

The Irish Experience: Fiscal Consolidation 2008-2014

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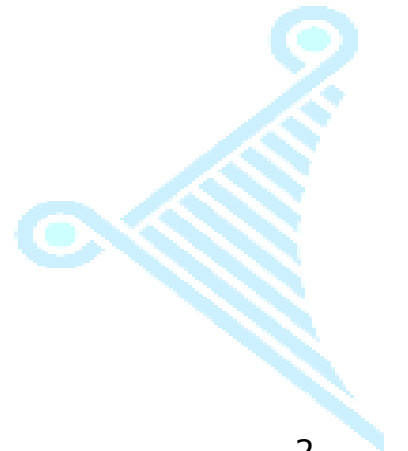
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8th June 2017



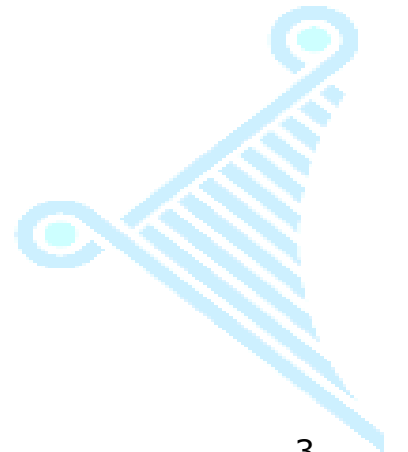
Introduction

- Recently Published IGEES Paper
- Focus on Expenditure Consolidation
- Examines 'best practice' empirically in terms of size, timing and composition.
- Analyse Irish Experience in this Context
- Highlight Countervailing expenditure pressures preventing consolidation "follow-through"



Overview of Presentation

- Part 1: Empirical Research
 - Defining and Identifying Fiscal Consolidation
 - Factors Affecting Success
 - “Optimal” Timing and Composition.
- Part 2: Irish Experience
 - Why?
 - Size
 - Timing
 - Composition
 - Expenditure Pressures

