Summer Economic Statement 2018

Opening statement by Mr Paschal Donohoe, T.D.,
Minister for Finance and Public Expenditure and Reform

11th July 2018

Introduction

Good evening.

I welcome the opportunity to be here today to discuss the Summer Economic Statement.

The Statement sets out the key elements of the Government's budgetary strategy over the medium-term. Broadly speaking this revolves around five key areas:

- Ensuring steady and sustainable improvements in living standards
- Rebuilding fiscal capacity
- The need for prioritisation and realism
- The need to avoid pro-cyclical fiscal policies
- That budgetary policy will focus on ensuring fiscal sustainability

In the short term, the Statement sets the framework for discussions on Budget 2019 over the coming months.

Economic Developments

In terms of the macro-economic situation, a suite of economic indicators confirm that the Irish economy is growing at a healthy pace.

My Department is forecasting GDP growth of 5.6 per cent this year and 4.0 per cent next year.

From 2020 onwards, GDP is expected to grow broadly in line with the potential growth rate of the economy with positive contributions from both exports and domestic demand.

Labour Market

Importantly, the strong growth performance is paying dividends in the labour market where there are now more people at work than ever before.

In parallel, the unemployment rate has fallen from a peak of 16 per cent in early-2012 to 5.1 per cent in June 2018.

Encouragingly, the number of people who are unemployed for one year or more continues to fall from over 200,000 in 2012 to 50,000 in the first quarter of this year.

These figures are a testament to the success of the *Government's Action Plan for Jobs* and *Pathways to Work*.

Indeed, we are fast approaching full employment. In this context, it is crucial that budgetary policy is managed in a way that does not overheat the economy.

Durable improvements in living standards

As I said when to the Dáil when presenting the Statement to the House, well-managed economies are characterised by durable improvements in living standards rather than the all-or-nothing approach that has been a feature of Irish economic history, especially in more recent times.

Our economic performance has been less consistent than that of other small open economies. Our propensity to suffer economic shocks and resilience to withstand such shocks has been out of line with countries with which we can compare ourselves.

When we pursued a pro-cyclical approach to fiscal policy, our comparator countries witnessed incremental and sustainable increases in living standards and retained their national sovereignty when the global financial crisis struck.

To avoid repeating the mistakes of the past, it is critical that we are constant in our approach. In essence, this means deciding on the appropriate economic and social model for the country and having the political commitment and consensus to stick with it across many different cycles.

Fiscal Developments

Turning to the public finances, the latest Exchequer Returns were very positive with cumulative receipts ahead of target and up 5.4 per cent year-on-year.

We are now well positioned in terms of achieving the overall annual tax target of €54.2 billion for 2018.

This provides further evidence that the public finances are being positioned on a sustainable footing.

Against this positive backdrop, we plan broadly to balance our books by running a very small deficit next year of **0.1 per cent of GDP**.

This reflects the political choices we have made in Project Ireland 2040 and the National Development Plan to increase capital spending substantially by €1.5 billion or 25 per cent next year, bringing capital expenditure to in excess of €7 billion.

We are prioritising capital spending in our schools, hospitals, universities and public transport system to address the serious infrastructural deficits that emerged during the recession and to position our economy and society for the opportunities and threats ahead.

However, the Government will not adopt taxation and spending measures that result in a deficit larger than 0.1 per cent of GDP.

This would accommodate a budgetary package of €3.4 billion, of which €2.6 billion has been pre-committed to expenditure measures leaving €0.8 billion for further allocation.

Any unfunded taxation or expenditure measures that go beyond this would necessarily involve even more borrowing and will result in a subsequent increase in the deficit position.

Let me stress what borrowing is: it is **spending other people's money** and, of course, it will have to be repaid.

Targeting minimum compliance with the expenditure benchmark allows an additional €0.9 billion but this would increase the deficit by 0.3 per cent of GDP.

If the Rainy Day Fund was also used instead to increase expenditure by €0.5 billion next year it would increase the deficit by a further 0.2 per cent of GDP.

The total impact of spending the €900 million and the €500 million dedicated to the rainy day fund would increase the deficit from 0.1 per cent of GDP to a **deficit of 0.6 per cent of GDP**.

This would be highly inappropriate at this stage of the cycle and would ensure that we are in breach of the fiscal rules as we would miss our medium-term objective (MTO) next year.

Fiscal rules

However, even if such spending was allowed under the rules it would not be appropriate in the current circumstances for a number of reasons.

Firstly, fully applying the rules would involve the adoption of pro-cyclical policies not remotely appropriate to our position in the economic cycle.

Secondly, with a debt to GNI* ratio of 100 per cent last year the focus must be on balancing the books and using windfall receipts to reduce public debt.

Finally, risks to the global economy are increasingly titled to the downside. In this context, the priority must be to rebuild fiscal buffers so that the Irish economy can best absorb economic shocks if and when they occur.

So I want to stress that the artist formerly known as fiscal space will not be getting a second airing.

Instead, the Summer Economic Statement makes it clear that budgetary policy will be designed on the basis of what is right for the economy in order to ensure continued, steady improvements in Irish employment and living standards **underpinned by stable and predictable tax revenue**.

Public Expenditure

Indeed, incremental and sustainable improvements in public services are always to be preferred over the 'feast-or-famine' alternative.

Expectations have increased given the remarkable performance of our economy.

However, I want to make it clear that not all demands can be met.

In the first instance, expenditure continues to exceed revenue and we are still borrowing to meet the shortfall; if more resources are allocated, the deficit would be even larger.

Excessive levels of expenditure in an economy at full employment entails risks.

Instead, the Government will prioritise spending that mitigates risk, enhances the resilience of the economy and raises our growth capacity.

In this context, the Government has set out its vision for Ireland over the medium term in Project Ireland 2040.

This includes the National Development Plan (NDP) and is the blueprint for Ireland's sustainable development – economically, socially and environmentally – for the future.

The NDP will improve our public infrastructure to ensure that all can benefit from the fruits of economic growth.

The provision of public services can also be enhanced – within existing allocations – by reforming the way public services are delivered.

Each year, central Government spends over €60 billion; I am convinced that there remains scope to improve the efficiency with which this is allocated.

The spending review, which will be published in July, will be crucial in this regard.

It is also vital that we **maintain a broad tax base** that generates a sustainable revenue stream necessary to fund public services.

We cannot build permanent expenditure commitments on revenues that may not be sustainable.

This is why the Government is setting aside some of the historically high levels of Corporation Tax for the purpose of creating the Rainy Day Fund.

Conclusion

While the latest economic data all point to an economy with considerable momentum, a continuation of robust growth cannot be taken for granted given the increasingly uncertain external environment.

The UK's imminent exit from the European Union, changes in the international corporate tax landscape, and the possibility of disruptions to the global trading system are some of the principal risks facing the Irish economy at present.

More generally, it's important to consider whether the reasonably favourable external conditions we have faced in recent years were actually another wave of the 'great moderation'.

If these conditions were to deteriorate in the coming years what would be the impact on the economy.

In this context, it is essential that we build up our fiscal capacity in order to respond to these challenges.

This is why the Government is prioritising reducing public debt, establishing a Rainy Day Fund, and avoiding pro-cyclical budgetary policies.

While there are risks ahead, there are also great opportunities. Of course, economic growth is a means to an end and not an end in itself – it enables us to pursue our goals of advancing social progress, promoting inclusivity and providing high quality public services.

This will help ensure that we achieve our objective of steady and sustainable improvements in living standards in our Republic.

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