Context for Budget 2019 – A Long-run Focus

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Research for new economic policies

Dashboard of Macroeconomic Indicators

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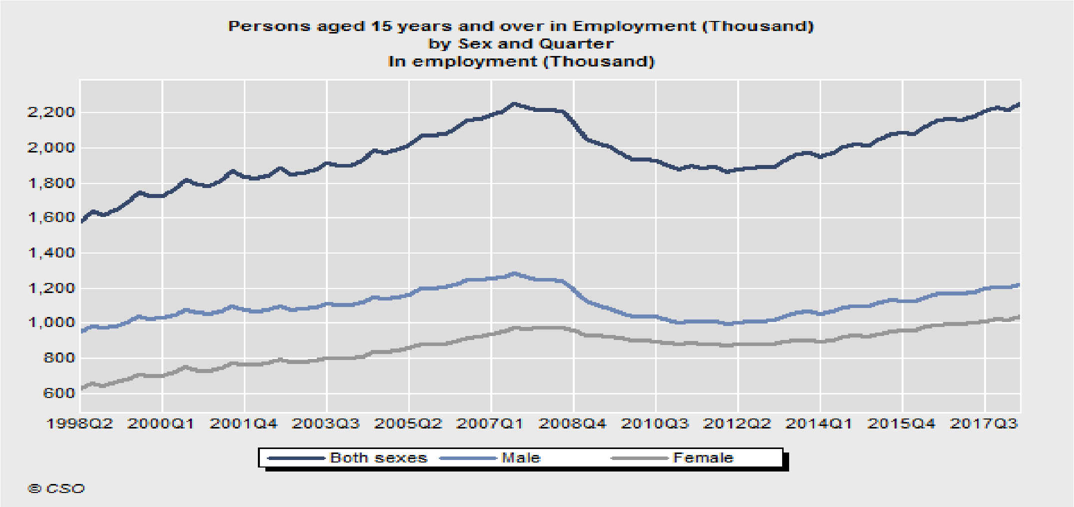
	2013	2014	2015	2016	2017	2018
Real GDP			*Percentage volume change over previous year*			
Euro area	-0.2	1.3	2.1	1.8	2.3	2.2
United Kingdom	2.1	3.1	2.3	1.9	1.8	1.4
United States	1.7	2.6	2.9	1.5	2.3	2.9
Unemployment**			*Percentage of active population*			
Euro area	12.0	11.6	10.9	10.0	9.1	8.4
United Kingdom	7.5	6.1	5.3	4.8	4.5	4.4
United States	7.4	6.2	5.3	4.9	4.4	3.9
Inflation***			*Percentage annual average rate of change*			
Euro area	1.3	0.4	0.0	0.2	1.5	1.5
United Kingdom	2.6	1.5	0.0	0.7	2.7	2.7
United States	1.5	1.6	0.1	1.3	2.1	2.5
Compensation per Employee			*Percentage change from previous period*			
Euro area	1.6	1.4	1.4	1.2	1.6	2.4
United Kingdom	2.8	0.5	1.1	3.3	2.9	2.9
United States	1.5	2.9	3.1	1.0	1.9	3.3
Employment			*Percentage change from previous period*			
Euro area	-0.8	0.8	1.0	1.3	1.5	1.1
United Kingdom	1.2	2.4	1.8	1.4	0.9	0.7
United States	1.0	1.6	1.7	1.7	1.3	1.1
Fiscal Balance			*Percentage of Gross Domestic Product*			
Euro area	-3.0	-2.6	-2.1	-1.5	-0.9	-0.6
United Kingdom	-5.4	-5.4	-4.3	-3.0	-2.3	-1.8
United States	-4.4	-4.0	-3.5	-4.2	-4.6	-5.3

