Congress Response to Budget 2012

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Background

This is not a time for economic orthodoxy. Yet that is what we are enduring in Ireland and Europe. Paralysed by the deepest recession since the 1930s, the response of governments has been deeply conservative and deeply wrong.

Everywhere, the crisis is deepening.

In Ireland domestic demand has fallen for 14 consecutive quarters – by a staggering 23%. This tells us that austerity is killing the patient. A few recent small rises in GNP - following a fall of almost 16% - does not represent 'green shoots.'

The level of budgetary 'adjustment' will cost us in jobs. This is particularly damaging as it is now clear that exports cannot do the 'heavy lifting' on job creation. Budget 2012 has brought to just over €24 billion the total size of the negative fiscal adjustment to date.

Congress has argued consistently that the period of adjustment should be extended to 2017 in order to minimise the deflationary, job-destroying impact.

Yet again we see that projections for GDP, GNP and total domestic demand have been adjusted downwards by the Government, since the publication of the Medium-Term Fiscal Statement in November.

We see that the latest pre-budget projections for economic growth and employment are more optimistic than those published by other analysts, including the Economic & Social Research Institute. The net impact of this Budget will therefore be to reinforce recent negative employment trends.
In the absence of a jobs investment stimulus this budget will serve only to aggravate the downward economic spiral. Instead Government continues to pursue austerity policies that are contracting the economy and embedding debt.

The domestic economy must be encouraged in recovering by creating jobs and generating significant additional revenues over time.

Congress acknowledges the difficult context in which this Government is operating. Even though severe constraints have been imposed arising from the 'Troika Agreement' there are choices that can be made.

Spending Cuts

In this Budget the Government opted to cut public spending in key areas that will impose further hardship on:

1. **People in work,** because the burden of taxation continues to fall on low to middle-income households, while average or effective taxes on high-income earners will not usually exceed 40%.
2. **People out of work,** because the net impact of the budget will be to further deflate the economy, depress consumer demand and lower investment in urgently needed infrastructure.

3. **The working poor**, who will continue to suffer the effects of insecurity, reduced wages and shorter hours.
4. **Families, children and women** through adjustments in various social welfare payments and entitlements especially those that impact on lone parents and those already living in poverty.

Cuts to public expenditure have been applied broadly across a range of sectors from education to social protection to health. Many of these cuts will entail additional charges, reduced services or cash payments to households. Those most reliant on services and income support will suffer the most. As an example, grants for schemes providing vital services to the unemployed, children, the elderly, the disabled and disadvantaged have been cut from €1,500 per participant to just €500 . As a consequence, the future viability of hundreds of Community Employment schemes is threatened. These cuts do not represent administrative savings costs but the end of Community Services in many areas with a further loss of jobs and income in the locality. Congress urges that these cuts be reversed.

Taxes

The Government has opted to raise taxes mostly through VAT and excise duties which will have a greater impact on low-income households, due to the regressive nature of indirect taxes. These increases will hit the lowest income households hardest - those who spend all of their income and have little if anything left for savings.

It would have been far better to place a temporary **2.5% levy on profitable corporations** which would have raised more money and would not have had a negative impact on jobs.
Unless companies are making profits, they will not pay the tax and most of those companies - especially multinational exporters - are doing very well.

The increase in the carbon tax will impact harder on low income and working households already struggling to pay their fuel and heating bills and pay for transport (the costs of both public and private transport will be driven up by the higher carbon tax).

In addition, the range of **new property reliefs** announced risk creating a minor rush to buy property in 2012, followed by an ending of all relief on properties bought after the end of next year.

It is disturbing that in the midst of an economic collapse, due in no small part to a myriad of property tax breaks (consistently opposed by Congress) that Government should choose to offer *more* property tax subsidies to speculators.

These tax subsidies will be funded by general taxpayers and may have unintended outcomes. Congress looks forward to studying the Cost Benefit Analysis undertaken by the Department of Finance in relation to these tax subsidies for wealthy investors.

While Congress is supportive of the principle of property tax we regard the standard household charge of €100 per annum as inequitable because it applies to all households alike irrespective of income.

