A New Economic Model

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What does the New Economic Model mean for Fiscal Policy and the Budget?

One of the key goals of the New Economic Model (NEM) is to spark a mature and honest debate about how we manage the public finances.

The Republic of Ireland and the UK (and as a consequence Northern Ireland) have been consistently plagued by unsustainable boom bust fiscal policies that have perhaps been the greatest source of economic volatility over the last half century. For example, the Great Financial Crash at the end of the 2000s brought severe recessions which were then made worse by governments withdrawing money from the economy as part of a policy known as 'austerity'.

While austerity policies undoubtedly lengthened and deepened the downturns it was prior budgetary mistakes that had constrained the ability to respond more appropriately. The fiscal mismanagement was so severe in the Republic that economic sovereignty was de-facto ceded to a troika of international institutional lenders.

More recently, the UK's experience under the Truss premiership illustrates that fiscal policy continues to have real constraints and not just for small countries. The UK's public finances remain fragile. But even surpluses can be illusory and there are legitimate concerns that current budgetary policy in the Republic is insufficiently prudent. Fragile and heavily concentrated 'windfall' corporation tax receipts are being used to balance the books and ignore longer-term problems. Without this windfall the government is running a deficit at a time of strong economic growth. This is a feckless failure of government.

The principles

The NEM argues we need to embed and hardwire sustainable budgetary policy into our economic model. We need to be resilient and that means being able to respond to crises such as future recessions and other shocks (pandemics, trade wars etc) by supporting the economy just as we did with such great success during the pandemic. While this means being much more careful when times are good, great care is also needed in the design of any budgetary rules so that other goals such as poverty reduction and long-run economic growth are not sacrificed.

More goals mean more complex rules. How should fiscal rules interact with major economic transition costs? What are the appropriate protocols around the use of 'once-off' supports and what should trigger such supports? How should we treat tax windfalls? Ultimately, we want to ensure that policy is sustainable but also that it does not impede necessary investments in the long-term health of the economy. Common sense guidelines might include:

(A) **Running meaningful current spending surpluses in the good and in the normal times**, which then enable us to properly defend the economy and households during a recession. Over the medium-term, a government's current spending should be completely financed through taxation and not through debt;

(B) **Applying a golden rule for investment that ensures sufficient and consistent resources for investment spending across the economic cycle.** Additional capital spending may be desirable but, if pursued, should be sourced from running surpluses of government revenue (primarily taxes) in excess of current or day-to-day spending;

(C) **Quarantining potentially transitory revenues so that they are not available for use either to fund day-to-day spending or to finance tax cuts**. All transitory revenues, for example the windfall corporation tax receipts in the Republic of Ireland, should be allocated either to long-term savings funds or to funding vehicles for future countercyclical investments in infrastructure. Other revenue sources may also prove transitory. For example, carbon taxes and other green taxes will decline over time to the extent we actually succeed in reducing greenhouse gas emissions. 'Temporary' receipts of this nature should not be used to finance ongoing current expenditure or tax cuts elsewhere, but instead should be allocated to finance temporary transition costs such as spending on green infrastructure;

(D) **Starting a mature debate about expenditure needs, fiscal sustainability, intergenerational equity and revenue sufficiency into the 2030s and beyond**. Multi-annual and transparent fiscal planning needs to be a priority. Government fiscal projections should be shown at least 10 years in advance. With this in mind, the Republic's 2022 Commission on Taxation and Welfare (COTW) made 116 policy recommendations around reforms to tax and fiscal policy. A similar commission should be established in the UK to address future expenditure and revenue needs. It is too simplistic to say taxes will need to go up. We also need to focus on tax design.

Conclusion

To be economically radically we must first be fiscally conservative. We can and should make the needed investments in infrastructure, education, health and many other areas. But we cannot promise these improvements and offer taxes at the same time. It is time for a mature debate.