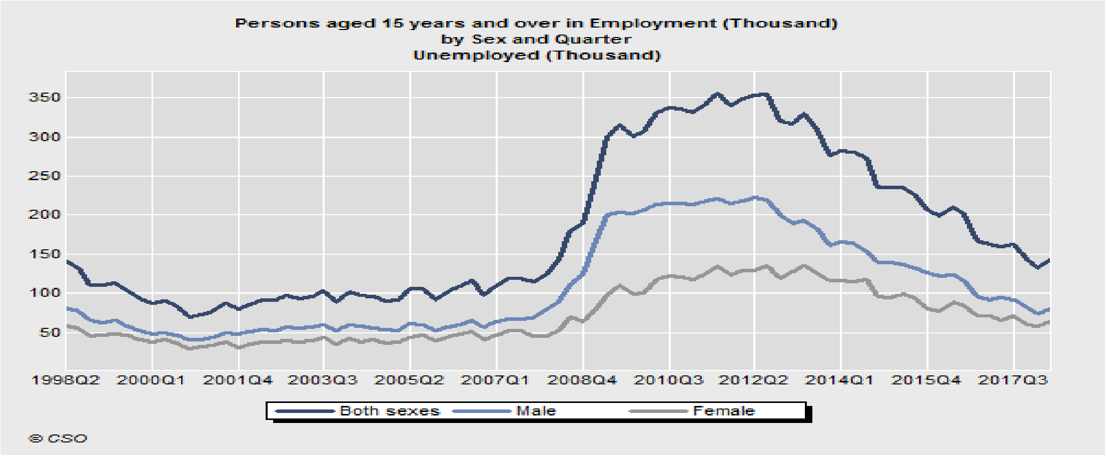
Dashboard of Macroeconomic Indicators (ROI)

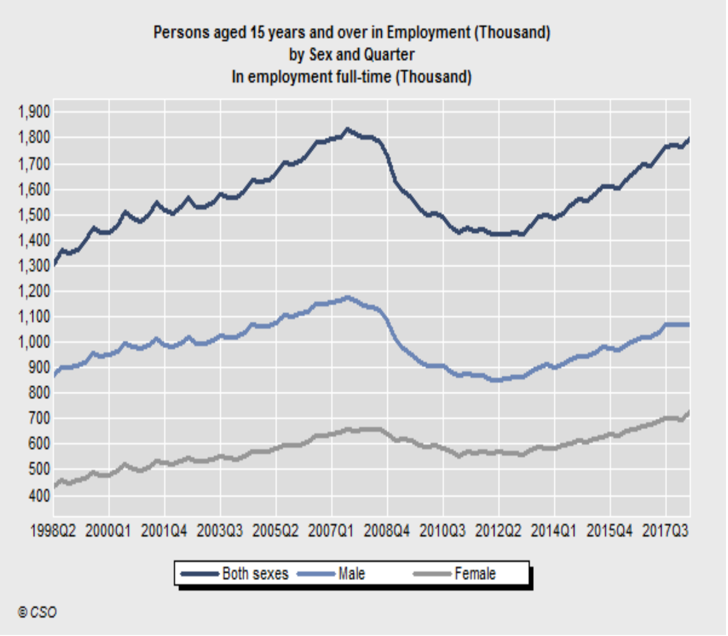
	2013	2014	2015	2016	2017	Latest
	Percentage volume change over previous year					
Gross Domestic Product	1.3	8.8	25.1	5.0	7.8	9.1 *(Q1'18)*
Modified Domestic Demand	2.5	4.1	4.8	5.6	3.2	4.8 *(Q1'18)*
Personal Consumption	-0.6	2.1	3.6	4.0	1.6	2.7 *(Q1'18)*
Retail Sales	0.7	6.3	8.4	6.7	2.9	4.3 *(M5'18)*
GNI* (current prices)	8.3	8.6	8.6	9.0	3.0	3.0 *(2017)*
	Percentage annual average rate of change					
Employment	3.0	2.6	3.5	3.7	2.9	2.9 *(Q1'18)*
Average Hourly Earnings	-0.3	-0.3	0.1	0.8	1.7	2.7 *(Q1'18)*
Average Weekly Earnings	-0.5	0.3	1.2	1.1	2.0	2.4 *(Q1'18)*
Inflation (CPI)	0.5	0.2	-0.3	0.0	0.4	0.7 *(M6'18)*
	Percentage of annual GDP or quarterly GDP					
Investment	18.7	20.7	24.1	35.7	23.5	19.5 *(Q1'18)*
Current Account Balance	1.5	1.1	4.4	-4.2	8.5	12.4 *(Q1'18)*
Government Balance (GGB)	-6.1	-3.6	-1.9	-0.5	-0.4	-2.0 *(Q1'18)*
Gov. Gross Debt (end-year)	119.7	104.1	76.8	73.4	68.4	69.3 *(Q1'18)*
	Percentage of labour force					
Unemployment	13.7	11.9	9.9	8.4	6.7	5.1 *(M6'18)*
Long-term Unemployment	8.0	6.7	5.4	4.3	3.0	2.1 *(Q1'18)*
	Percentage of households					
Deprivation	30.5	29.0	25.5	21.0	-	21.0 *(2016)*
At Risk of Poverty	16.5	17.2	16.9	16.5	-	16.5 *(2016)*
	Percentage					
Gini Coefficient	32.0	32.0	30.8	30.6	-	30.6 *(2016)*

