Irish Fiscal Advisory Council

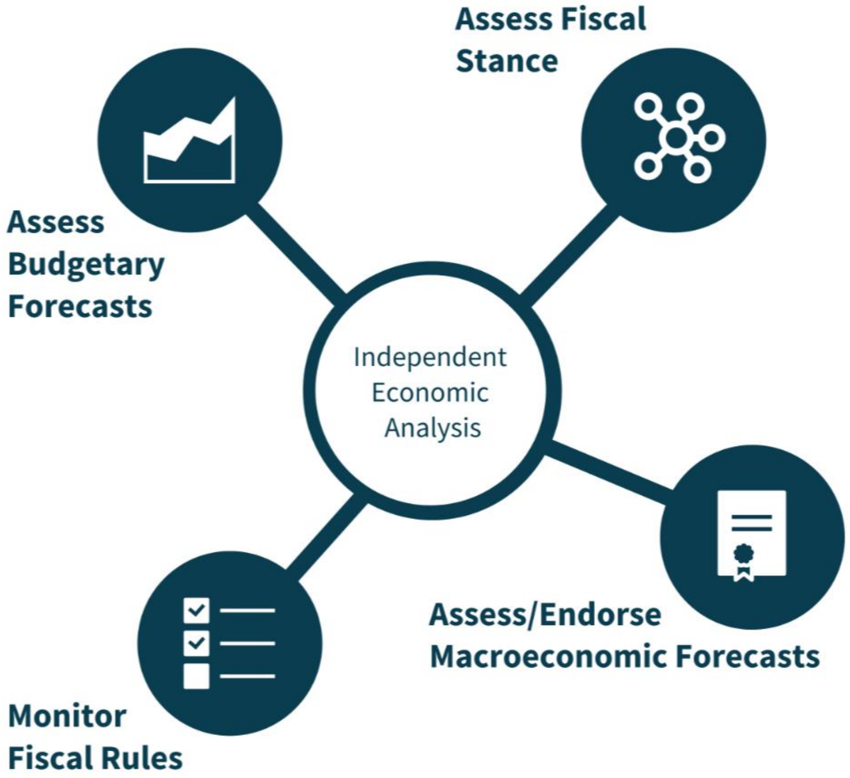
# Fiscal Assessment Report

December 2020

*Sustaining the economy through Covid-19*

# December 2020 Fiscal Assessment Report

- The Fiscal Council is an official independent body with a mandate to assess the public finances
- The December 2020 *Fiscal Assessment Report* provides an assessment of the projections and policies set out in *Budget 2021*



# Key messages

- Covid-19 is having a major impact, but the outlook has improved
- Uncertainty is exceptionally high: Covid-19 and Brexit
- The deficit will be around 10% of GNI* this year and in 2021
- For 2021, large temporary supports and stimulus of €12bn are welcome
- The €2.1bn contingency and €3.4bn recovery fund are helpful
- However, *Budget 2021* includes permanent increases in spending of €5.4bn, possibly up to €8.5 billion
- These permanent commitments—without identifying how they will be funded sustainably—are not conducive to prudent budgetary management
- There are significant fiscal pressures in future years from fiscal adjustment, ageing, reducing overreliance on corporation tax and climate change
- The Government should use its medium-term strategy in April 2021 to deliver credible plans
- Strengthening the fiscal framework and spending review process would help

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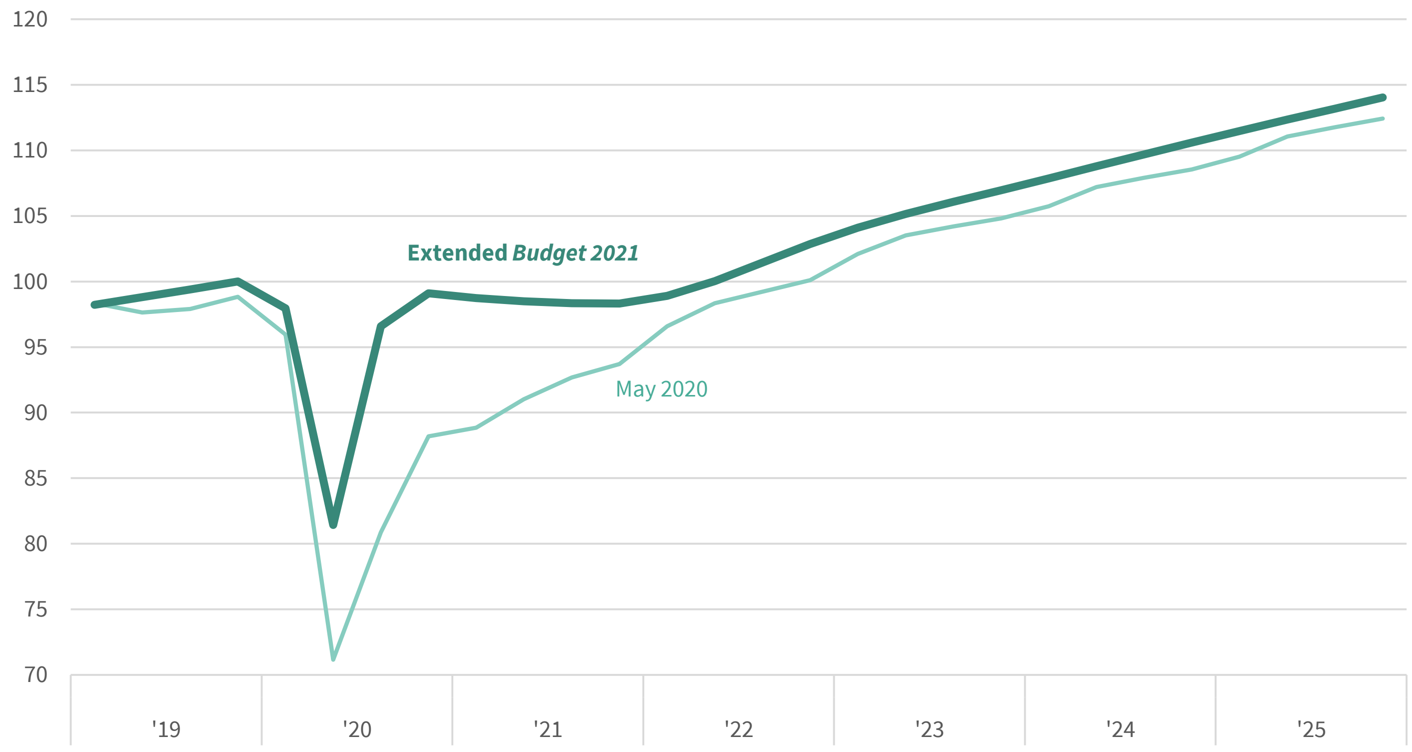
# Covid-19 is having a major impact on the economy, but the outlook has improved

