Economic Outlook

Autumn 2014

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Research for new economic policies

Projections for Output, the Public Finances and the Labour Market, (ROI)

	2013 values	2013	2014	2015	2016
National Income		*Percentage real change over previous year*			
Gross Domestic Product	€174.8bn	0.2	5.0	3.0	2.9
Personal Consumption	€83.3bn	-0.8	1.2	1.3	1.4
Investment	€26.5bn	-2.4	9.7	8.0	7.0
Government Consumption	€26.0bn	-0.5	2.1	0.0	0.0
Exports	€184.1bn	1.1	8.1	3.2	3.3
Imports	€147.7bn	0.6	6.9	2.7	2.9
Government Finances		*Percentage of GDP*			
General Government Balance	€10.01bn	-5.7	-3.7	-2.1	-1.4
Gross Debt	€215.5bn	123.3	116.6	113.3	109.4
Labour Force		*Percentage change over previous year*			
Employment	1,881,150	2.3	1.8	2.0	1.9
		Percentage of Labour Force			
Unemployment	282,200	13.0	11.5	10.6	9.8

Economic Outlook for the Republic of Ireland

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- Outlook is continuation of gains in employment and output in the remainder of 2014 and in 2015
  - Modest return to growth in personal consumption will continue
  - Growth will be driven by increasing investment - albeit from a very low base as a % of GDP – and by net exports
  - Continued improvement in employment and a fall in the unemployment rate
    - Still a lot of slack in the labour market
    - But employment continues to fall in the Western half of the country

- A number of concerns and risks remain
  - High levels of public and private indebtedness
  - Weak credit conditions and low investment/GDP ratio
  - High levels of long-term unemployment and youth unemployment
    - Becoming structural?
    - Hysteresis effects are a potential threat to recovery
  - Supply side shocks arising out of geopolitical difficulties
  - The threat of deflation and persistently low growth in the Euro area
    - Secular stagnation

Public Finances in the Republic of Ireland

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- The Republic's public finances remain fragile
  - Ireland's gross debt to GDP ratio in 2013 was the 4th highest in the EU at 123.7% and Ireland's gross debt to GNP ratio in 2013 was the 2nd highest in the EU at 146.0%
  - The deficit will be close to 3.7% of GDP in 2014 and we project will be 2.1% in 2015 and 1.4% in 2016
  - Debt to GDP will still be close to 110% of GDP in 2016 – vulnerable to shocks

- Government revenue as % of GDP is low by Western European standards
  - There is no room for reducing total government revenue in Budget 2015

- Primary (non-interest) public spending is already low by EU standards, and by modern historical standards in Ireland
  - Further cuts to public spending will put immense pressure on public services, public investment and social transfers

