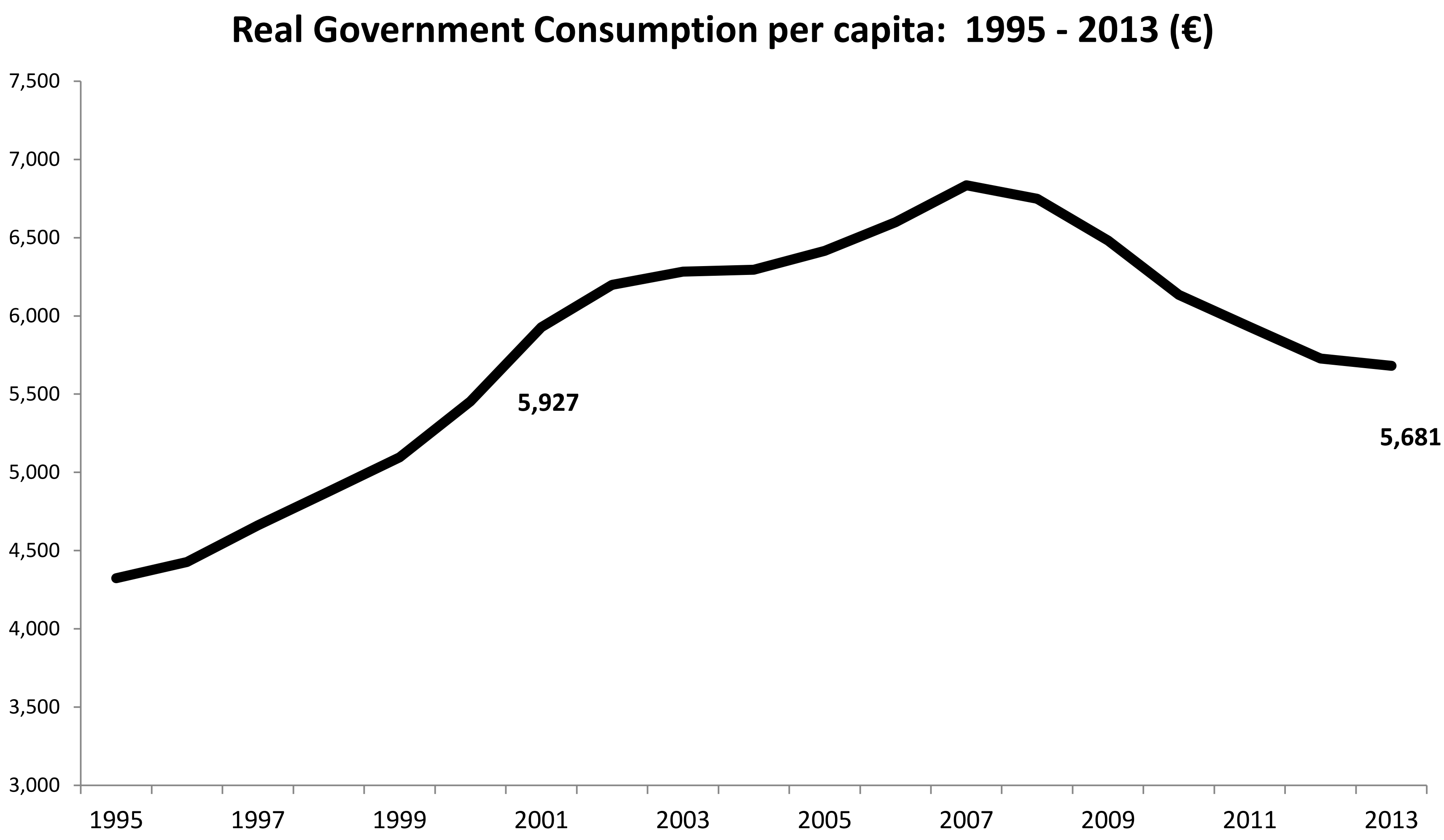
- Real primary spending per capita will fall by nearly 10 percent over the next four years – or €4 billion.
- Government consumption per capita will fall by over 8 percent – or €2.4 billion.
- Investment per capita will fall by over 15 percent – or nearly €400 million.
- Public finances will gain from reduced unemployment costs but much will be cancelled out by increased elderly-related expenditure.