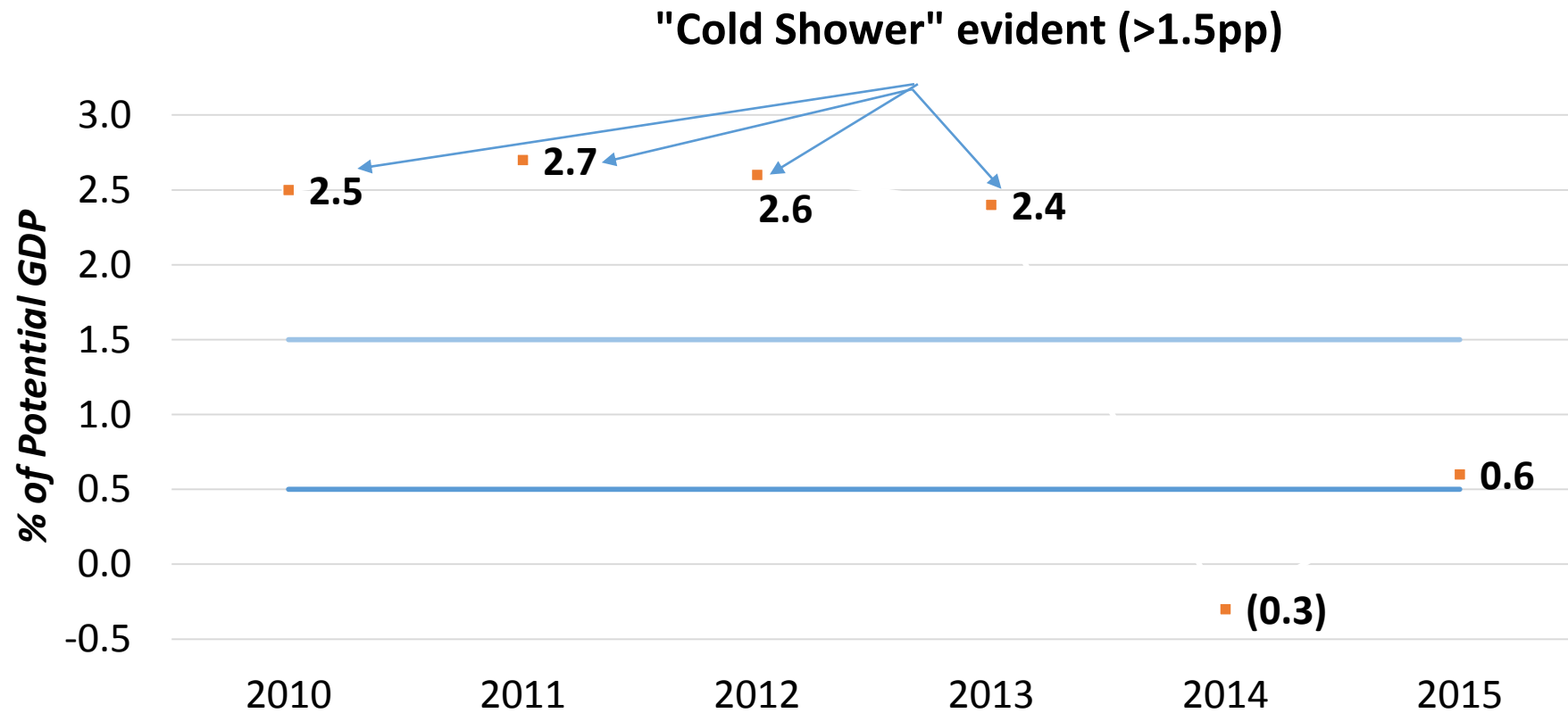


Defining Fiscal Consolidation

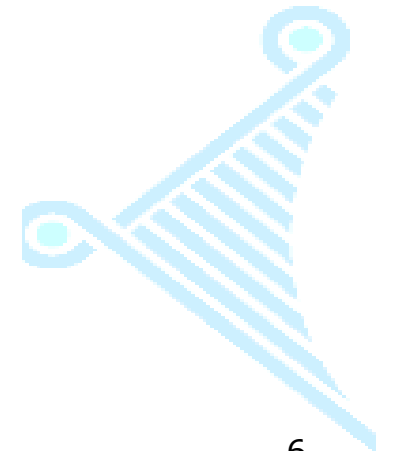
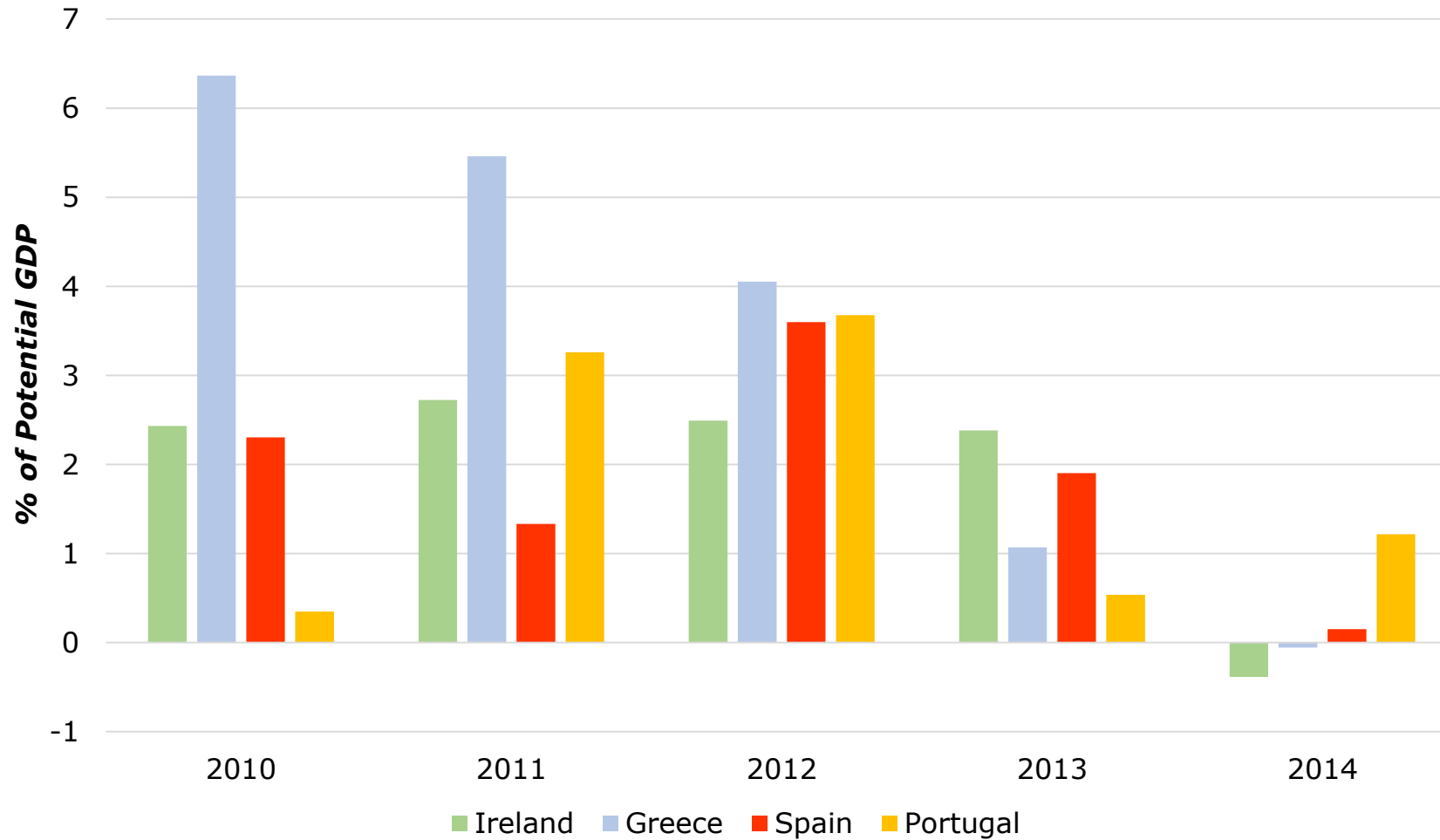
- Fiscal consolidation is discretionary fiscal policy aimed at improving the state of public finances.
- Consolidation episodes are identified empirically using the *Structural Primary Balance (SPB)*.
- **Gradual consolidation:** SPB improves by least 1.5 pp in three years, with no annual deterioration larger than 0.5 pp.
- **"Cold shower":** SPB improves by more than 1.5 pp in a single year (Evident in Irish case).



Illustrating the 'Cold Shower' Improvement in the Structural Primary Balance - Ireland