While Congress welcomes the proposed increases to capital acquisition, DIRT and capital gains taxes (which will make up €100m, or one tenth of the total planned tax rises), we believe the burden of taxation is still very unfair, because:

1. Capital taxes are still very low. Ireland is still exceptional in having **no wealth tax**.
2. Inequitable **tax breaks** for property rent and various other headings have not been tackled and have been expanded in some cases, with little economic or social rationale.
3. **Tax exiles** continue to avoid tax and lecture citizens on how the country should be run in their best interests.
4. The estimated effective rate of tax on income for higher earners is **still likely to be less than 40% on average**.

Government should have targeted its tax changes at higher income and wealthy households, rather than on working people and lower income households.

This could have included **a wealth tax, a temporary corporate levy, a clean-up of tax breaks (tax expenditures) and the Financial Transactions Tax (FTT)**.

The lifting of the **Universal Social Charge** floor to over €10,000 per annum is welcome. However, the net impact on workers in this bracket will be slight: on average less than €2 per week and probably much less in the case of part-time workers who will be affected by the change in Jobseeker payments.

Congress believes that the threshold should have been raised much higher. A combination of welfare cuts and increases in charges and prices will impact very severely on low paid workers.

This together with the abolition of Joint Labour Committees will present a huge burden on the lowest paid workers and their families.

Austerity is Not Working

Unemployment is the biggest single scourge. It impacts on the morale, health and dignity of not just those out of work but their communities and, ultimately, society as a whole.
Government's own projections are for a fall in total employment next year. The recent ESRI report projects a further increase in the rate of unemployment. To date, all recent projections by the ESRI and the Government in relation to unemployment have regrettably, proved to be over-optimistic.

The rise in VAT will push up inflation by 1% and eliminate many jobs. It would have been far better to have progressive taxes on high incomes and soaring corporate profits. This could raise far more than the VAT increase and would have no impact on demand.

There are 316,000 less people at work now than in 2007 and a further 25,000 will almost certainly lose their jobs next year. There are 40 job seekers for every one job in Ireland, compared to the European average of eight. This is second only to Latvia.

Continuing to cut public spending and hitting low-income households with additional charges and taxes merely exacerbates the spectre of deflation, contraction and unemployment.
It is precisely the wrong medicine at precisely the wrong time.

The recent ESRI report indicated an even bigger fall as well as a further cut in real disposable income when the impact of price increases and taxes are factored in.

Economic commentators are agreed that next year will be the fifth year in a row when **real personal income will fall**.

All indicators point towards lower capital investment thanks to continuing cuts or deferrals in the public capital programme, personal consumption and in Government consumption.
There is no evidence that Government has calculated or properly modelled the economic impact of increasing VAT, reducing social welfare payments and withdrawing public services and programmes.

The lack of a radical **Jobs Initiative** is deeply disappointing. Congress has advanced many proposals for funding such a jobs stimulus over the first four years of this deep recession.

The one bright note is that the Government may yet act on the Congress suggestion to **incentivise pension fund** investment in job creation, as detailed in our pre-Budget Submission.

And Banking is Not Working

At the core of this budget is a refusal to share the burden of banking debt. This is why workers, families, children, communities and young people who are forced to emigrate will continue to foot the bill for banking failure.

A vast amount of private, corporate debt was transferred to the taxpayer over the past three years. Much of this debt – but not all – was guaranteed by Government on behalf of taxpayers. In the case of one 'bank' alone (what was Anglo-Irish) the **taxpayer is liable for at least €3.1billion every year for the next 15 years**.

And this does not include future interest payments, which are scheduled to run to 2030, at least.

The next payment of Anglo-Irish 'Promissory Notes' will be in March 2012.

That one payment alone is the **equivalent of the entire budget for primary school education** in this country. This is the context in which the budget has been framed, choices made and adjustments implemented to spending and revenue.

It is also worth noting that credit is still not flowing to business, despite the banks having been saved by the taxpayer.

Some of the vast sums taken from our National Pension Reserve Fund and put into the banks should be used for SMEs, or alternatively some of the remaining €5.3bn.
But there is a better, fairer way.

Growth is the Key

Noticeable by its absence from this Budget was a credible strategy to make **serious inroads into unemployment**. Government needs to focus on labour intensive infrastructural projects, such as:

1. Broadband
2. Water and waste
3. Energy retrofitting
4. Elimination of prefabs from all schools over the next two years.

