Discussion of Fiscal Policy Papers
UCD-DEW Conference on Responding to the Crisis

Prof. Karl Whelan

University College Dublin

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Ireland's Fiscal Situation: Where Do We Stand?

- Department of Finance released a Stability Program Update on Friday night, which clarifies the seriousness of the current fiscal crisis.
- I would now summarize the outlook for 2009 with the following numbers.
- The government will spend about €79 billion this year:
  1. Approximately €20 billion on public sector pay and pensions.
  2. Approximately €28 billion on transfers of various types.
  3. Approximately €31 billion on other stuff (spending to maintain services and capital projects).
- The government will receive about €60 billion in revenues.
- This leaves a shortfall of about €19 billion.

Public Sector Pay in a Budgetary Context

- Public sector pay cuts are widely cited as necessary for solving the fiscal crisis.
- For instance, take this quote from an Irish Times opinion piece from last Friday (Headline: Cowen Has a Straightforward Task):

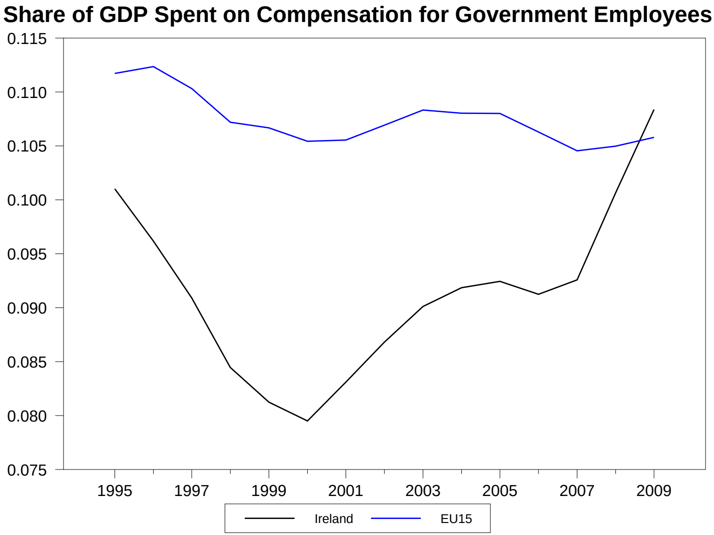
> *It is up to Cowen to roll up his sleeves and cut public sector pay to turn our budgetary position towards balance. When that is done we will get on the same virtuous circle we boarded after the harsh measures of the late 1980s.*

- But dealing with public sector pay alone will not come close to solving the fiscal crisis.
- A 10% cut in public sector pay will save €2 billion, still leaving a €17 billion hole!

Public Sector Pay in a Wider Context

- Most of the €20 billion pay bill goes on:
  1. The health service (€8 billion)
  2. Education (€6.4 billion)
  3. The Gardaí Siochana (€1.3 billion)
- The average public sector worker is a guard, nurse or teacher, not an overpaid paper-pusher.
- Many commentators have focused on our Bloated Public Sector.
- Comparing data on our public sector wage bill with other countries gives some pause for thought on this.
- The wage bill has been rising as a share of GDP but is only just set to exceed the EU15 average.

A Bloated Public Sector?