Cold Shower in Programme Countries

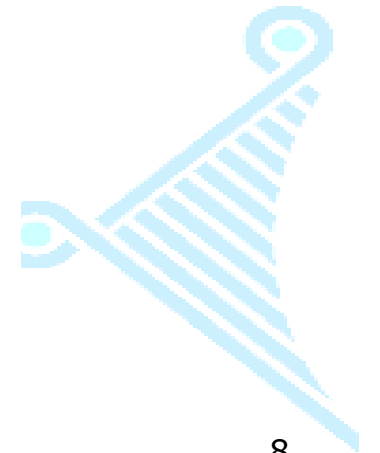
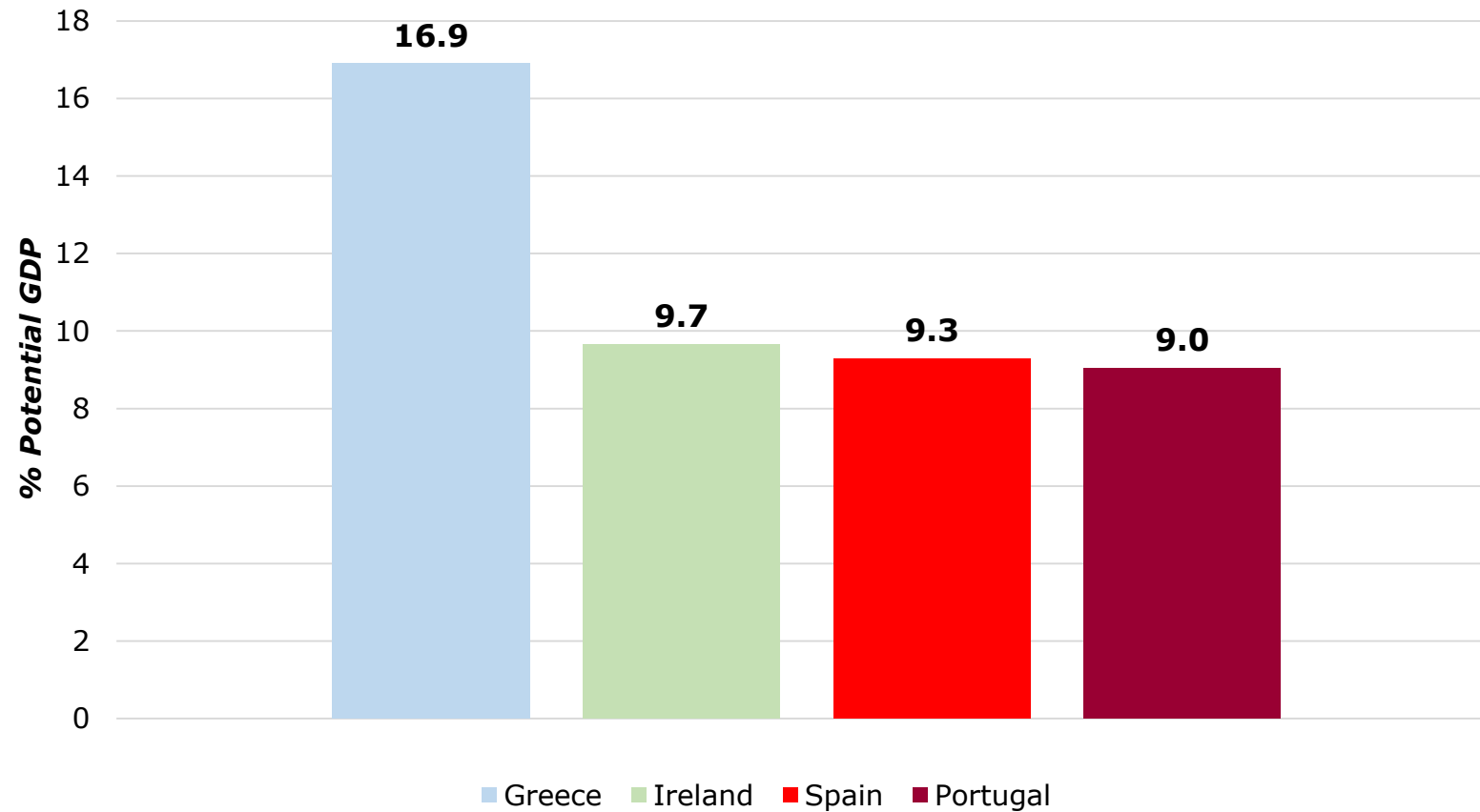


Size and Success of Fiscal Consolidation

- **"Size" of consolidation:** cumulative improvement in the SPB from the start to the end of the retrenchment period (10 pp of potential GDP in Ireland from 2009 to 2014).
- **"Success" of Fiscal Consolidation:**
 - 3 years after the start of consolidation:
 1. the debt to GDP ratio is 5 pp lower;
 2. the SPB does not deteriorate by more than 0.75% in cumulative terms.



Consolidation Size in Programme Countries



Which factors affect the Success of Consolidation?

- **Macroeconomic environment;**
 - *Positive vs Negative Output gap*
- **Initial conditions of the public finances;**
 - *Low vs High Debt*
- **Financial crisis;**
- **Monetary conditions;**
 - *Low interest rates*
- **Timing of consolidation;**
 - *Front-loading vs back-loading*
- **Composition of the fiscal adjustment;**
 - *Productive vs Unproductive expenditure /
Distortionary vs Non-distortionary Taxation*

Ideal Composition of Expenditure and Revenue Measures

Priority

- Expenditure on education and health;
- Public investment in infrastructure and R&D;
- Spending on child care and family;
- Indirect and property taxes;
- Income tax: broad tax base and lower average and marginal tax rates.

Non-Priority

- Expenditure on subsidies, pensions and unemployment benefits
- Personal, corporate taxation and social security



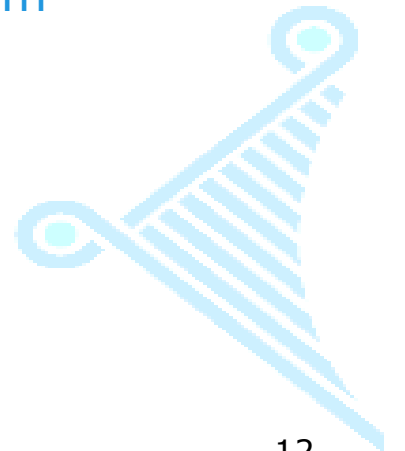
Summary “Optimal” Principles of Consolidation

- **Expenditure reductions** over tax increases;
- **Safeguard productive spending** categories;
- Strengthen institutional **fiscal framework** and structural reforms;
- Avoid increasing inequality;
- Focus on **property and indirect taxes**;
- Adjustment when macroeconomic environment is positive;
- Follow a **gradual pace**;
- however, **high debt levels** and financial crashes can necessitate an **accelerated** adjustment process.