## Underlying domestic demand has outperformed in the short term

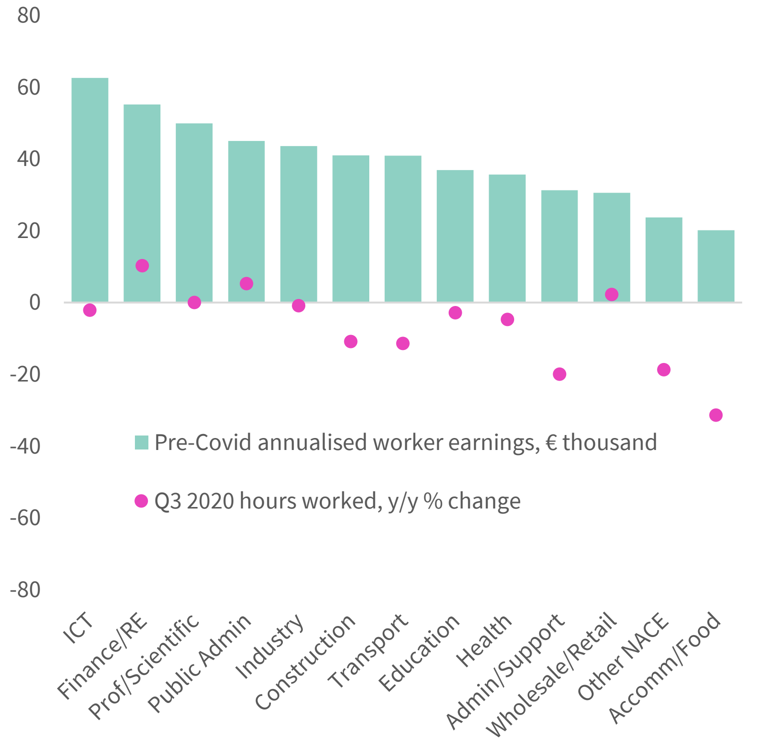
100 = Q4 2019 for the latest scenario




Sources: Department of Finance; and *Pre-Budget 2021 Statement*, September 2020.

# The impact of the crisis is complex

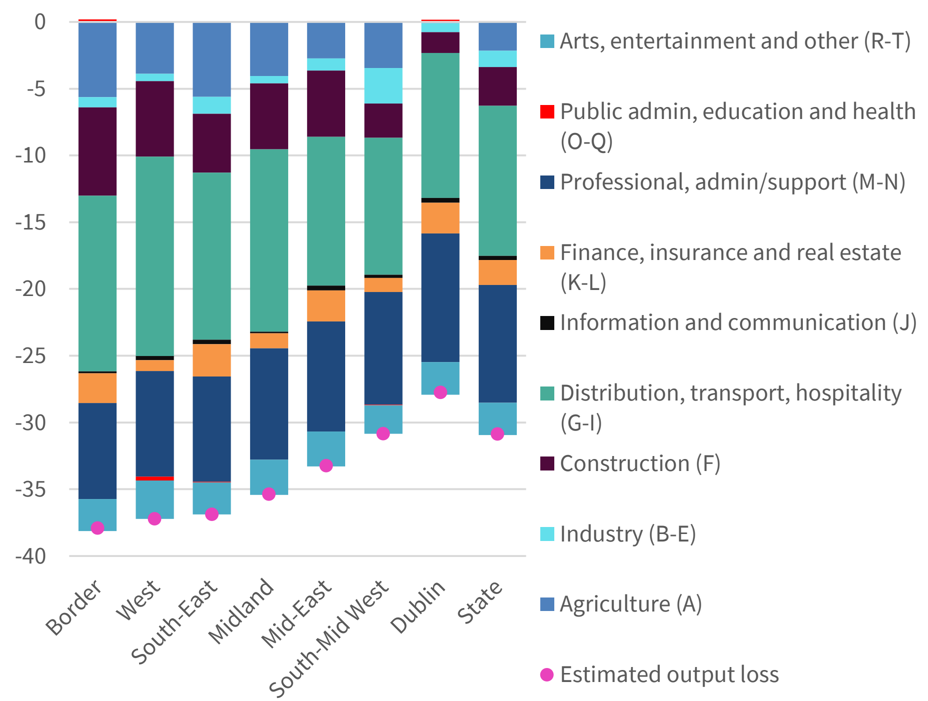
## Workers in low-earning sectors are worst affected by Covid-19




Sources: CSO, Labour Force Survey and Earnings and Labour Costs; and Fiscal Council workings.
Note: Annualised worker earnings are shown for Q3 2019. These are millions of hours worked per week, times (365/7), times average hourly earnings, divided by total employment in a quarter.

## Q2 2020 activity in Dublin was likely less affected than elsewhere

% change (based on 2017 gross value added data by sector and region)




Sources: CSO; Department of Employment Affairs and Social Protection; and Fiscal Council workings.
Note: South West and Mid-West have been combined as a result of repressed data due to confidentiality.

