Irish Fiscal Advisory Council

# Fiscal Assessment Report

# June 2018

Press Briefing, 5th June 2018

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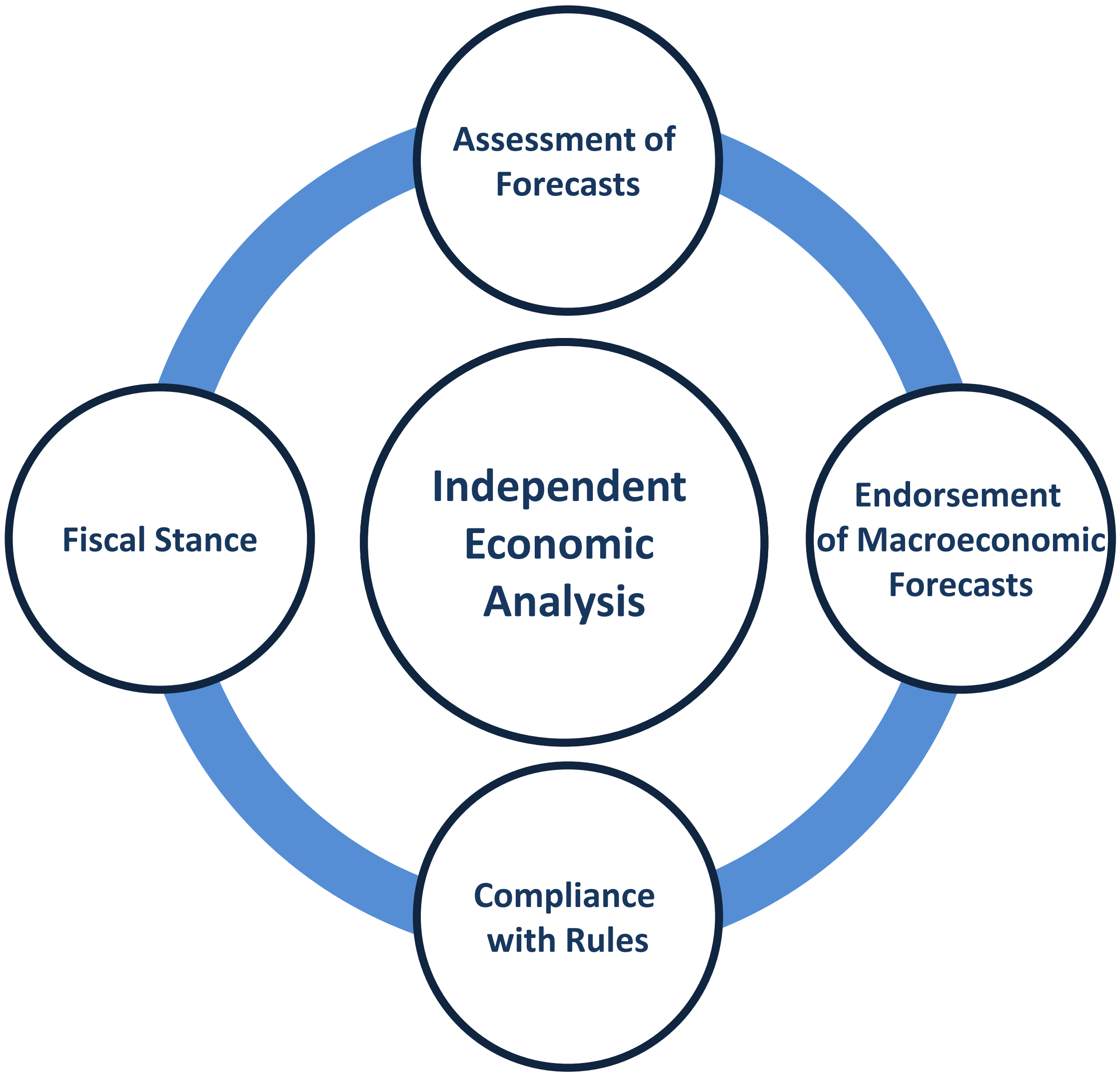
# Some Background

# IFAC's Mandate:



# IFAC and the Fiscal Assessment Report:

- IFAC consists of a Five-Member Council
- and a Six-Member Secretariat
- IFAC's Fiscal Assessment Reports assess the Government's budgetary stance; macro forecasts; and compliance with fiscal rules. This is our 14th Fiscal Assessment Report.

# Key Messages

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# (1) There is no case for additional fiscal stimulus in 2019

- The Government should at least stick to its plans for 2019. Anything more expansionary is not likely to be appropriate.

- An appropriate policy would be to increase spending in line with sustainable long-term growth.

  – Implies limit for spending increases or tax cuts of up to €3½ billion (“gross fiscal space”): starting point for Budget 2019.

- Previously announced measures – including sharp increases in public investment – mean that the Government’s scope for new initiatives in Budget 2019 will be limited.

- Unexpected increases in tax revenues or lower interest costs should not be used to fund further budgetary measures.

# (2) Improving the budget balance by more than planned would be desirable

- It would be desirable for the Government to improve the budget balance by more than planned.
- This would recognise the risks of overheating and the opportunity provided by favourable times.
- Revenues from a faster-than-expected recovery in housing construction should be used to build buffers either through:
  - additional Rainy Day Fund contributions
  - faster debt reduction
- Spending should not be allowed to continue to drift up as unexpected – and likely cyclical or transitory – revenues arise.

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# (3) The Government needs a credible plan for the medium term

- Focusing on the right budgetary stance and being prepared to be more cautious than the fiscal rules allow is the correct approach for the Government to follow.
- Yet there is a danger that the current policy framework is insufficiently equipped to prevent a return to procyclical fiscal policy.
  - Sensible tools such as the Rainy Day Fund and a medium-term debt target need more development if they are to be effective.
  - A working paper accompanying this report shows how a countercyclical Rainy Day Fund could work with modest changes to the fiscal rules.

# Macroeconomic Context

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# The Macro Context:

- A rapid cyclical recovery has taken place since at least 2014 and this is continuing at a strong pace.
- There is much uncertainty, yet most coherent estimates suggest that the domestic economy has been growing faster than its potential growth rate since 2014.
- Estimates suggest that the economy is producing close to its medium-term potential in 2018 and will move beyond it next year and after.
- The Council welcomes the Department's publication of alternative estimates of the cycle to help to provide a sound basis for setting the economy and the public finances on a sustainable path.