Why Fiscal Consolidation in Ireland

- **Weak public finances.**
 - Wide gap between government expenditure and receipt (underlying deficit peaked at 11.5% of GDP in 2009).
- **Cost of Financial System Repair:**
 - Utilisation of financial resources / borrowing reducing scope for prolonging deficit (2009-2011)
- **Maintaining credibility of the financial markets**
 - Wide bonds spread since 2008 and loss of market access from 2010 onwards.
- **External Surveillance:**
 - Compliance with the EDP's deficit targets from 2009 to 2015.
 - EU/IMF Programme from 2010-2013.



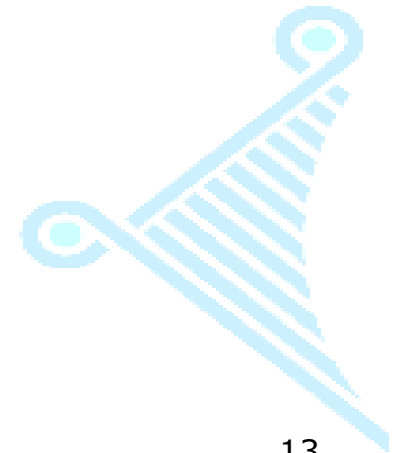
Broad Adjustment Composition

- Nine Budgetary Events
 - €30bn ($\frac{1}{5}$ GDP) of Measures
 - Broadly split 2:1 in favour of expenditure

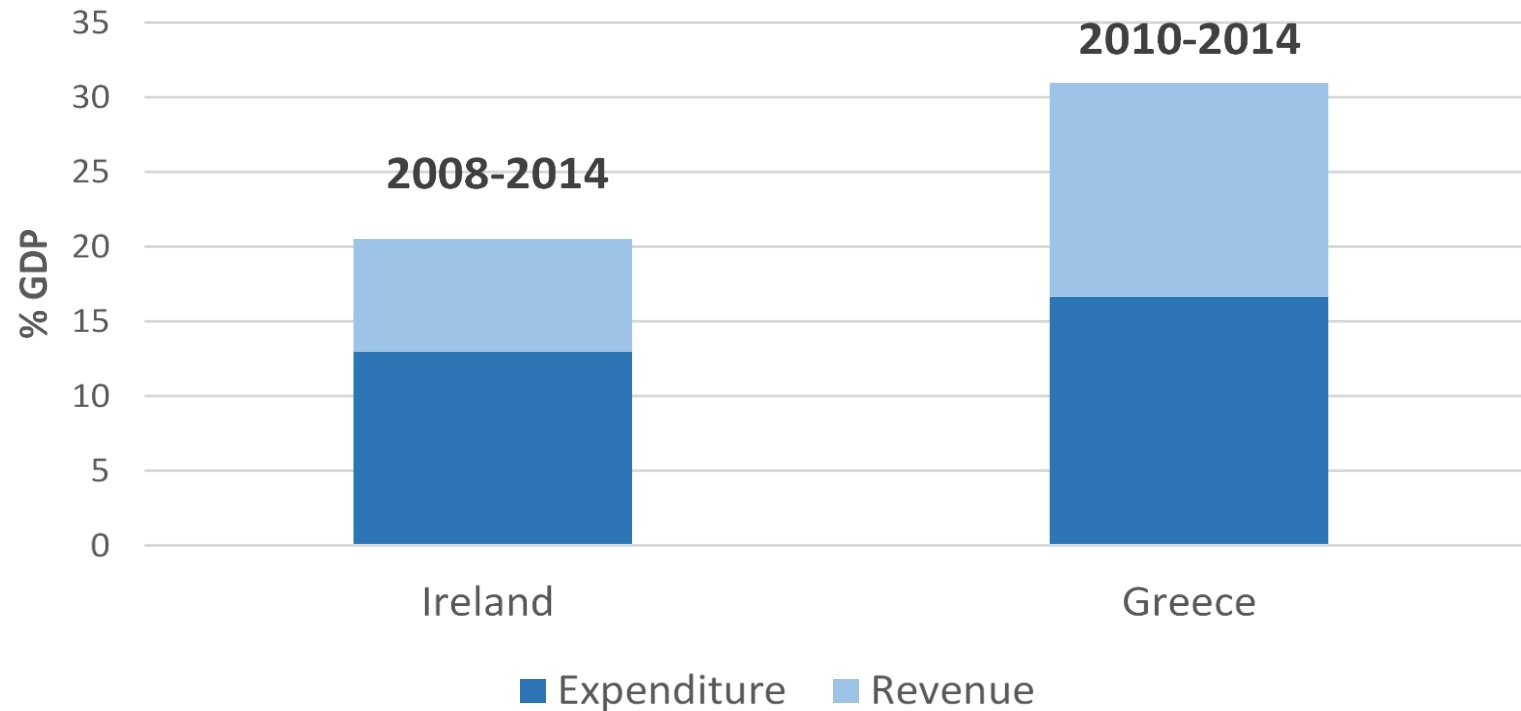
Table 3: Announced Ex Ante Consolidation

€bn	Total	Revenue	Expenditure	Current	Capital
July 2008	1	-	1	1	-
Budget 2009	2	2	0	0	0
February 2009	2.1	-	2.1	1.8	0.3
Supplementary Budget 2009 (April)	5.4	3.6	1.8	1.2	0.6
Budget 2010	4.4	0.1	4.3	3.2	1
Budget 2011	6.1	2.2	3.9	2.1	1.9
Budget 2012	3.2	1	2.2	1.4	0.8
Budget 2013	3.1	1.2	1.9	1.4	0.5
Budget 2014	2.5	0.9	1.6	1.5	0.1
Total	29.8	11	18.8	13.6	5.2

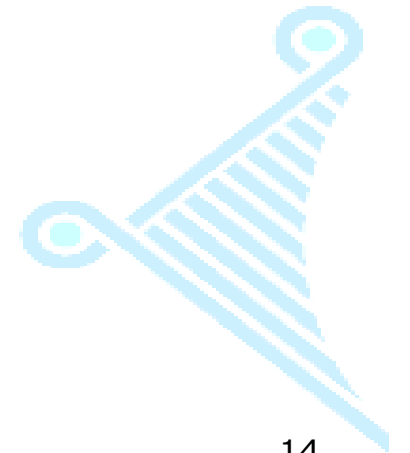
Source: Budget Documentation (Various Years).



