

Opening Statement – Oireachtas Committee on Budgetary Oversight

‘Views on the Overall Budgetary Package as set out in the Summer Economic Statement and Specific Issues to be addressed in the Budget’

Dr Tom McDonnell and Ciarán Nugent, NERI

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1. Introduction

The NERI would like to thank the Cathaoirleach and the members and staff of the Committee for the invitation to appear before you and present our views on the economy, on the budgetary package, and on compositional issues. My name is Tom McDonnell and this is my colleague Ciarán Nugent.

2. Economic context and outlook

A correct understanding of whether the economy is overheating, in recession, or somewhere else along the cycle, matters greatly for budgetary policy and for the appropriate fiscal stance taken by Government.

If the economy is in a downswing then it makes sense for Government to stimulate the economy in a Keynesian fashion. The opposite is true if the economy is overheating. Unfortunately, Irish governments have a long and unhappy history of pro-cyclical budgets.

Our analysis is that the economy is close to overheating. Employment rates and hours worked are at or close to record levels, with employment growing by 3.5% in the year to the second quarter. The unemployment rate of 4.1% and long-term unemployment rate of 1.2% are also highly suggestive of a tight labour market. There are evident labour shortages and capacity constraints in sectors such as construction and ICT. Consumption and retail sales continue to grow at reasonably strong rates year-on-year. Demand has been supported by the winding down of savings from their pandemic era highs as well as by fiscal stimulus.

However, price inflation remains a significant issue with the CPI increasing 6.3% year-on-year in August.¹ In particular, there is concern that inflation is becoming sticky with core inflation

¹ In contrast the HICP increased 4.9% year-on-year and has been below 5% for the last three months. The difference between the outturn for the CPI and the HICP is primarily attributable to the rising cost of mortgage

at 6.4%. Real wage growth was negative in the second quarter as hourly (5.1%) and weekly (4.3%) earnings growth failed to keep up with inflation. We expect that positive real wage growth will resume by the end of this year although this is predicated on no major upward shocks to inflation.

The outlook for the next six to twelve months is mixed. Tightening monetary policy is exerting downward pressure on trading partner economies and will gradually depress demand in the Irish economy. Consumer sentiment indicates a broadly negative perception of future economic activity and prospects, amidst high inflation and pressure on household finances. Construction and manufacturing PMIs imply a broadly stagnant outlook, although the services PMI suggests some positive growth momentum.

Overall, there is a sense of winners and losers. Net household wealth has reached record levels and corporate profits are healthy but deprivation rates are on the rise.

3. Fiscal position

3.1 Short-run

The short-run fiscal position is healthy. This is mainly due to the surprisingly robust and potentially unsustainable performance of the corporation tax yield. The risks underlying a reliance on an elevated corporation tax yield are well understood, with circa €12 billion in receipts potentially transitory in nature. Even so, the shift to a 15% rate will likely further boost receipts in 2024. Ireland is expected to be just one of two Euro area countries to run a surplus in 2024 while Ireland's debt level expressed as a percentage of GNI* is below the Euro area average. However, it should also be noted that with the economy and labour market performing so strongly, the structural budget balance is actually somewhat worse than the headline budget balance.

3.2 Medium-to long-run

The medium-to-long term fiscal position is extremely challenging. Age related expenditure is projected to increase by 3.3% of GNI* by 2030 and will rise further in the following decades. Climate action will lead to diminished revenues from fossil fuels and to greater expenditure

interest repayments (+51.3% year-on-year). The main contributors to annual inflation are currently mortgage interest, rents, electricity, gas and solid fuels, food, restaurants and hotels, and the cost of holidays.

in a range of areas while the corporation tax yield is extremely vulnerable to evolving tax games and decisions made in other countries.

Ireland's per capita public spending is low relative to peer high-income EU countries. To meet the challenges of the future – for example, demographics, decarbonisation and digitalisation - we will need to increase public investment in health and social care, in childcare, education and training, in energy and water infrastructure, in broadband, in public transport, and in the direct costs arising from demographic change and from the green and digital transitions,

Overall, we strongly agree with the analysis of the Commission on Taxation and Welfare (COTW) that government revenue must increase materially as a percentage of national income. Tax cuts are obviously problematic in this context particularly when we are so reliant on potentially transitory corporation tax receipts.

4. Budgetary design and options

4.1 Managing Windfalls

It would be unwise to use 'windfall' receipts to fund current spending increases or permanent tax cuts. Adjusted measures of the budget balance that exclude these receipts are therefore helpful in properly framing the debate.

The Department of Finance is proposing to use the transitory receipts to set-up a State savings vehicle in order to part pay for future ageing costs. There is certainly merit in this strategy. Once the fund is large enough the annual return will effectively amount to a new revenue stream that reduces medium-to-long-term pressure to increase taxes. But there is scope to do this and also to set up one or more infrastructure funds. For example, to support the green transition over the next 20 years and to address the housing crisis. Regardless of how we use the transitory funds we will still need significant structural revenue increases over the medium-term to pay for future ageing and other costs.