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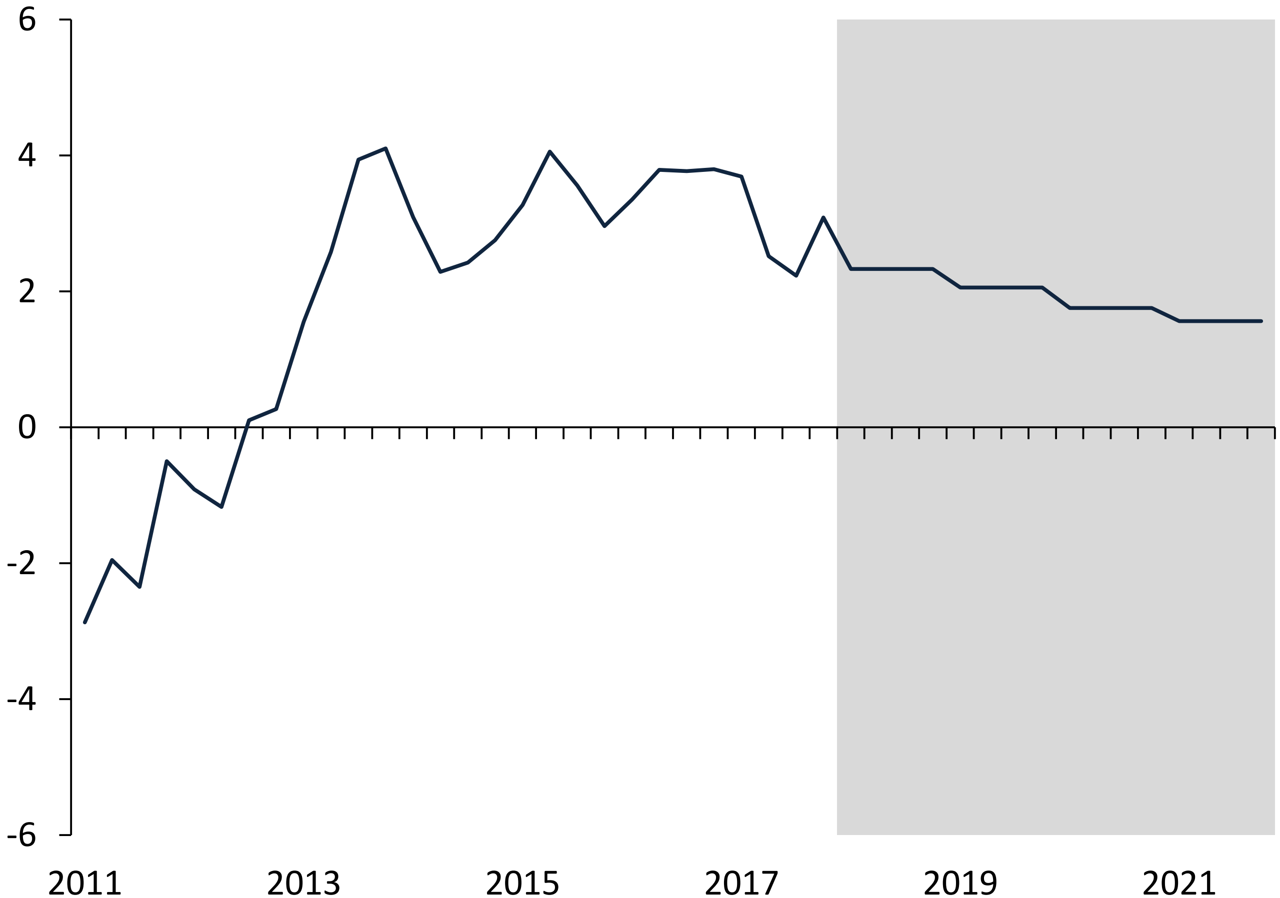
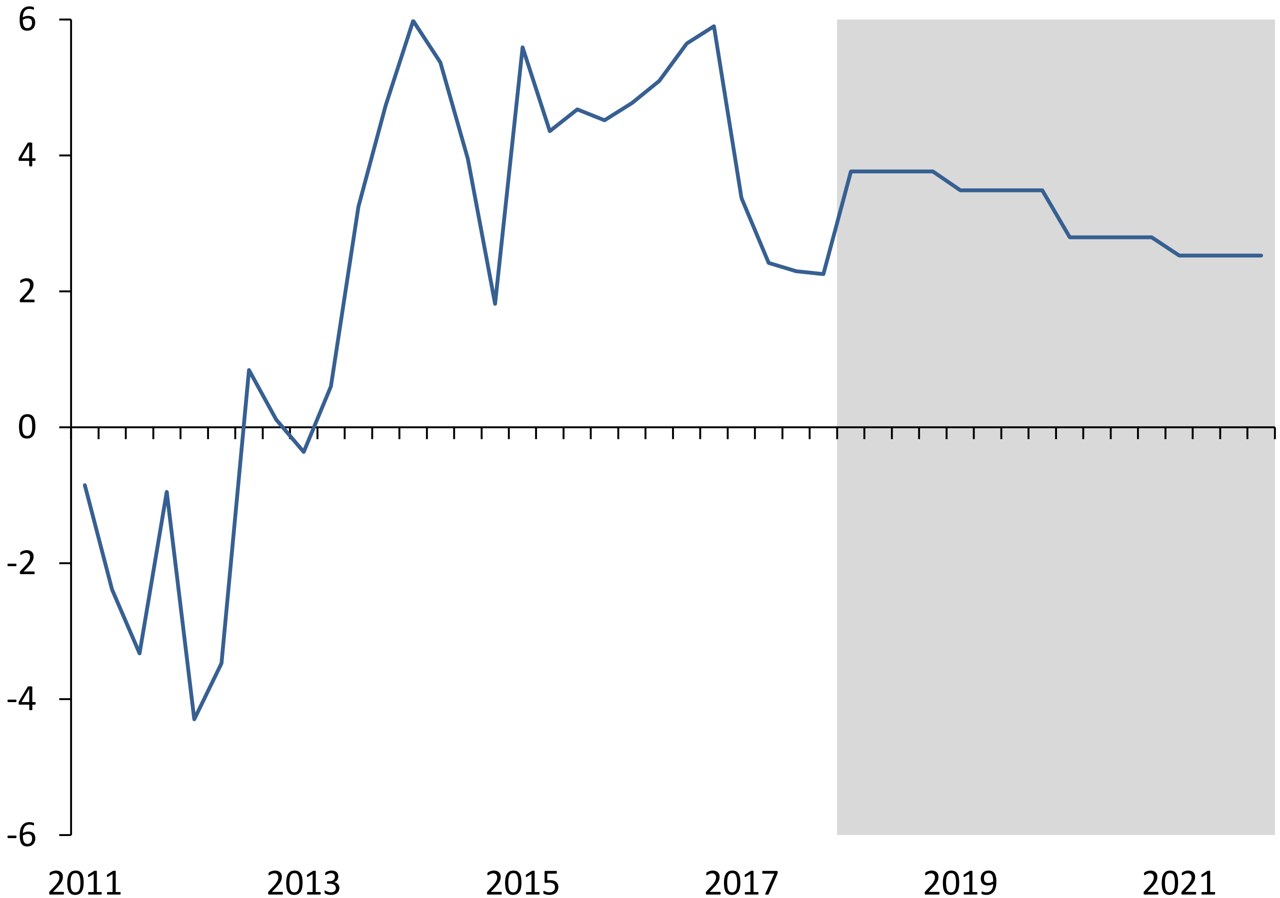
## Employment