Fiscal Adjustment Experience: Ireland Vs Greece

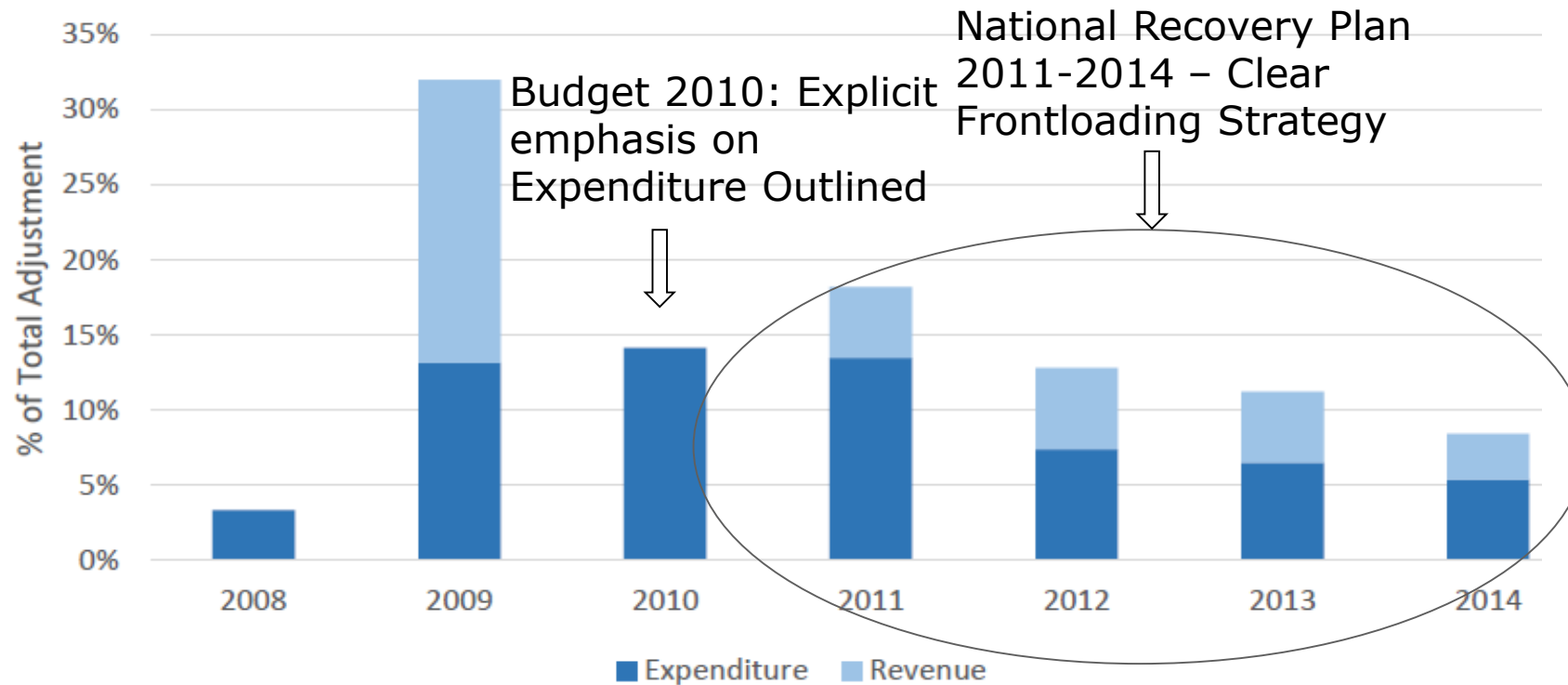


Source: Greek Finance Ministry.



Timing: Front-loading Strategy?

- Initially, focus on Revenue measures until Budget 2010 / National Recovery Plan (NRP)..
- Gradual adjustment preferable but external conditions...
- Frontloading as an explicit strategy less clear in early years of adjustment..



Actual Consolidation higher than originally foreseen

- Fiscal Goalposts continually shifted requiring evermore fiscal effort
- Importance of NRP:
 - Comprehensive multi-year Consolidation plans → clarity on composition and timing of remaining adjustments

Table 5: Multiannual Consolidation Plans

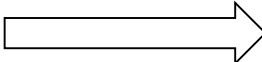
(€bn)	Consolidation Type	2009	2010	2011	2012	2013	2014	Total
Budget 2009 (April)	Expenditure	1.8	2.25	2.5	---	---	---	14.8
	Revenue	3.6	2.5	2.1	---	---	---	
Budget 2010	Expenditure	---	4.3	3 ⁹	3			15.7
	Revenue	---	0					
NRP	Expenditure	---	---	3.9	2.1	2	2	25.5
	Revenue	---	---	2.1	1.5	1.1	1.1	

Source: Budget Documentation (Various Years).

