Opening Statement – Oireachtas Committee on Budgetary Oversight

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ESRI

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Introduction

Let me begin by thanking the Chair for the invitation to the ESRI to appear before the Committee. I am Dr. Karina Doorley, and I am joined by my colleagues Dr. Conor O'Toole and Dr. Dora Tuda. We are grateful for the opportunity to appear before the Committee today to provide our views on Budget 2024.

Macroeconomic Context

Let us first provide our latest macroeconomic assessment, taken from the Autumn 2023 Quarterly Economic Commentary. This contextualises our understanding of Budget 2024. The Irish economy emerged in a strong and resilient manner post the COVID-19 pandemic but it now looks set to experience more moderate, normalised, rates of growth.

This moderation of economic growth is coming through two differing channels. First, the international economy is weakening; inflation remains elevated, interest rates have continued to increase, and demand in countries such as Germany and, in particular, China, has faltered. Ongoing geopolitical tensions and a reappraisal of international supply chain linkages are also providing headwinds for international economic integration and trade. Over and above these general developments and more specific to Ireland, we are also currently experiencing slowdowns in key multinational export sectors, such as pharmaceuticals, which have lowered our overall growth rate for this year. We believe modified domestic demand (MDD) – a more accurate reflection of domestic activity – is likely to grow at 1.8 per cent in 2023, while GDP is set to decline by 1.6 per cent. We expect growth of MDD next year (2024) of 2.4 per cent and GDP growth of 3.5 per cent.

Notwithstanding the normalising of activity domestically and the slowdown in international trade, the domestic Irish economy is currently operating at capacity, in particular in relation to employment intensive sectors like construction. The Irish labour market continues to perform robustly, with unemployment stabilising at approximately 4 per cent over the past year, indicating the economy is close to, or at, full employment.

In this environment, additional domestic pressures are likely to feed through to prices in the short term. However, targeting expenditure towards addressing infrastructure bottlenecks and improving the productive capacity of the economy can alleviate capacity constraints in the medium term.

Within this context, from a macroeconomic perspective, the total budgetary package is substantial. With the Consumer Price Index (CPI) likely to increase by 6% this year and unemployment at 4%, the budgetary package does risk adding to inflationary pressures. In terms of long-term fiscal planning, the introduction of two savings funds, the Future Ireland Fund and the Infrastructure, Climate and Nature Fund, are welcome, in particular as a store of windfall corporate tax gains. These Funds set a positive precedent in terms of providing for future liabilities such as ageing and the climate transition but also providing targeted funding to deal with capacity constraints. However, it could be argued that a greater level of windfall transfers could have been made to the funds. The specific deployment of the infrastructure capital, coupled with investments under National Development Plan, will have to be cognisant of short-term inflationary challenges while attempting to deal with capacity bottlenecks.

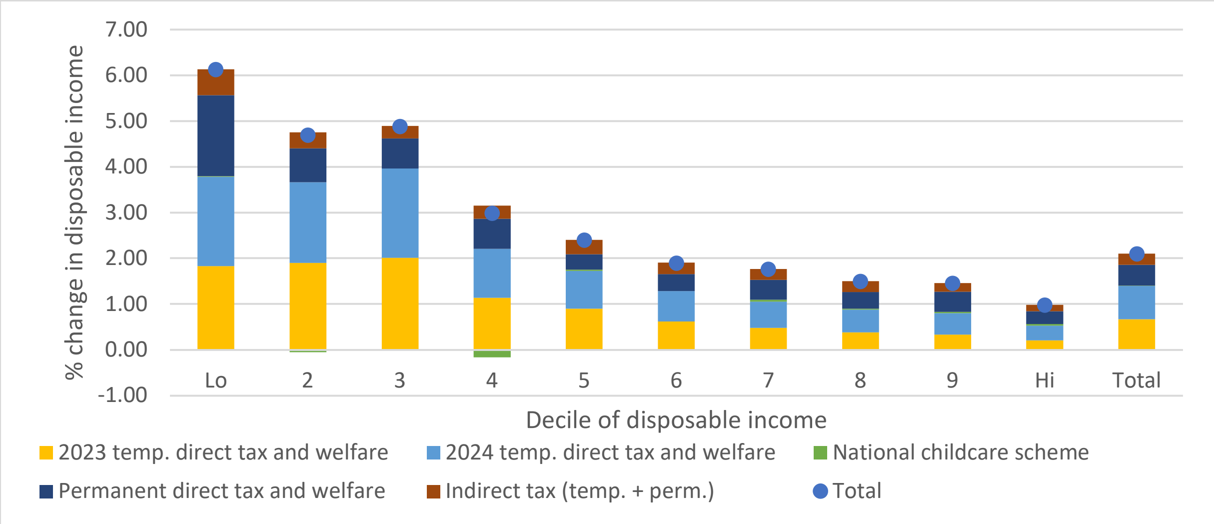
Distributional Impact of Budget 2024

Every year, the ESRI carries out a distributional impact assessment of the Budget using SWITCH, the ESRI's tax-benefit model. This work is possible thanks to core funding provided to the ESRI by the Department of Public Expenditure, NDP Delivery and Reform and funding for the SWITCH work program provided by the Departments of Health, Finance, Social Protection and Children, Equality, Disability, Integration and Youth.

We compare the effect of the budgetary reforms to a scenario in which policy reform keeps the distribution of income constant. In practice, this implies comparing changes in the parameters of the tax and welfare system to an 'indexed' baseline, in which these parameters change in line with forecast income growth.

