

The housing slump is taking an enormous toll on the public finances--and there is worse to come. Tax revenues in January and February were down 8 per cent compared with the same period a year earlier. This outcome was markedly worse than the Government had anticipated in the recent budget.

Receipts from stamp duty and capital gains tax have tanked. Together, the tax yield from these two sources plunged an eye-popping €630 million in January and February from the same months last year. VAT revenues have also weakened, coming in 7 per cent below target.

The drop in VAT receipts suggests that consumer spending is faltering. That should hardly be surprising, as consumption usually stalls during housing downturns. Additional layoffs in the building industry over coming months will depress spending further. So much for some analysts' projections that robust consumer spending will keep our economy out of recession.

The Government has pencilled in a budget deficit of one per cent of GDP this year. The way things are going, the outcome is more likely to be closer to three per cent. What's more, we know from other countries' experiences that the public finances typically deteriorate for several years after the peak in house prices. This means that by 2010 the deficit could be well above the EU threshold of three per cent.

How might the government respond to the prospect of violating EU rules? Hopefully not by resorting to quick fixes that damage medium-term competitiveness, like increases in income taxes and cuts in infrastructure spending. Been there, done that. Better to temporarily run large deficits and incur the wrath of Brussels than to repeat the mistakes of the past.