Increasing Fiscal Effort Required

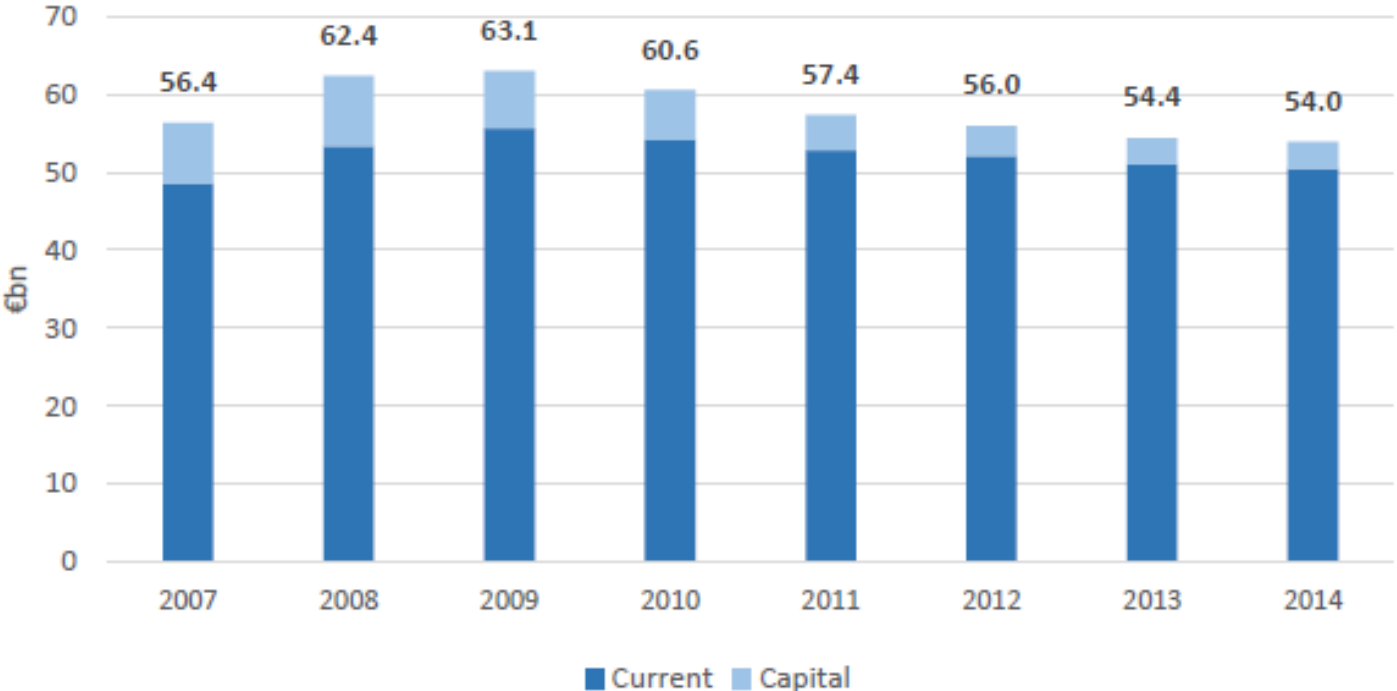
Effect on Gross Voted Expenditure

- €19bn of Expenditure Measures



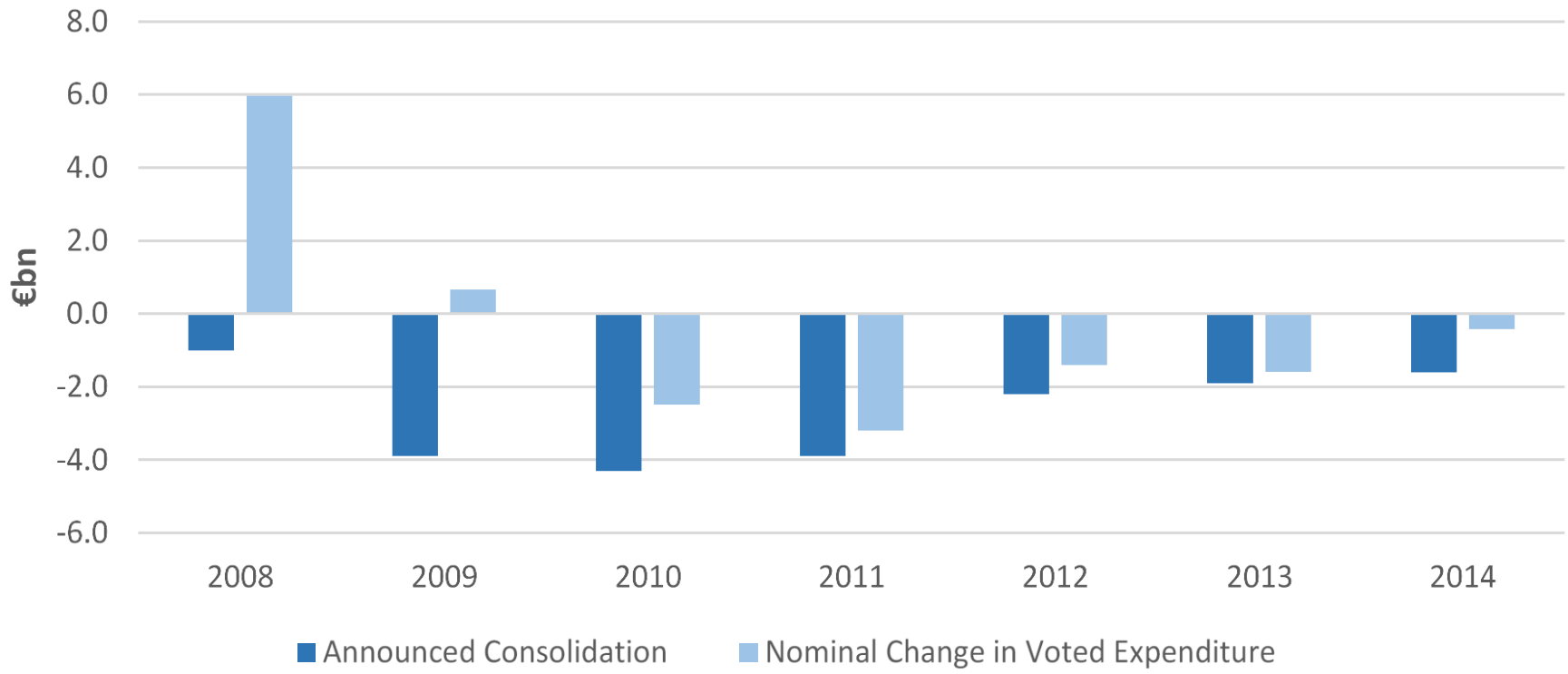
- €9bn reduction in Gross Voted Expenditure

