Opening Statement – Oireachtas Committee on Budgetary Oversight

'The Updated Economic and Fiscal Position in advance of Budget 2023 and additional one-off measures for 2022'

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Introduction

Let me start by thanking the Chair and the members and staff of the Committee for the invitation to appear before you today. I am accompanied by my NERI colleague and economist Paul Goldrick-Kelly.

The NERI is very grateful for this opportunity to present our views on the economic and fiscal position. I will begin by discussing the economic context and labour market developments before discussing the appropriate role of fiscal policy and various options.

Economic context and outlook

Western economies generally recovered quickly from the pandemic. However, the bounce back in demand came up against significant supply constraints and disruptions arising from the lockdowns. The resultant inflationary pressures were then exacerbated by the war in Ukraine and the further rise in global commodity prices. Rising prices have prompted central banks to raise interest rates and otherwise tighten policy. Rising prices have also precipitated a decline in real incomes and a worsening cost of living crisis in many countries.

Global growth is now weakening. The UK economy is projected to be in recession by the end of this year, with price inflation continuing to eat into real incomes and the volume of demand. Similarly, the emerging combination of tightening monetary policy, declining real incomes, and weakening consumer confidence means that there is now a meaningful risk of the United States, and especially the Euro area, falling into recession.

Ireland's own recovery held up well in the second quarter with strong growth in investment in machinery and equipment, new dwelling construction and service consumption although retail sales have softened in recent months. We don't project a technical recession in the short-run but we do anticipate a weakening of growth in demand.

The labour market is now close to full employment and hours worked in the economy is at a record level. The unemployment rate was 4.3% in August with the job vacancy rate elevated over pre-pandemic levels. The composition of employment has generally shifted towards more high value sectors – a very positive development. However, the CSO employee index suggests that net employment has stalled in recent months.

Real incomes and living standards will actually fall for most households this year, notwithstanding the tight labour market. Inflation projections are especially tentative at the moment, but our baseline view is that economy-wide price inflation is likely to average over 8% this year, but reach 10% for lower income households. This is because such households generally spend a higher portion of their incomes on the type of necessities such as energy, food and rent that are experiencing the sharpest price increases.

Fiscal position and fiscal policy

We will see a significant rise in deprivation rates for those on fixed incomes in the absence of meaningful fiscal or regulatory interventions from government. The NERI's view is that all social assistance increases in Budget 2023 should at least match inflation in order to protect real incomes and to ensure that no one is left behind by the cost of living crisis.

Budget 2023 can help dampen inflationary pressures by focusing on targeted measures to reduce the cost of using public services such as education, public transport and healthcare.

Once off measures related to current spending generally make poor policy. Particularly given that prices are unlikely to fall in the short-to-medium term. However, the ongoing energy crisis is placing considerable pressure on household budgets. Government's response must support households in need, while remaining consistent with longer-term objectives of reduced energy use and decarbonisation of supply. Government could explore direct payments and/or adjusted energy rates to soften the impact of these price shocks. We are happy to discuss further in the questions and answers.

Fortunately, the public finances are in a reasonably strong position. Tax receipts have been buoyant this year with a modest projected surplus in both 2022 and 2023, albeit the position is flattered by the surge in corporation tax receipts. Most of our debt is fixed at low interest rates.

Our view is that the expected €6.7 billion budgetary package is broadly appropriate in terms of the fiscal stance, and strikes a good balance. Supporting the economy but not overly inflationary.

Budgetary supports should be targeted on those households likely to experience distress and Government should not attempt to chase inflation for all households. Higher income households have generally built up significant savings during the pandemic with aggregate household deposits rising sharply. Many of these households can absorb the hit to their real incomes by reducing their rate of savings. Such households do not need fiscal support from government to manage the cost of living crisis and are unlikely to experience any qualitative decline in their living standards.

In particular, the stated plan to cut taxes for middle and higher earners seems unwise to us. Income tax cuts are very badly targeted in terms of helping the households experiencing income adequacy issues, and they will push against the need to temper inflation.

The government should also remain conscious of the very significant medium-to-long run fiscal pressures from age-related demographic change, pressures from the investment and other costs of the climate transition, and pressures from the gradual loss of receipts from fuel excises as Ireland achieves its climate targets. This is before we even consider the existing spending deficits in areas like childcare, education, R&D and public housing. The reliance on corporation tax receipts is a further worry as it means the health of the public finances depends on the performance of a small sub-set of firms.