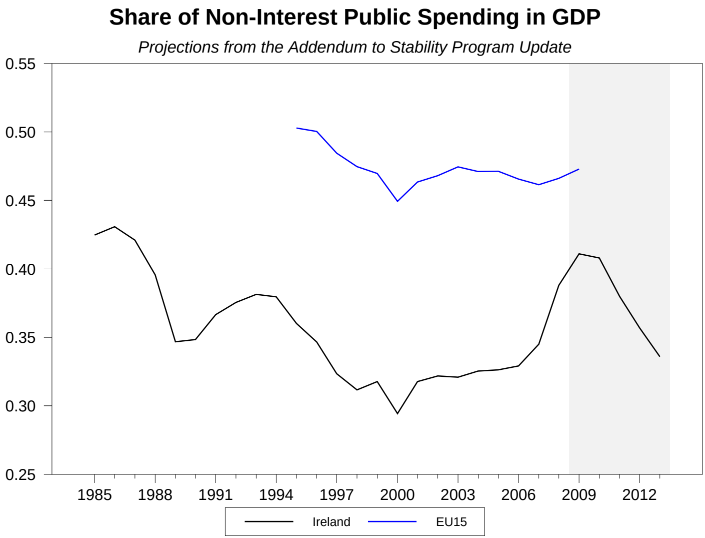
Multi-Pronged Adjustment Required

- It's easy to see why the focus has been on public sector pay.
- There is good evidence for a public sector pay premium, though the size of this premium is quite uncertain.
- But, also, the other options have all been essentially ruled out by government ministers at various times:
  1. Raising taxes ("no further room to raise taxes").
  2. Cutting transfers ("need to protect the vulnerable").
  3. Spending less on stuff ("maintaining front-line services" and "prioritizing capital spending").
- But it is hard to see how stability will be achieved without adjustments in all of the components.
- Capital spending should not be considered sacred, nor should transfer payments. And some raising of taxes also seems inevitable.
- But how much from each? Don't ask me, I'm an economist not a philosopher-king! This is a decision for governments.

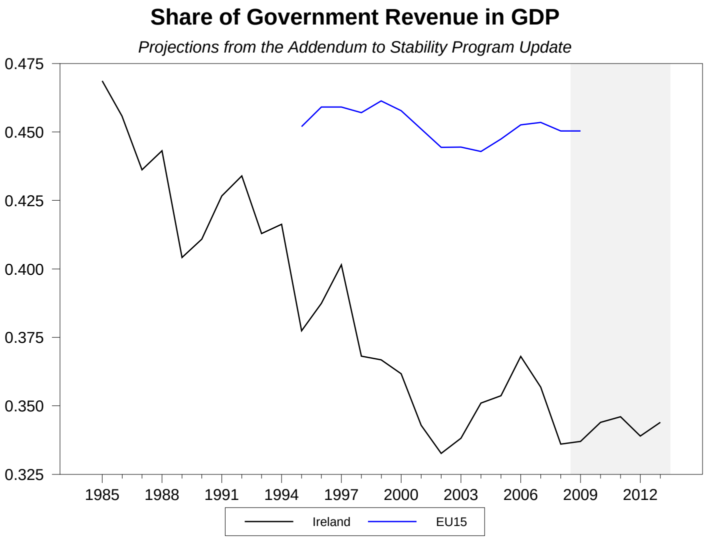
Hard Choices, Serious Tradeoffs

- The Celtic Tiger era was a great time to be a politician.
- We could have more guns, more butter .... and tax cuts.
- And our catch-all governments delivered exactly that.
- We now have to wake up to the serious political and economic (even ideological) tradeoffs that politicians in normal countries have always had to face.
- With more spending on public services and lower taxes at the same time, our Boston versus Berlin discussion now seems like something of a faux debate. This time it will be real.
- Table 6 of Friday's Addendum to the Stability Program Update provides a table showing restoration of GGB to -2.5% of GDP by 2013, with almost all of the adjustment coming from a reduction in the expenditure share of GDP.
- The Addendum did not comment on this table but Philip did. Let's put these figures in context.

Spending Heading Towards the European Average



Taxation Well Below European Average



Designing a Better Fiscal Future

- Patrick Honohan has pointed out that the income tax reductions of the social partnership era left us with a very cyclically-dependent tax base. Hence the sudden collapse in revenue.
- We will need to design a new tax base that will provide more stability in the future.
- One small proposal: Replace stamp duty with a property tax. Eliminates an important distortion.
- All expenditure programs (services and transfers) will need close examination.
- Who will do this analysis? The civil service is woefully short of technically trained (PhD-level) economists.
- Two proposals:
  1. A new team of technically-trained economists at the Dept. of Finance. US Council of Economic Advisors could be a model.
  2. An independent fiscal policy assessment agency, e.g. Swedish Fiscal Policy Council