

Countries around the world are putting together fiscal stimulus packages to try to cushion their economies from the effects of the global financial crisis. Should the Government heed calls for a fiscal stimulus plan for this country? The answer is an unambiguous no.

Cuts in VAT rates, along the lines introduced in the UK, would do little to bolster economic activity in this country. For starters, part of the tax cut may not be passed on to consumers. More importantly, a substantial chunk of Irish households' spending is on imported goods. Increased spending on imports provides only limited support to our economy. The bang for the buck from a VAT cut is small in an open economy like ours because much of the impulse leaks out through higher imports.

A stimulus proposal might be effective if it were huge. But the country can't afford such a plan. Claims that a VAT cut could be self-financing are baseless. Figures from the Dept. of Finance suggest that each percentage point cut in the standard VAT rate reduces annual tax revenues by about €450 million. Slashing VAT to the UK rate of 15 per cent would add another €3bn to the State's already enormous borrowing requirement. As the economists at the website www.irisheconomy.ie point out, there's a limit as to how much the Government can safely borrow on international markets.

A cut in VAT would also likely do little to stem the flow of shoppers across the border with Northern Ireland. Price differentials between the Republic and the North largely reflect the weakness of sterling and differences in business costs. A fiscal stimulus won't solve these problems. A focus on improved competitiveness and realistic wage-setting would be much more valuable. Meanwhile, budgetary policy should aim at avoiding national bankruptcy.