

# PUBLIC FINANCE

## INTRODUCTION CERTIFICATE IN ECONOMICS

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# CONTENTS & OBJECTIVES

- OVERVIEW OF COURSE
- HISTORICAL EVOLUTION OF PUBLIC SPENDING
- THE PUBLIC FINANCE MEASURES
- EXPLAINING SPENDING GROWTH
- THE IRISH PUBLIC FINANCES

# READING

READING:

STRATEGIC PUBLIC FINANCE, BAILEY – CHAPTER 3

COMPARATIVE LEVELS AND EFFICIENCY OF IRISH  
PUBLIC SPENDING (CHAPTER 3), DPER, SPENDING  
REVIEW (2018)

“MANAGING THE PUBLIC FINANCES IN A FULL-  
EMPLOYMENT ECONOMY”, CONEFREY et al (2023)

# PUBLIC FINANCE

1. INTRODUCTION
2. BUDGETARY FRAMEWORKS
3. FISCAL RULES
4. FINANCIAL MANAGEMENT REFORM
5. ECONOMIC ASPECTS OF TAX
6. ECONOMICS OF DEBT
7. CAPITAL APPRAISAL TECHNIQUES
  
8. EXAM PREP/ REVISION

- PUBLIC FINANCE: ACTIVITIES OF THE PUBLIC SECTOR IN THE ECONOMY
  - Government spending, taxation & borrowing
- CIRCULAR FLOW OF INCOME

$$Y \text{ [GDP]} = C + I + G + X - M$$

- GDP AS A MEASURE OF ECONOMIC WELFARE
- GOVERNMENT AS AN ECONOMIC AGENT IN ITS OWN RIGHT
  - Capital projects
  - Purchaser of goods & services
- INFLUENCE OF GOVERNMENT ACTIONS OVER THE OTHER ECONOMIC AGENTS
  - Taxation policy on decisions regarding work
  - Corporation tax as an influence on the level of Investment
  - Government borrowing as an influence on private borrowing decisions

# PUBLIC SPENDING: A HISTORICAL OVERVIEW

## ■ ALLOCATION

- PROVISION OF GOODS AND SERVICES THAT WOULD NOT OTHERWISE BE PROVIDED BY THE MARKET SYSTEM
- ISSUE: HOW MUCH OF THE GOOD TO SUPPLY AND WHAT SHOULD THE CONSUMER PAY?
- FREE-RIDER PRINCIPLE
- VOTING AS A PROXY

## ■ REDISTRIBUTION

- CORRECTION OF THE SKEWED DISTRIBUTION OF INCOME AND WEALTH IN AN ECONOMY
- ISSUE: DIFFICULT TO MEASURE UTILITY FROM INCOME
- EXAMPLES: PROGRESSIVE INCOME TAX SYSTEM COMBINED WITH WELFARE, VAT ON LUXURIES ETC./ SPATIAL STRATEGY
- DOES INVOLVE AN EFFICIENCY COST

## ■ STABILISATION

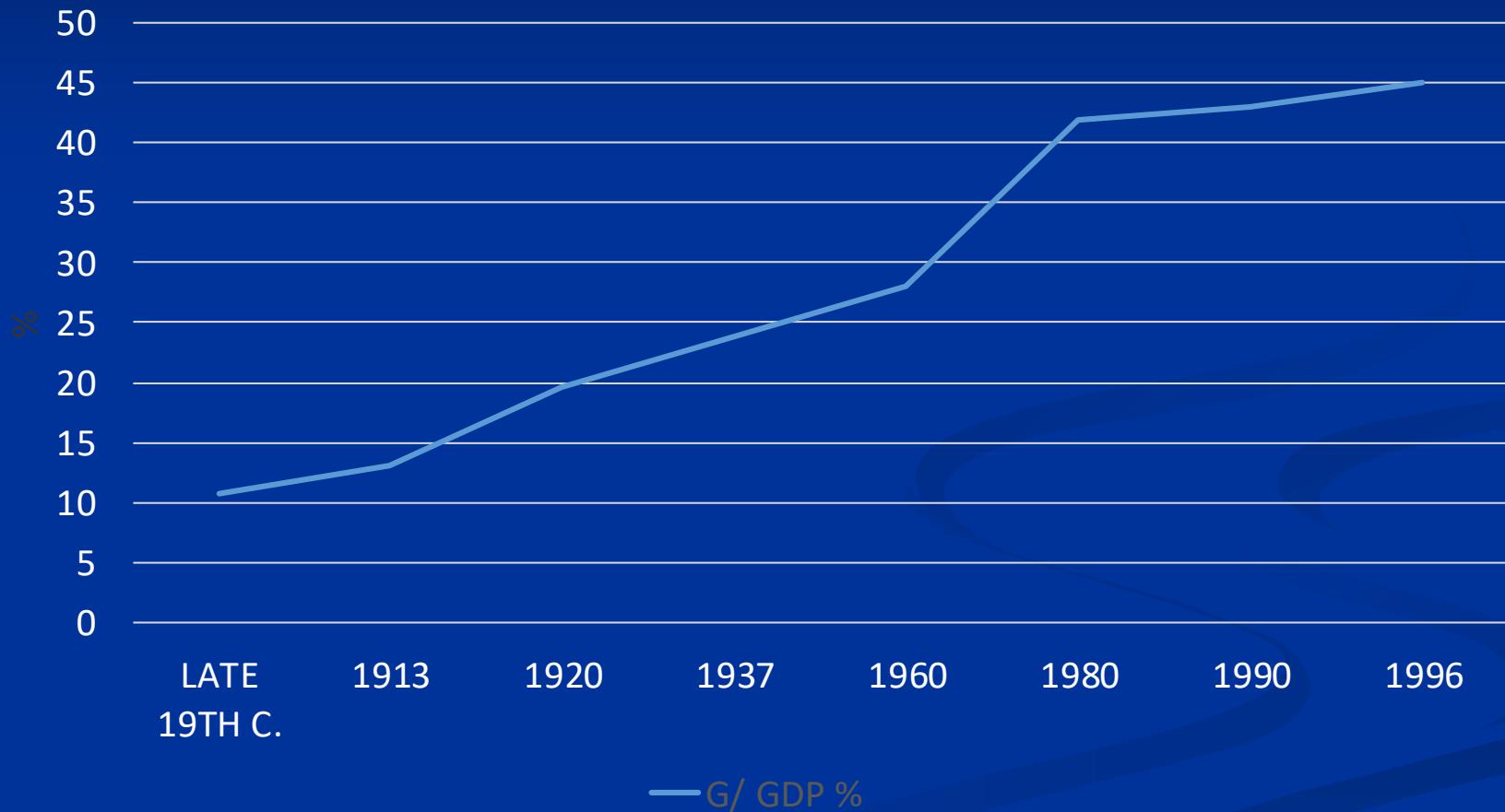
- ■ SUCCESSFUL ATTAINMENT OF MACRO-ECONOMIC OBJECTIVES SUCH AS A STABLE GROWTH RATE, LOW UNEMPLOYMENT AND STABILITY OF THE PRICE LEVEL
- ■ ACHIEVED THROUGH FISCAL POLICY
- ■ THREE BRANCHES OF ECONOMIC POLICY
- ■ FRAMEWORK FOR ASSESSING PUBLIC FINANCE