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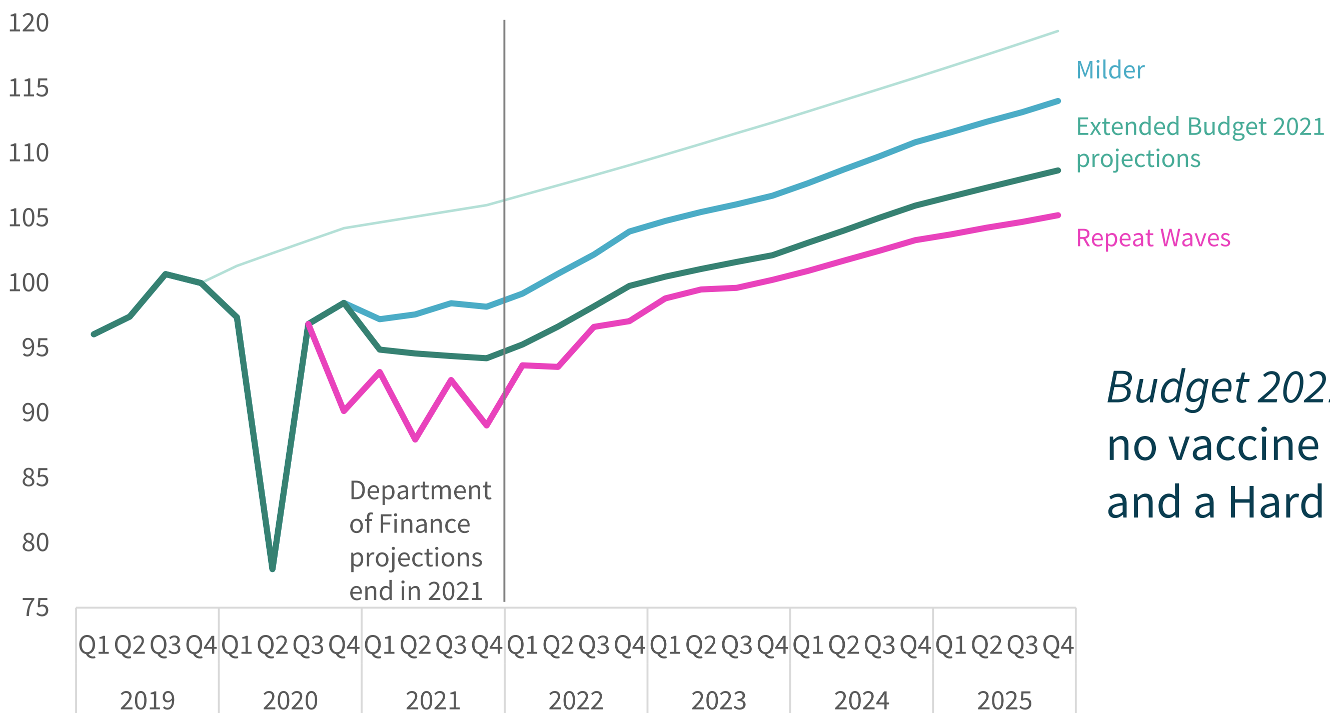
# Uncertainty is exceptionally high due to COVID-19 and Brexit

**Real GNI* (Index: Q4 2019 = 100)**




*Budget 2021* assumed no vaccine until 2022 and a Hard Brexit

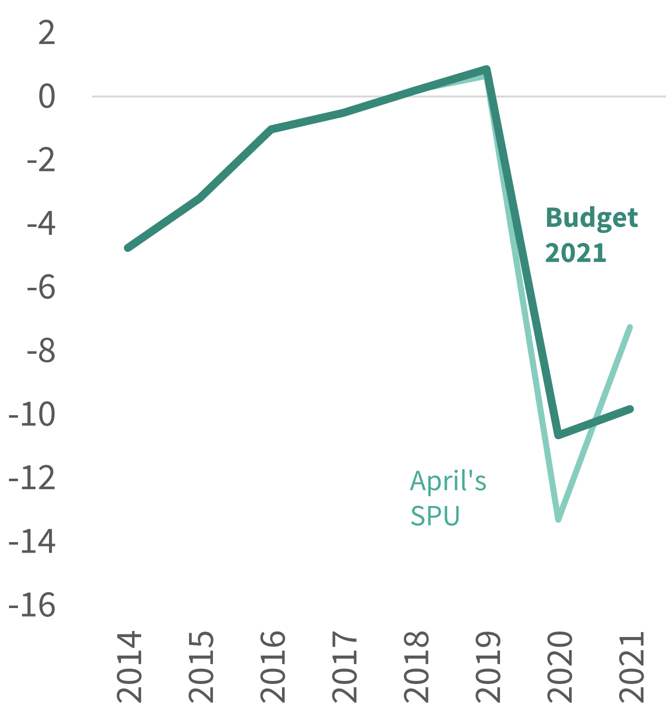
Sources: CSO; Department of Finance, *Budget 2021*; and Fiscal Council workings.
Notes: Quarterly real GNI* is estimated as the sum of UDD, the change in inventories, subsidies less taxes, and adjusted exports less adjusted imports, where the latter items are constructed according to the method described in Box E of the May 2020 *Fiscal Assessment Report*.