Our view is therefore that any tax cuts should be fully offset by tax increases in other areas. For example, by eliminating certain tax breaks and increasing taxes on capital.

Conclusion

To conclude.

The fundamental position remains strong but falling incomes presage weaker demand, while high inflation is causing income adequacy issues for some households.

We have the fiscal resources to fully protect vulnerable households provided the government takes a targeted approach in the Budget.

Paul and I are happy to take any questions or elaborate upon any of our points. Thank you.

Appendix

Table 1 Real economic growth rates (annual change, %), GDP unless stated

	20' Q2	21' Q1	21' Q2	21' Q3	21' Q4	22' Q1	22' Q2
Euro area	-14.7	-0.9	14.7	4.0	4.7	5.4	3.9
UK	-21.1	-5.0	24.5	6.9	6.6	8.7	2.9
US	-9.1	0.5	12.2	4.9	5.5	3.5	1.7
Germany	-10.5	-2.1	10.1	1.9	1.2	3.6	1.7
China	3.2	18.3	7.9	4.9	4.0	4.8	0.4
Japan	-10.2	-1.7	7.3	1.2	0.4	0.2	
Russia	-7.4	-0.3	10.5	4.0	5.0	3.5	-4.0
Ireland							
GDP	*1.4*	*11.4*	*19.5*	*10.4*	*13.8*	*10.8*	*11.1*
MDD	*-12.7*	*-5.1*	*14.7*	*3.9*	*10.4*	*12.8*	*10.6*

Notes: Irish GDP data is distorted by the outsize activities of a small number of multinationals. Modified Final Domestic Demand gives us a better understanding of the performance of the domestic facing economy.

Sources: Eurostat: *GDP main aggregates*, CSO: *Quarterly National Accounts*, Trading Economics: *GDP data*.

Table 2 Consumer Prices (Annual Change, %), HICP Unless Stated

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Euro	5.1	5.9	7.4	7.4	8.1	8.6	8.9	9.1
UK	5.5	6.2	7.0	9.0	9.1	9.4	10.1	-
US	7.5	7.9	8.5	8.3	8.6	9.1	8.5	-
Germany	5.1	5.5	7.6	7.8	8.7	8.2	8.5	8.8
China	0.9	0.9	1.5	2.1	2.1	2.5	2.7	-
Japan	0.5	0.9	1.2	2.5	2.5	2.4	2.6	
Russia	8.7	9.2	16.7	17.8	17.1	15.9	15.1	-
Ireland	5.0	5.7	6.9	7.3	8.3	9.6	9.6	8.9

Notes: US (PCE), UK, Russia, Japan and China (CPI); August data are preliminary estimates

Sources: Eurostat: *Inflation – Flash Estimate*, Trading Economics, US Federal Reserve, Bank of England

Table 3 Labour market snapshot, 2nd quarter

All Q2	2019	2021	2022	19-22 %Δ
Population aged 15 and over ('000s)	3912.6	4015.9	4063.5	3.9
Labour Force ('000s)	2427.0	2533.2	2674.5	10.2
Employment ('000s)	2296.2	2349.1	2554.6	11.3
Employment rate, 15-64 (%)	69.0	68.6	73.5	4.5pp
Employment rate 20-24 (%)	64.1	60.4	69.2	5.1pp
Full time employed ('000s)	1835.0	1872.6	2010.5	9.6
Part time employed ('000s)	461.0	476.5	544.1	18.0
Actual hours worked (millions)	78.51	75.88	83.03	5.8
Average hours worked	36.6	36.0	36.3	-0.8
Unemployed ('000s)	130.9	184.1	119.9	-8.4
Unemployment rate (%)	5.4	7.3	4.5	-0.9pp
Unemployment rate 20-24 (%)	12.3	16.3	8.6	-3.7pp
Long-term unemployed ('000s)	40.8	49.5	31.8	-22.1
Long-term unemployment rate (%)	1.7	2.0	1.2	-0.5pp
Participation rate (%)	62.0	63.1	65.2	+3.2pp

Notes: Aggregate 2021 data is significantly distorted by the pandemic but is shown for reference; seasonally adjusted unemployment rate was 4.3% in August; pp = percentage point