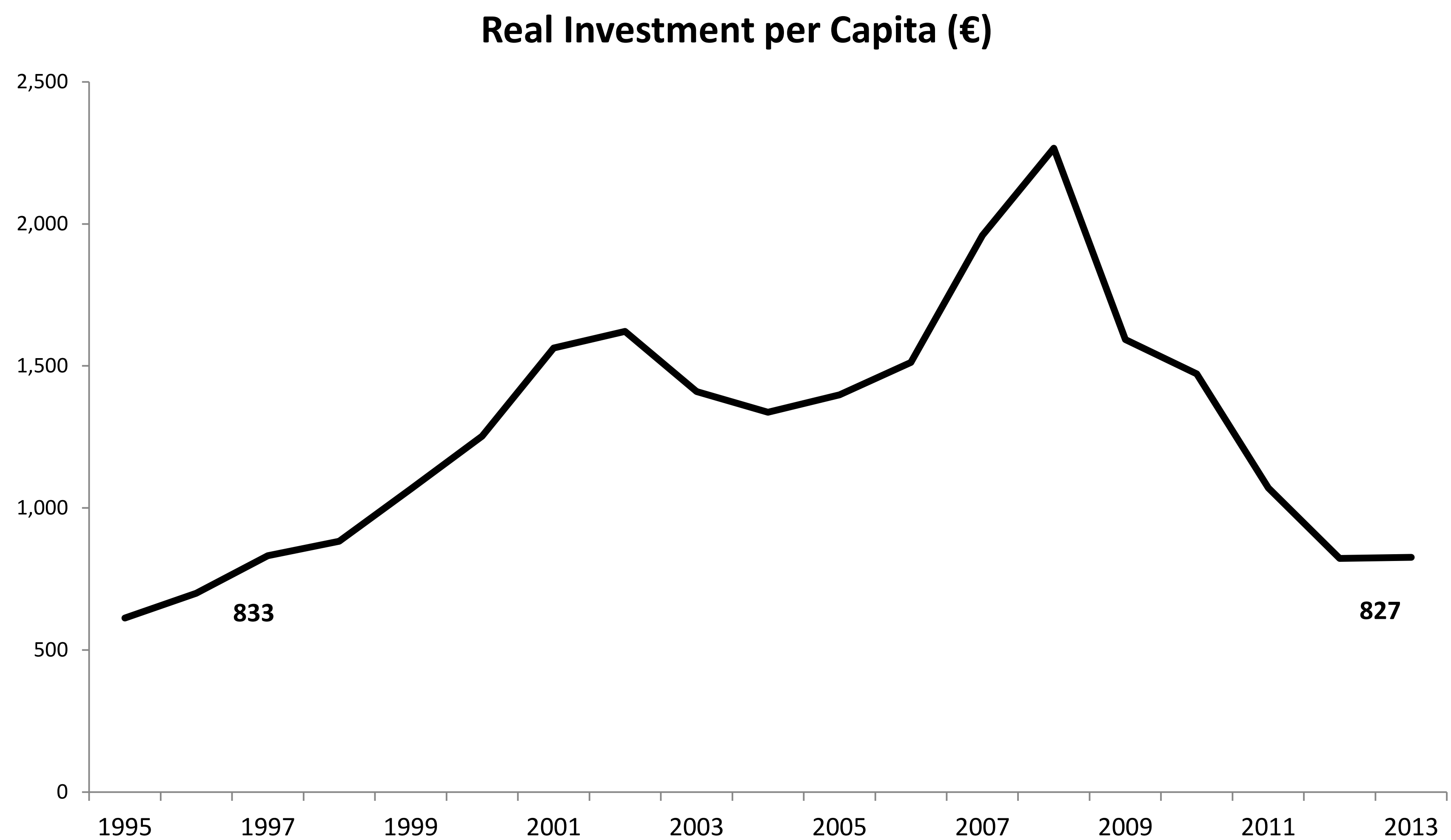
# 2. Squeezing the Public out of the Economy

- The strategy being pursued will essentially squeeze the public out of the economy. This specifically refers to:
- a) **Government Consumption**: public services provided by the state and purchases by the government of goods and services produced by market producers that are supplied to households (collective and individual consumption).
- b) **Public Investment** – as measured by Government gross capital fixed formation
- Both these categories have suffered a substantial fall in real terms per capita during the recession.

