3.4 Three Medium-term Fiscal Scenarios and Risk Analysis

Five-year ahead fiscal projections, as usually provided in the Budget and SPU are key to informing budgetary choices. With uncertainty exceptional high, this section develops three fiscal scenarios out to 2025 consistent with the Mild, Central and Severe scenarios set out in Box D, Chapter 2. The Central scenario is designed so that it matches general government expenditure and revenue forecasts (for 2020 and 2021) published in *SPU 2020*. These scenarios reflect both different economic outcomes and the different policy measures required in each scenario, assuming that policy reactions are broadly in line with those to date.

Box I: Policy Measures and Fiscal Scenarios

This box sets out three fiscal scenarios based on the macroeconomic scenarios set out in Chapter 2 Box D. These scenarios are based on the implementation of announced and existing policy measures. For periods of lock-down, it is assumed that the Government mobilises the same supports as have been used to date. For the Central and Mild scenarios, the only lockdown period is the 12-week period running from late-March 2020 to mid-June 2020. For the Severe scenario, there are additional 12-week lockdown periods in Q4 2020 and Q2 2021.

Income Supports/Unemployment Payments.

In lockdown periods, we assume that the enhanced PUP and the TWSS are available. In each case, these schemes are as they currently operate, with a wage subsidy of up to 85 per cent and a PUP of €350 per week. We assume that those whose employment is impacted by the lockdown period are split evenly between the PUP and the TWSS.

In non-lockdown periods, those who are unemployed receive the standard Jobseeker's Benefit/ Jobseeker's Allowance payments.

We assume that Social Welfare payments are indexed in line with private sector wages. Pension expenditure (state pensions and public sector pensions) is projected to increase by approximately €1 billion per year on average over 2022-2025. This is driven by both demographic change and increases in line with private sector wages. It is assumed that the statutory retirement age increases to 67 in 2021.

Health Expenditure

We assume that the additional funding planned for health spending is sufficient in the Central scenario (€2 billion). For the Mild case, while this scenario implies slightly less demand for health services, we assume that there is no saving relative to the Central scenario. This is because additional staff have already been hired, private facilities have been rented and additional equipment has been purchased. For the Severe case, we assume that each additional wave of the virus (which corresponds to a 12-week lockdown period) implies additional healthcare costs of €1 billion. For the Severe scenario, there is an additional €1 billion of health spending in both Q4 2020 and Q2 2021.

Beyond 2021, for all three scenarios, health spending is projected forward using Fiscal Council standstill estimates. These are estimates of the cost of maintaining 2021 service levels, after taking account of service demand (driven by demographics) and price pressures.

Business Supports

For the Mild and Central scenarios, it is assumed that loan guarantees do not lead to fiscal costs. As a result, the only costs incurred are €0.3 billion in business supports which are included in *SPU 2020* projections. For the Severe scenario we assume that €500 million of losses arise in 2023 and a further €1 billion in 2024.

Public Pay Bill

For the Central scenario, *SPU 2020* forecasts of compensation of employees are used for 2020 and 2021. Thereafter, Fiscal Council Stand-Still Scenario estimates are used (Fiscal Council, 2019b). These take account of increases in public sector employment required to hold service levels constant in light of increasing demand due to demographic change. Pay rate increases in line with private sector wages are assumed. There are slight differences between the three scenarios for the public sector pay bill, as inflation and private sector wage pressure differs in each of the three scenarios.

Capital Spending

In all three scenarios, capital spending takes the values forecast in *SPU 2020* for 2020 and 2021. Thereafter, general government capital spending is assumed to be 4.4 per cent of GNI*. This reflects previous government plans to have exchequer capital spending amounting to 4 per cent of GNI*. A further 0.4 percentage points of non-exchequer spending is assumed, leaving a general government total of 4.4 per cent.

As GNI* is different in each of three scenarios, this mechanically leads to different levels of capital expenditure in each of the three scenarios. In 2025, capital spending in the Mild scenario is projected to be €1.9 billion higher than in the Severe scenario.

Revenue

In terms of government revenue, we assume that there is no difference in policy between the three scenarios. In effect, this assumes that there are no major policy changes that yield or cost significant revenue.[42] Changes in the macroeconomic driver multiplied by the elasticity are used for projections of revenue. Judgement applied to forecasts in 2020 and 2021 is assumed to unwind over the following two years. As a result, there is no judgement applied for 2024 or 2025 (apart from corporation tax).

Judgement is applied to corporation tax receipts after 2021. This is to take account of the possible impact of the OECD's BEPS initiative. The amount of judgement applied is based on the estimates given in the *January 2020 Fiscal Strategy* published by the Department of Finance (2020b). Corporation tax receipts are reduced relative to the baseline level by €0.5 billion in 2022, €1 billion in 2023, €1.5 billion in 2024, and €2 billion in 2025. Despite this negative judgement, receipts increase slightly over this period.

Budget Dynamics and Interest Costs

An interest model nested in the Council's Fiscal Feedbacks Model was used to generate interest projections, with the assumption that marginal interest costs were about 1 per cent in each scenario. While there are upside risks to this assumption for more severe scenarios, more accommodative monetary policy would also be possible in those scenarios, which would be expected to drive down interest rates. The Central scenario mirrors projected interest costs for 2020 and 2021, while the Mild and Severe scenarios mirror SPU projections for 2020.

[42] For income tax, beyond 2022, it is assumed that tax bands widened in line with wage rates. As a result, there no yield from non-indexation beyond 2022.