## Activity could return to end-2019 level between early 2022 and 2023

# The deficit will be around 10% of GNI* in 2020, better than expected, and also in 2021

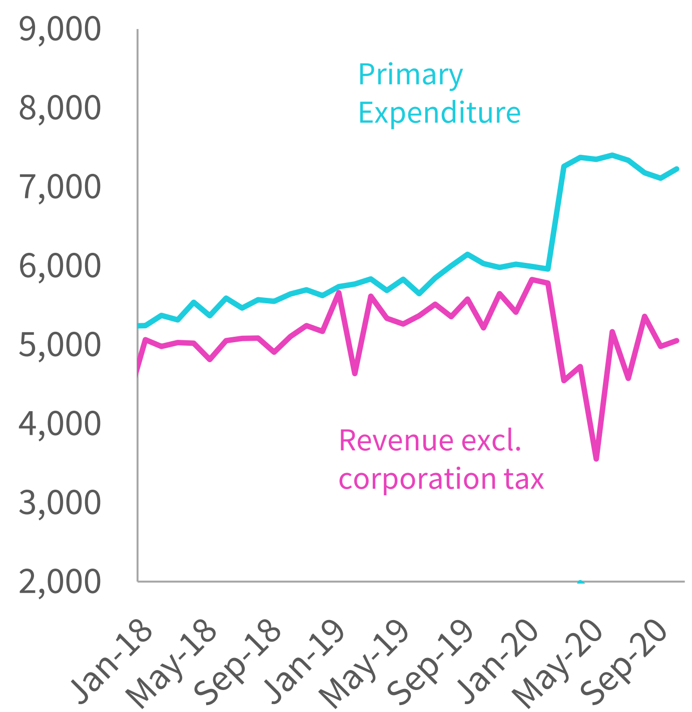
**Budget deficit**

% GNI*




**Seasonally adjusted revenue and primary expenditure**

€ million



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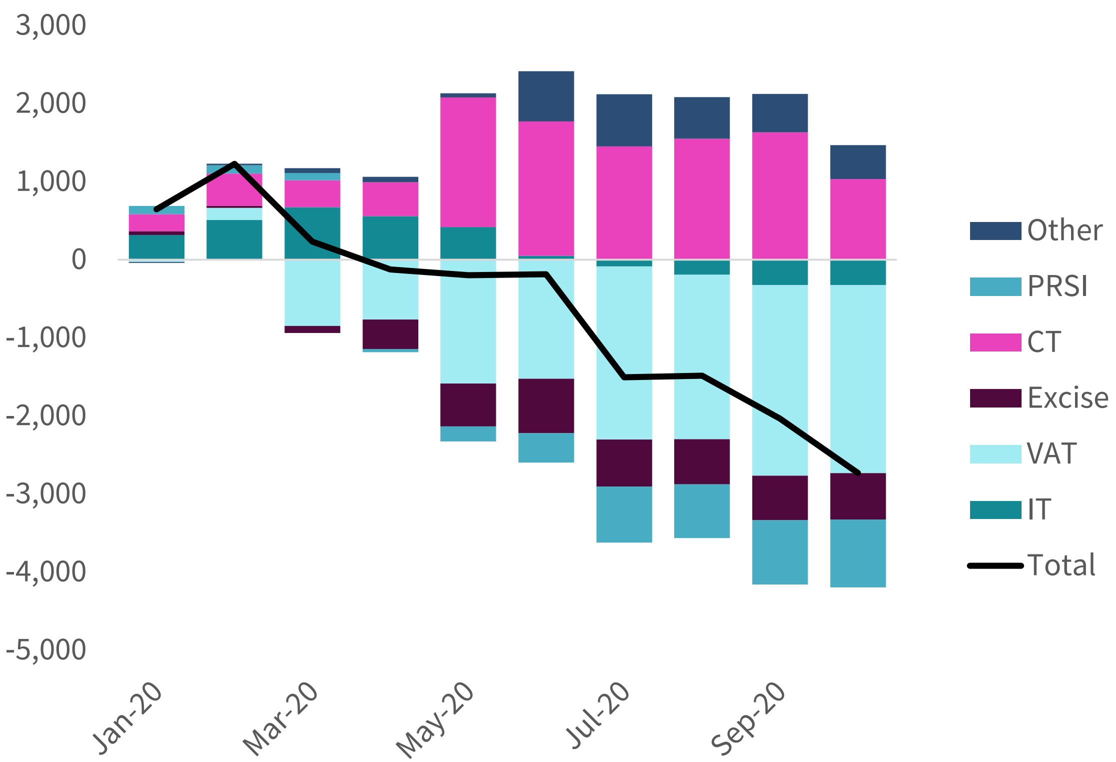
# Revenue has fallen but is recovering and has proven more resilient than expected

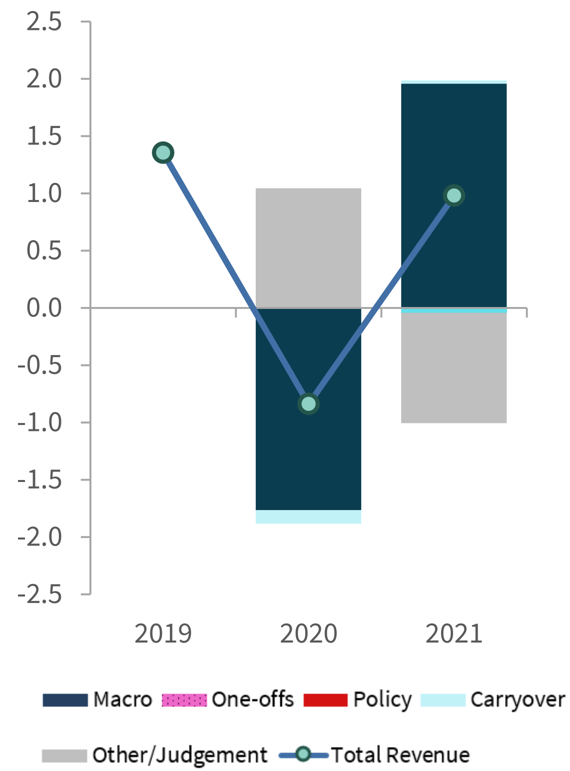
**Cumulative revenue change**

€ million (y/y)




**Income tax more resilient that economic performance suggests**

€ billion change year-on-year




Sources: Department of Finance and Fiscal Council Workings

Notes: Other includes stamps, capital taxes, motor tax, customs and other unallocated tax receipts. PRSI includes excess receipts over expenditure as per the memo item. IT and CT are gross of CRSS deductions.