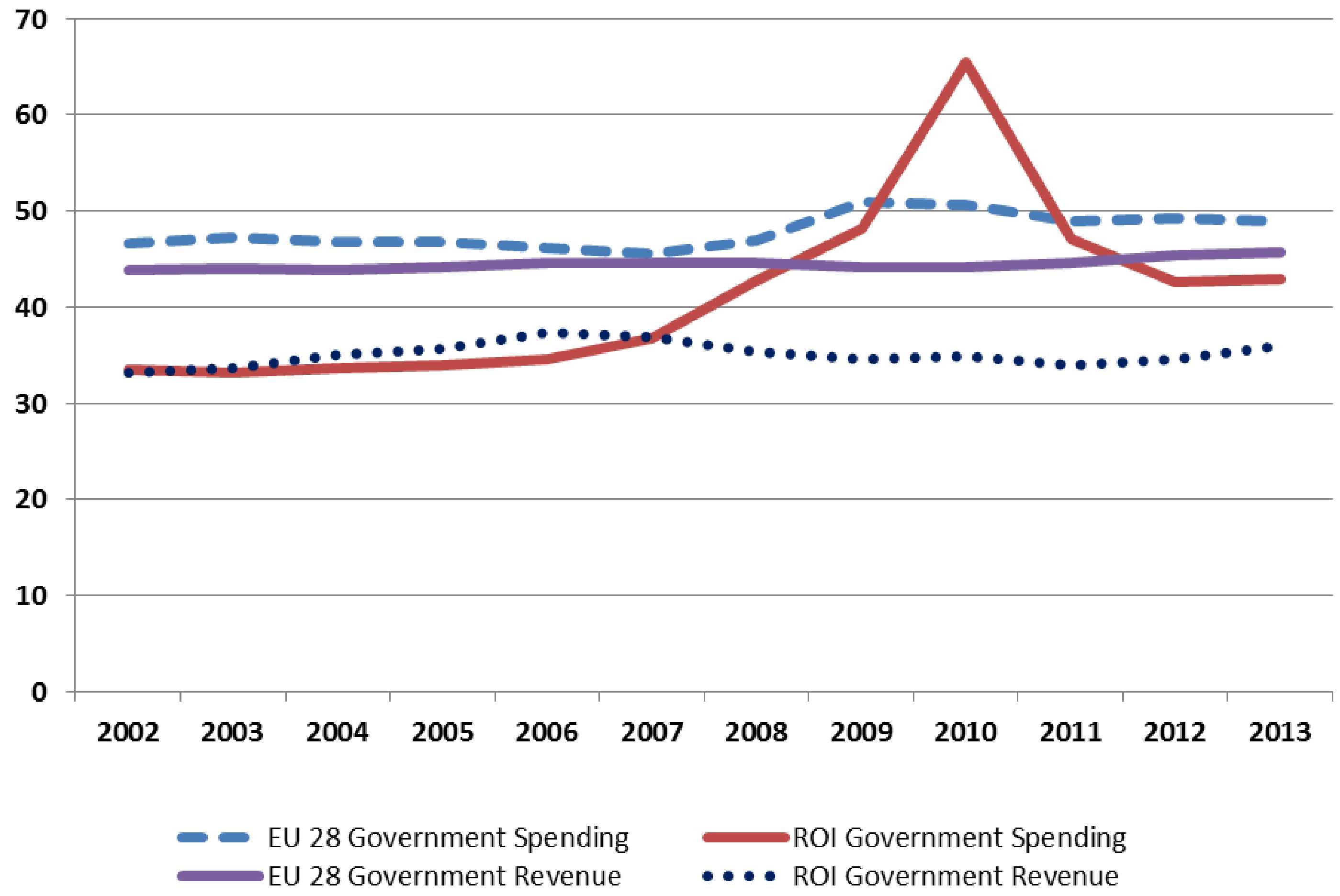
- Structural deficit appears to be close to zero (marginally in deficit)
  - Implies minimal need for additional discretionary consolidation

Cumulative Fiscal Adjustments

2008-2015, (€billions)

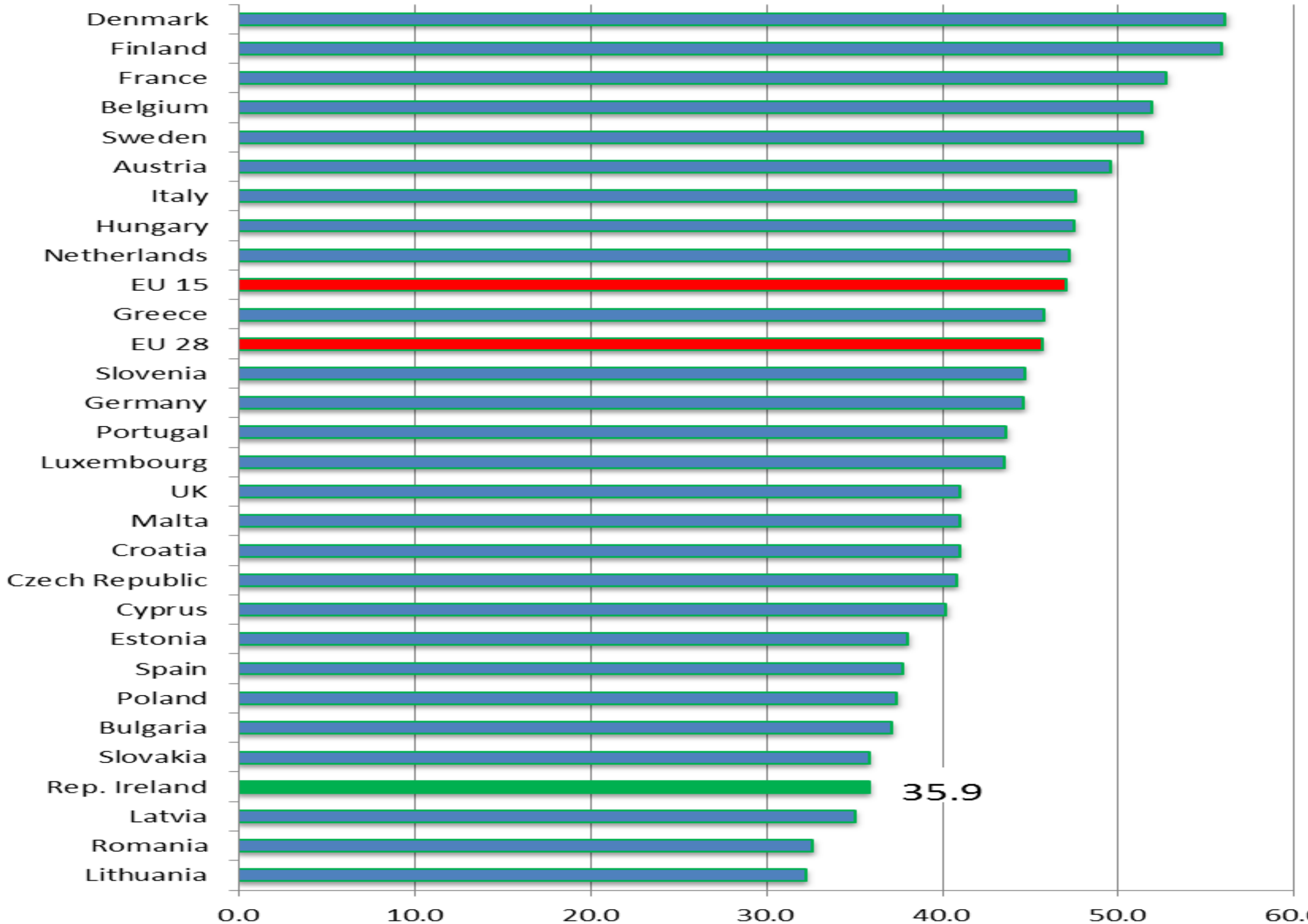
	Total adjustment (including 2015)	2008-2010	2011-2013	2014	2015
Revenue	**-11.5**	-5.6	-4.3	-0.9	-0.7
Expenditure	**-20.5**	-9.2	-8.4	-1.6	-1.3
of which					
Capital Expenditure	*-5.0*	*-1.6*	*-3.3*	*-0.1*	*0.0*
Current Expenditure	*-15.5*	*-7.6*	*-5.1*	*-1.5*	*-1.3*
Total adjustment	**-31.8**	-14.7	-12.6	-2.5	-2.0