% change y/y, volumes



## Underlying Domestic Demand

% change y/y, volumes



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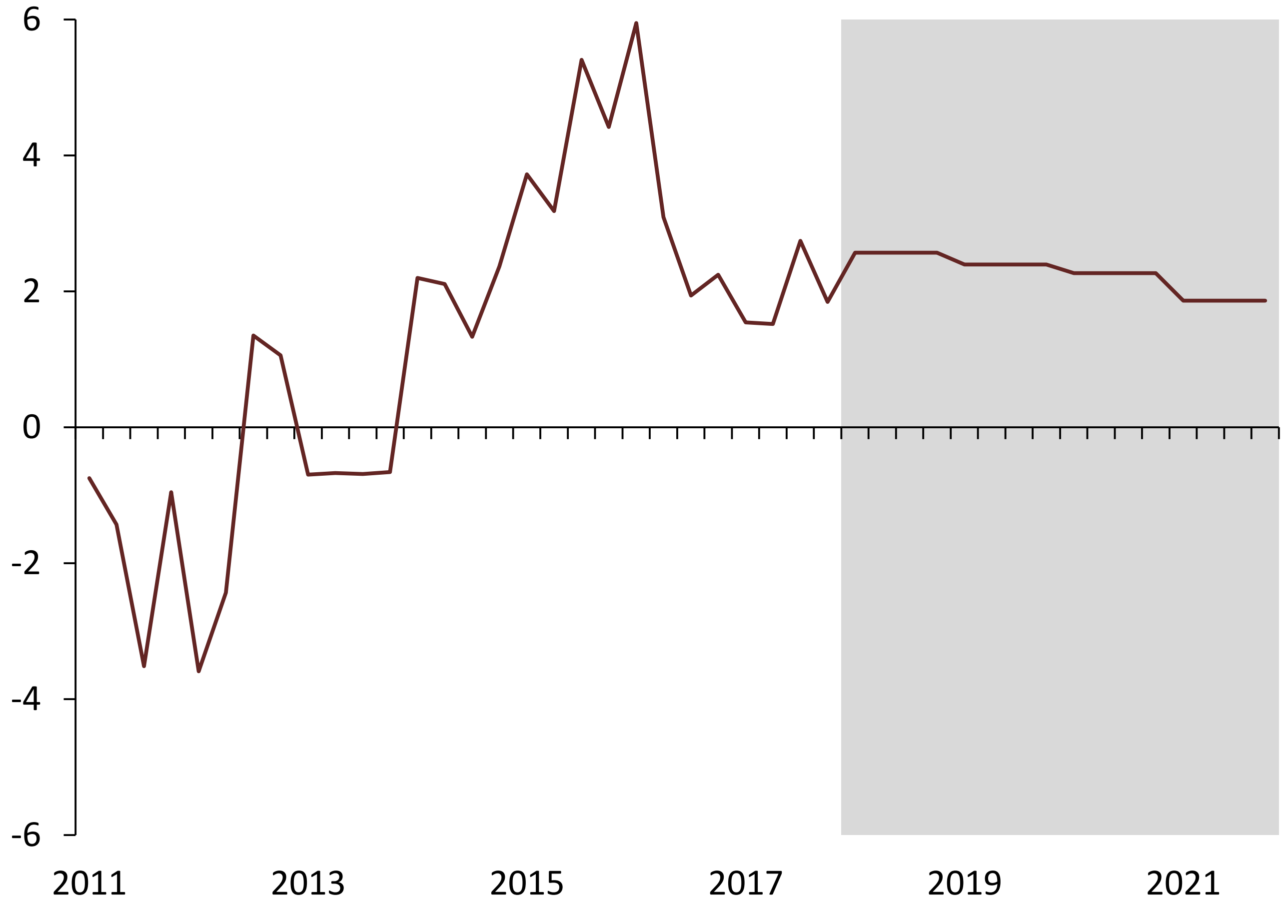
## Personal Consumption