# Real Government Consumption per capita

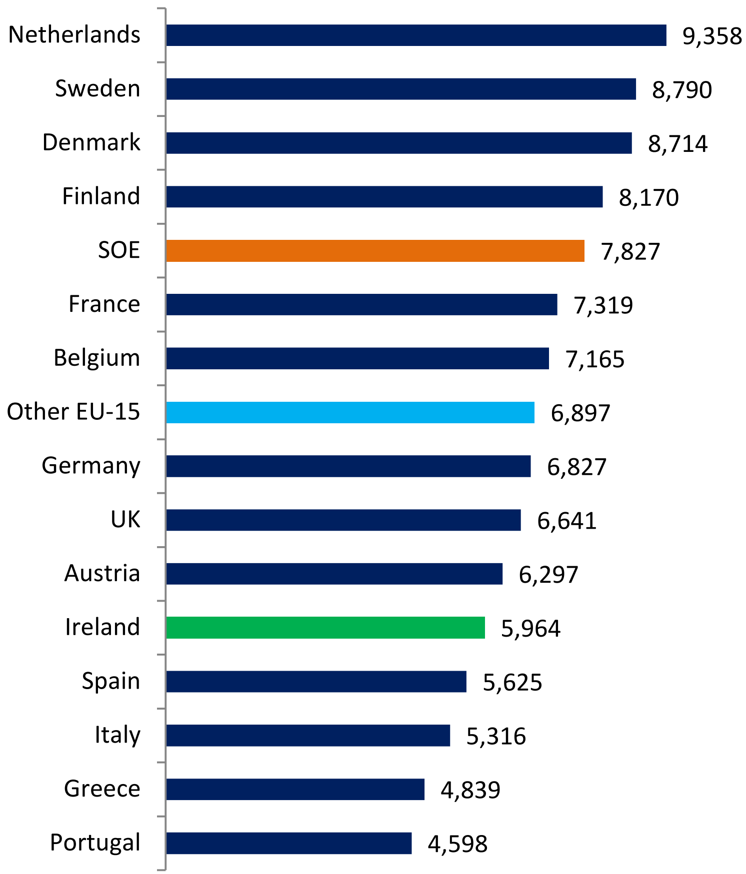


# Real Public Investment per capita

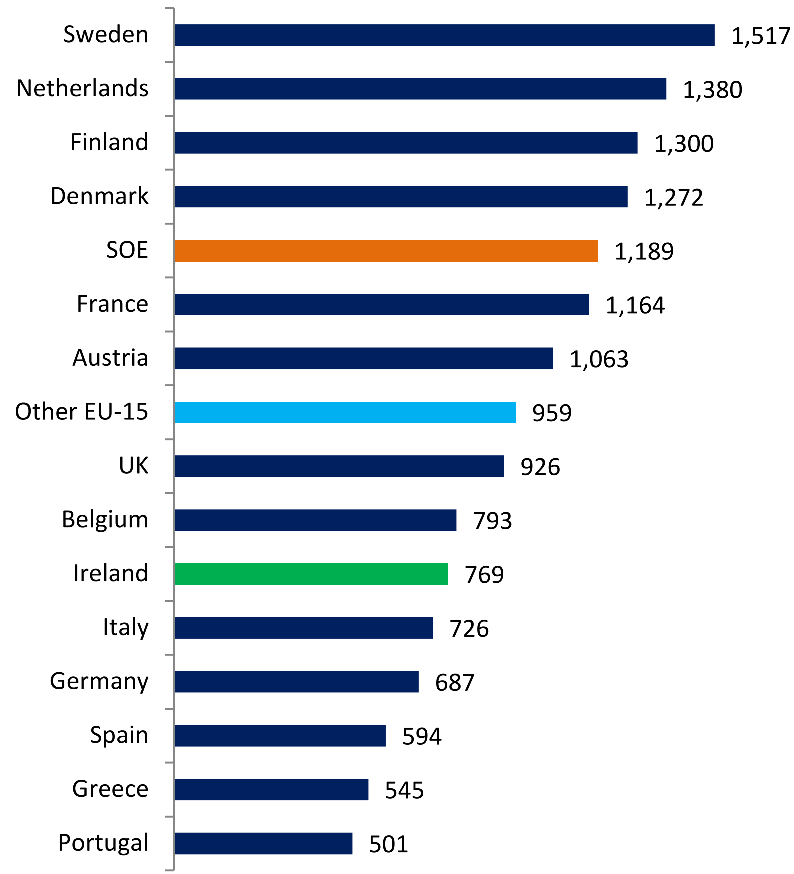


# European Comparisons:  2013 (PPP per capita)

## Government Consumption




## Public Investment



# Ireland Lags Well Behind EU Averages

- **Government consumption**: Ireland is 14 percent below the average of other EU-15 countries.  Need to increase spending by €4.8 billion reach the average. The elderly demographic of other EU-15 countries requires higher spend.  But so does our youth demographic.
- Compared with our peer group – other small open economies – we'd have to increase government consumption by €7 billion.
- **Public Investment**:  Ireland is 20 percent below average.  Need to increase spending by €800 million to reach average (€1.7 billion to reach SOE average).
- But Ireland is currently undergoing an investment crisis – total investment in the economy is 40 percent below the Eurozone average.  Need higher public investment to crowd-in private investment

# 3. Wrong-Way Fiscal Policy

- Fiscal policy should be boosting investment in our economic and social infrastructure Yet, the Government will continue to cut spending in real terms per capita. Why?
- **Balanced Budget**: the Government intends to balance the budget by 2018. This is the third wave of irrational fiscal policy.
- **1st Wave**: pro-cyclical policy prior to the crash.
- **2nd Wave**: Pursuing austerity during falling output (also pro-cyclical).
- **3rd Wave**: With continuing high unemployment by 2018 (8 percent – possibly higher if emigration falls) and continued social and economic infrastructural deficits – it makes no sense to pursue a balanced budget. Not necessary to reduce debt ratio in accordance with fiscal rules.