# Large temporary supports and stimulus are supporting the economy in 2020 and 2021

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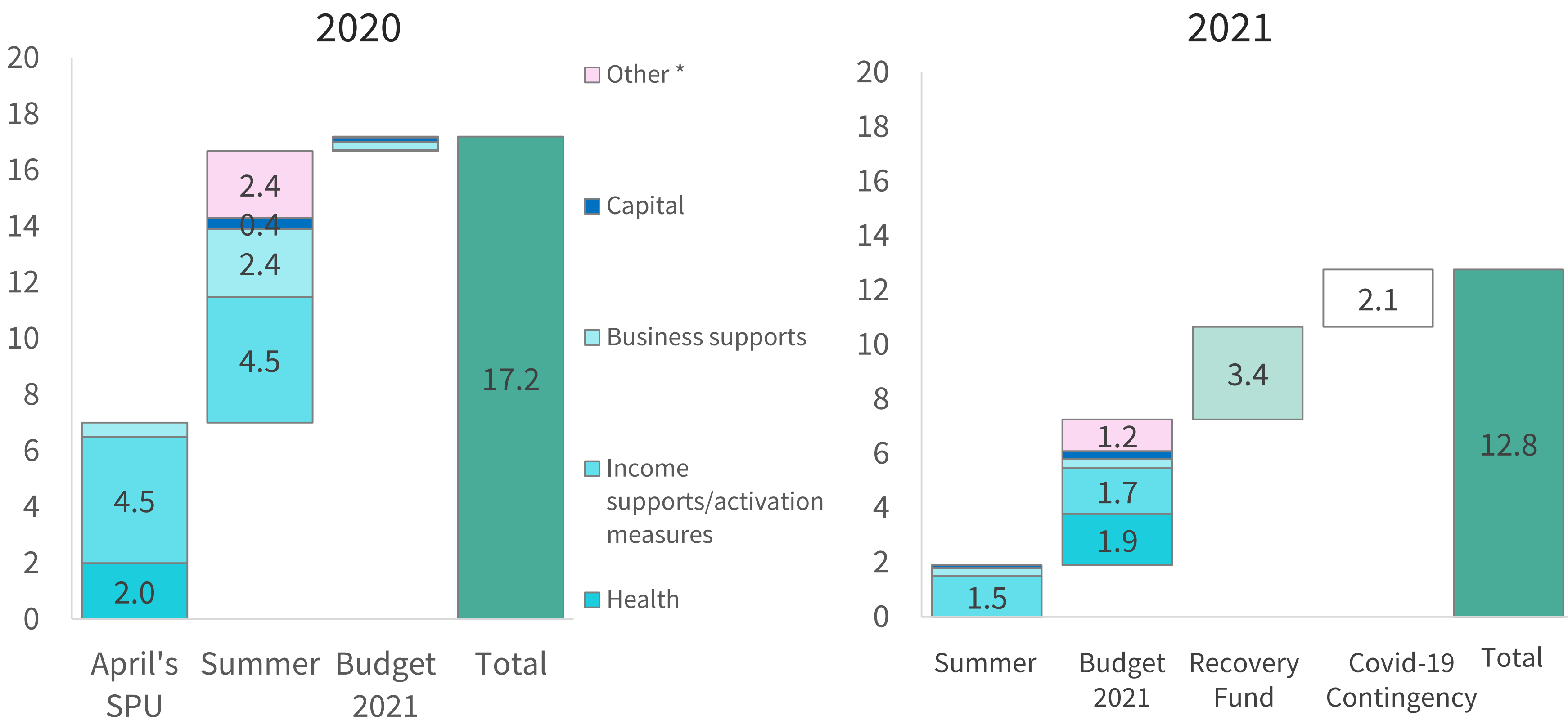
## Net spending related to Covid-19 in 2020 has grown substantially

€ billions, net spending

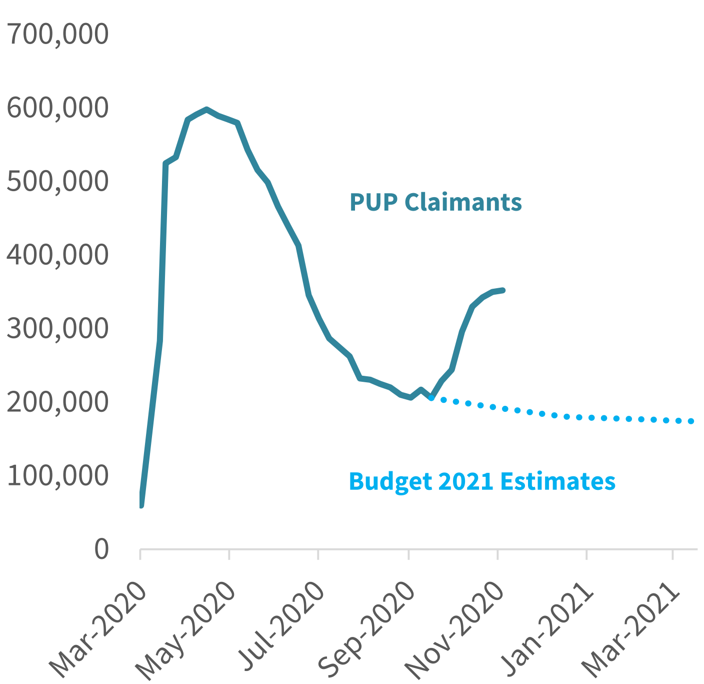



Sources: Department of Finance; and Fiscal Council workings.
Notes: Net spending is shown in gross voted terms. Tax measures, such as the reduction in the VAT rate from 23 to 21 per cent, are included as net spending on business supports. "Other" measures include additional spending spread across various departments.