This year, we found that measures announced as part of Budget 2024 will result in average gains to real income for households next year. The package of tax cuts, welfare increases, one-off payments and indirect tax cuts is worth around 2% of household disposable income on average, with higher gains for low-income compared to high income households.

FIGURE 1 THE EFFECT OF BUDGET 2024 ON THE DISTRIBUTION OF INCOME COMPARED TO AN INCOME-INDEXED 2023 POLICY



Source: Authors' calculations using ITSim linked to the 2015-2016 Household Budget Survey uprated to 2024 prices, and SWITCH run on 2019 Survey of Income and Living Conditions data, uprated to 2024 income levels.
Notes: Deciles are based on equivalised household income, using CSO national equivalence scales. Temporary measures announced as part of Budget 2024 are split into those occurring in 2023 (2023 temp. direct tax and welfare) and those occurring in 2024 (2024 temp. direct tax and welfare). The baseline excludes temporary measures for 2023.

The total budgetary package is progressive and our research estimates that it will result in reductions in the at-risk-of-poverty (AROP) rate of most groups, compared to a budget pegged to income growth. However, this reduction is accomplished mainly though the temporary measures in the budgetary package. For example, without the one-off measures, the AROP rate for elderly households would actually increase by close to 1 percentage point. With inflation moderating and wages growing strongly, policymakers should now consider moving away from one-off payments and benchmarking social welfare payments to provide more certainty to those dependent on them.

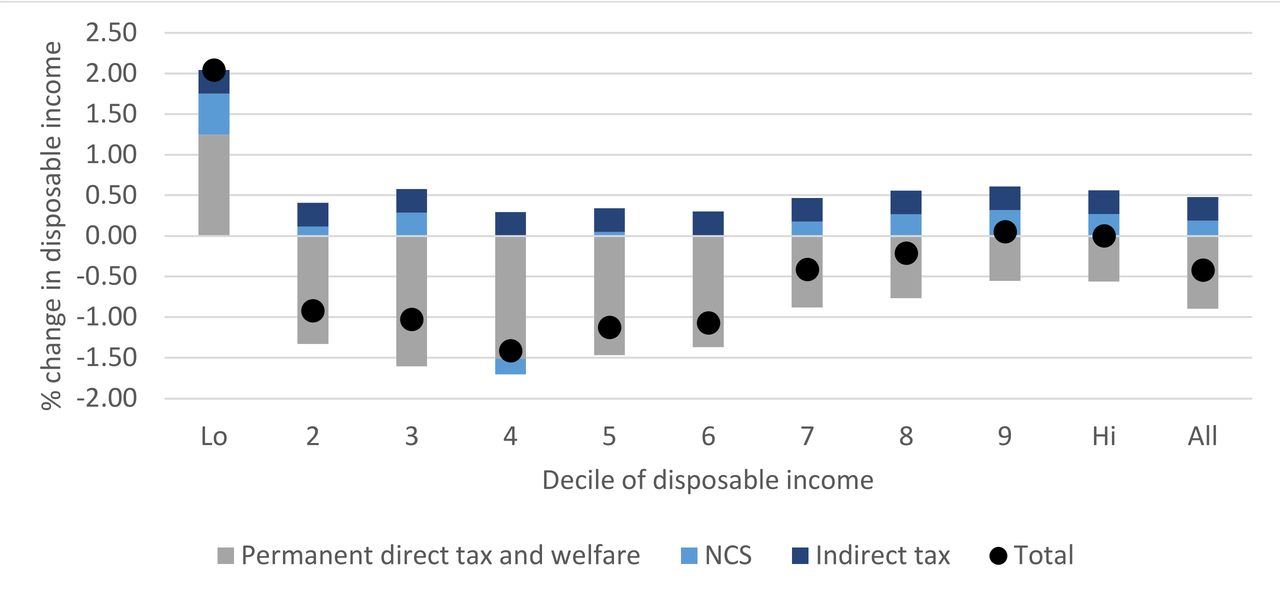
The increase in the universal component of the National Childcare Scheme (NCS) of €0.74c per hour – which takes effect next September - will reduce the out-of-pocket childcare costs of those using formal childcare, potentially increasing female labour supply. However, the effective freeze to the thresholds for more generous means-tested supports through the NCS may result in lower income households who experience wage inflation receiving less support with their childcare costs.

We assessed the distributional impact of Budget 2024 on two equality grounds: gender and disability. We estimate that Budget 2024 provides higher income gains for households with disabilities, compared to households without disabilities. However, this is wholly due to the package of temporary measures. Looking at permanent measures alone, we estimate that households without disabilities gain more in real terms than households with disabilities. Budget 2024 is mostly gender-neutral, with both men and women gaining 2 per cent of disposable income on average.

Medium-term perspective

Taking the last four budgets together, many tax and welfare changes since 2020 have been below wage and price inflation over the same period. This trend is somewhat reversed by Budget 2024. However, compared to a scenario of budgets pegged to income growth, households will have lower purchasing power in 2024, compared to the beginning of 2020. This amounts to 0.5% of disposable income on average, with larger losses for middle income households.

FIGURE 2 **DISTRIBUTIONAL ANALYSIS 2020-2024 WITHOUT ONE-OFF MEASURES**



Source: Authors' calculations using ITSim linked to the 2015-2016 Household Budget Survey uprated to 2024 prices, and SWITCH run on 2019 Survey of Income and Living Conditions data, uprated to 2024 income levels.
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