

Medium-Term Fiscal Challenges for Ireland

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The Fiscal Debate

- 2012 budget
- 2012-2015 stabilisation phase
- 2015-2030 medium-term fiscal correction

Fiscal Responsibility Act

- Bill to be released by end of 2011
- Hints: March 2011 *Reforming Ireland's Budgetary Framework* (DF)
- IFAC
- Fiscal Rules
- Performance Budgeting
- Medium-term fiscal planning
- European context: "Six Pack" reforms

Fiscal Rules

- Literature focus: how to maintain stable position, once achieved
- Transition: speed of debt reduction?
- Trend issue: rise in ageing-related expenditures (pensions, healthcare)

Implication

- Large cyclically-adjusted primary surpluses required throughout 2015-2030
- Fiscal discipline supported by a rules-based fiscal framework

Illustrative Examples

- IMF Fiscal Monitor, September 2011: 5.6% CAPB during 2020-2030 to hit debt/GDP ratio of 60% in 2030
- Challenge compounded by 1.5% of GDP increase in ageing-related spending over 2010-2030
- IFAC FAR, October 2011: 5.2% primary surplus during 2015-2030 to get debt/GDP ratio to 41% in 2030

Designing Fiscal Rules

- Clarity: main policy variable is cyclically-adjusted primary balance (CAPB)
- Cyclical frequency: CAPB target “over the cycle”
- Target CAPB vs outcome CAPB: correction account needed
- Target debt/GDP ratio?

Fiscal Process

- Debt target a political decision: re-set in year 1 of each new government ('informed' by IFAC etc)
 1. Steady-state debt target (40%?; 20%?; 0%; -X%?)
 2. Near-term debt target for final year of government
 3. Delivers target for CAPB over life of the government
- Political accountability: legal responsibility to run "prudent" fiscal policy
- Multi-year fiscal focus, in combination with annual counter-cyclical management
- Fixed CAPB target inappropriate for long-term legislation

Fiscal Policy “Over the Cycle”

- GDP cycle; inflation cycle; current account cycle; credit cycle; asset price cycle
- Modelling of cyclical position
- Cyclical activism requires low steady-state debt ratio
- Macro-level fiscal policy
- “Fiscal Devaluations” (mix of tax policies)

Conclusions

- Fiscal Responsibility Act a fundamental shift in Irish political system
- Good design and sustainability calls for rigorous, broad-ranging debate (economics and politics)