Economic Commentary

Ireland’s Medium Term Economic Strategy 17 Dec 2013

The Irish Government has just published its Medium Term Economic Strategy , entitled ‘*A Strategy for Growth’,* covering the years up to 2020.It provides ‘an overall framework for social and economic policies that are being developed and implemented by the Government’ and sets out a strategy for recovery, based on three pillars; debt sustainability, measures to boost the flow of credit ,and support for employment through the removal of barriers to growth in specific sectors and the opening up of sheltered sectors to competition and investment.

The publication does set out some broad macro eco-onomic projections although there is little detail. Growth in the economy is expected to pick up, from 0.2% this year to 2% next and 2.8% by 2016, as set out in the October Budget, and then accelerates to 3.5% from 2017 onwards. The Department of Finance assumes that productivity growth (output per worker) will grow at a steady 1.5% per annum so employment is therefore projected to grow by an average of 2% per year in the latter part of the period, with the result that a net 238k jobs are created from 2014 to 2020. This would bring the total numbers at work to over 2.1 million , the figure recorded at the peak of the previous cycle in 2007.What that would do to migration flows is anybody’s guess and the Department assumes that labour force growth will be a more modest 1% per annum with the result that there is a steady fall in the unemployment rate over the period, from over 13% this year to under 10% by 2018 and 8% by 2020.

The fiscal situation also improves in the projection; the General Government deficit falls steadily, from 7.3% in 2013 to 3% in 2015 and 1% by 2017,before moving to a modest surplus The debt ratio is still forecast to peak this year, at 124%, and then also declines over the period, reflecting the projected pick up in growth (nominal GDP is expanding by over 5% per annum from 2017 onwards) and the fact that the Government will be running a strong primary surplus (i.e. tax receipts will exceed exchequer spending excluding debt interest payments)

The projected decline in the debt ratio will keep Ireland in line with EU requirements and these also stipulate that Ireland has to eliminate the structural budget deficit. That concept may be arcane but will become less of a mystery over time as it will prove a significant constraint on future policy decisions on spending and taxation. If the deficit was seen as largely cyclical it would disappear as the economy picked up, but in Ireland’s case the deficit is seen as largely structural so it requires fiscal adjustments to eliminate. Moreover the structural deficit is high (at 6.5% of GDP in 2013) and its projected elimination by 2017 will require further budget adjustments. That is not to say the government cannot increase spending in a given year or reduce some taxes but spending has to rise at a slower pace than GDP over the medium term or the tax burden has to rise.

Most forecasters envisage a pick up in the Irish economy in the medium term but no doubt some will argue the projections are too optimistic ,although it is worth noting that the average growth rate over the period, at 2.9%, is well below the ESRI’s recent medium term forecast of 4%. History suggests that the projections have a low probability of materializing anyway but it does serve a purpose in highlighting that Ireland still faces a high structural deficit and that there is still an ongoing need for difficult fiscal decisions.