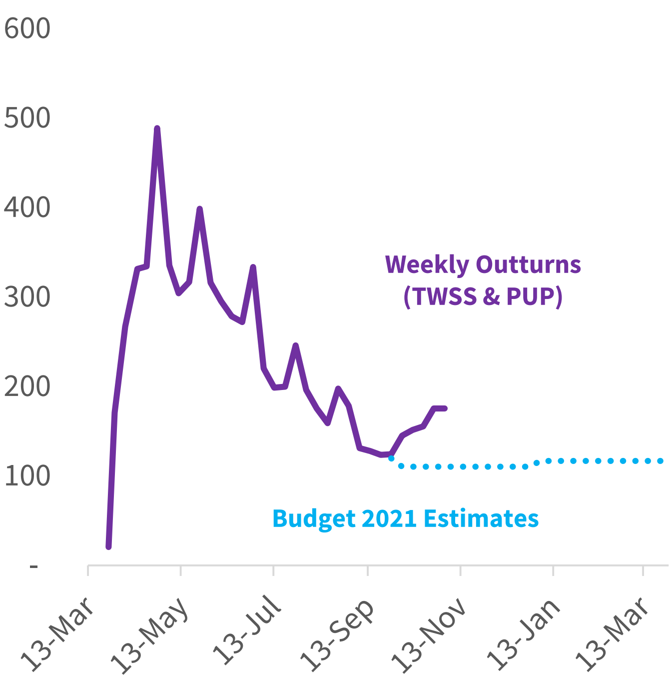
# The allocation of a €2.1bn contingency, as well as the recovery fund,  helps good budgeting