# Role of Fiscal Rules

- If we maintain a deficit, we may run afoul of the Structural Balance rule. This featured in the Fiscal Treaty referendum: the budget balance when cyclical movements are removed.
- It cannot be directly measured or observed. It is closer to alchemy than a coherent macro-economic rule. The ESRI and Department of Finance are critical of the EU's measurement – as it is more closely related to a large, closed economy like Germany than a small open one like Ireland.
- No one really believes in the structural balance – it was the price European Christian Democracy demanded in exchange for participating in bailout funding and placating its voter base.
- **Alternative**: ignore it (as long as other macro-economic measurements are on target); develop our own measurement; or boost potential GDP through investment: the ESRI has shown that the structural balance will fall with higher growth.

# Tax Cuts Are Privileged over Spending

- Another main reason for continuing real public spending austerity is the privileging of tax reductions over economic and social investment. Why?
- **Ideological**: the assumption that a low-tax, low-spend, small-public realm economy is more growth-efficient
- **Reductionist**: boosting living standards is reduced to tax cuts that deliver cash in people's pockets rather than seeing that public spending increases are more effective in boosting living standards: affordable childcare, higher subvention of public transport, subsidised prescription medicine, etc. These can more effectively reduce household costs.
- **Strategic**: tax cuts will reduce upward pressure on wages – the old social partnership formula via the backdoor (without any social or partnership). Main beneficiary – employers.