There and back again…..11 years to restore employment levels (and with a large population)



Q2 2018 = 2.255 million
Previous peak
Q3 2007 = 2.2522 million
Male employment still
65,000 off its peak





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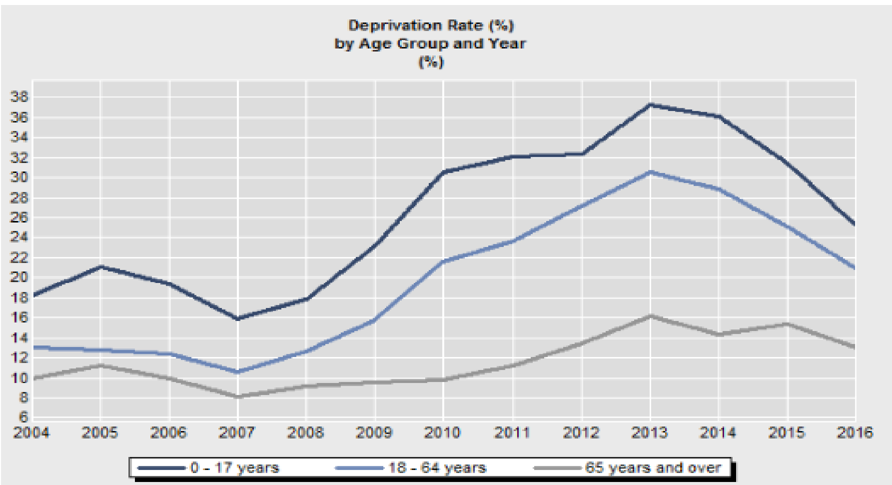
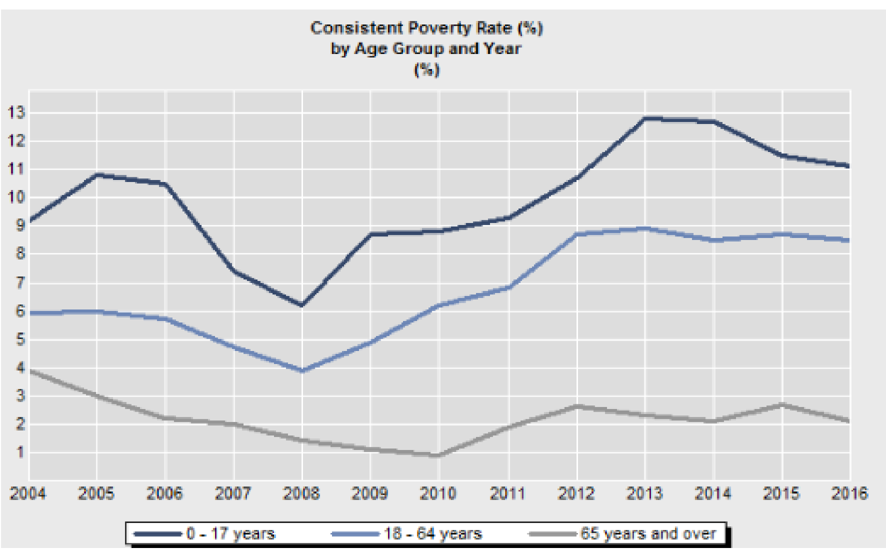
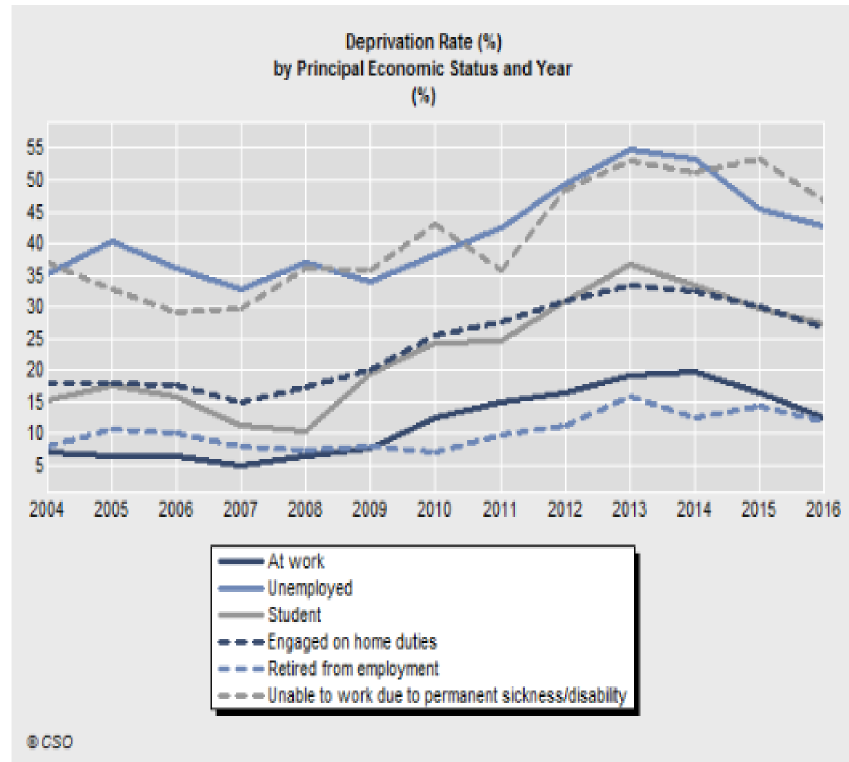
Trends in poverty and deprivation (children, disabled and unemployed are the most at-risk groups)







Economy overheating? - Not yet

- We cannot directly observe the cyclical position.
- Menu of indicators:
  1. A falling and below the long-term average **unemployment rate**; *(Yes, but the UR is higher than in the UK and US and worse than 14 EU countries)*
  2. A rising and above long-term average **employment rate**; *(Mixed, growth was +3.4% y-on-y in Q2 2018, but employment rate (20-64) was 15th in the EU in 2017)*
  3. A faster than average rate of growth in **consumer prices**, *(No – CPI has been below 1% since 2012)*
  4. A faster than average rate of growth in **asset prices**; *(Annual property price increases are in double digits - but just 80% of peak)*
  5. A faster than average rate of growth in **wage inflation**; *(Annual hourly earnings were +2.7% in Q1 but context of decade long stagnation)*
  6. A faster than average rate of **growth in underlying investment**, *(Yes – double digit y-on-y real growth in each of the last 2 quarters)*
  7. A rising and above long-term **underlying investment rate** as a per cent of modified output*; (Rate increased from 20.7% in 2016 to 22.5% in 2017 – in line with long-run expectations - rate was 17.5% in 2013)*
  8. A faster than average rate of **growth in private consumption** *(Mixed – real growth was just 1.6% in 2017 but 2.7% y-on-y in Q1)*
  9. A faster than average rate of **growth in the volume of retail sales** *(No, y-on-y growth was -0.8% in Q1 and +2.4% in Q2*)
  10. A faster than average rate of **growth in private sector credit** *(Mixed – lending to households for house purchases up just 0.4% y-on-y in May, - overall household lending remains muted – lending to SMEs was up 3.3% y-on-y in Q1 – credit advanced to Irish enterprises is in decline)*
  11. A deterioration in the **current account balance** particularly if it is already negative, (Difficult to interpret – modified current account balance was 1.2% of GNI* in 2017)
  12. A sustained deterioration in the **savings rate** *(No – savings rate of households was 9.7% of GDI in Q1 2018. Long-run average from 1999 to 2017 was 8.4%).*