# THE PUBLIC FINANCE MEASURES

- STANDARD MEASURE OF PUBLIC FINANCE =  $G/GDP\%$
- G INCLUDES:
  - CENTRAL & LOCAL GOVERNMENT CURRENT SPEND FINAL GOODS & SERVICES
  - INTEREST ON PUBLIC DEBT
  - TRANSFERS & SUBSIDIES
  - CAPITAL SPENDING

- COULD ALSO EXTEND TO INCLUDE:
  - TAX/ GDP
  - BORROWING/ GDP
  - DEBT/ GDP
- THE PUBLIC FINANCES AS A *SYSTEM*
  - SPENDING LEVELS SHOULD BE DETERMINED WITH REFERENCE TO THE MEASURES REQUIRED TO FUND THEIR SPENDING
    - *FINE GAEIL (1980s)*
    - *THE JOBS INTIATIVE (2011)*

# G/ GDP(%) INTERNATIONAL POSITION - HISTORICAL PERSPECTIVE



Source: Public Spending in the 20<sup>th</sup> Century, Tanzi & Schuknecht

- PUBLIC CHOICE (1980s)
  - STUDY OF THE MECHANISM THAT CAPTURES VOTES AND TRANSLATES TO PUBLIC POLICY
  - IMPERFECTIONS LEAD TO GOVERNMENT FAILURE
  - VARIOUS FACTORS
    - POLITICAL BEHAVIOUR
    - BUREAUCRATIC BEHAVIOUR
    - VOTING IMPERFECTIONS
    - LOBBY GROUPS
    - BUDGET MODELS (INCREMENTAL)

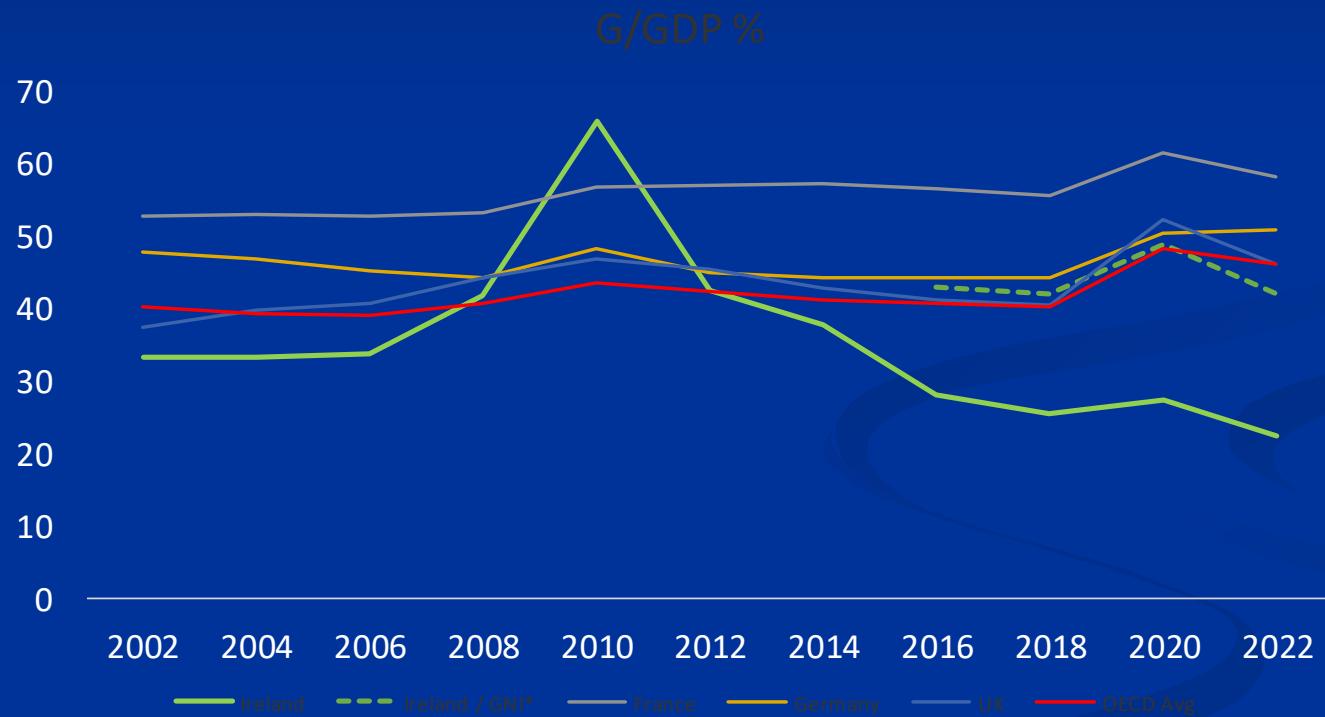
# UPWARD TREND: EXPLANATIONS

- DEMAND SIDE THEORIES:
  - VOTERS' PREFERENCES FOR PUBLIC GOODS & SERVICES
    - AS INCOMES GROW, DEMAND FOR QUANTITY & QUALITY OF PUBLIC SERVICES GROWS
  - VOTERS' PREFERENCES FOR REDISTRIBUTION OF INCOME
    - EXTENSION OF THE FRANCHISE
  - RISK AVERSION
    - REQUIREMENT FOR WELFARE
  - ECONOMIC GROWTH
    - GREATER NEED FOR WELFARE
    - LESS RESISTANCE TO GROWING TAX BURDENS

- PRESSURE GROUPS
  - VOTING FOR THEIR PARTICULAR INTEREST
- URBANISATION
  - TRANSPORT & CRIME
- SUPPLY-SIDE THEORIES
  - BEHAVIOUR OF BUREAUCRATS
    - PRODUCTIVE INEFFICIENCY
    - ALLOCATIVE INEFFICIENCY
  - BEHAVIOUR OF POLITICIANS
    - ELECTORAL CYCLES
    - COALITION GOVERNMENTS/ INDEPENDENTS
  - FISCAL ILLUSION
    - TRUE COST OF PUBLIC SPEND IS HIDDEN