Figure 6: Evolution of Gross Voted Expenditure, 2007-2014

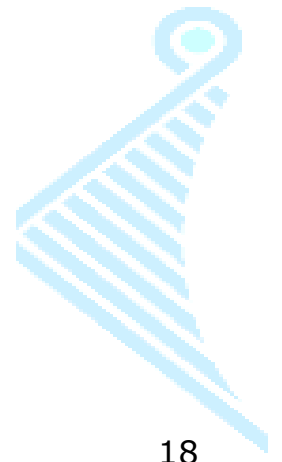


Expenditure Pressures and Consolidation /2

Figure 7: Consolidation Measures Vs Actual Change in Gross Voted Expenditure (Annual)

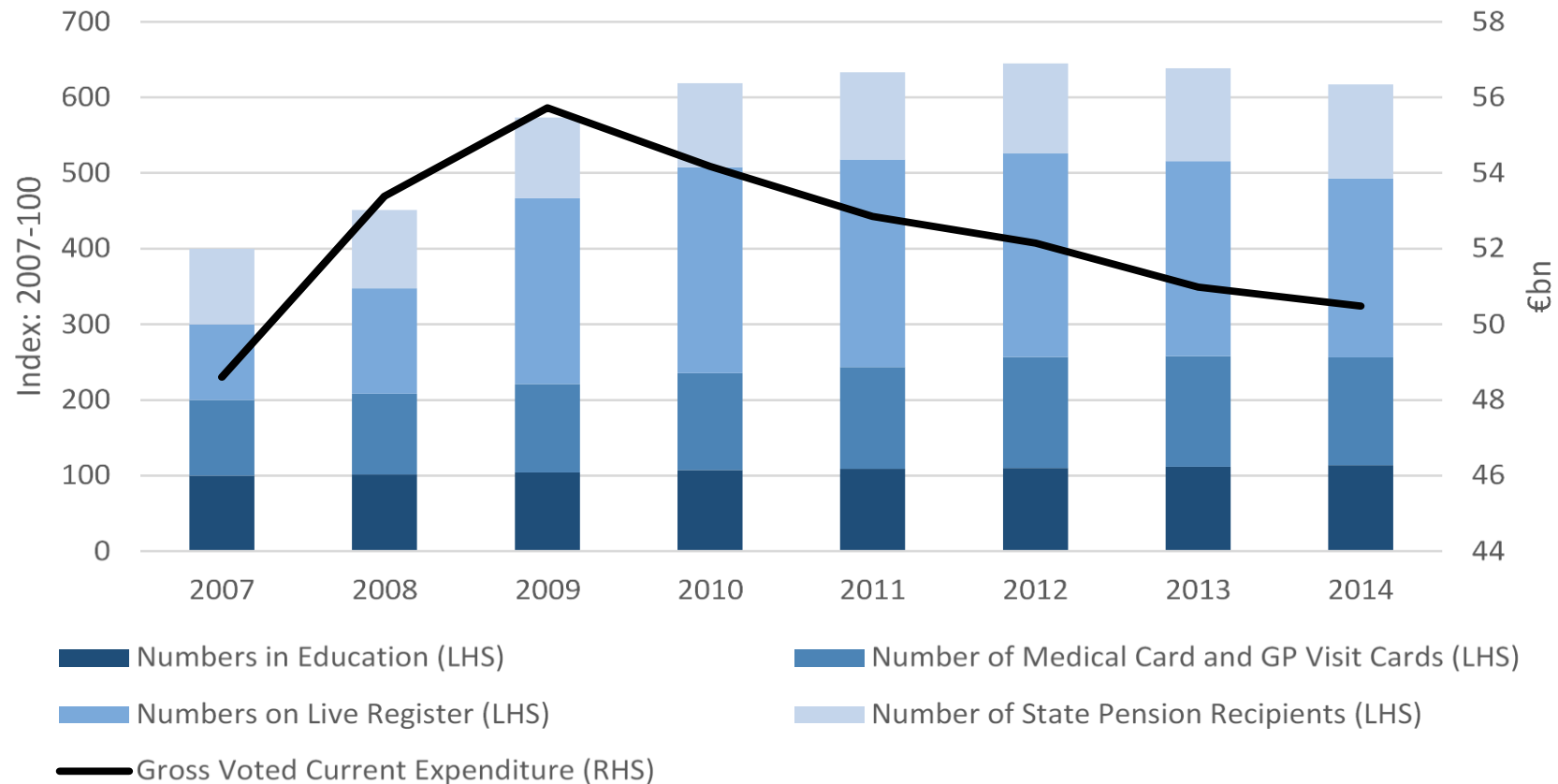


Source: Budget Documentation and Department of Public Expenditure and Reform.



Expenditure Pressures and Consolidation

Figure 5: Illustration of Expenditure Pressures and Fiscal Consolidation



Source: CSO and Relevant Government Departments.