**Claimants of PUP to date and illustrative scenarios**

A. Estimated number of claimants



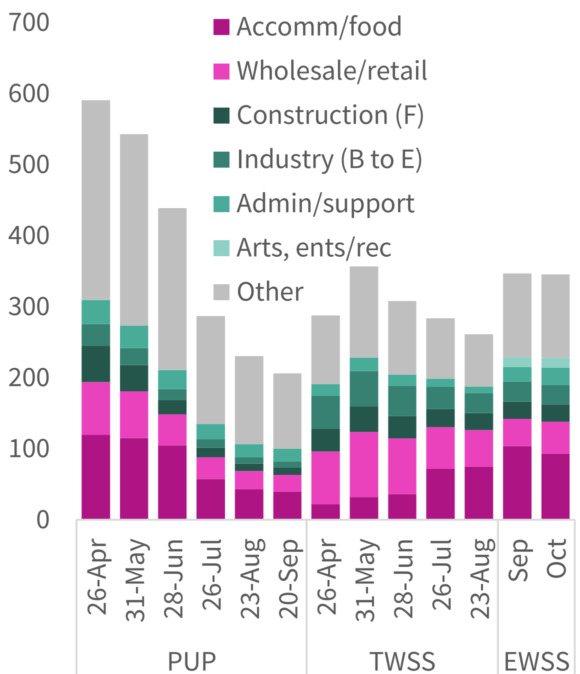

B. Cost estimates of TWSS & PUP, €m per week



# The large-scale support and counter-cyclical stimulus measures in *Budget 2021* are appropriate

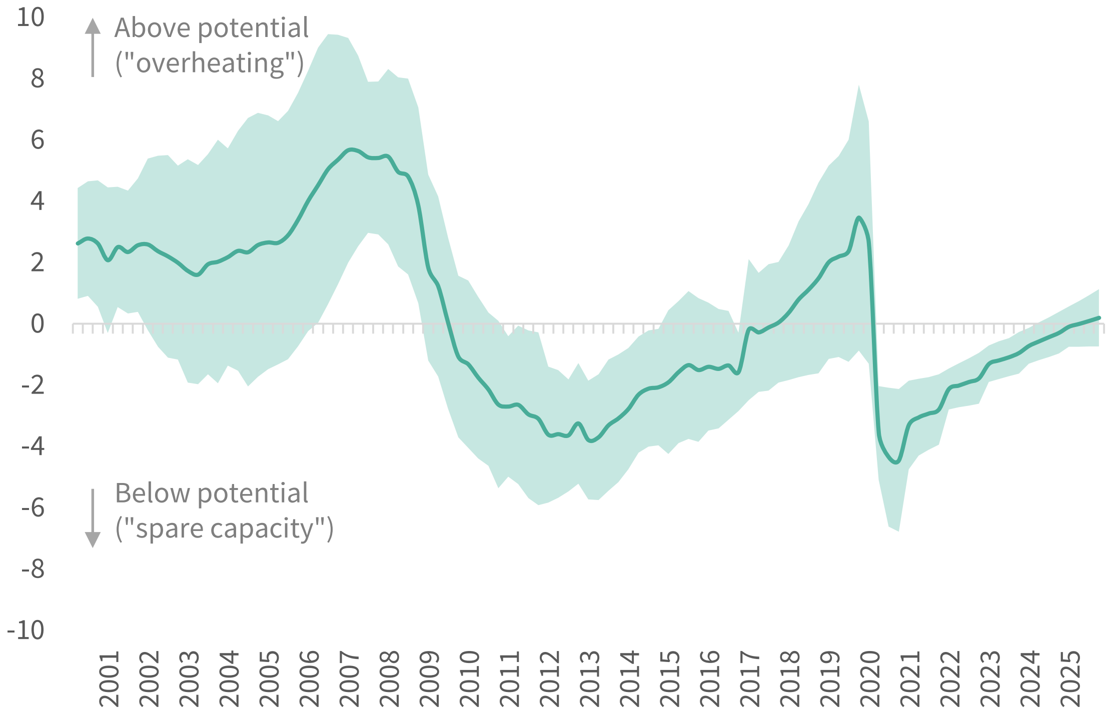
**Some sectors are heavily affected**

Thousands of people availing of supports




**Substantial spare capacity in the coming years**

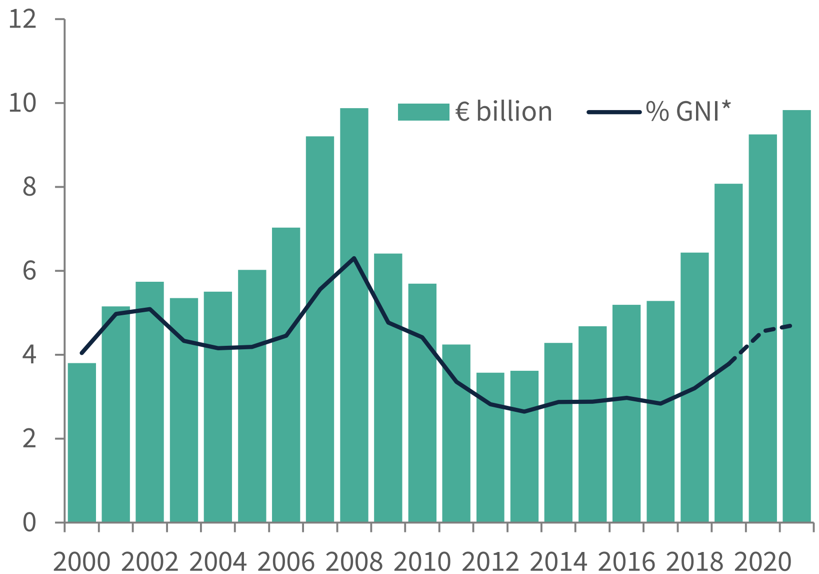
% potential, output gap (gap between actual and potential output)



# Public investment is set to rise

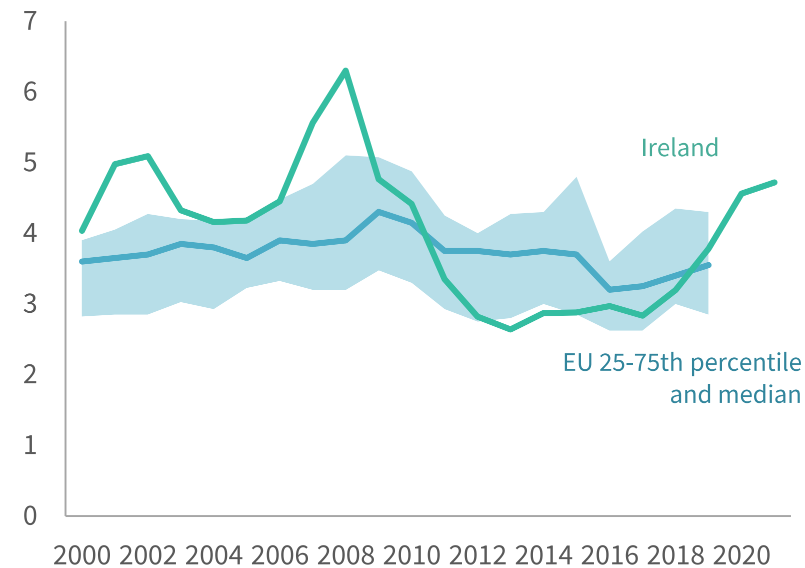
## Investment spending set to rise

€ billions




## High in the context of the EU

% GNI* (% GDP for other countries)

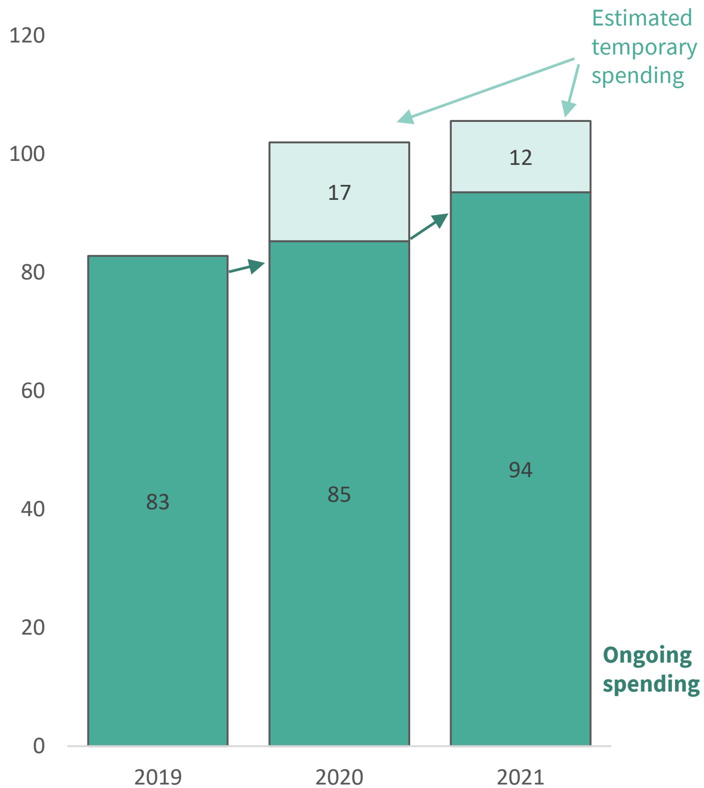



Sources: National Development Plan (NDP), 2018–2027; CSO; Department of Public Expenditure and Reform; Eurostat; and Fiscal Council workings.
Notes: The NDP notes that commercial semi-state bodies, state-owned enterprises and other non-Exchequer bodies make their investment decisions in line with business plans that, for the vast majority, did not extend past 2021 at the time of the publication of the NDP.