It would be possible to fund such an investment programme from a range of sources:

- A redirection of **private Irish pension funds** into domestic infrastructure (of which there is over €70bn) and follow the model proposed by Congress, SIPTU and adopted in the UK by George Osborne last week. We estimate that €4 billion – or 5% of current pension funds - could be leveraged into the economy;
- Tap into resources from the **European Investment Bank** (EIB);
- Use some of the remaining resources from the **National Pension Reserve Fund** (NPRF);

Conclusion

Our analysis points to the urgent need for:

- A major investment stimulus to generate new economic activity, especially job creation;
- A more realistic timeframe over which to reduce the budget deficit, through a combination of measures including policies to enhance economic growth and generate additional revenues to the public purse.

The presence of an **expansionary fiscal contraction Tooth Fairy** is implied by claims that budgetary cuts will give greater certainty and confidence to consumers. There is no evidence that continuing reductions in public expenditure and tax increases have boosted consumer spending. A country is not a household where you must keep spending down to meet income and balance your books every month. A country is like an enterprise where you need to save seeds, plant and nurture growth. There is little evidence that this Government has:

- a vision of where Irish society needs to go;
- a sense of justice that puts the interests of working people, the poor and the excluded before that of international creditors and high-income / high-wealth individuals living here; and
- a thought-out strategy to create employment and renew economic activity.

Instead, it is a case of the slow strangulation of our economy and society with more cuts planned for 2013, 2014 and 2015. Ireland deserves far better.

December 2011

Some technical notes on Budget 2012

This note focuses on two issues:

- How does the 'domestic' economy contribute to GDP growth along with our net trade with the rest of the world?
- What are the salient trends in Government spending and revenue, here and in the EU27, in the past and into the future?

Domestic demand as an engine of growth in GDP and employment

'Domestic demand' is the sum of what Irish consumers, investors (in physical things such as buildings, infrastructure and equipment) and Government spend in any given year. 'External demand' is the excess of total exports over imports in a given year. If exports exceed imports external demand has a positive value. If imports exceed exports external demand takes a negative value.

Total Gross Domestic Product equals domestic and external demand added together[1] It is projected by Government (Economic and Fiscal Outlook published on 6 December – EFO hereafter) that GDP will rise by 1.3% in real terms in 2012. Of this increase of 1.3%, an estimated +2.3% points is accounted for by a projected increase in net exports. In other words, GDP would grow by 2.3% next year if domestic demand were unchanged from what it is in 2011. However, Government expects a decline of approximately 1% in domestic demand in 2012. So, GDP growth is projected to increase by 1.3% = 2.3 – 1.0.

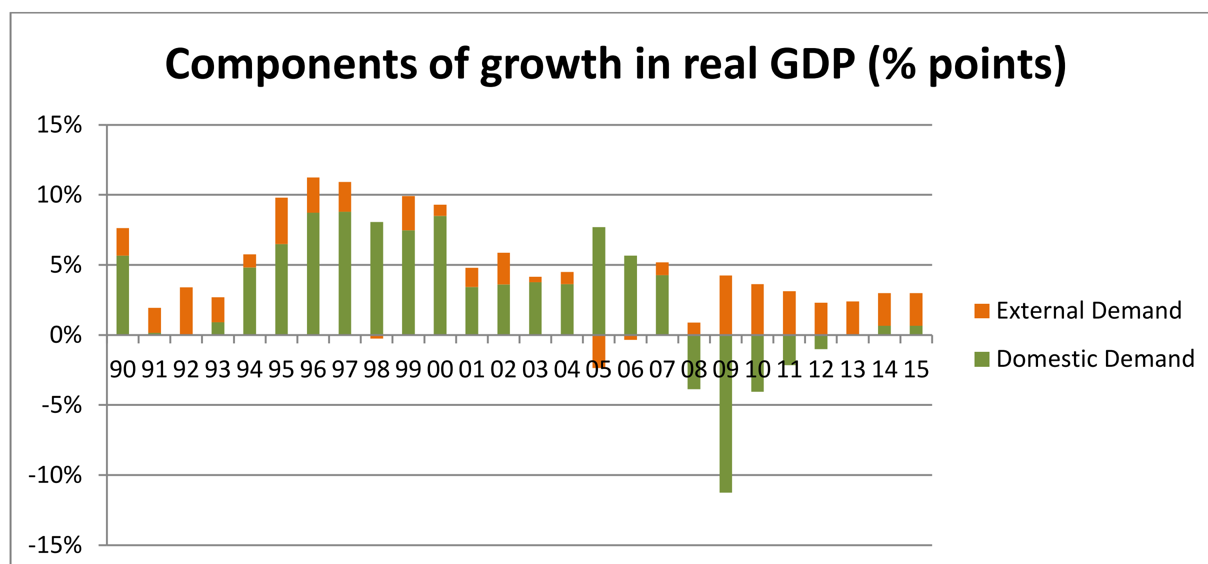
Figure 1, below, provides an estimate of how changes in GDP have broken down into the domestic and external components for each year going back to 1990. What is striking about the growth in GDP from 1990 to 2007 is that the bulk of the increase in any year was related to domestic demand. Following the collapse in GDP from 2008 to 2009 domestic demand has contracted sharply (at a rate never recorded since national accounts data were developed here in the 1940s) while net exports have continued to increase. Were it not for export growth GDP would have declined further in 2010 and in 2011. Some of the explanation for the growth in net export demand is the buoyancy in particular overseas markets and product lines. Some of the explanation is the contraction in imports in 2008-2009 as consumer demand plummeted in Ireland.