- STRUCTURE OF GOVERNMENT
  - CENTRAL & LOCAL DIVIDE
- PRODUCTIVITY DIFFERENTIAL (BAUMOL'S LAW)
  - RISING WAGE BILL IN THE PUBLIC SECTOR
- DIFFICULT TO DISENTANGLE CAUSE & EFFECT THEORIES
- NO SINGLE THEORY HAS PROVIDED AN EXPLANATION ACROSS TIME & COUNTRIES

# MIXED ECONOMY IN IRELAND vs. OECD AVG



Source: OECD Economic Outlook, 2022

# CAUTIONS OF COMPARISON

(Lawlor & McCarthy, 2003)

1. RATIO – IMPACTED BY GDP GROWTH
2. IRELAND'S GDP > GNP
3. IMPACT OF DEBT SERVICING COSTS
4. DEMOGRAPHIC FACTORS
5. ACCOUNTING FOR PENSIONS
6. WHAT ABOUT FINANCING?

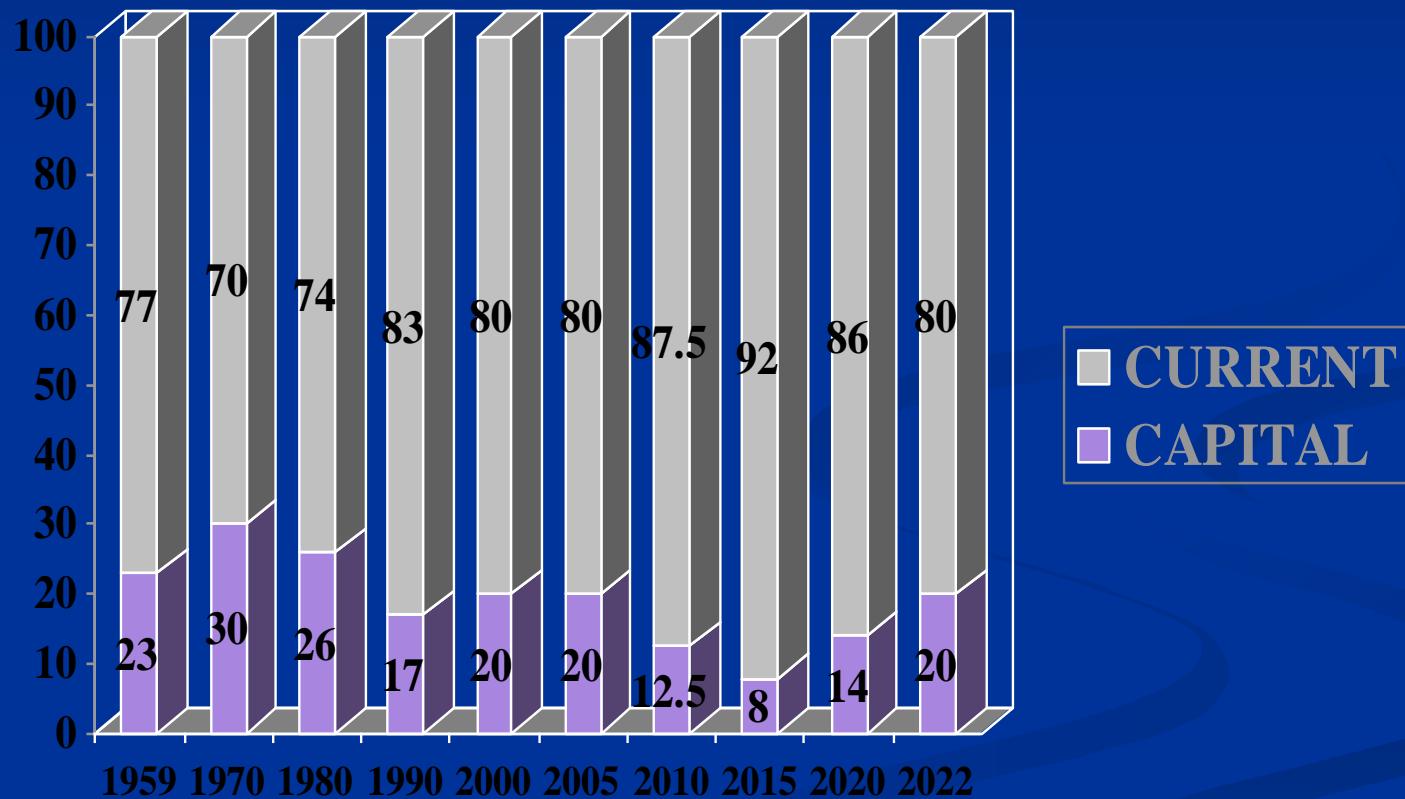
# CAUTIONS OF COMPARISON (DPER, 2018)

- GAP BETWEEN SPENDING METRICS (IRELAND vs EU AVERAGE) IN 2015
  - AS % GDP = 20%
  - AS % GNI\* = 5%
  - AS % GNI\* AND AGE-ADJUSTED = 0.6%
- VOLATILITY OF IRISH GROWTH VERY STRONG (5 – 10%)
- ON A SECTORAL BASIS (as % GNI\* AND AGE-ADJUSTED):-
  - HEALTH SPENDING WELL ABOVE AVERAGE
  - SOCIAL PROTECTION WELL BELOW AVERAGE