Economic Outlook (per Summer QEO)

- We project **real GDP** will grow by a strong, and above trend, rate of <u>5.8% in 2018</u> on the back of strong employment growth as the cyclical upswing continues.
- Modified domestic demand grew by over 6% in H1

- Growth should start to slow to its trend rate thereafter. We project real growth of <u>3.8% in 2019</u> and then annualised growth of close to 3% thereafter.
  - The 2019 forecast is extremely tentative given the inherent uncertainty surrounding Brexit negotiations
- Dept. Finance expects growth of 5.6% in 2018 and 4.0% in 2019, ESRI projects 4.7% and 3.9%, CBI projects 4.7% and 4.2%

- Labour market conditions should continue to improve in 2018 and 2019. Total employment should increase by over 100,000 over the period 2018-2019.
- Unemployment rate will range between 4.5% and 5% in 2019.
- The tightening labour market will drive wage growth – average hourly earnings growth should be well over 3% in 2019.
- Wage and employment growth will vary from sector to sector. We foresee particularly strong gains in the construction sector as housing output increases.

- Inflation remains subdued but wage pressure and strengthening domestic demand should start to push up prices gradually over the next 6-18 months

Macro projections

	2017	2016	2017	2018	2019
Real Output		*Percentage real change over previous year*			
Gross Domestic Product	€294.1bn	5.0	7.2	5.8	3.8
Personal Consumption	€99.9bn	4.0	1.6	2.7	2.5
Government Consumption	€29.6bn	3.5	3.9	2.3	2.2
Investment	€69.0bn	51.7	-31.0	10.1	9.7
Exports	€352.6bn	4.4	7.8	6.5	5.6
Imports	€263.3bn	18.5	-9.4	6.2	7.0
Earnings		*Percentage nominal change over previous year*			
Average Hourly Earnings	€22.43	0.8	1.7	2.9	3.4
Government Finances		*Percentage of GDP*			
General Government Balance	-€1.0bn	-0.5	-0.4	-0.2	-0.1
Gross Debt	€201.3bn	73.4	68.4	66.4	63.9
Labour Force		*Percentage change over previous year*			
Employment	2,194,150	3.7	2.9	2.9	2.1
		Percentage of labour force			
Unemployment	157,850	8.4	6.7	5.3	4.7

Downside risks to growth

(almost identical to last year)

There is a wide range of other **downside risks** to our baseline projection including:

- **Rising energy prices**
  - Would increase consumer and producer costs and dampen domestic demand
- **International moves towards protectionism**
  - Volatile and mercantilist US administration – escalation in protectionism would harm an SOE like Ireland
- **Monetary policy**
  - Rising interest rates are inevitable in the medium term (Ireland is still highly indebted)
- **Brexit**:
  - Lower growth and potential growth in the UK
  - Weaker Sterling and currency volatility
  - Impact on trade and on businesses with cross border value chains
  - Impact on investment decisions
- **US tax policy; EU level CCCTB**
  - Fiscal implications (could impact FDI)
- **Declining competitiveness – housing and childcare costs**
  - Can be ameliorated through public policy
- **Downward trend in productivity growth becomes structural**
  - Public policy needs to focus on the inputs to long-run growth…….