Government projections to 2015 (refer to Figure 1) assume significant continuing growth in net exports as an offset against falling or stagnant domestic demand. Only by 2014 and 2015 is there any recovery in domestic demand. Even then, the projected annual growth rate is a under 1%. It seems very unlikely that employment levels will recover to any significant extent without a significant boost to domestic demand. Following a period of 'jobless growth' in the early 1990s employment began to rise sharply from 1993 onwards – mainly in firms and sectors meeting domestic demand. Export growth also played a significant part.

[1] GDP also contains a relatively minor statistical discrepancy in any year as well as changes in the value of physical stocks. The latter is included under 'domestic demand' in this paper.

Figure 1

Where the growth came from in the past and where it is projected to come from in the near future



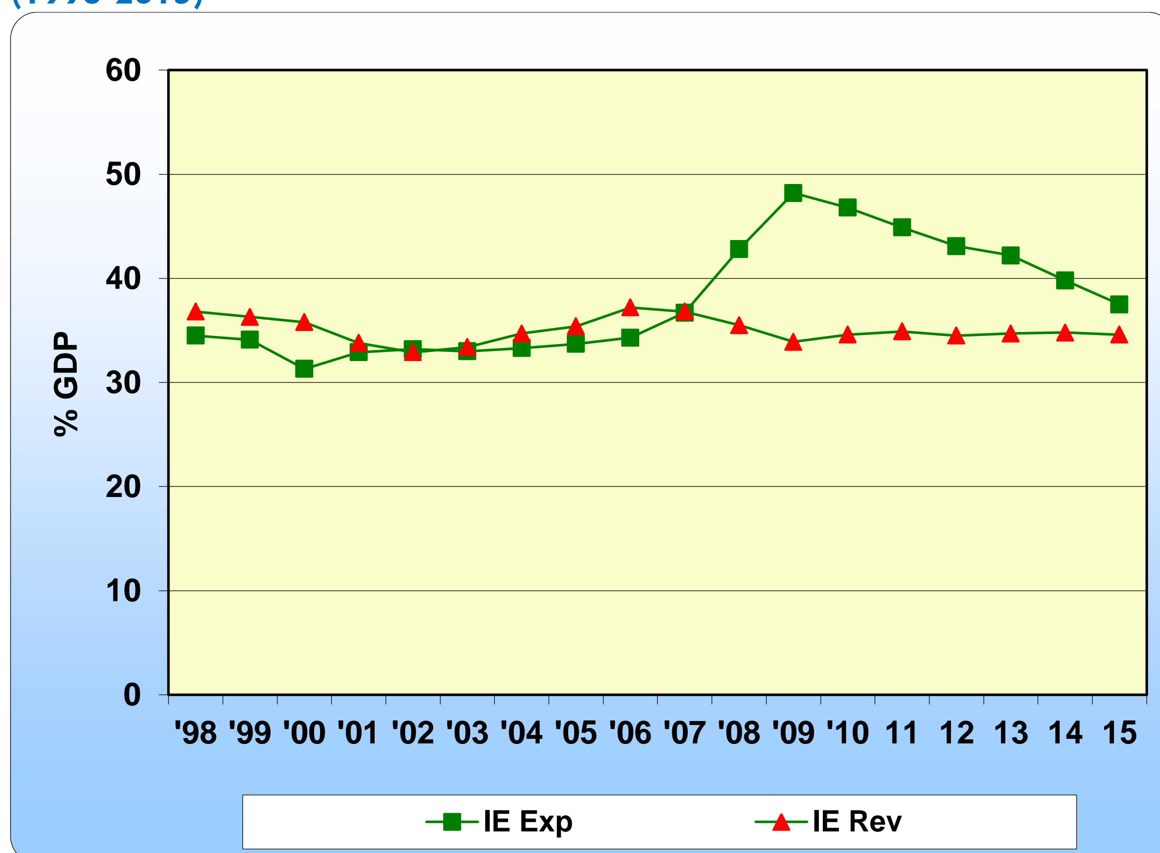
Source: European Commission Ameco database for 1990-2010 and Economic and Fiscal Outlook, 2011 for 2011 and later years.