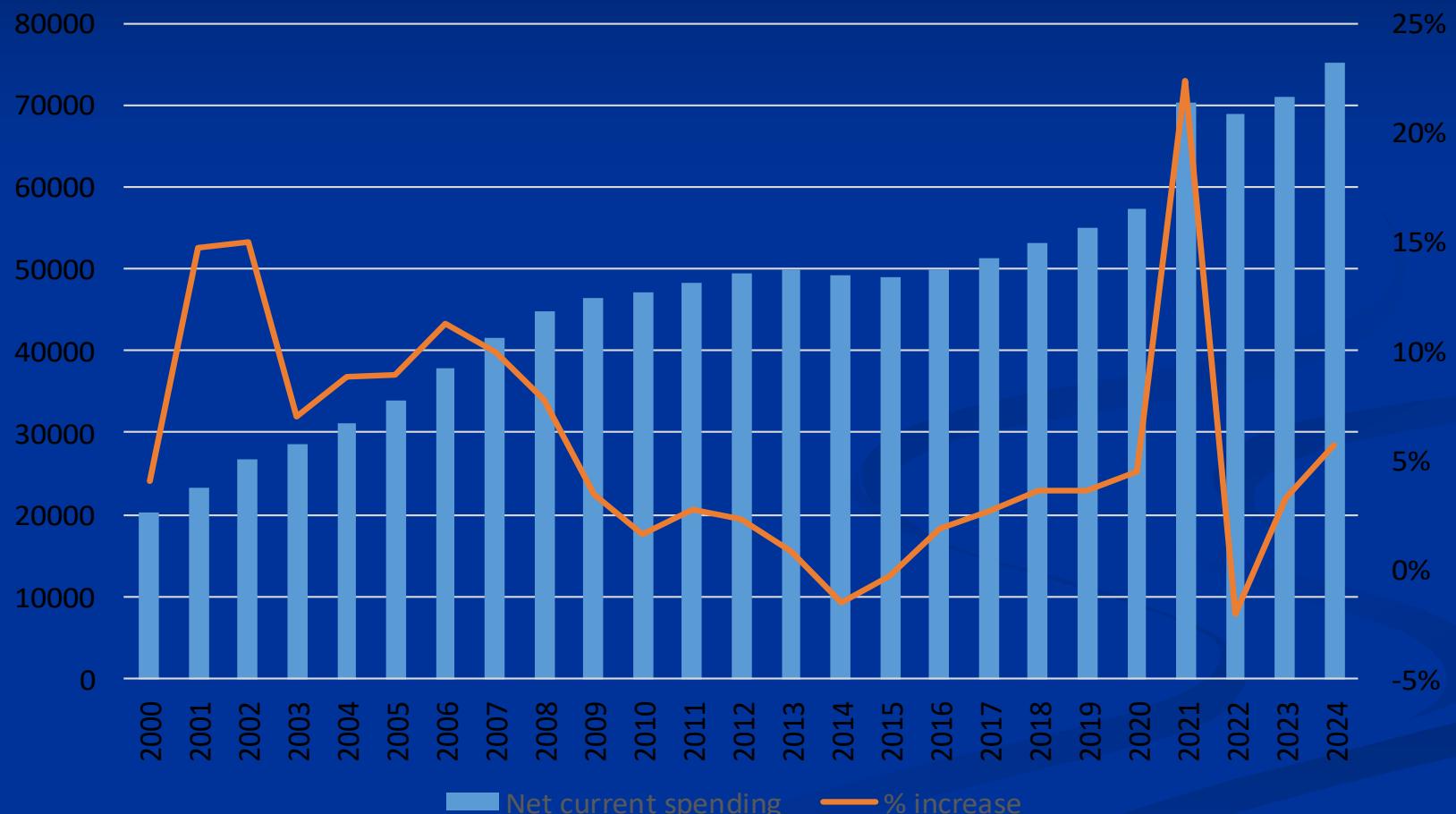
# THE IRISH PUBLIC FINANCES

AN OVERVIEW

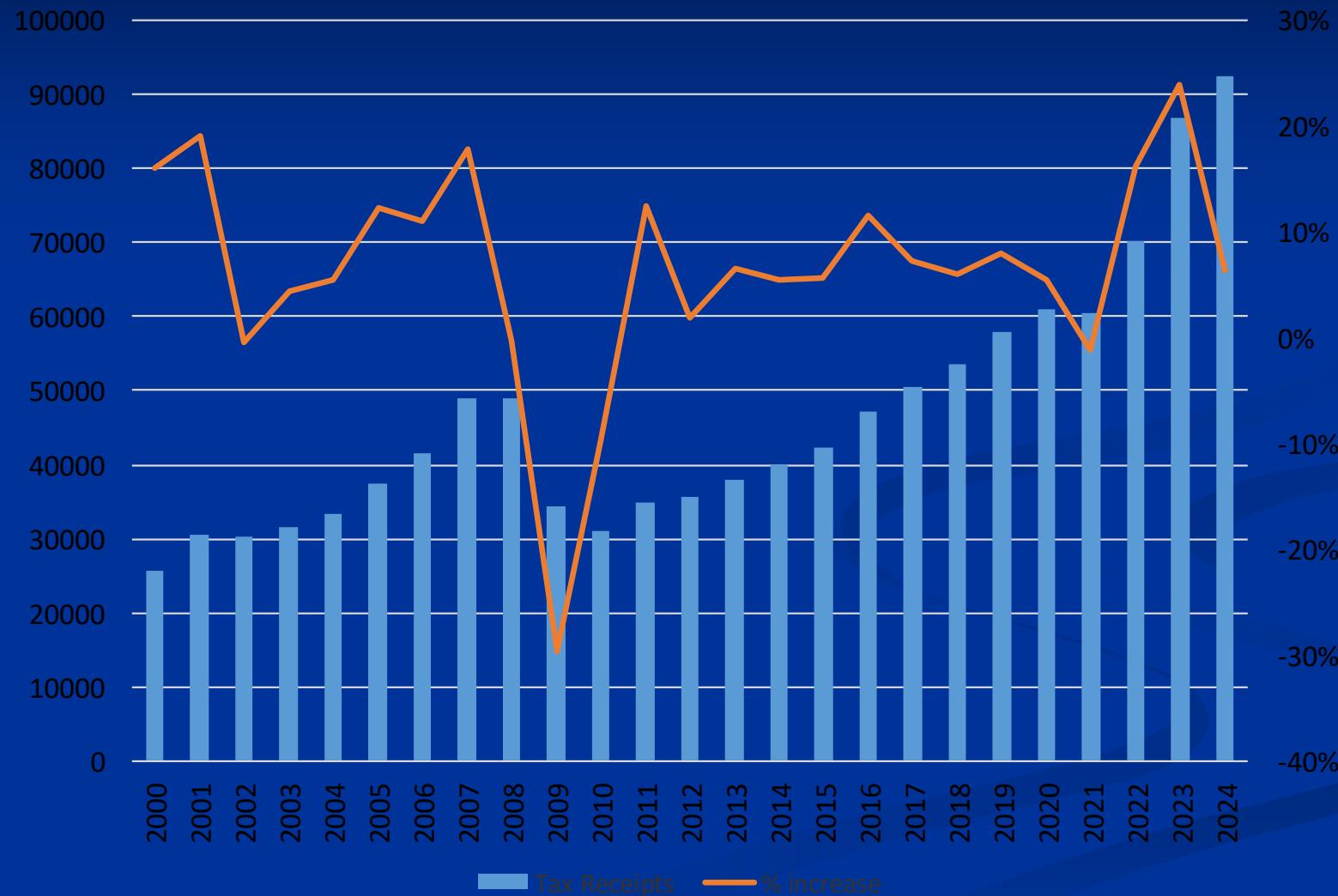