Growth friendly fiscal policy

- Economic growth depends on:
  - A) **the investment rate**,
  - B) **demographic changes**,
  - C) **participation and employment rates**, and
  - D) **changes in total factor productivity**.
    - The growth of labour productivity is a function of <u>growth in the stocks of human and fixed capital</u>, as well as changes in the technological base and its diffusion.
- Growth friendly fiscal policies are those that sustainably boost the amount of labour inputs employed and/or those that boost average labour productivity.
- Fiscal policy is crucial to this process and it is important to describe the current position…..

Hierarchy of Fiscal Consolidation Instruments (OECD, 2013)

Generic Rank	Instrument	Generic Rank	Instrument	Generic Rank	Instrument
1 **(least damaging spending cut or tax increase)**	Business and other subsidies (e.g. tax expenditures)	4-8 **(ranking changes if we add 'environment' as a policy goal)**	Environmental taxes	13	Public capital investment
2-3	Pensions	4-8	Unemployment benefits	14-15	Health services (in kind)
2-3	Other property taxes	9-10	Other government consumption	14-15	SSCs
4-8	Recurrent taxes on immovable property	9-10	Sales of goods and services	**16**	Childcare/family
4-8	Personal income taxes	11-12	Sickness and disability payments	**17** **(most damaging spending cut)**	Education
4-8	Corporate income taxes	11-12	Consumption taxes (non-environment)		

Fiscal context

- Clear improvement in recent years
- The debt interest to government revenue ratio is expected to decline from 12.6 per cent in 2013 to a projected 6.7 per cent in 2018
- General government deficit of 0.4% GDP (€1 billion) in 2017. Gross debt was 68.4% of GDP in 2017.
    - The annual deficit was €14.1 billion as recently as 2012.
- The deficit should be close to 0.2% of GDP in 2018 (0.3% of GNI*).
- The structural deficit cannot be measured directly but is probably close to 0.2% of potential output.
- Fragilities:
    - Overreliance on CT receipts (doubled between 2013 and 2017 and top 10 payers account for 39%)
    - Net government debt burden is one of the highest in the OECD when using GNI*

Government revenue as a proportion of output, %

	2012	2013	2014	2015	2016
Ireland (GNI*)	39.3	37.8	38.0	38.0	36.5
European Union (GDP)	38.3	38.7	38.7	38.5	38.9
United Kingdom (GDP)	33.3	33.2	32.7	33.1	33.7
Ireland (GDP)	28.4	28.8	28.7	23.4	23.5
Ireland (Modified Hybrid)	35.3	34.8	35.0	32.9	32.7

Notes: The 'Modified Hybrid' is a modified version of the 'hybrid' measure of GDP and GNP developed by the Irish Fiscal Advisory Council as an estimate of Ireland's fiscal capacity and is included here for comparative purposes. It is calculated as GNI* + 0.4(GDP-GNP).

Implicit Tax Rates, (% of potential tax base)

		2012	2013	2014	2015	2016
Consumption	Ireland	21.9	22.7	24.0	24.2	24.7
	EU 27*	19.8	20.0	20.2	20.4	20.6
Labour	Ireland	31.7	32.0	33.3	33.1	32.7
	EU28	35.8	36.0	36.0	35.8	36.1
Capital	Ireland	15.0	14.7	15.3	13.3	13.4
	21 EU country average**	23.5	23.4	23.4	24.0	26.0

Per capita receipts from taxes and SSCs, high-income EU countries in 2016, €

Country	Total Tax Revenue (Millions)	Population (Thousands)	Tax Revenue per capita
Luxembourg	20,291	583.5	35,212
Denmark	128,802	5,728.0	22,568
Sweden	204,961	9,923.1	20,806
Finland	95,154	5,495.3	17,341
Austria	149,273	8,736.7	17,157
Belgium	187,754	11,331.4	16,599
Netherlands	272,972	17,030.3	16,077
France	1,016,412	66,859.8	15,232
Germany	1,224,797	82,348.7	14,905
Ireland	**64,187**	**4,755.3**	**13,581**
United Kingdom	806,646	65,595.6	12,337
Weighted Average			**15,050**
Gap per Capita (€)			1,469
Scaled Gap (€ Billions)			6.9
Ratio (%)			90.2