Shrinking the State and moving away from European norms?

Figure 2 presents data on trends in total Government expenditure. Spending and revenue (which includes taxes and other receipts) tracked each other up to 2007 at a low percentage of GDP by EU standards. The arrival of recession in 2008 suddenly depleted revenue and raised spending as a result of escalating unemployment. Far from there being an 'explosion' in public spending prior to the crisis in 2008, as many have claimed, public spending tracked growth in GDP as did revenue – notwithstanding cuts in tax rates and increases in tax breaks in the course of the early part of the last decade.

Figure 2

Trends in Total General Government Expenditure and Revenue – ROI (1998-2015)



Source: Eurostat

Note: public expenditure relating to bank recapitalisation in Ireland in 2010 was excluded in the above chart.

A striking feature of fiscal adjustment as pursued, here, both before and after the November 2010 Troika Agreement is that it has leaned on expenditure and not on tax. When measured as a percentage of GDP, the entire adjustment is on the expenditure side with the share of total revenue in GDP staying constant over the remainder of the adjustment period. In fact, total revenue is projected to fall – not increase – from an estimated level of 34.9% of GDP in 2011 to a slightly lower level of 34.6% in 2015 (page D.19 of EFO). On the other hand, total spending is projected to fall sharply from an estimated level of 44.9% of GDP in 2011 to 37.5% in 2015. In other words, the entire burden of adjustment – when expressed as a target % of GDP in 2015 falls on expenditure.

The implication of this adjustment, if carried through, will be to shrink the size of Government spending as % of GDP to a level shared by EU member states at the bottom end of the European league. Figure 3, below, compares EU States in terms of the percentage of GDP collected in Revenue. Clearly, Ireland is close to the red-bar states in this Figure in 2010.

But, what might happen if the fiscal consolidation package is followed through using the latest figures provided on 6th December? If it were assumed that all other EU Member States hold their current 2010 level of spending to 2015, then Ireland would reach the bottom of the list in 2015 as the lowest spending State in the EU27. Put another way, the Republic of Ireland will move from being a low-revenue and low spend State to being the lowest spend State in the EU27 and still one of the lowest-revenue collecting States (Figure 4 below). This would be an odd outcome given the apparent desire to move towards greater harmony in regard to the public finances more generally across the European Union.