# CAPITAL & CURRENT SHARE OF GOV. SPEND



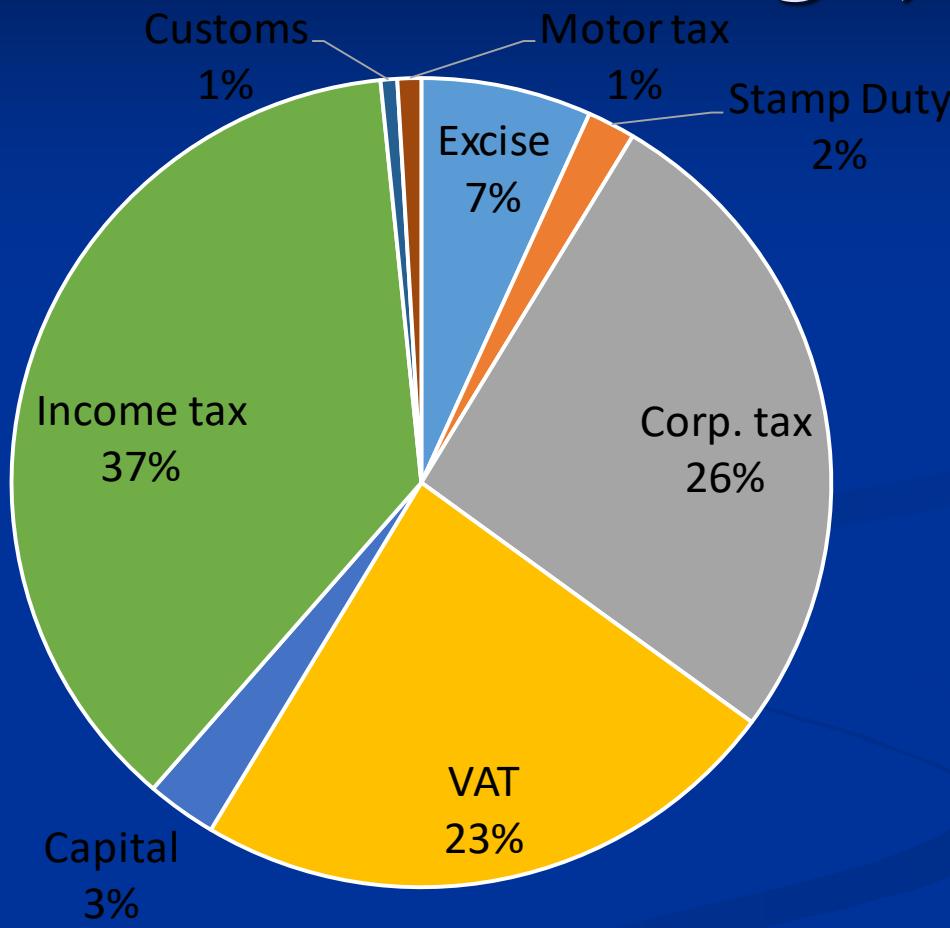
# Net current spend (€m) Budgeted Figures