- Most of the gap is accounted for by Social Security Contributions

Income tax plus employee social security contributions in 2016, % of gross wage earnings (single person at average earnings), EU15 and OECD35

	Country	Total	Income Tax	Employee SSC	Gross wage earnings
1	*Belgium*	**40.7**	26.8	14.0	58,214
2	*Germany*	**39.7**	19.0	20.7	61,750
3	*Denmark*	**36.2**	36.2	0.0	57,310
4	*Austria*	**31.9**	13.9	18.0	55,680
5	*Italy*	**31.1**	21.6	9.5	42,166
6	*Luxembourg*	**31.0**	18.1	12.8	65,522
7	*Finland*	**30.8**	22.0	8.8	48,479
8	*Netherlands*	**30.4**	16.9	13.5	63,549
9 (Wages are US dollars	*France*	**29.1**	14.8	14.3	47,817
10 with equal pp)	*Portugal*	**27.6**	16.6	11.0	29,946
11	*Greece*	**25.4**	9.6	15.8	32,974
12	*Sweden*	**24.9**	17.9	7.0	47,450
13	*United Kingdom*	**23.3**	14.0	9.4	53,020
14	*Spain*	**21.4**	15.0	6.4	40,276
15	***Ireland (ROI)***	**19.2**	**15.2**	**4.0**	**44,737**
Non-EU Western European					
	Norway	**27.9**	19.7	8.2	60,020
	Iceland	**29.2**	28.9	0.3	59,044
	Switzerland	**16.9**	10.7	6.2	70,077
Unweighted averages					
	EU15 (ex. ROI)	**30.3**	18.7	11.5	50,297
	OECD	**25.5**	15.7	9.8	43,015
Other					
	OECD median	**25.4**	15.2	9.4	44,737
	United States	**26.0**	18.3	7.7	52,543

Total tax wedge as % of total labour costs (single person at average earnings), 2016, EU15 and OECD35

EU15		Country	Total	Income Tax	Employee SSC	Employer SSC	Labour Costs
1		*Belgium*	**54.0**	20.8	10.9	22.3	74,913
2		*Germany*	**49.4**	15.9	17.3	16.2	73,683
3		*France*	**48.1**	10.8	10.5	26.8	65,294
4		*Italy*	**47.8**	16.4	7.2	24.2	55,609
5		*Austria*	**47.1**	10.8	13.9	22.4	71,776
6		*Finland*	**43.8**	17.9	7.1	18.7	59,663
7		*Sweden*	**42.8**	13.6	5.3	23.9	62,359
8		*Portugal*	**41.5**	13.4	8.9	19.2	37,058
9	(Wages are US dollars	*Greece*	**40.2**	7.7	12.6	19.9	41,169
10	with equal pp)	*Spain*	**39.5**	11.6	4.9	23.0	52,319
11		*Luxembourg*	**38.4**	16.2	11.4	10.8	73,489
12		*Netherlands*	**37.5**	15.2	12.2	10.1	70,665
13		*Denmark*	**36.5**	35.9	0.0	0.8	57,759
14		*United Kingdom*	**30.8**	12.6	8.4	9.7	58,714
15		***Ireland (ROI)***	**27.1**	**13.8**	**3.6**	**9.7**	**49,547**
Non-EU Western European							
		Norway	**36.2**	17.5	7.3	11.5	67,823
		Iceland	**34.0**	26.9	0.3	6.8	63,384
		Switzerland	**21.8**	10.0	5.9	5.9	74,439
Unweighted averages							
		EU15 (ex. ROI)	**42.7**	15.6	9.3	17.7	61,034
		OECD	**36.0**	13.4	8.2	14.4	50,214
Other							
		OECD median	**38.1**	12.6	7.6	13.9	54,053
		United States	**31.7**	16.9	7.1	7.7	56,956

