Pre-Budget Presentation
UCD President's Lunch

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An Unprecedented Budget

- A few weeks ago, I expected a tough budget to try to convince private sovereign bond markets to continue lending to the Irish state.
- However, the problems in the banking sector caught up with the government.
- We have now entered a multi-year agreement with the EU and IMF, including fiscal targets.
- This budget is step one of this agreed plan.

The Four Year Plan

	2011	2012	2013	2014
Deficit/GDP	9.1%	7.0%	5.5%	2.8%
Adjustment	€6bn	€3.6bn	€3.1bn	€3.1bn

Why So Much Adjustment in 2011?

- A big upfront adjustment made sense when attempting to convince bond markets that the fiscal situation was sustainable.
- Once in EU-IMF plan, why do we need €6 billion of the €15 billion adjustment to be in 2011?
- I don't know. The answer appears to be that the Europeans insisted on a big upfront adjustment.
- Tomorrow's budget (and extensive conditionality that follows it in 2011) may represent the biggest loss of sovereignty due to the EU-IMF deal.

Risks Due to Front-Loading

- The Irish economy is in terrible shape: Perhaps bouncing along the bottom after a huge decline.
- Adjustment of €6 billion—close to 4 percent of GDP—risks depressing the economy further.
- A more gradual approach to adjustment would have been preferable.
- Large upfront adjustment many be due to politics: EU wanted to get as much adjustment as possible "locked in" before the election and uncertainties due to new government.

Still, Don’t Shoot the Messengers

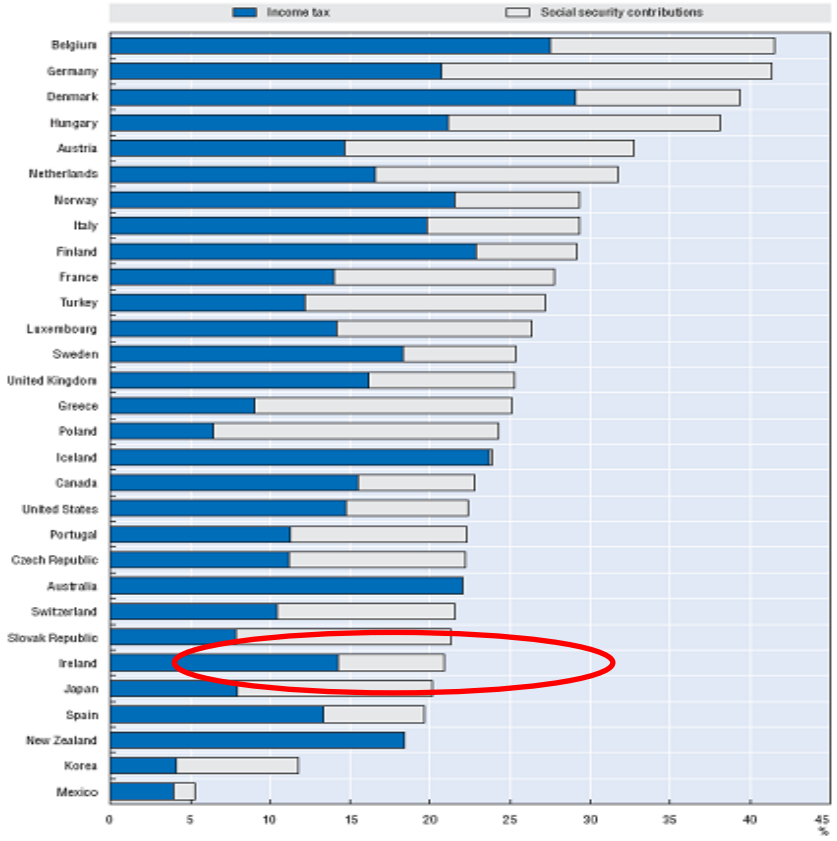
- The politics of this situation—an unpopular government negotiating a multi-year fiscal deal in their final weeks—are terrible.
- Expect years of complaints about nasty outsiders imposing harsh cuts and tax increases.
- But without EU\IMF, the deficit would need to be reduced to **zero** immediately.
- And sovereign default would restrict ability to run deficits for years and raise the cost of any borrowing.
- We don’t have any choice other than deficit reduction.

