NERI Quarterly Economic Observer

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Key Economic Trends

	2007	2008	2009	2010	2011	2012	2013
Total Employment (% of working-age population)							
ROI	69.2	67.6	61.9	59.6	58.9	58.8	60.5
NI	68.4	67.8	64.7	66.1	67.4	67.3	66.9
UK	71.5	71.5	69.9	69.9	69.5	70.1	70.8
Euro area	65.5	65.9	64.5	64.1	64.2	63.8	63.5
Unemployment (% of labour force)							
ROI	4.7	6.4	12.0	13.9	14.7	14.7	13.1
NI	4.0	4.5	6.5	7.1	7.2	7.5	7.6
UK	5.3	5.6	7.6	7.8	8.0	7.9	7.5
Euro area	7.5	7.6	9.6	10.1	10.1	11.3	12.0
Gross Domestic Product (% volume change over previous year) – *NI output refers to GVA*							
ROI	5.0	-2.2	-6.4	-1.1	2.2	0.2	-0.3
NI	8.8	-1.0	-3.2	1.8	0.4	1.2	N/A
UK	3.4	-0.8	-5.2	1.7	1.1	0.3	1.7
Euro area	3.0	0.4	-4.5	1.9	1.6	-0.7	-0.4

Economic Outlook for the Republic of Ireland

- Our outlook is for continued improvement in employment and output in 2014 and 2015
  - A return to growth in personal consumption in 2014 after a decline in 2013.
  - A strong return to growth in investment; albeit from a very low base
  - Continued improvement in employment and a fall in the unemployment rate
- A number of concerns remain
  - High levels of public and private indebtedness
  - Weak credit conditions
  - High levels of long-term unemployment and youth unemployment
- There are risks to the forecast
  - Hysteresis effects are a potential threat to recovery
  - Supply side shocks arising out of geopolitical difficulties
  - The threat of deflation in the Euro area

Economic Outlook for Northern Ireland

- Economic recovery will start to take hold with modest increases in employment and output
  - The pace of the recovery will continue to lag that of the UK
  - Prospects are somewhat unclear due to the potential impacts of the Scotland independence referendum and next May’s general election in the UK
    - The result of the independence referendum may threaten the continuance of the current method of apportioning public expenditure in the UK, the Barnett formula
    - The result of the general election has implications for the UK’s membership of the EU

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

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	2013 values	2013	2014	2015	2016
National Income		*Percentage real change over previous year*			
Gross Domestic Product	€164.1bn	-0.3	2.1	2.9	3.0
Personal Consumption	€83.1bn	-1.1	1.1	1.2	1.3
Investment	€18.4bn	4.2	9.9	8.0	7.0
Government Consumption	€25.1bn	-0.5	-0.9	-1.6	0.0
Exports	€177.1bn	0.2	2.3	3.2	3.3
Imports	€138.7bn	1.0	2.4	2.7	2.9
Government Finances		*Percentage of GDP*			
General Government Balance	€11.8bn	-7.2	-4.7	-2.5	-1.8
Gross Debt	€202.9bn	123.7	118.7	116.4	113.1
Labour Force		*Percentage change over previous year*			
Employment	1,881,150	2.3	2.2	1.9	1.9
		Percentage of Labour Force			
Unemployment	282,200	13.0	11.5	10.7	9.9

Range of Projections for Annual Change in Real GDP (ROI)

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	2014	2015	2016	2017	2018
NERI	2.1	2.9	3.0		
Department of Finance (April 2014)	2.1	2.7	3.0	3.5	3.5
Central Bank of Ireland (April 2014)	2.0	3.2	-	-	-
European Commission (May 2014)	1.7	2.9	-	-	-
IMF (April 2014)	1.7	2.5	-	-	-
OECD (May 2014)	1.9	2.2	-	-	-
ESRI (April 2014)	2.6	3.5	-	-	-
Investec (April 2014)	2.0	2.2	2.2	-	-

Public Finances in the Republic of Ireland

- The Republic's public finances remain fragile and a 'Do Nothing' stance in Budget 2015 will be insufficient to restore the public finances to a sustainable path
  - The deficit will be close to 4.7% of GDP in 2014 and gross debt will be almost 119% of GDP
  - 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%
- Government revenue as a percentage of GDP is very low by Western European standards
  - There is no room for tax cuts 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
- On the balance of evidence, Ireland's structural deficit is now close to zero, albeit marginally in deficit. This implies there is minimal need for additional discretionary consolidation

General Government Revenue and Expenditure

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IMF Estimates and Projections, (Per cent 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

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

Tax Revenues (including SSCs), Ireland & EU

(Percent 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

Fiscal Policy Options

- Fiscal policy is not just about deficit reduction
    - A delicate balancing act and there is unquestionably a strong public interest in controlling the deficit and the national debt
        - Sustainability, creditworthiness and stability, intergenerational fairness
        - A large debt overhang is a potential drag on long-run growth and output potential
    - Yet the larger the budgetary adjustment, the greater the impact in terms of reduced domestic demand, lower short-run growth, and higher unemployment
        - Short term losses can be 'sticky'
        - There are also hysteresis effects which can become structural within the economy and (loss of human capital, business closures, a reduced capital stock) which can permanently reduce potential output
        - Long-term unemployment; loss of potentially viable businesses

Global Competitiveness Rankings and Government Revenue, 2013, (Per cent 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			

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.

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
  - Our projections indicate a €2 billion adjustment of the type suggested in budgetary documentation will lead to a public deficit of 2.5% in 2015
- The actual impact on employment, unemployment, growth and the deficit will depend on the size and the composition of the adjustment
  - 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
- NERI is proposing an €800 million adjustment in Budget 2015 based on a three pronged strategy

Composition of the Adjustment

- The budget is about choices
  - Fiscal consolidation with equity and growth
    - Important to choose the fiscal instruments with the best welfare outcomes
    - Diminishing returns to consolidating each instrument
- NERI is proposing a three pronged strategy
  - A discretionary fiscal adjustment composed mainly of increases in government revenue
  - An accompanying investment package that restores annual public investment in the Republic to the EU average in 2015
  - A modest increase in social spending as part of a social emergency fund targeted at the most vulnerable individuals and communities

NERI's Proposed Fiscal Stance for Budget 2015 (€millions)

Contraction	(€millions)	Expansion	(€millions)
Revenue	**900**		
Taxes on wealth *(CAT and Net Wealth Tax)*	200		
Reform of tax expenditures	100		
Employer PRSI	100		
Water charges	500		
Expenditure	**300**	**Expenditure**	**400**
Carryover *(including HRA)*	300	Capital spending *(Social Housing)*	200
		Current spending	200
Total Fiscal Contraction	**1,200**	**Total Fiscal Expansion**	**400**
Net Fiscal Contraction	**800**		

Estimated Differences in 2015: Output, Employment and the Public Finances, (Percentage Point Difference)

	Government Plan vs. 'Do Nothing'	NERI Plan vs. 'Do Nothing'	NERI Plan vs. Government Plan
GDP Growth	-1.2	+0.7	+1.9
General Government Balance	+0.8	+0.8	+0.0
Employment (Persons)	-16,500	+18,100	+34,600
Unemployment Rate	+0.8	-0.9	-1.7

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