Figure 3

Total Government Revenue as % of GDP in 2010

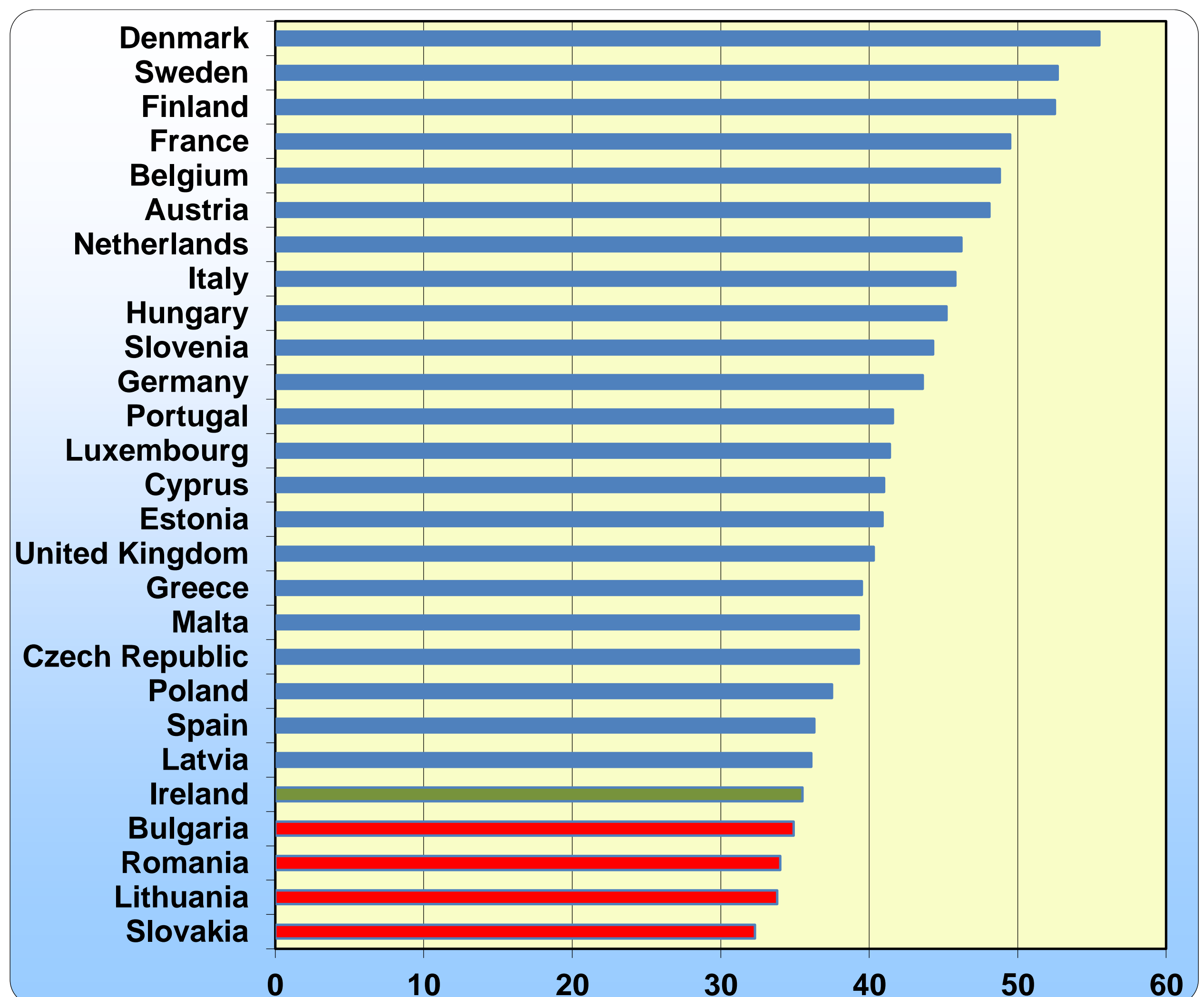
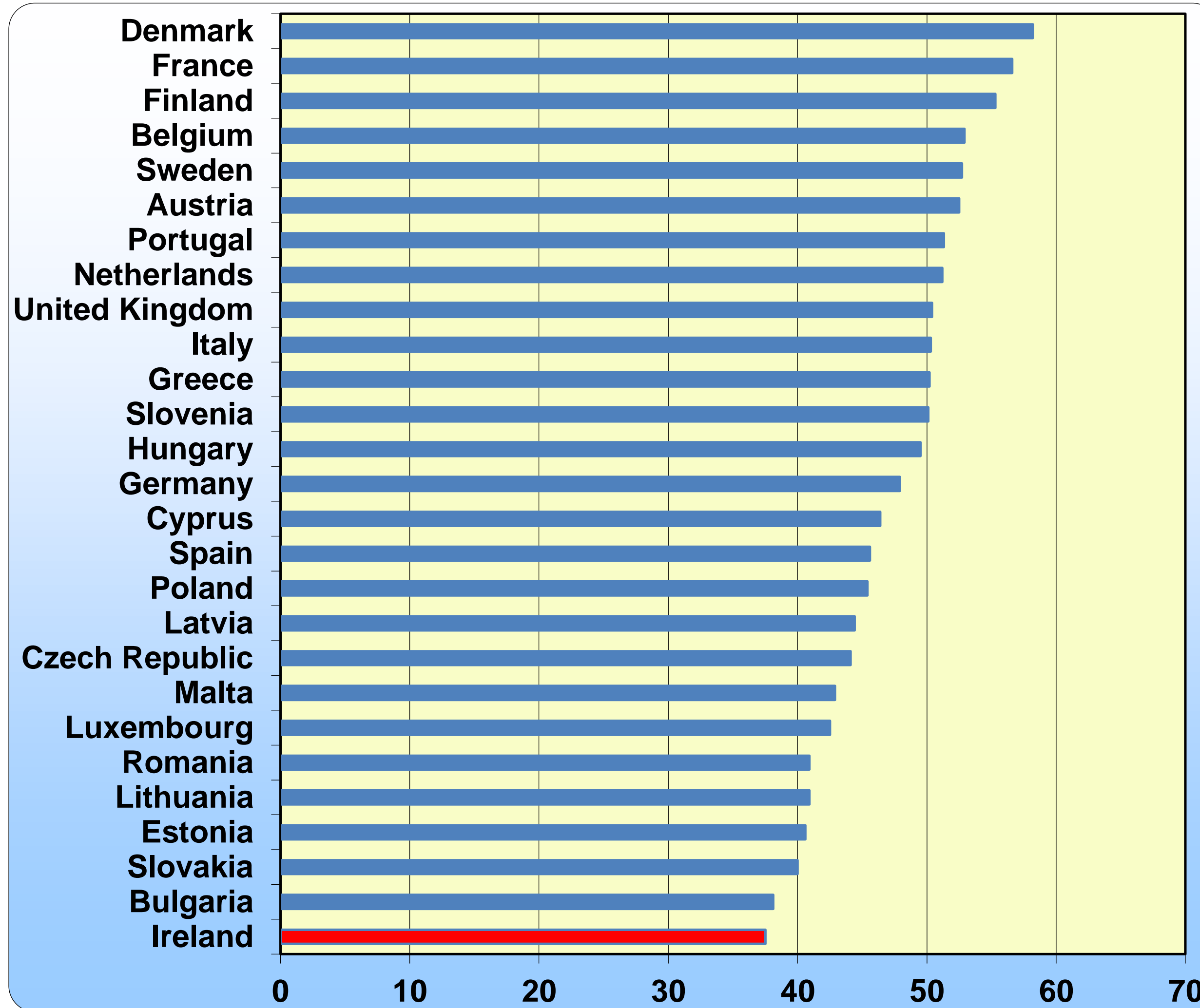