So Is There Anything Left to Debate?

- **YES.**
- EU\IMF mainly care about the macro aggregates.
- Plenty of room for doing adjustment in a different way than in the government plan.
- For instance, government propose €5 billion in tax increases and €10 billion in spending cuts over 2011-2014. This mix could be changed.
- But focusing on making the income tax system more progressive—raising taxes mainly on the rich—isn't likely to work.

Employee Tax and PRSI Contributions

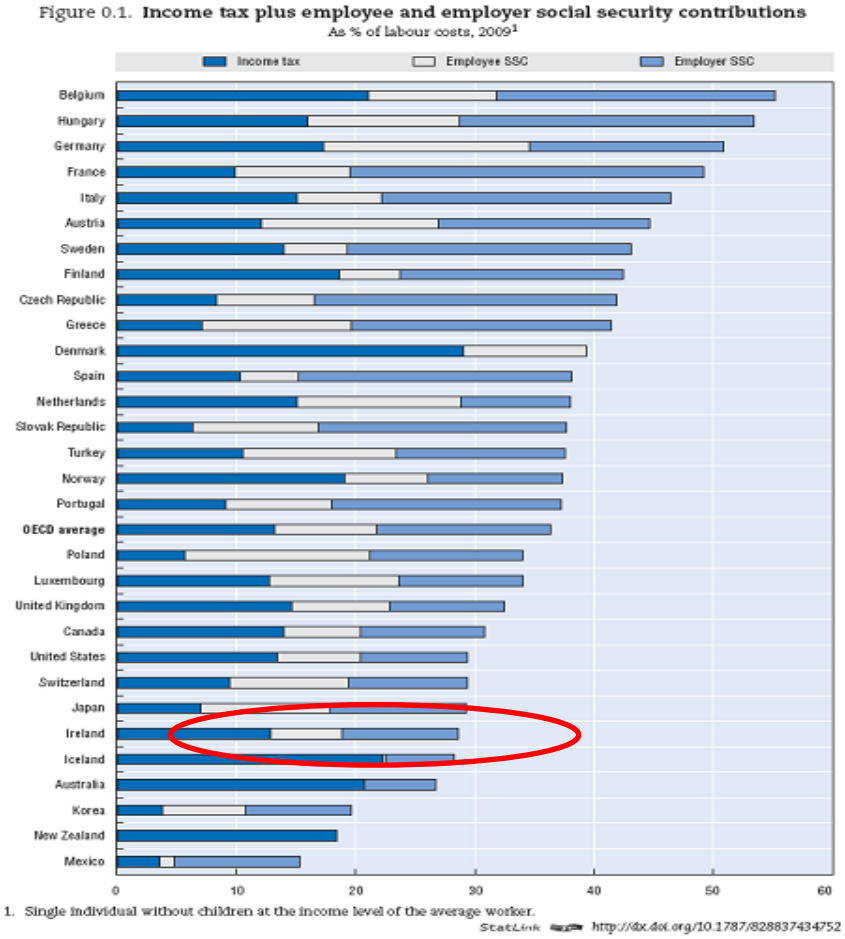
Figure 0.2. **Percentage of gross wage earnings paid in income tax and employee social security contributions 2009** [1, 2]