% change y/y, volumes



## Nominal GNI*

% change y/y, nominal

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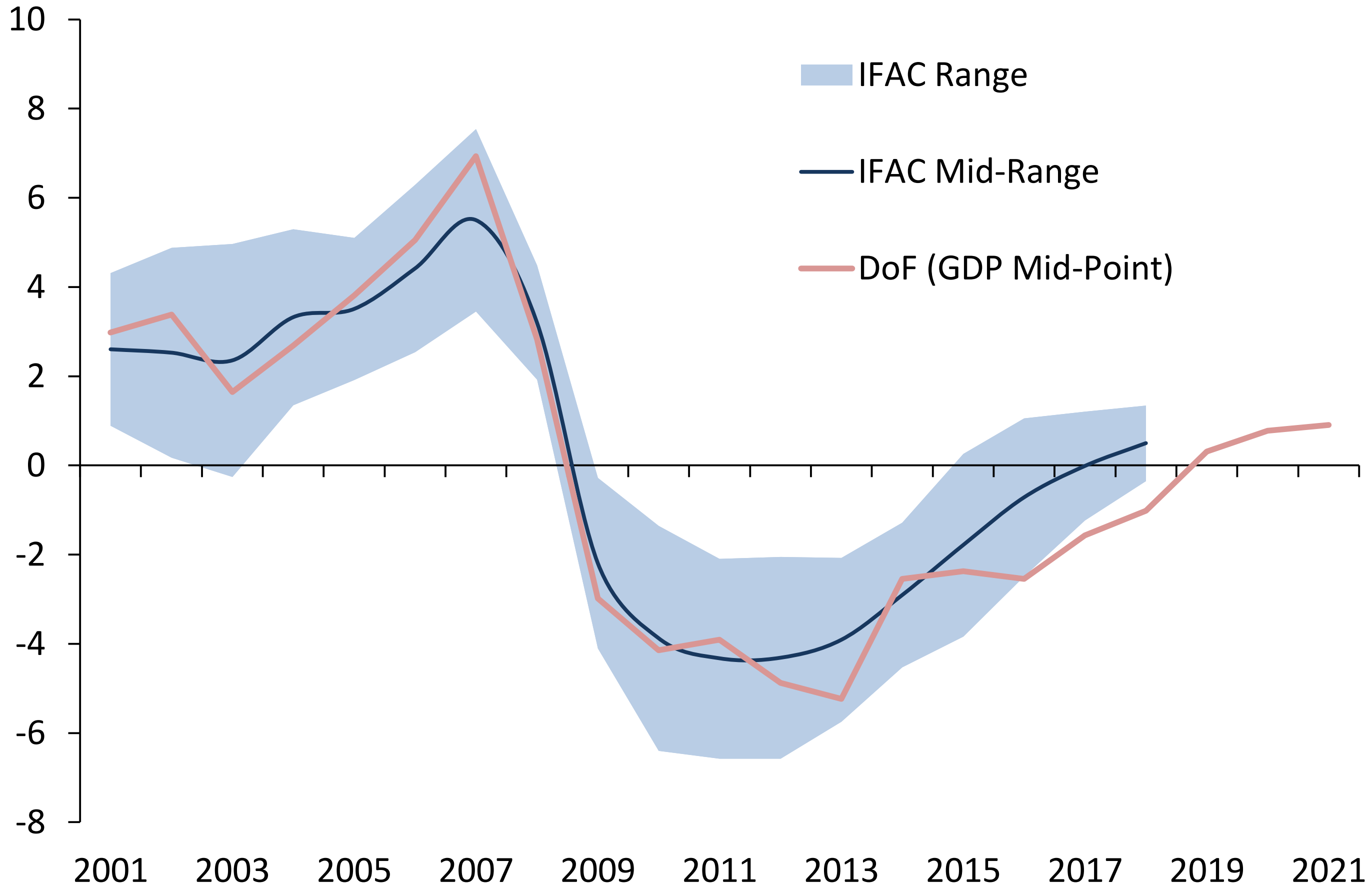
## Ireland’s Cyclical Recovery

Output gap estimates (percentage of potential output)



# Short term: upside risks from housing

- There are also burgeoning pressures in the housing sector, where persistent undersupply has been evident.
- Faster-than-assumed growth in housing output – although needed – could prompt overheating pressures unless offsetting measures are taken elsewhere.

# Medium term: downside risks

- Negative shocks will inevitably occur in future years.
- There are clear downside risks over medium term:
  - Brexit
  - US trade policy
  - International tax environment

# Impact of a large, foreign-owned multinational firm exiting Ireland

- The IFAC report highlights how corporation tax receipts would be particularly vulnerable to an exit of a large, foreign-owned multinational firm.
- This reflects the high concentration of payments among the top ten contributing firms.
- Corporation tax receipts are forecast to remain at record high levels and near their peak share of Exchequer taxes.

## Direct Effects on Taxes, Earnings and Economic Activity in Ireland

**€ million unless stated**

| | Typical Large Firm[a] | Total | Large Firm Share (per cent of Total) |
|---|---|---|---|
| **Taxes and Earnings** | | | |
| Corporation Tax | 276 | 7,353 | 3.7 |
| Employee Taxes/PRSI | 62 | 15,997 | 0.4 |
| Employee Net Earnings | 79 | 30,419 | 0.3 |
| **Economic Activity** | | | |
| Gross Value Added | 4,975 | 255,294 | 1.9 |
| Employment (thousands) | 2 | 2,133 | 0.1 |

*Sources:* CSO; Revenue Commissioners; and internal IFAC calculations.
*Notes:* [a]The direct impacts of a typical large foreign-owned multinational firm on GVA, employment and employee taxes/PRSI and net earnings are estimated using the relative size of corporation tax payments for a top-ten firm compared to a top 96 foreign-owned firm ranked by corporate tax payments made in 2016.

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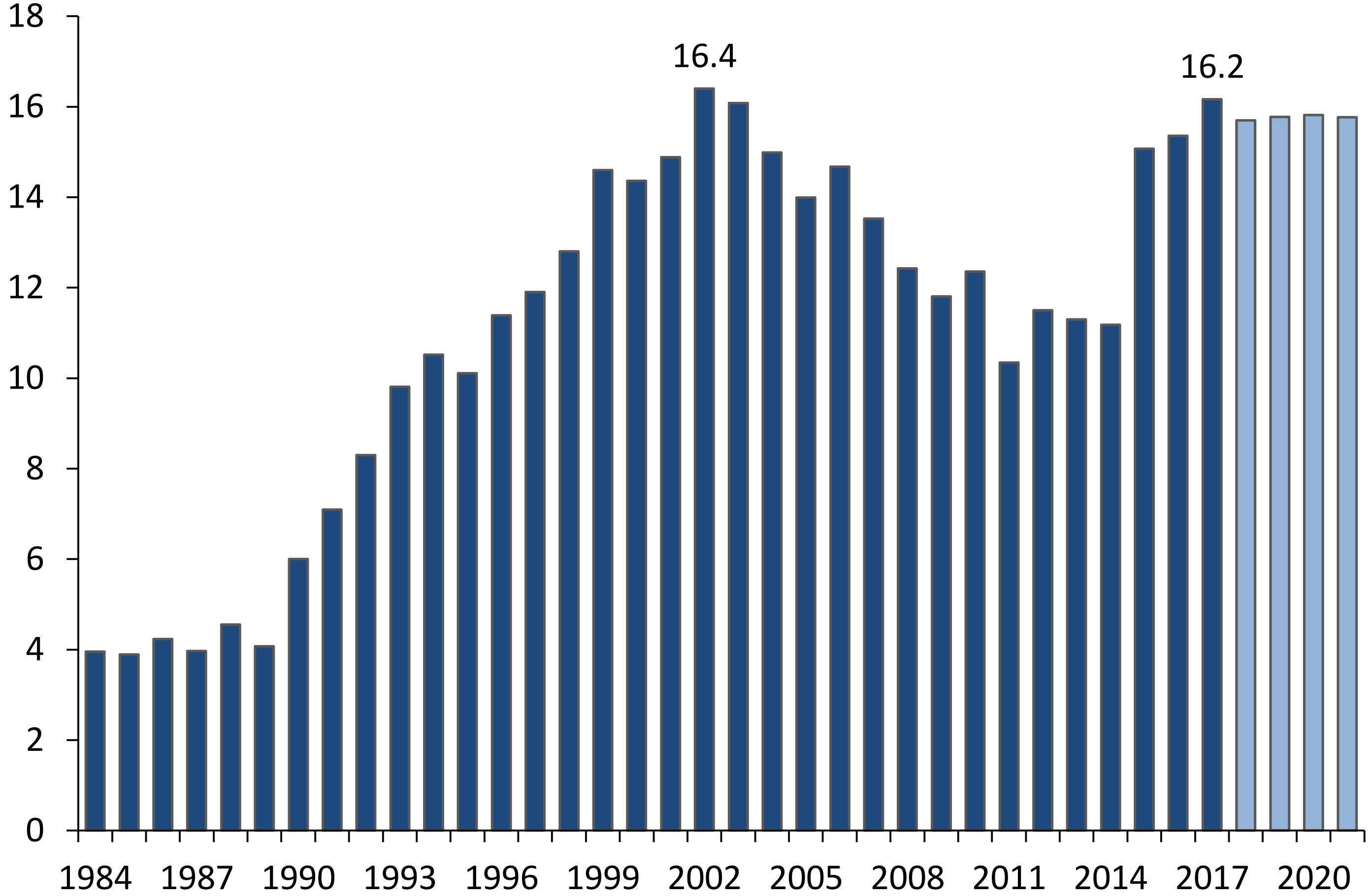
## Corporation tax receipts are forecast to remain at record high levels