Sources: CSO: *Labour Force Survey*

Table 4 Employment by sector, thousands or % change, 2nd quarter

All Q2	2019	2021	2022	19-22 %Δ	2022 Share %
Agriculture, forestry, fishing	100.6	107.9	105.8	5.2	4.1
Construction	146.2	127.3	167.3	14.4	6.5
Industry	282.2	311.5	321.1	13.8	12.6
Wholesale, retail, vehicle repair	297.8	302.7	321.2	7.9	12.0
Transport & storage	105.8	100.4	110.9	4.8	4.3
Accommodation, food services	180.8	120.9	168.2	-7.0	6.6
ICT	117.5	141.0	164.9	40.3	6.5
FIRE	112.8	131.6	130.9	16.0	5.1
Professional, scientific & tech	139.1	158.3	166.7	19.8	6.5
Administration & support	109.7	97.4	105.9	-3.5	4.1
Public admin & defence	111.6	128.8	127.2	14.0	5.0
Education	178.8	212.6	215.5	20.5	8.4
Human health & social work	286.9	305.8	331.1	15.4	13.0
Other activities	119.7	97.8	108.6	-9.3	4.3
Not stated	6.9	*	9.1	31.9	0.4
All sectors	2296.2	2349.1	2554.6	11.3	100

Sources: CSO: *Labour Force Survey;* FIRE is Financial, insurance and real estate

Table 5 Employee Index from Administrative Data Sources, 2022 (June unless stated)

	Index (Non-SA)	Index (SA)
2019	101.0	100.8
2020	90.7	90.5
2021	100.1	99.9
January	106.1	106.0
February	105.1	107.1
March	106.4	108.2
April	107.0	108.9
May	107.6	108.4
June	108.1	107.9

Notes: 2019 = 100

Sources: CSO: *Monthly Estimates of Payroll Employees Using Administrative Data*

Table 6 Job vacancy rate by economic sector, 2nd quarter

All Q2	2019	2021	2022
Construction	1.1	1.0	1.7
Industry	0.6	1.0	0.9
Wholesale, retail, vehicle repair	0.8	1.0	1.1
Transport & storage	0.2	0.7	1.1
Accommodation, food services	1.6	0.4	1.1
ICT	1.9	2.3	2.1
FIRE	1.7	2.1	3.1
Professional, scientific & tech	2.5	2.2	4.4
Administration & support	1.1	2.2	1.9
Public admin & defence	1.6	2.1	2.3
Education	1.3	1.1	1.5
Human health & social work	0.6	0.6	0.9
Arts, entertainment & other	1.2	1.4	1.8
All sectors	1.1	1.2	1.6

Note: JVR = number of job vacancies/ (number of occupied posts + number of job vacancies) *100

Sources: CSO: *Labour Force Survey*

Table 7 Weekly earnings by sector, € or % change, 2nd quarter

All Q2	2019	2021	2022	19-22	21-22
HICP	102.0	103.0	111.6	9.4	8.3
CPI	102.4	103.5	111.8	9.2	8.0
Industry	898.55	942.39	993.31	10.5	5.4
Construction	789.40	834.24	907.17	14.9	8.7
Wholesale, retail, vehic repair	593.43	634.07	660.77	11.3	4.2
Transport & storage	846.43	794.61	870.10	-1.8	9.5
Accommodation, food service	365.97	377.67	404.80	10.6	7.2
ICT	1198.52	1299.98	1442.80	20.4	11.0
FIRE	1151.37	1219.28	1280.09	11.2	5.0
Professional, scientific & tech	952.94	1028.22	1072.82	12.6	4.3
Administration & support	618.19	694.92	717.42	16.1	3.2
Public admin & defence	972.60	1023.15	1023.86	5.3	0.1
Education	852.77	929.30	913.96	7.2	-1.7
Human health & social work	749.62	783.19	808.19	7.8	3.2
Arts, entertainment & other	498.42	557.28	588.71	18.1	5.6
All sectors	771.63	850.81	871.62	13.0	2.4
Private sector	711.04	791.13	819.36	15.2	3.6

Notes: CPI index is December 2016 = 100; HICP index is 2015 = 100

Sources: CSO: *Earnings and Labour Cost Quarterly, Consumer Price Index*

Table 8 Hourly earnings by sector, € or % change, 2nd quarter,

All Q2	2019	2021	2022	19-22	21-22
HICP	102.0	103.0	111.6	9.4	8.3
CPI	102.4	103.5	111.8	9.2	8.0
Industry	23.38	24.79	25.95	11.0	4.7
Construction	21.42	22.49	24.46	14.2	8.8
Wholesale, retail, vehic repair	19.36	20.46	21.28	9.9	4.0
Transport & storage	23.84	22.50	23.34	-2.1	3.7
Accommodation, food service	13.29	15.63	15.05	13.2	-3.7
ICT	32.13	34.68	38.80	20.8	11.9
FIRE	33.16	35.17	36.85	11.1	4.8
Professional, scientific & tech	27.94	29.48	31.58	13.0	7.1
Administration & support	18.48	22.03	22.26	20.5	1.0
Public admin & defence	26.29	28.44	28.99	10.3	1.9
Education	36.16	37.84	38.79	7.3	2.5
Human health & social work	23.75	24.30	25.57	7.7	5.2
Arts, entertainment & other	17.61	19.93	20.39	15.8	2.3
All sectors	23.69	26.07	26.78	13.0	2.7
Private sector	21.87	24.20	24.98	14.2	3.2