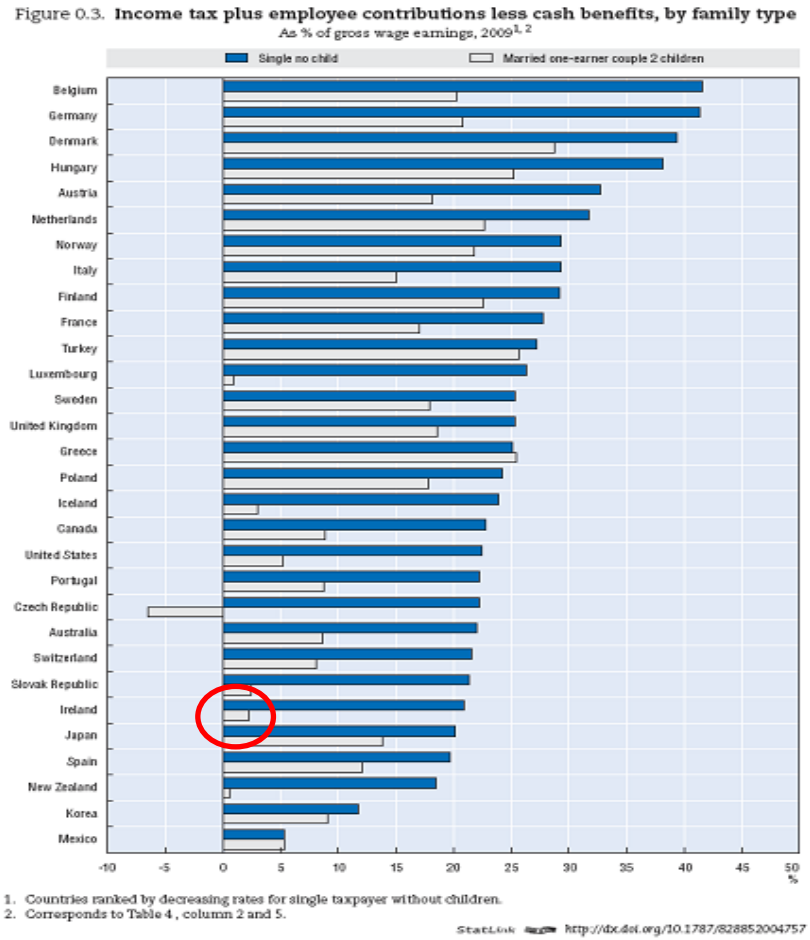
1. Countries ranked by decreasing tax burden.
2. Single individuals without children at the income level of the average worker.

StatLink http://dx.doi.org/10.1787/828847316603

Employee Plus Employers Tax Burden



Employee Tax Burden Minus Cash Benefits



Tax System is Highly Progressive

- Income plus PRSI tax rates for single people at selected percentages of average wage:

	67%	100%	167%
Ireland	14.2	20.9	32.5
EU-15	24.2	29.2	36.1
OECD	21.1	25.6	31.4

Adding in Child Benefit

- Income plus PRSI tax rates minus cash benefits for married couple, two kids, one earner on average wage and **second earner** at selected percentages of average wage:

	0%	33%	67%
Ireland	2.2	4.9	11.1
EU-15	16.7	18.4	22.2
OECD	13.3	16.0	19.5

High Marginal Tax Rates

- Income plus PRSI tax rates for single people at selected percentages of average wage:

	67%	100%	167%
Ireland	35.9	54.8	54.8
EU-15	50.1	52.1	54.5
OECD	43.0	45.9	48.0

Elements of a Fairer Approach

1. **More Emphasis on Wealth Taxes**: A larger and more graduated property tax (Plan's proposal only raises €530 million).
2. **No Universal Social Contribution**: Keep poorest workers out of tax net (fairness\work incentives). Higher basic rate a better approach.
3. **Taxing Child Benefit**.
4. **More Focus On Revenue Raising**: Less on cutting program expenditure in health and education.

A New Approach to Budgeting

- The four-year plan needs to herald a new approach to budgeting.
- A new budget process:
  - Detailed multi-year budgets.
  - Budget proposals brought to the Dail for debate months prior to budget day.
  - Distributional analysis should be provided throughout the budgetary process: We should know who wins and who loses.

After the EU-IMF Bailout

- Government project peak Debt-GDP ratio of 102% (Debt-GNP ratio might be 130%)
- EU project slower growth, so higher Debt-GDP ratio
- Add extra banking costs and the high interest on bailout loans and debt-GDP ratio may be over 115%.
- We've come back from this before.
- But in 2014, sovereign bond markets will be worried about default and the interest rate on future bond market borrowings could be high.
- Possibility of default\restructuring is very real.