% of total Exchequer tax revenue




*Sources:* Department of Finance; and internal IFAC calculations.
*Note:* Dark bars show outturns for 1984–2017; light bars show *SPU 2018* forecasts for 2018–2021.

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# Fiscal Context

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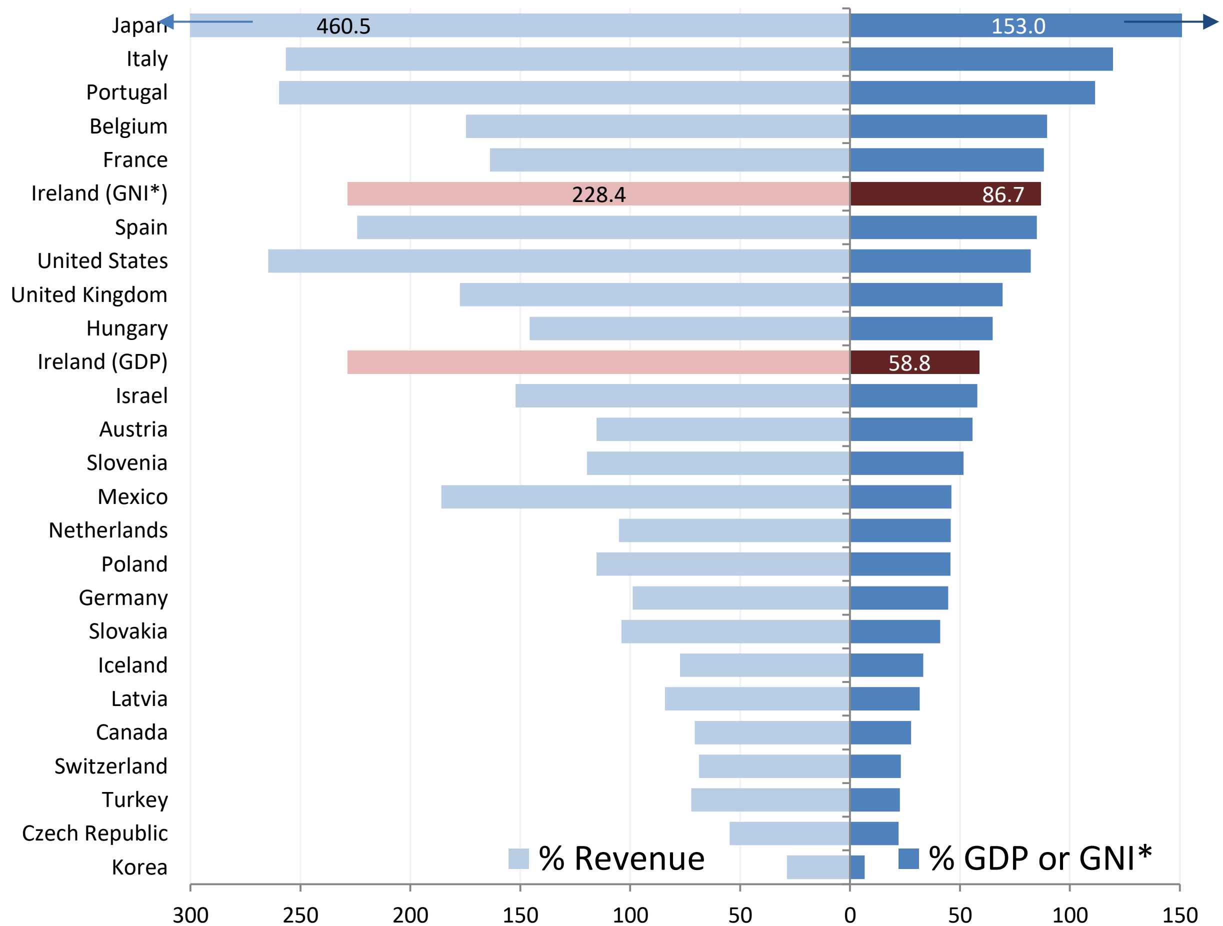
# Debt remains high and improvements on the budgetary front have stalled since 2015

- Ireland's debt burden is still among the highest in the OECD and is understated by standard GDP comparisons.
  - Set against a comparable measure of national income like GNI*, the net debt burden is equivalent to 87 per cent, the sixth highest in the OECD behind only Italy, Portugal, Belgium, France and Japan.
- A strong cyclical recovery has taken place – one reinforced by a number of favourable tailwinds. Despite this, the Government's primary balance has barely improved.