# Tax Receipts(€m) Budgeted Figures

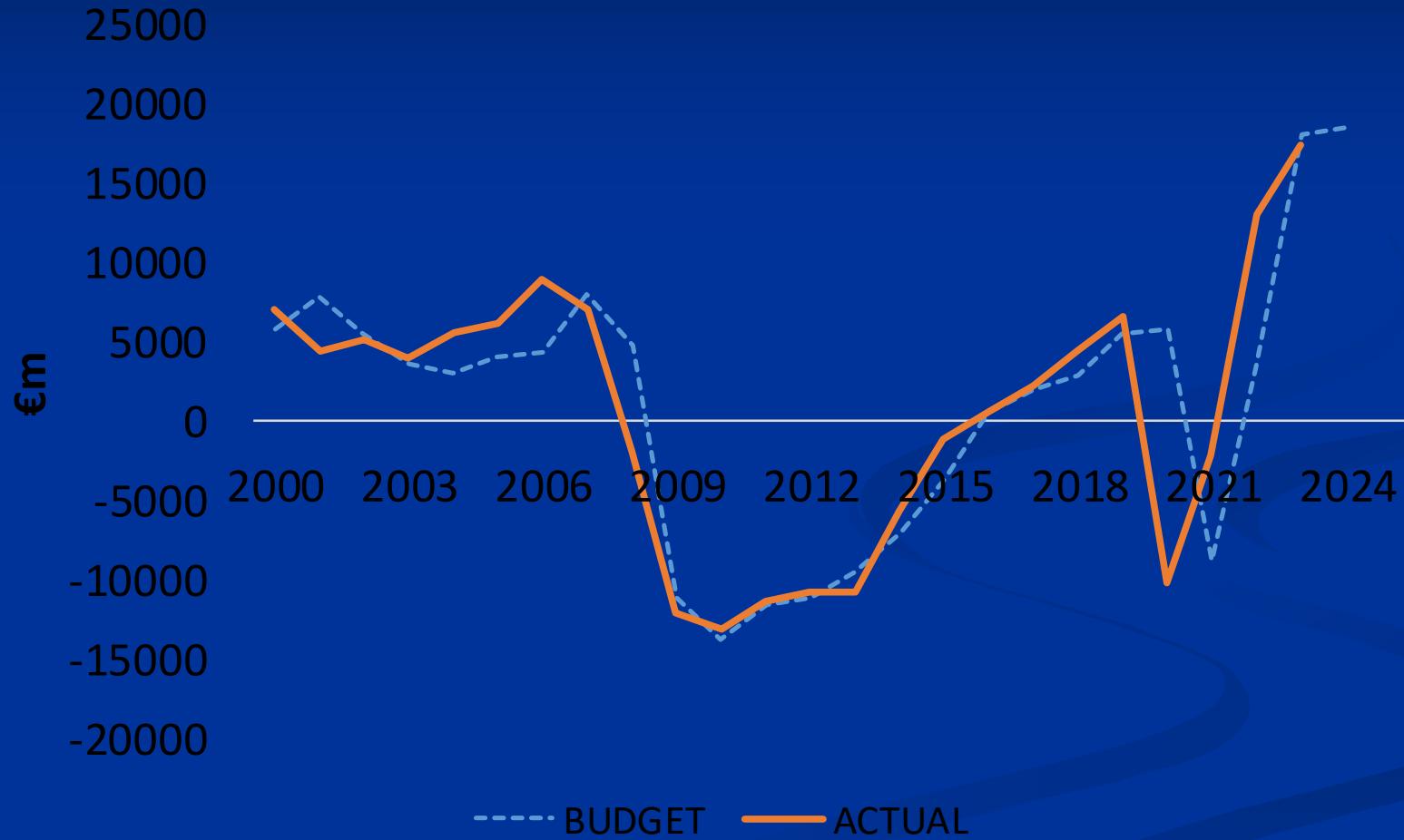


# COMPOSITION OF TAX REVENUE (as forecast 2024 Budget)

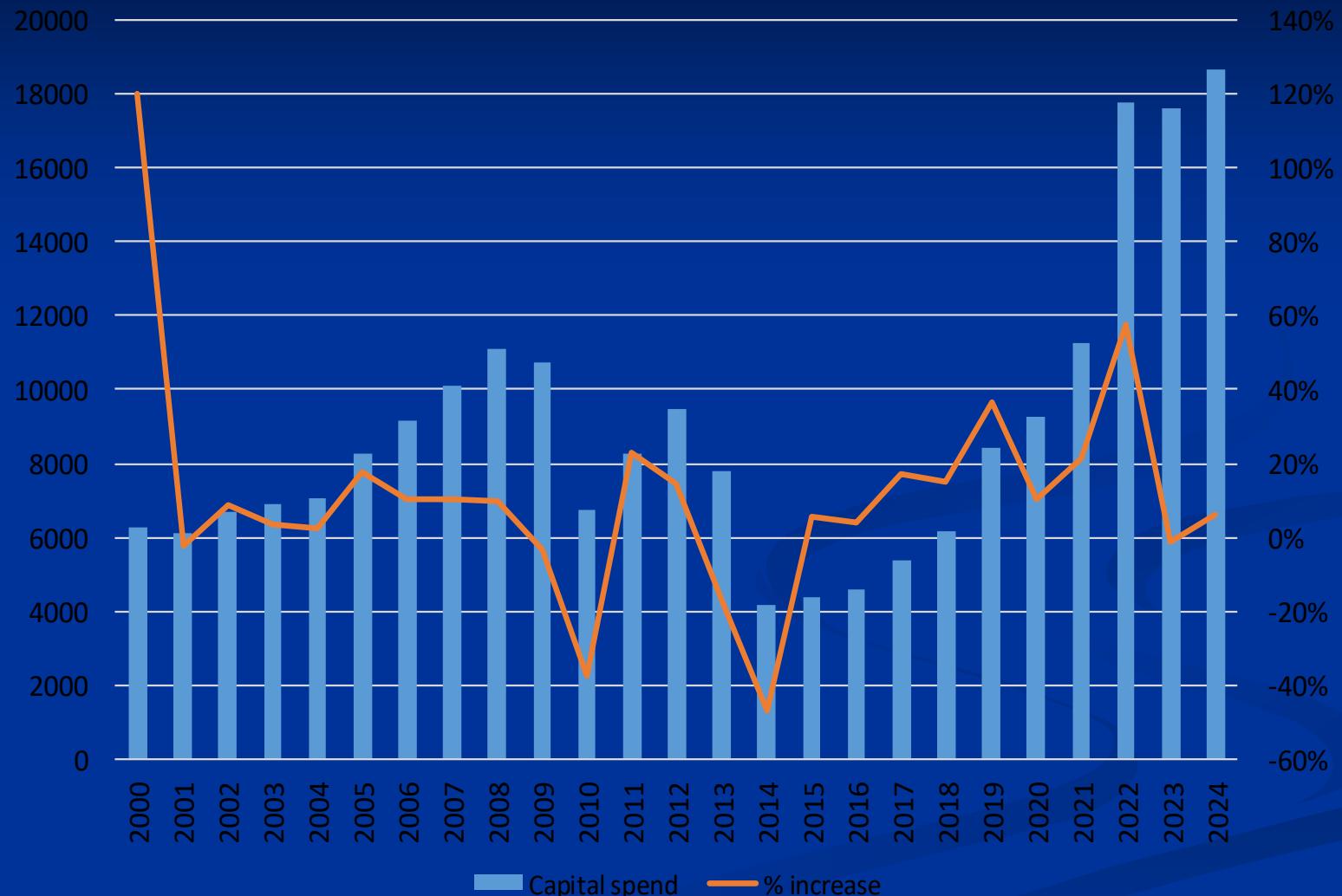


■ Excise ■ Stamp Duty ■ Corp. tax ■ VAT ■ Capital ■ Income tax ■ Customs ■ Motor tax