Trends in General Government Expenditure and Revenue, % GDP - ESA95



General Government Revenue,% of GDP, 2013

ESA 1995



Tax Revenues (including SSCs), Ireland & EU

(% of GDP) - Eurostat

		2007	2008	2009	2010	2011	2012
Total Tax and SSC	Ireland (GDP)	31.5	29.5	28.1	28.0	28.2	28.7
	Ireland (GNP)	36.6	34.3	34.1	33.6	35.1	35.5
	Ireland (HYB)	34.4	32.2	31.4	31.1	32.0	32.4
	EU	39.3	39.2	38.3	38.3	38.8	39.4
	Euro	40.0	39.6	39.1	39.0	39.5	40.4
Main Categories							
Taxes on Consumption							
	Ireland	11.3	10.9	10.1	10.3	9.8	10.0
	EU	11.0	10.8	10.7	11.1	11.2	11.2
Taxes on Labour *(includes employer PRSI)*							
	Ireland	10.7	11.2	11.7	11.5	12.1	12.2
	EU	19.1	19.5	19.9	19.7	19.8	20.1
Taxes on Capital							
	Ireland	9.4	7.4	6.3	6.2	6.3	6.5
	EU	9.3	8.9	7.8	7.7	7.9	8.2
Selected Sub Categories							
Taxes on Capital Stock/Wealth	Ireland	2.8	2.2	1.9	1.9	2.2	2.2
	EU	2.8	2.8	2.7	2.5	2.6	2.8
Taxes on Corporate Income	Ireland	3.5	2.9	2.4	2.5	2.3	2.4
	EU	3.4	3.1	2.3	2.4	2.6	2.6
Taxes on Capital and Business Income	Ireland	6.6	5.2	4.3	4.3	4.1	4.3
	EU	6.4	6.1	5.1	5.2	5.3	5.4
Taxes on Property	Ireland	2.3	1.7	1.4	1.5	1.4	1.4
	EU	2.3	2.3	2.1	2.1	2.2	2.3
VAT	Ireland	7.6	7.3	6.4	6.4	6.0	6.2
	EU	7.0	6.9	6.7	7.0	7.1	7.1
Environmental Taxes	Ireland	2.5	2.4	2.4	2.6	2.5	2.5
	EU	2.4	2.3	2.4	2.4	2.4	2.4
Social Security Contributions (SSCs)	Ireland	5.0	5.4	5.7	5.7	4.8	4.4
	EU	12.2	12.5	12.8	12.6	12.7	12.7
Employee SSCs	Ireland	1.7	1.9	2.3	2.4	1.2	1.1
	EU	3.7	3.8	3.8	3.8	3.9	3.9
Employer SSCs	Ireland	3.1	3.3	3.3	3.1	3.4	3.1