# 4. Growth Rates: A Statistical Recovery

- Coming off recession and years of stagnation, Government is 'banking' on high growth rates. Over the next two years they project growth rates between 8 and 9 percent. Is this a real description of the Irish economy?
- Hard to disagree with the ESRI's Dr. John Fitzgerald:
- *' . . . the standard EU harmonised national accounts are not a satisfactory framework for understanding what is happening in the Irish economy.'*
- Why are our national accounts failing to accurately describe the Irish economy?

# Growth Rate Projections and Empty Calories

- **Multi-nationals (MNCs) and GDP**: Everyone knows GDP is not the best measurement. Not just because MNCs make profits here and then repatriate. MNCs profits are generated in other economies and 'imported' here to take advantage of low tax rate and tax haven-conduit facilities. GDP is distorted by MNC profit-shifting – before you start taking account profit-repatriation.
- **Using GNP**: Not satisfactory, either. The ESRI uncovered a real problem: re-domiciled MNC profits are artificially boosting GNP but have no impact on the real economy. This can count in billions - in 2012, it was €7.5 billion or 5 percent of GNP.
- **The IFSC**: IFSC can distort growth numbers . The Central Bank:
- *'Financial sector developments, which are for the most part unrelated to the domestic economy, account for a significant portion of the rise in GNP . . .they would further support GNP growth unrelated to domestic consumption, investment or export activity.'*
- Profit flows and retentions impact on the GNP but with little impact on real economy.