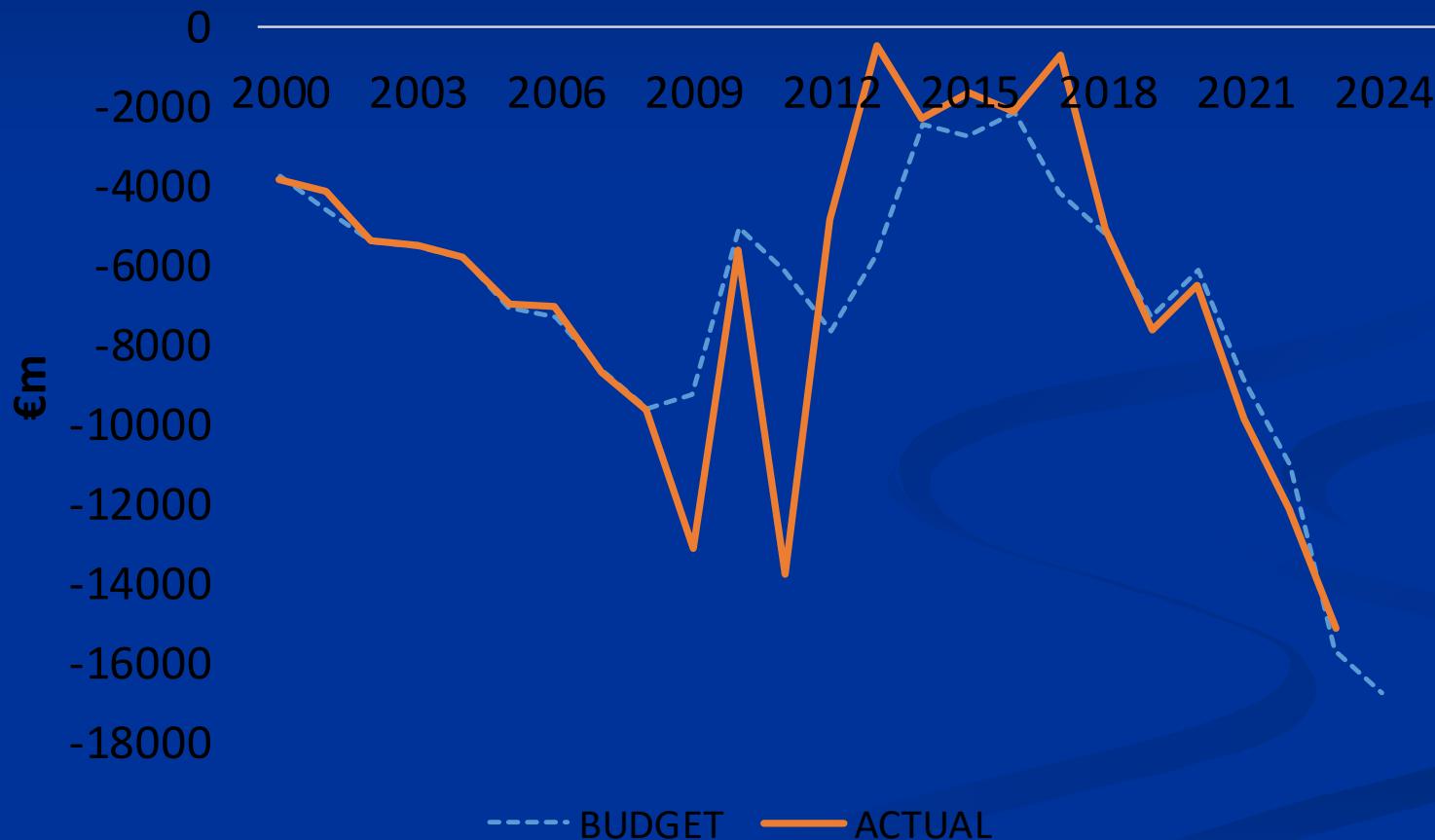
# CURRENT ACCOUNT BALANCE



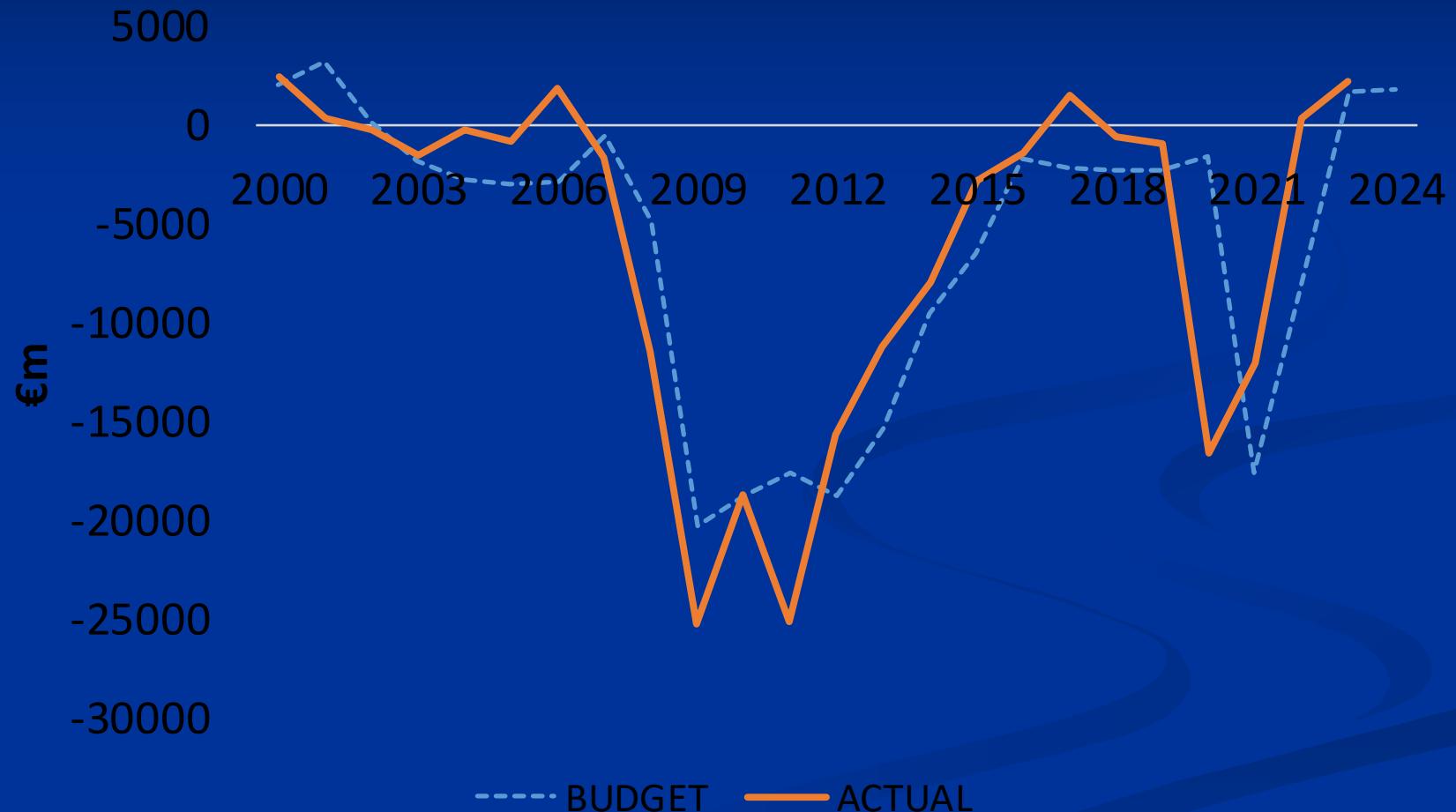
# Capital spending (€m) Budgeted Figures



# CAPITAL ACCOUNT BALANCE



# EXCHEQUER BALANCE



# CONSOLIDATION EFFORT

- GAP IN PUBLIC FINANCES = €30bn
  - €20bn TAX SIDE
  - €10bn SPEND SIDE [DEBT SERVICE & WELFARE]
- CORRECTION OF €30bn TO PUBLIC FINANCES

	2008	2009	2010	2011	2012	2013	2014	TOT
REVENUE	0.0	5.6	0.0	1.4	1.6	1.4	0.9	10.9
SPENDING	1.0	3.9	4.3	3.9	2.2	1.9	1.6	18.8
TOTAL	1.0	9.4	4.3	5.3	3.8	3.5	2.5	29.8
CUMULATIVE	1.0	10.4	14.7	20.0	23.8	27.3	29.8	

Source: SMYTH, 2017

# COVID-19 FISCAL IMPACT

	2020 (€bn)	2021 (€bn)	2022 (€bn)	2023 (€bn)	TOTAL (€bn)
SPEND	14.7	12.5	3.7	1.5	32.4