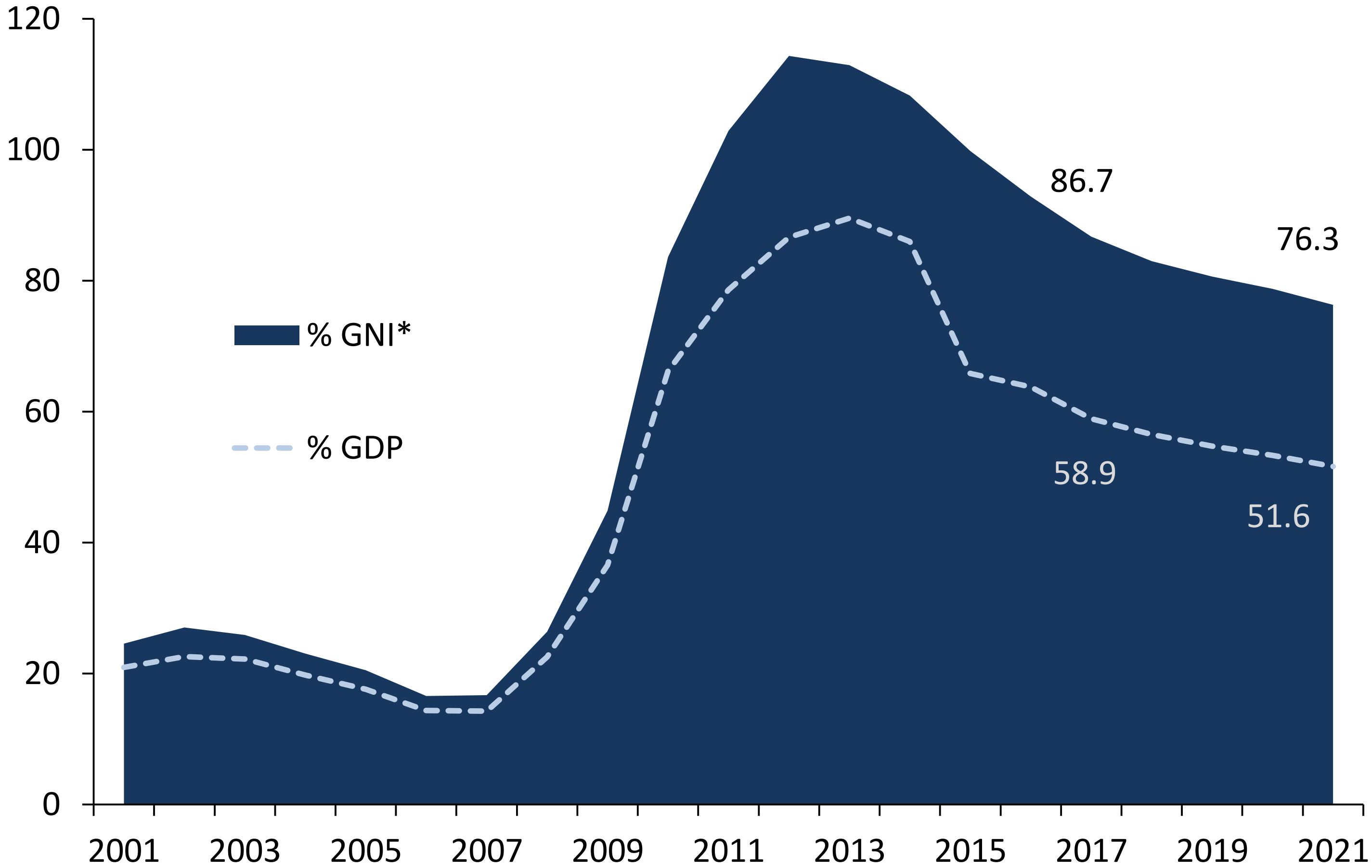
OECD Countries' Net Government Debt

End-2017 net general government debt as % revenue (LHS); and as % GDP or GNI* (RHS)