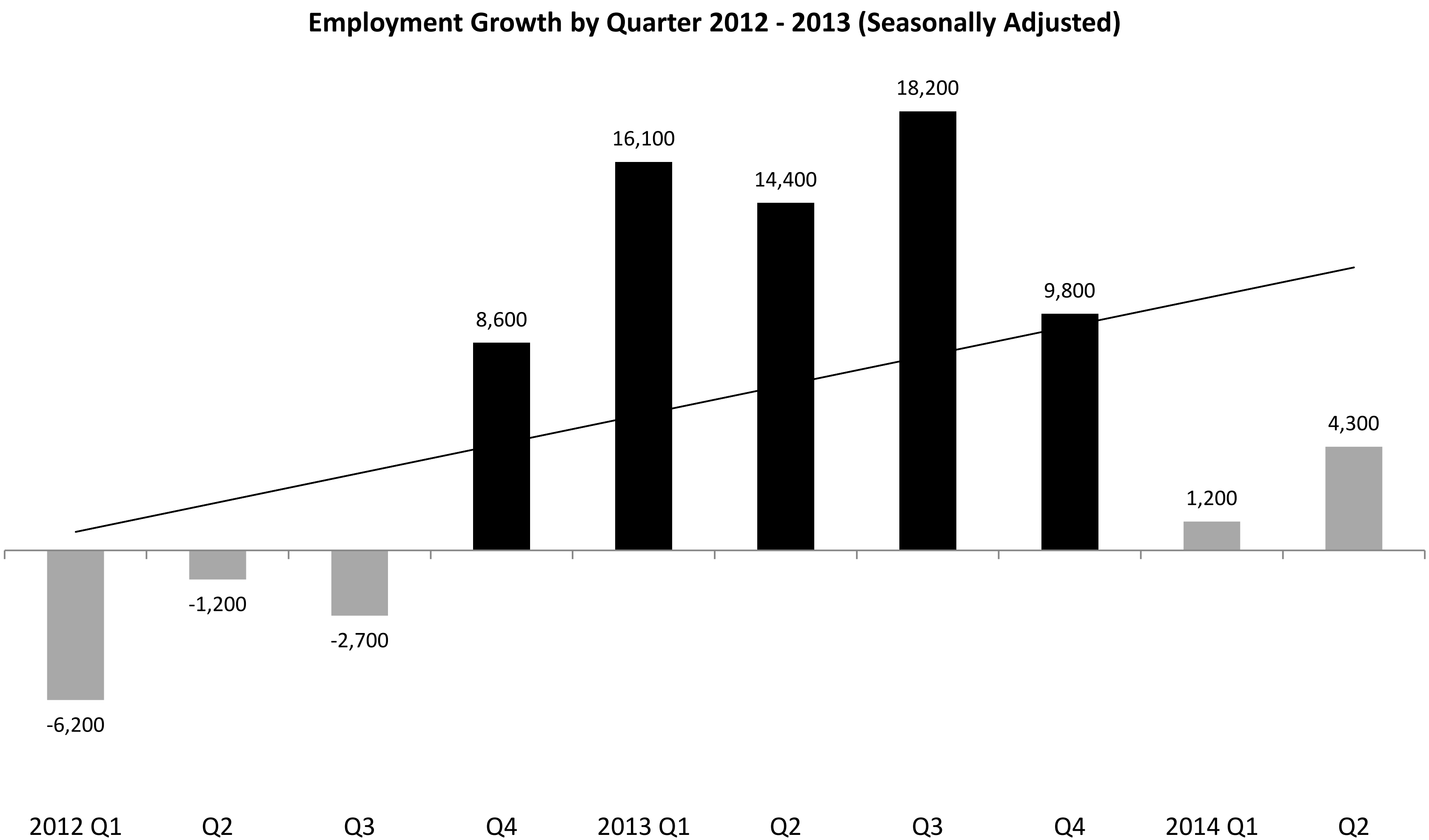
# And More

- **New Basis for Calculating Exports**:
- *' . . . goods owned by an Irish entity that are manufactured in and shipped from a foreign country are now recorded as Irish exports.'*
- This led to sharp rise in exports this year –Central Bank, ESRI and Government warned about credibility. Recent upswing in GDP is primarily export-driven, but 'real' is this?.
- **New Basis for Calculating Investment**: R&D now included in National Accounts. This led to revising investment upwards by 54 percent. The average revision upwards among EU-15 countries was 14 percent. Are we seeing accounting practices of MNCs impacting here? More research needed.
- **Government consumption**: Government points out a quirk:
- *'Government consumption growth in the first half of 2014 (at 5.3 per cent) was particularly strong . . .largely a statistical effect due to longer hours worked under Haddington Road Agreement.'*
- Our growth projections may come true – but much may be empty calories

# Employment Also Affected by Statistical Revisions

- Following each census, the CSO revises their QNHS sample base to cohere census. This will lead to changes in the composition of employment and the numbers actually employed. The CSO warned against ‘interpreting trends’ during this period of revision, or ‘realignment’ of their sample base; repeatedly.
- One could ignore the CSO’s warning and pretend the revision made no difference to employment growth, but this requires us to believe that the laws of economic gravity have been suspended in Ireland.
- In 2012 employment fell by 11,000 – and this was after a loss of nearly 300,000 since the start of the crisis. However, in 2013 everything changed. Employment grew on a full-year basis by 43,000. This was quite a turnaround. But there were some problems.

# Down, Up and Down Again



# Making (un)Sense of Employment Growth

- First, 2013 employment growth took place while economy remained in a domestic demand recession - employment is sensitive to domestic demand.
- Second, the usual pattern of an economy coming out of a recession is that employment growth lags. The first beneficiaries in rising business output are those in employment (increase in hours).
- Third, self-employment (own-account) grew by over 10 percent - by over three times the rate during the boom. Doesn't make sense – not with domestic demand stagnation.
- When CSO's revision ended employment growth was muted.
  - In the first half of 2013, employment grew by **30,000** (domestic recession)
  - In the first of 2014, employment grew by **5,500** (domestic growth)
- All this suggests we approach employment numbers cautiously.

# 5. Conclusion

- **What we know:**

➢ Government consumption and public investment are being returned to levels of over a decade ago and even further
➢ Government projections see a further fall in these categories and overall public expenditure up to 2018
➢ We are well behind spending/investment levels in other EU-15 countries
➢ All in pursuit of a balanced budget in 2018 (and to avoid tax increases, and to engage in macroeconomic alchemy)

- **What we don't know:**

➢ How substantial growth projections are (or how real our national accounts are)
➢ How many jobs were actually created last year

- **We may experience growth over the medium-term (even substantial statistical growth) but may continue to experience real-world stagnation.**