Summary of the Main Expenditure Drivers

- Automatic stabilisers, demographics etc

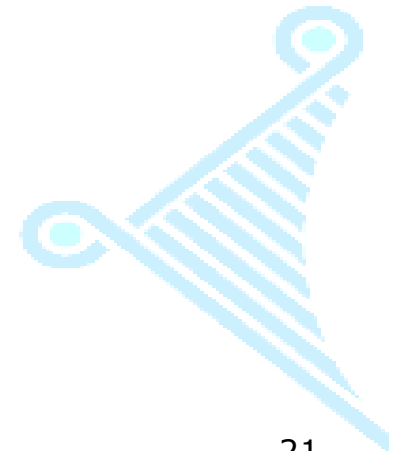
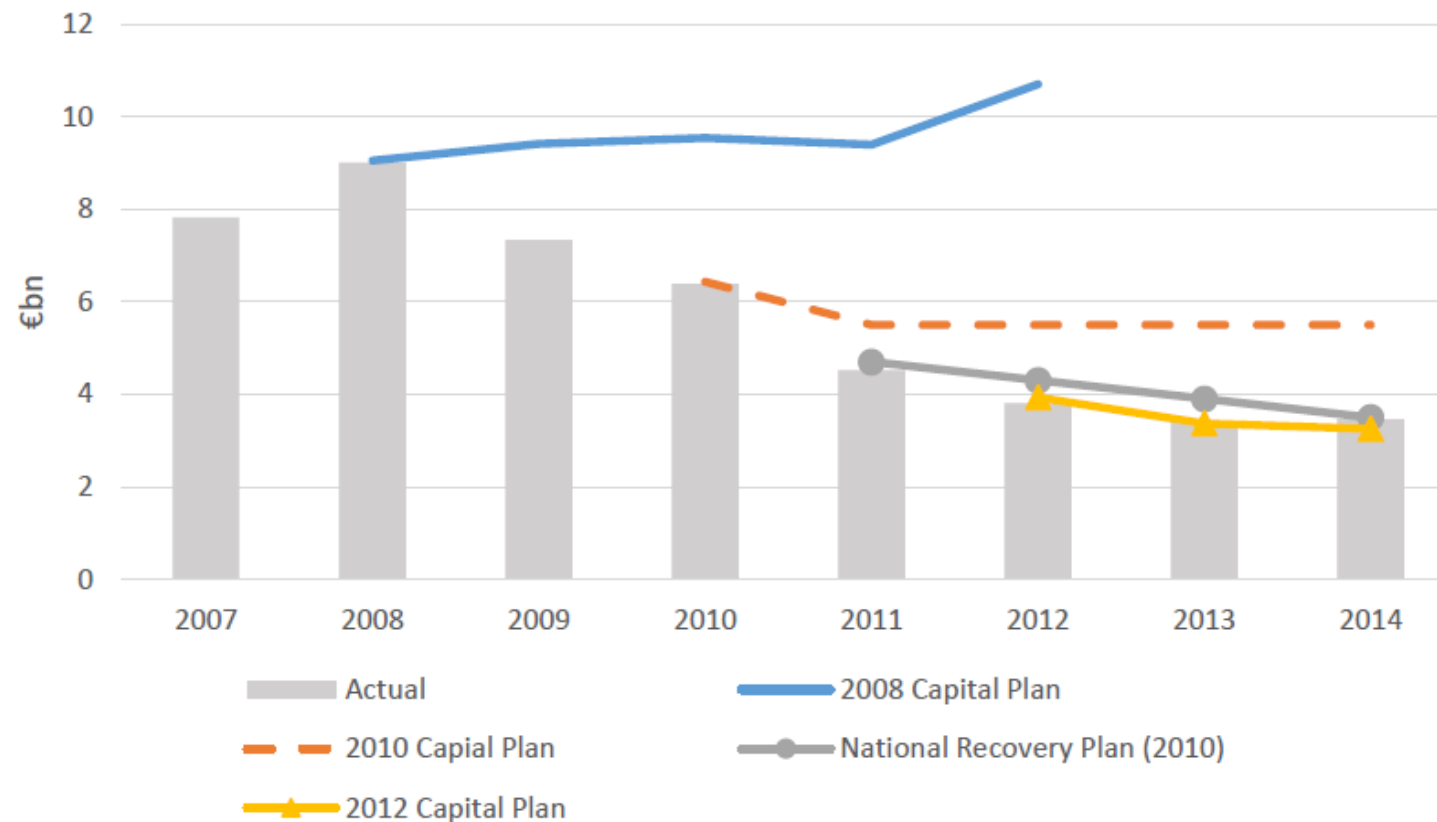
Table 6: Estimated Main Expenditure Drivers 2007-2014 (cumulative)

<i>(€bn)</i>	2007	2008	2009	2010	2011	2012	2013	2014
Unemployment Expenditure (LR)	1.4	2.1	3.7	4.1	3.9	3.6	3.7	3.3
Pension Related Expenditure (DSP)	5.0	5.5	5.9	5.9	6.1	6.3	6.5	6.6
Public Service Pension Expenditure	1.5	2.1	2.6	2.7	2.8	3.1	3	3.0
Employment Supports	0.1	0.2	0.2	0.3	0.5	0.6	0.7	0.7
Illness, Disability and Carer	2.8	3.3	3.5	3.6	3.4	3.3	3.4	3.4
Public Sector Increments	-	0.3	0.5	0.8	0.9	1.0	1.1	1.2
Total	10.9	13.5	16.4	17.3	17.7	18.0	18.3	18.2

Source: Department of Social Protection, Authors' Estimates.

Expenditure forgone

- Not an official definition of consolidation but interesting to look at:
 - Recruitment embargo, Pay increases withheld, allocations under legacy versions of public capital plans which never came to be (below)



“Success”?

- EDP targets achieved every year (albeit with extensions).
- “Success” of Fiscal Consolidation:
 - 1) Decrease in debt-GDP ratio within 3 years?
 - No, took longer but adjustment over 7 years..
 - 2) Halt deterioration /improve in SPB within 3 years?
 - Yes, substantial (8pp improvement after third year).



Conclusion:

- The Irish experience followed best practice in terms of broad composition (was expenditure-based).
- Consolidation played a significant role in reducing the borrowing requirement as well as contributing to the stabilisation of the debt-GDP ratio.
- A front-loaded adjustment was not ideal but a more gradual pace of consolidation was not possible.



Conclusion / 2

- Areas of productive spending such as capital consolidation could have been safeguarded to a greater extent.
- Numerous measures were introduced to expand the tax base notwithstanding the overwhelming emphasis on direct taxation.
- Some measures, such as the increase in VAT, were certainly more regressive than others but as a whole no discernable negative effect on inequality is apparent.