IFAC:

- ‘PRUDENT AND NECESSARY’
- COUNTER-CYCLICAL
- NO PENALTY IN FINANCIAL MARKETS

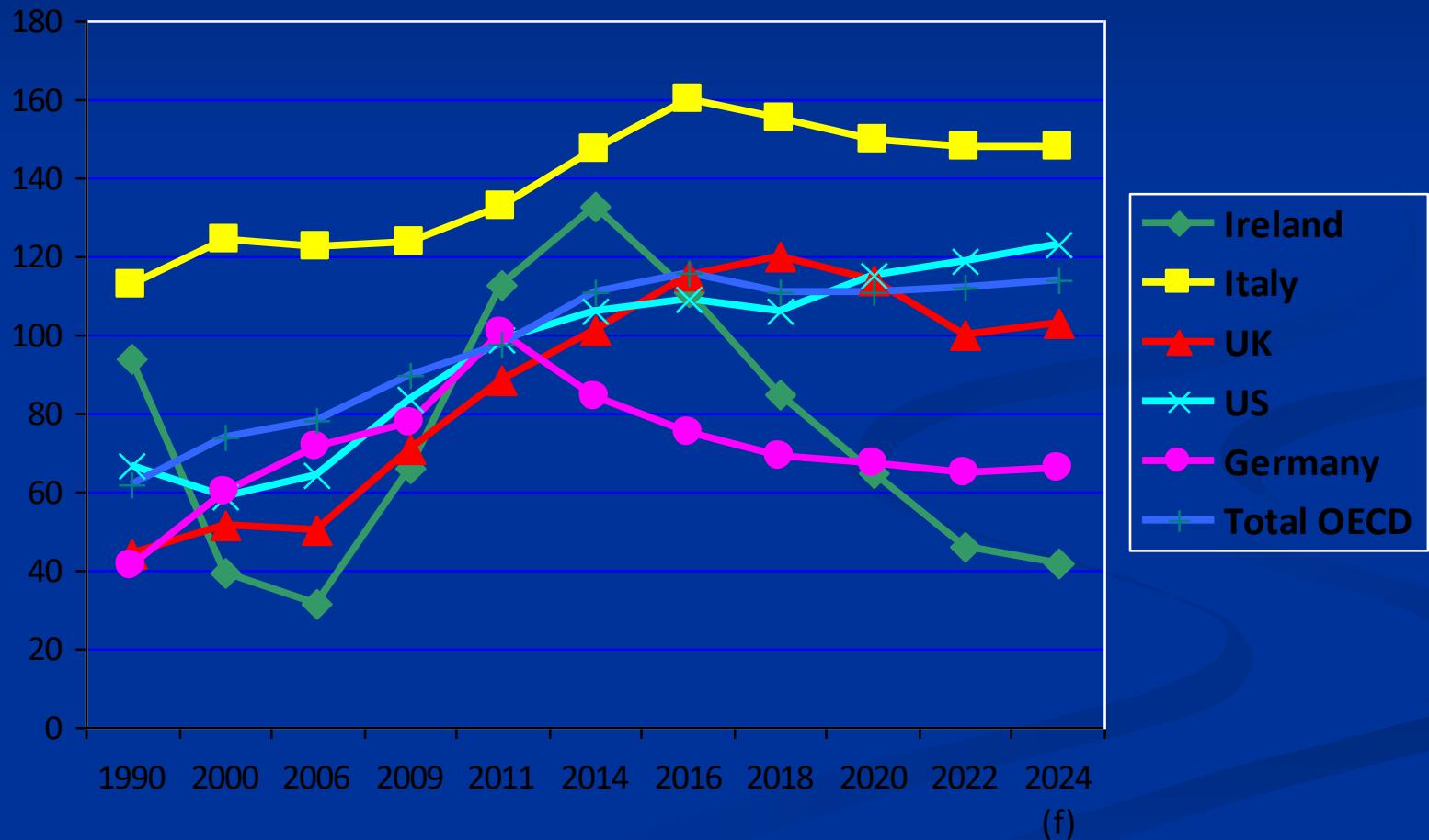
**BUT:** EXTRA €5-8bn IN 2021 (OUTSIDE OF COVID)?

# DEBT

	2007	2017	2023
GROSS DEBT (€bn)	47	201	223
DEBT/ GDP%	24%	68%	41%
DEBT/ GNI*	29%	110%	76%
DEBT INTEREST (€bn)	2	5.9	3.3

- DECRIBED AS ‘SUSTAINABLE BUT HIGH’
- RISKS
  - RISING INTEREST RATES
  - NO ROOM FOR MANOEUVRE

# DEBT TRENDS (% GDP) – OECD



# PUBLIC FINANCE RISKS ?

- BUDGET SURPLUS HELPED BY TEMPORARY EXCEPTIONAL FACTORS
  - WINDFALL CT RECEIPTS
  - INFLATION-DRIVEN TAX RECEIPTS
- FUTURE PRESSURES
  - AGEING
  - CLIMATE TRANSITION
  - DIGITAL TRANSITION
- HIGH LEVELS OF DEBT
- GROWING IMPORTANCE OF CORP TAX RECEIPTS
- SLOWDOWN IN PRODUCTIVITY GROWTH

# CONCLUSION (1)

- IMPORTANCE OF PUBLIC FINANCES IN TERMS OF ECONOMIC IMPACT
- UNDERSTANDING OF THE G/GDP RATIO
- RATIONALE FOR *SOME* GOVERNMENT INTERVENTION IN AN ECONOMY – HAS CHANGED OVER TIME
- DYNAMICS FOR MORE SPENDING ARE STRONG AND ONE-SIDED
- GLOBAL UNDERSTANDING OF IRISH PUBLIC FINANCES

# CONCLUSION (2)

## ■ ARE THE IRISH PUBLIC FINANCES IN A HEALTHY POSITION?

- CURRENT BUDGET SURPLUS (IN ‘GOOD’ TIMES)
- WERE HIGH CAPITAL SPENDERS (PRE CRSIS)
- RELATIVELY LOW DEBT LEVELS COMING INTO 2008 CRISIS
- NATIONAL PENSION RESERVE
- NARROWED THE DEFICIT AS PER PLAN (BY 2015)

BUT:

- CURRENT SPENDING GROWTH [returning with growth]
- VULNERABILITY OF TAX BASE [property (00s)/ now = corp ]
- COST OF BORROWING [legacy/ future interest rates?]
- LATENT SPENDING PRESSURES?