Figure 4 Total General Government Expenditure in ROI in 2015 (assuming no change in 2010 ranking among EU27)



Finally, it is useful to summarise trends in spending and revenue with the average across the Union (Figure 5). Public expenditure, here, was below EU27 norms in the years prior to the recession of 2008. The gap was, typically, as much as 12 percentage points. A similar gap held in regard to total revenue as a % of GDP. Not infrequently, two objections are made to comparisons of this sort:

A GDP, it is claimed, is a misleading guide to total available national income – instead GNP should be used in which case the share of public spending and revenue is much higher than is the case when GDP is used as the measure.

B Ireland is unique in various respects with regards to its age-structure (older populations tend to spend more on areas such as health) and its relatively low military sector.

Point A does not hold because included in total spending and revenue is the value of taxes paid by multi-national companies resident in Ireland. A precise figure is not available. However, it is likely to exceed €3bn per annum (total Corporate Taxes collected were in excess of €3.7bn this year). GDP measures the total output, income or expenditure in a country in a given year. All profits earned in Ireland are, potentially, taxable. If GNP were to be used as a reference point then the value of corporate taxes, employers' social security and other payments by multinationals would need to be deducted from total spending or total revenue. Another consideration is that all EU fiscal targets including Stability Programme Updates work on GDP figures and not GNP figures.

In regard to point B, further research would be required to test this. Ireland's age-structure is such as to require greater outlays of public funds on initial education – thus cancelling some of the effects of possibly lower health spending arising from a relatively younger population. Military spending does account for greater spending in other jurisdictions but the impact is not greater than 1-2% points. The average EU27 spend on defence was 1.6% of GDP in 2009 compared to 0.5% in Ireland. The highest proportion of GDP spent by public authorities on defence was in Greece (at 3.6%).

The real position is that:

- Total revenue and taxes are low in Ireland – not least because taxes on profits and wealth is low
- The low-tax/low-spend policy stance is more to do with domestic political choice than an externally imposed formula
- The Republic of Ireland is set to see a sharp contraction in public spending as a share of total income with a likely loss in public services; and
- Unemployment is likely to remain at very high levels as domestic demand remains flat for most years to 2015 and possibly much later.

Figure 5

Trends in Spending and Revenue EU27 and ROI