4.2 The Budgetary Stance

Budgetary policy should be countercyclical. When the economy is overheating it is generally prudent to adopt a relatively tight fiscal policy, and vice versa during periods of underperformance. The budget – in its current form – will modestly add to overheating and to inflation, while proposed income tax cuts will disproportionately benefit the better off.

We note the Fiscal Council's most recent estimate that stand-still costs for core current spending will amount to €4.6 billion. This exceeds the Summer Economic Statement's proposed current spending increase of €4.3 billion with obvious implications for public services. Crucially, the fiscal rules allow us to increase spending by as much as we want each year provided that there are offsetting measures that increase taxes.

4.3 Budgetary Options: Reconciling Cost of Living Pressures versus Inflation Pressures

Clearly there is a tension between successfully addressing the cost of living crisis and simultaneously avoiding further inflationary pressure. Yet cost of living pressures are not universal. Household savings are above the historical average and household net wealth is at record levels. Median net wealth for owner-occupiers was over 300,000 for owner-occupiers in 2020 but just €5,300 for renters.

We **do** need to protect low income households from cost of living pressures — not half-heartedly through once-off measures as was done last year — but through structural uplifts in child, working age and old age payments that adequately benchmark against wages and the cost of living. Increases to all welfare payments should fully compensate for the surge in price inflation that we have experienced. The minimum wage should be increased to a genuine living wage. In addition, targeted reductions in end-user costs for public services such as transport, health and education would help alleviate cost of living pressures without stoking inflation.

Once-off measures only make sense if we expect the inflation rate to be negative. This strategy should not be repeated in Budget 2024. A related point is that we need to move to multi-annual budgeting and to a holistic and evidence-based approach to incomes policy that is actually based on adequacy and the cost of living. We support the COTW proposals for a second tier of child benefit and for an enhanced working family payment based only on income.

However, we strongly caution against tax cuts in Budget 2024. The evidence is clear that cuts to income tax or to the USC will be highly regressive in the sense that higher income households will disproportionately benefit from changes to rates and bands. Finally, tax cuts of this nature will not just make it more difficult to meet pre-existing and future challenges but they will also be pro-cyclical and inflationary.

Appendix

Table 1: Tax revenue (including SSCs), % of GDP (GNI* for Ireland), 2021

Country	Labour	Consumption	Capital	Total
EU27	20.9	11.2	8.5	40.7
Germany	23.0	10.3	7.7	41.1
Denmark	24.3	13.4	10.4	48.1
France	22.9	11.7	10.5	45.1
Netherlands	19.4	11.9	8.3	39.7
Belgium	22.0	10.9	10.6	43.6
Finland	21.1	13.8	8.2	43.0
Sweden	24.2	11.9	6.7	42.8
UK (2019)	13.0	11.1	9.7	33.8
Ireland (Rep.)				
Eurostat (<i>Tax Trends</i>)	16.2	10.9	11.2	38.5
<i>Tax Gap to EU27 (€ billions)</i>				5.1

Sources: Eurostat (2023) [Taxation Trends in the European Union](#), CSO (2022) [National Accounts](#)

Notes: SSCs are Social Security Contributions.

Table 2: Tax revenue from labour, selected countries, % of GDP (GNI* for Ireland), 2021

Country	Employee	Employer	Non-employed	Total
EU27	10.2	8.2	2.5	20.7
Germany	13.5	7.1	3.0	23.2
Denmark	18.3	0.7	5.3	22.8
France	8.9	12.2	1.9	22.9
Netherlands	10.0	5.3	4.1	19.6
Belgium	11.7	7.8	2.4	21.9
Finland	10.6	7.5	3.0	21.1
Sweden	10.0	11.6	2.6	24.2
UK (2019)	8.8	3.9	0.2	13.0
Ireland (Rep.)				
Eurostat (<i>Tax Trends</i>)	11.8	4.1	0.4	16.2

Sources: Eurostat (2023) [Taxation Trends in the European Union](#), CSO (2022) [National Accounts](#)

Table 3: Implicit Tax Rates (ITRs) in selected countries, 2021

Country	Labour	Consumption	Capital (2019)
EU27	37.8	17.9	-
Germany	37.7	16.3	31.2
Denmark	36.6	24.2	41.9
France	39.6	18.5	54.2
Netherlands	31.3	20.1	15.9
Belgium	40.4	18.2	35.1
Finland	38.7	21.2	
Sweden	38.5	21.7	27.0
UK (2019)	25.7	15.2	-
Ireland (Rep.)	33.1	20.7	14.1

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

Table 4: Decomposition of the ITR 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
Finland					
Sweden	18.1	0.0	18.1	20.9	43.8
United Kingdom	12.6	5.2	17.8	8.0	25.7
Ireland (Rep.)	19.7	4.6	24.3	9.2	33.5

Sources: See McDonnell (2021) [How Heavy is the Weight of Tax in the Republic of Ireland – Some High Level Facts](#)

Notes: PIT is Personal Income Tax. SSC is Social Security contribution. PT is Payroll Tax. Comparative data for 2021 is not yet available.