Government Revenue and Expenditure

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IMF Estimates and Projections, (% of GDP)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue													
ROI	37.3	36.7	35.4	34.5	34.9	34.1	34.5	35.7	36.0	36.1	35.8	35.6	35.5
Euro	45.3	45.3	45.0	44.9	44.8	45.3	46.3	46.9	46.9	47.0	47.0	47.0	47.0
Expenditure													
ROI	34.4	36.7	42.7	48.3	65.4	47.2	42.7	43.1	41.1	39.1	38.1	37.2	36.6
Euro	46.6	46.0	47.2	51.2	51.0	49.5	50.0	49.9	49.5	49.0	48.4	47.9	47.5

Global Competitiveness Rankings and Government Revenue, 2013, (% GDP) – WEF & EC

Ranking	Country	Revenue	Ranking	Country	Revenue
3	Finland	56.0	17	Belgium	52.0
4	Germany	44.7	22	Luxembourg	43.6
6	Sweden	51.5	23	France	52.8
8	Netherlands	47.3	-	**Top ten**	**49.9**
10	United Kingdom	41.3	28	Ireland(GDP)	35.9
15	Denmark	56.2	28	Ireland(GNP)	42.4
16	Austria	49.7			

Scale of the Adjustment

- An adjustment of €2 billion in Budget 2015 is unnecessary
  - Ireland is required to reduce the public deficit below 3% in 2015
  - This can be achieved with a neutral budget – risks remain (vulnerable to shocks)
  - Too much austerity increases the threat of embedding a high level of structural long-term unemployment in the economy and potentially reinforces ‘hysteresis effects’
    - This diminishes the productive capacity of the economy
  - Yet vulnerabilities do remain – unwise to so dramatically change the plan
- NERI is proposing an €800 million net adjustment
  - A consolidating budget focussed on the revenue side – scope for some reversals in cuts (e.g. mental health services)
  - But…
- Public capital investment remains extremely low
  - An economy growing at 3% per annum should be aiming to average its public investment ratio at 3% of GDP - - equivalent to €5.4 billion in 2014 terms

A Strategic Approach

- Time to expand the focus from year-to-year deficit targets to a longer-term strategic approach emphasising the real economy (employment, real incomes, growth)
- **How do we sustainably increase the productive capacity of the economy?**
  1. Increase the labour supply (fiscal dimension)
  2. Investment in physical capital (infrastructure), R&D (innovation, broadband) and human capital (education and training, social infrastructure, public services)
     - Public and private dimension
     - Irish and European dimension
     - Cost of borrowing is at an all time low – represents an opportunity
- What are the key fiscal instruments?

Balancing Equity and Growth: Hierarchy of Fiscal Consolidation Instruments (OECD)

Generic Ranking	Instrument	Generic Ranking	Instrument	Generic Ranking	Instrument
1	Business Subsidies	4-8	Environmental taxes	13	Public 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	Education
4-8	Corporate income taxes	11-12	Consumption taxes (non-environmental)		

Reductions in public pension spending scores highly in the hierarchy of consolidation instruments. However this ranking refers to an increase in the retirement age which keeps productive workers in the labour force and increases output. Reducing the pension rate (payments to individuals) does not score highly from a welfare perspective mainly because such a measure would be highly regressive.

Economic Debates (1)

	Current Orthodoxy	Alternatives
Fiscal policy	• Low taxation • Tax breaks • Aggressive tax avoidance	• Robust, fair tax systems • End global tax avoidance • Increase redistribution
Monetary policy	• ECB with only price stability mandate • Inflation dogma 2% • No Lender of Last Resort	• Triple ECB mandate: full employment, sustainable growth and price stability • Lender of Last Resort
Industrial policy	• Laissez faire private activity • Tax breaks • Corporate subsidies • Privatisation	• State-led productive investment in physical and human capital to facilitate private activity • Green economy • Role for European Investment Bank • Mixed economy

Economic Debates (2)

	Current Orthodoxy	Alternatives
Banking policy	• *Laissez faire* private activity • 'Light touch' regulation	• Robust regulation • Re-examine role of banking • Curtail 'shadow banking' and financial speculation (e.g. FTT)
Workers' rights	• Casualisation of work • Part-time work and irregular work • Erosion of working conditions	• Strengthen minimum standards including pay and pensions • Support trade union activity • Adapt protections to include the changing nature of paid work
Incomes policy	• Wage stagnation • 'Poverty traps' and welfare dependency	• Increase the wage share of total income

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