Notes: CPI index is December 2016 = 100; HICP index is 2015 = 100

Sources: CSO: *Earnings and Labour Cost Quarterly, Consumer Price Index*

Table 9 Tax revenue (inc SSCs), selected countries, % of GDP (GNI* for Ireland), 2019

Country	Labour	Consumption	Capital	Total
EU27	20.7	11.1	8.2	**40.1**
Germany	23.2	10.2	6.9	**40.3**
Denmark	22.8	13.4	9.8	**46.1**
France	21.2	11.7	11.0	**45.5**
Netherlands	19.6	11.8	7.9	**39.3**
Belgium	21.9	10.8	10.6	**43.6**
United Kingdom	13.0	11.1	9.7	**33.8**
Italy	21.2	11.3	9.8	**42.3**
Sweden	25.0	12.1	5.9	**43.0**
Ireland				
Eurostat *(Tax Trends)*	16.0	11.3	9.5	**36.9**
CSO *(Government Finance)*				**37.7**
Negative Tax Gap to EU27 (€ billions)				*5.1*

Notes: SSCs are Social Security Contributions.

Sources: Eurostat: *Taxation Trends in the European Union*, CSO: *National Accounts*, CSO: *Government Finance Statistics*, McDonnell, T (2021) *How is heavy is the weight of tax*, NERI Research in-Brief No. 79

Table 10 Tax revenue from labour, selected countries, % of GDP (GNI* for Ireland), 2019

Country	Employee	Employer	Non-employed	Total
EU27	10.2	8.2	2.3	**20.7**
Germany	13.5	6.9	2.9	**23.2**
Denmark	17.2	0.7	5.0	**22.8**
France	8.8	12.4	1.7	**22.9**
Netherlands	10.1	5.5	4.0	**19.6**
Belgium	12.0	7.9	2.0	**21.9**
United Kingdom	8.8	3.9	0.2	**13.0**
Italy	8.4	9.8	3.0	**21.2**
Sweden	10.3	11.9	2.7	**25.0**
Republic of Ireland				
Eurostat *(Tax Trends)*	11.5	4.3	0.2	**16.0**

Sources: See Table 9

Table 11 Implicit tax rates (ITR) in selected countries, 2019

Country	Labour	Consumption	Capital
EU27	38.1	17.4	-
Germany	38.1	15.8	31.2
Denmark	34.6	24.0	41.9
France	39.9	18.3	54.2
Netherlands	32.5	19.7	15.9
Belgium	40.4	17.7	35.1
United Kingdom	25.7	15.2	31.5
Italy	43.8	16.2	30.4
Sweden	39.0	21.6	27.0
Republic of Ireland	33.5	19.4	14.1

Sources: European Commission (2021) Taxation and Customs Union, Data on Taxation;

Table 12 Decomposition of the implicit tax rate on labour in selected countries, 2019

Country	Employee PIT	Employee SSC	Employee Total	Employer SSC & PT	Total
EU27	*12.6*	*8.6*	21.1	17.0	38.1
Germany	*13.3*	*11.9*	25.2	12.9	38.1
Denmark	*33.2*	*0.1*	33.3	1.3	34.6
France	*9.7*	*6.8*	16.5	23.4	39.9
Netherlands	*10.7*	*10.4*	21.1	11.4	32.5
Belgium	*16.0*	*8.3*	24.3	16.1	40.4
United Kingdom	*12.6*	*5.2*	17.8	8.0	25.7
Italy	*14.4*	*5.9*	20.3	23.5	43.8
Sweden	*18.1*	*0.0*	18.1	20.9	39.0
Republic of Ireland	*19.7*	*4.6*	24.3	9.2	33.5

Notes: PIT is Personal Income Tax. SSC is Social Security contribution. PT is Payroll Tax

Sources: See McDonnell, T: NERI Research in-Brief No. 79