Per capita public spending excluding interest payments in 2017, €bn

Country	Population ('000s)	Total spending	Per capita spending €
Luxembourg	596.3	23.5	39,478
Denmark	5,766.0	146.5	25,412
Sweden	10,057.7	232.8	23,147
Finland	5,509.8	117.9	21,403
Austria	8,794.3	174.4	19,833
Belgium	11,384.6	218.2	19,166
France	67,127.8	1,251.7	18,646
Netherlands	17,132.0	305.0	17,802
Germany	82,712.7	1,399.0	16,915
Ireland (ROI)	**4,876.0**	**71.4**	**14,642**
United Kingdom	65,998.2	891.4	13,507
Weighted average			**17,306**
Gap per capita (€)			2,664
Scaled gap (€ billions)			13.0

Per capita public spending on Gross Fixed Capital Formation and R&D at current prices, €

Country	2016 (GFCF)	2017 (GFCF)	4 Year Average (GFCF)	2015 (R&D)	2016 (R&D)
Belgium	825	852	837	266	276
Denmark	1,859	1,721	1,783	507	472
Germany	811	860	801	343	360
France	1,123	1,152	1,151	260	262
Luxembourg	3,587	3,733	3,529	569	555
Netherlands	1,438	1,503	1,442	357	362
Austria	1,217	1,267	1,206	344	353
Finland	1,587	1,574	1,555	361	360
Sweden	2,057	2,158	2,024	453	465
UK	969	930	988	215	191
Ireland (ROI)	**1,071**	**1,128**	**1,020**	**194**	**201**
Weighted Average	**1,066**	**1,087**	**1,072**	**298**	**299**
Scaled gap (€ billions)	0.0	-0.2	0.3	0.5	0.5
Ratio (%)	100.4	103.7	95.2	65.3	67.4

Education spending - Per pupil spending gap between Ireland and the high-income OECD country median was €2.1 billion in 2015/16

Public Spending on early childhood education and care, high-income European countries, % of GDP, 2013

	Total	Childcare	Pre-primary
Sweden	1.64	1.1	0.5
Denmark	1.36	-	-
France	1.27	0.6	0.7
Norway	1.25	0.5	0.7
Finland	1.11	0.6	0.5
Belgium	0.78	0.1	0.7
United Kingdom	0.76	0.1	0.7
Netherlands	0.69	0.3	0.4
Germany	0.58	0.2	0.4
Ireland	**0.52**	**-**	**-**
Austria	0.49	-	-

Public spending on early childhood education and care per child aged 0-to-5 was lower in Ireland than in any other high-income European country on a USD PPP basis.
Spending per child was even less than the EU average, despite Ireland's much higher per capita income than the EU average.

Investing in sustainable and <u>inclusive</u> growth

Long-run growth

- Long-run focus should be on **boosting productive and innovative capacity** and on doing so in a way that is inclusive and sustainable
  - Infrastructure, education, public R&D, childcare
- Chronic underfunding of R&D/science and education (per pupil basis) needs to be addressed over the medium-term
  - Spending on infrastructure should be countercyclical with a target of circa 3.5% of output over the economic cycle (multiannual planning)
- Obvious implications for the direction of tax policy
- This long-term focus on productive and innovative capacity is also the appropriate strategy to counter the negative economic impact of Brexit
  - Even so, a once-off Brexit adjustment fund may be needed (once-off exemption under the fiscal rules?)

Other policy issues (selected)

- Immediate priority in housing (a moral issue but also implications for competitiveness and social cohesion)
  - Is housing a commodity or a home?
- Ageing population will push ROI's social insurance fund into deficit by 2021
  - ROI's revenue gap is mostly explained by low SSC levels (elephant in the room)
- High debt levels in a the context of rising interest rates – what is the appropriate policy response?
- How could a Rainy Day Fund be made compatible with the Fiscal Rules?

Can we have <u>an activist and 'entrepreneurial' state</u>?

- What does industrial policy look like in a future world of CCCTB and digital taxation ?
- How do we build an innovation system and how do we improve absorptive capacity of firms?