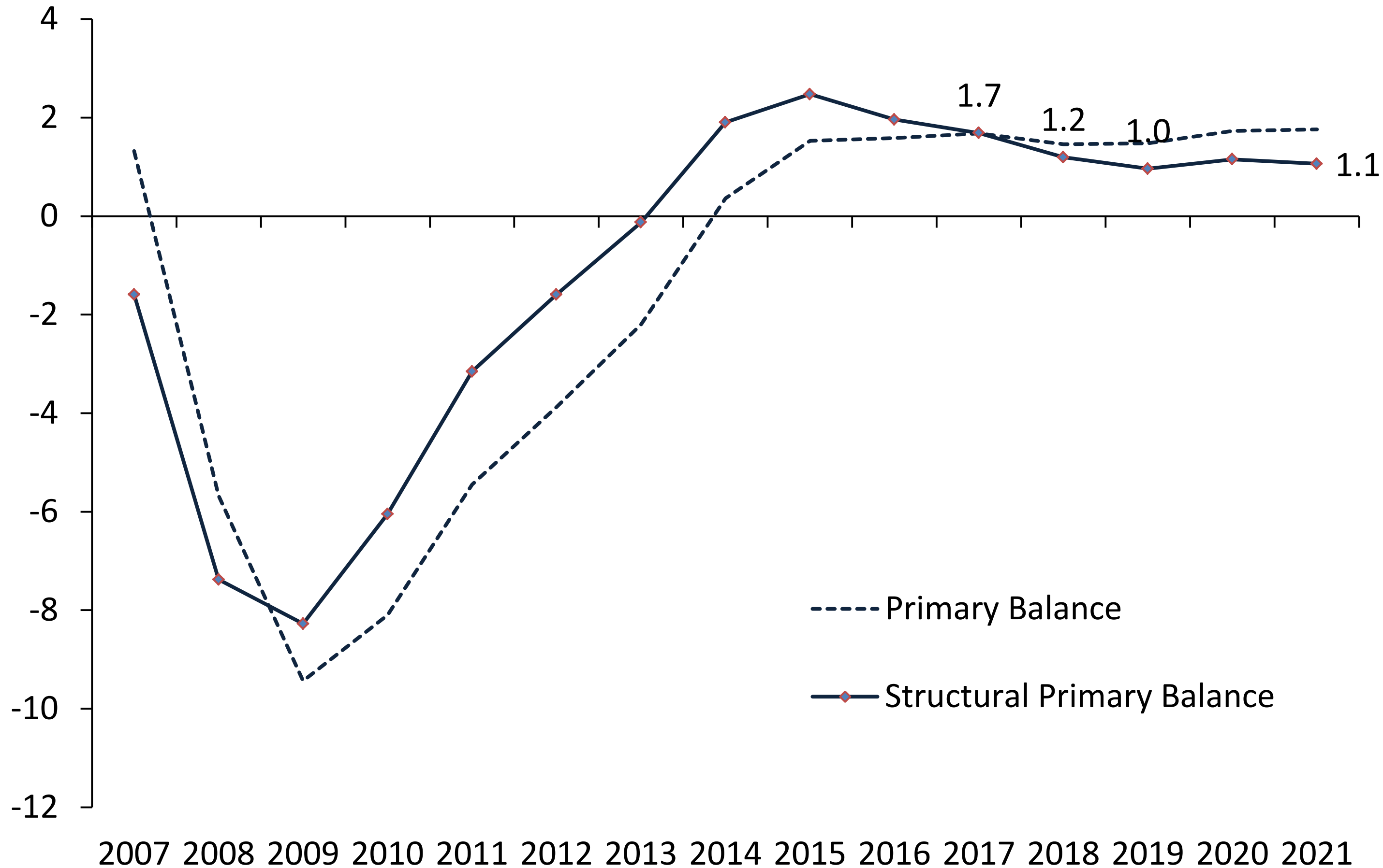
## Ireland’s Net Government Debt Levels

% GNI* and % GDP, General Government basis



## Ireland's Primary Balance Has Barely Improved Since 2015

% GDP, General Government basis

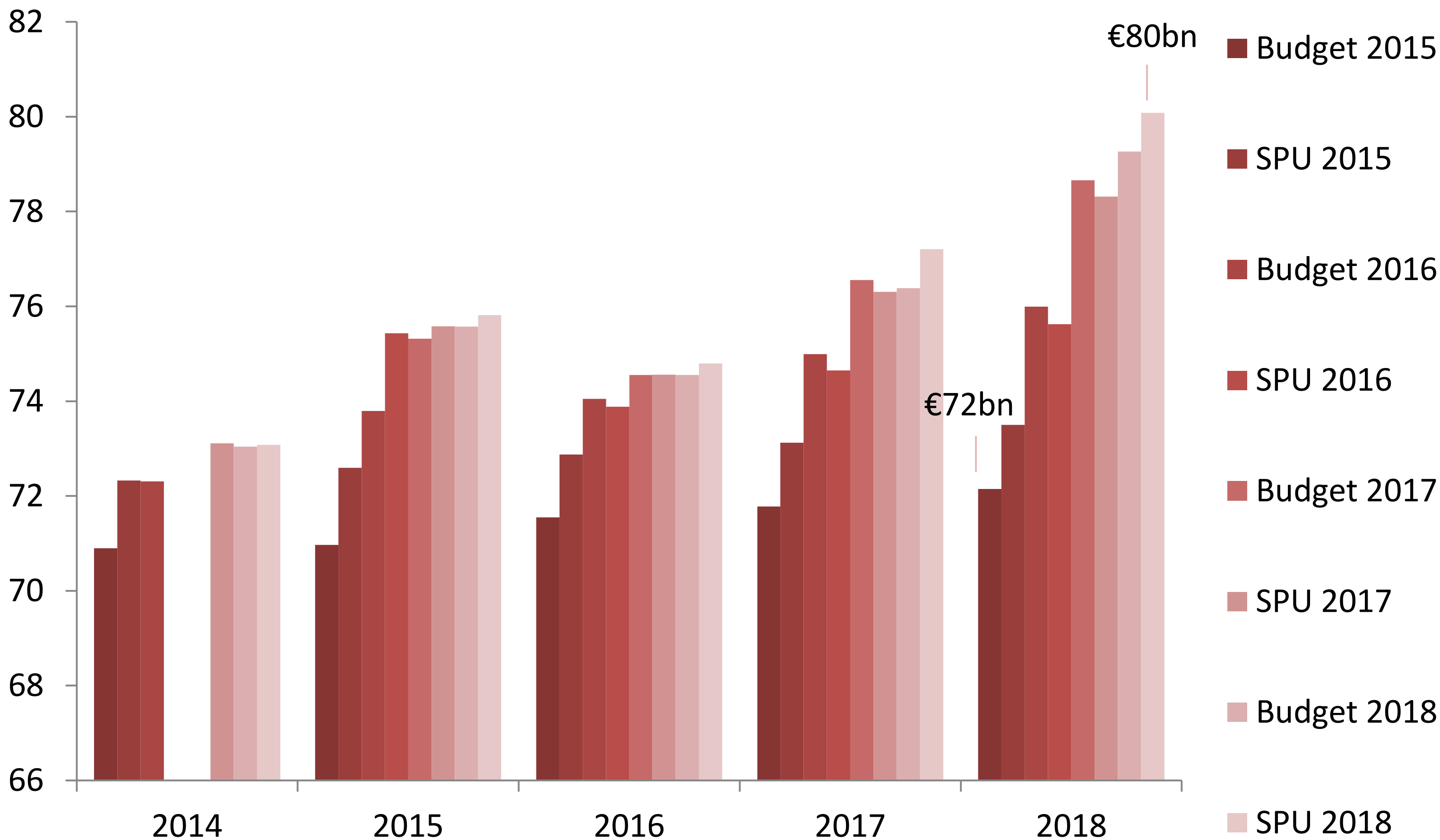


# Spending Drift

- The report highlights how Spending Drift has been a key contributor to the stalling in improvements to the Government's primary balance.

## Successive Forecasts of Expenditure Have Risen

General government expenditure, € billion



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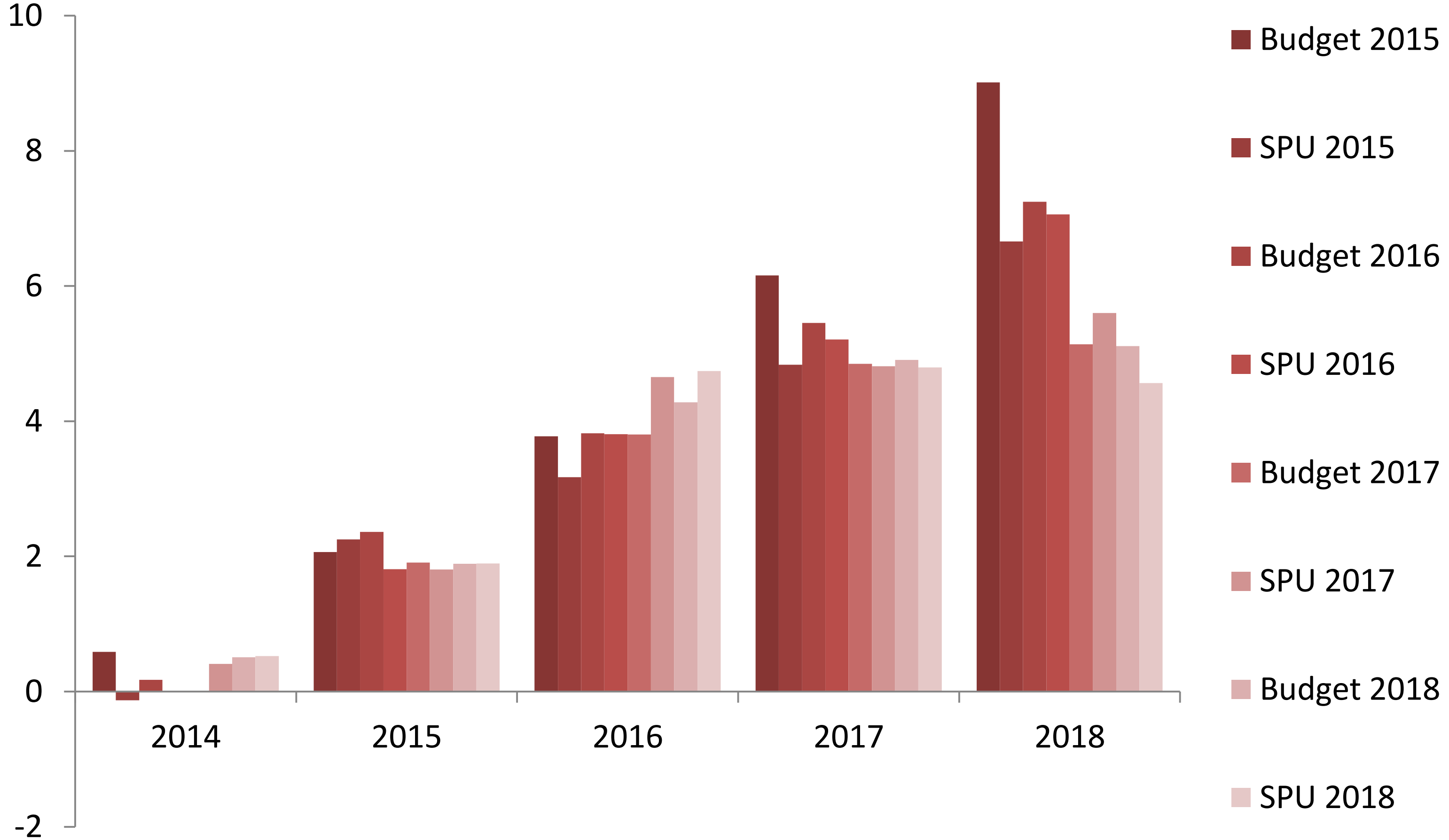
## So that planned primary balances have shown little change even as revenues rises

Primary balance, € billion



# Sensible tools need development to prevent a return to procyclical fiscal policy

- Sensible policy tools such as the Rainy Day Fund and a medium-term debt target, which were set up to help with medium-term budgeting need more development if they are to be effective.
- The shortening of the horizon in the Government's most recent projections from five to three years ahead is not compatible with the aim of achieving medium-term fiscal stability.

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# Rainy Day Fund

- A working paper accompanying this report shows how a countercyclical Rainy Day Fund could work with modest changes to the fiscal rules.
- It explores how such funds can be used
  - (i) to address procyclical bias in measurements of the cycle, which underpin the EU fiscal rules; and
  - (ii) to enhance the scope for fiscal stimulus in future downturns while also making it more desirable to set aside savings in good times.

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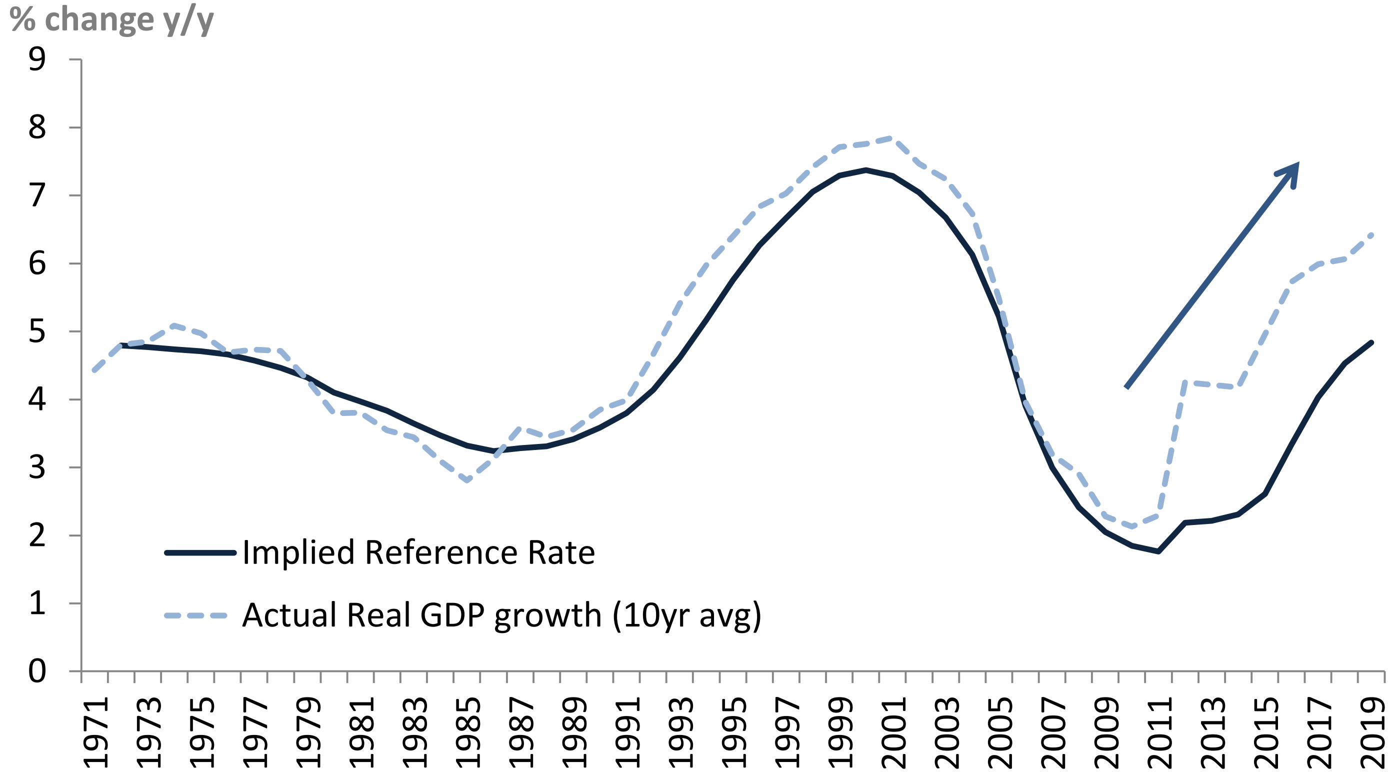
# The speed limits for government spending are rising as the economy grows fast

## Procyclicality of Allowed Spending Growth Rates (Reference Rates) under the Fiscal Rules




*Sources:* European Commission (Autumn 2017 estimates); own workings.
*Note:* Data show the implied Reference Rates based on ten-year averages of the estimated potential output growth rates, which are derived using the commonly agreed methodology.

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# Recap of Key Messages

- (1) The Council assesses that there is no case for additional fiscal stimulus in 2019 beyond existing plans.
- (2) Improving the budget balance by more than planned would be desirable, especially given risks of overheating and favourable times.
- (3) The Government needs a credible plan for the medium term.
  - Focusing on the right budgetary stance is the correct approach. Yet the current policy framework is insufficiently equipped to prevent a return to procyclical fiscal policy.