# However, *Budget 2021* included €5.4bn, possibly over €8bn, of permanent spending measures

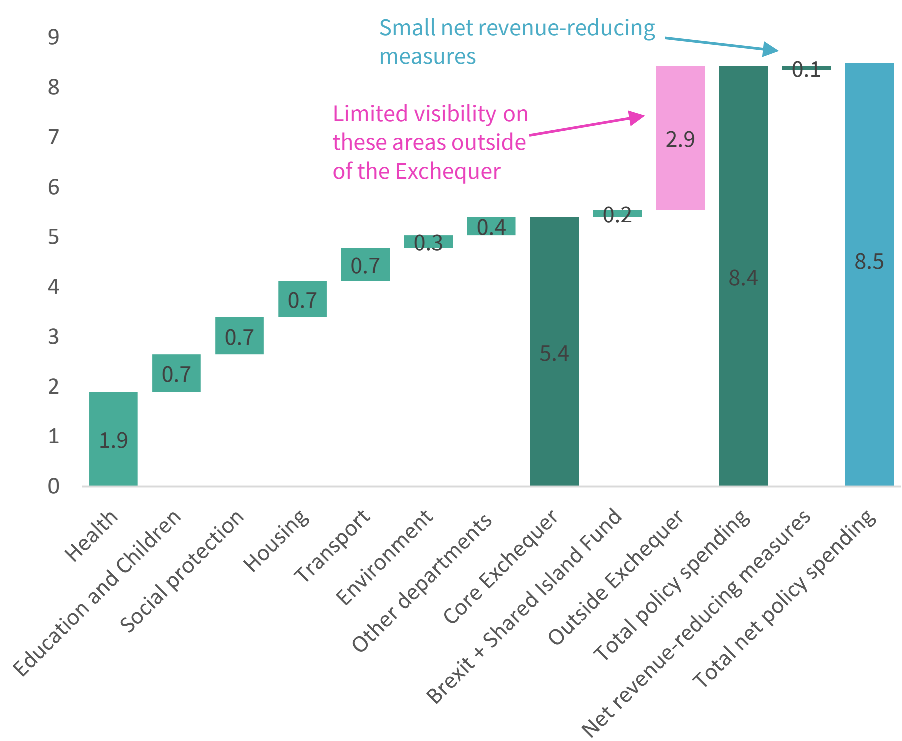
### Fall in temporary spending masks sharp rise in policy spending in 2021

€ billion




### Permanent spending increases are spread across many areas

€ billions, core spending increases in 2021




Greater transparency is needed on General Government developments

# This includes substantial staff increases

## Departmental staff increases introduced as part of *Budget 2021*

| Departmental Vote | Change (Levels) | Change (%) |
|---|---|---|
| Health | 12,515 | 10.0 |
| Education | 2,215 | 2.5 |
| Higher Education | 560 | 2.2 |
| Children | 480 | 8.7 |
| Garda | 347 | 1.8 |
| Revenue | 310 | 4.6 |
| Agriculture | 214 | 4.2 |
| Foreign Affairs | 197 | 11.0 |
| Social Protection | 188 | 3.1 |
| Other | 661 | 3.9 |
| **Total** | **17,687** | **5.9** |

Sources: Department of Finance Expenditure Report 2021.
Note: This table excludes interdepartmental transfers of staff.

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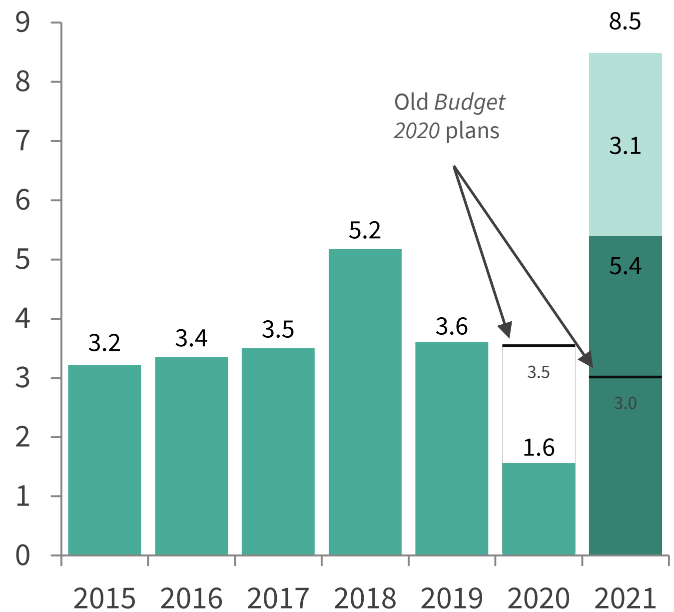
# The Council assesses that large increases in permanent spending — without identifying sustainable funding — is not appropriate

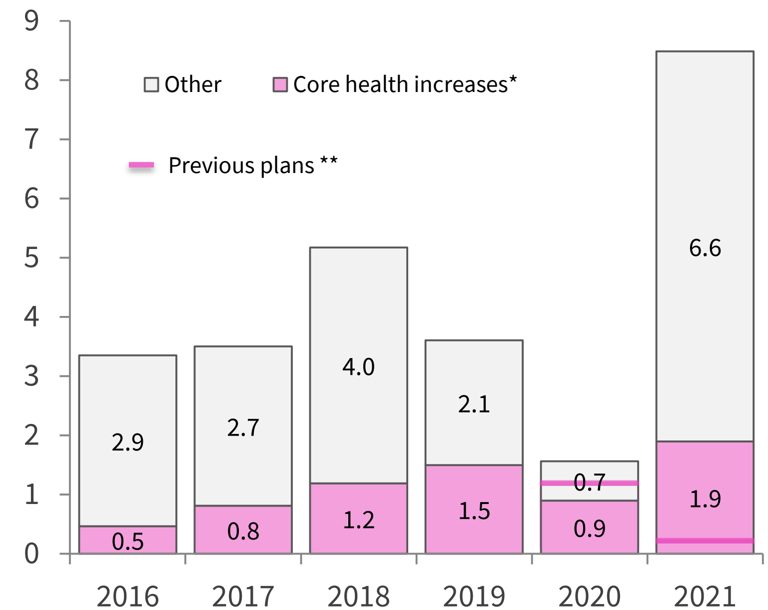
**Large net policy spending increases**

€ billion



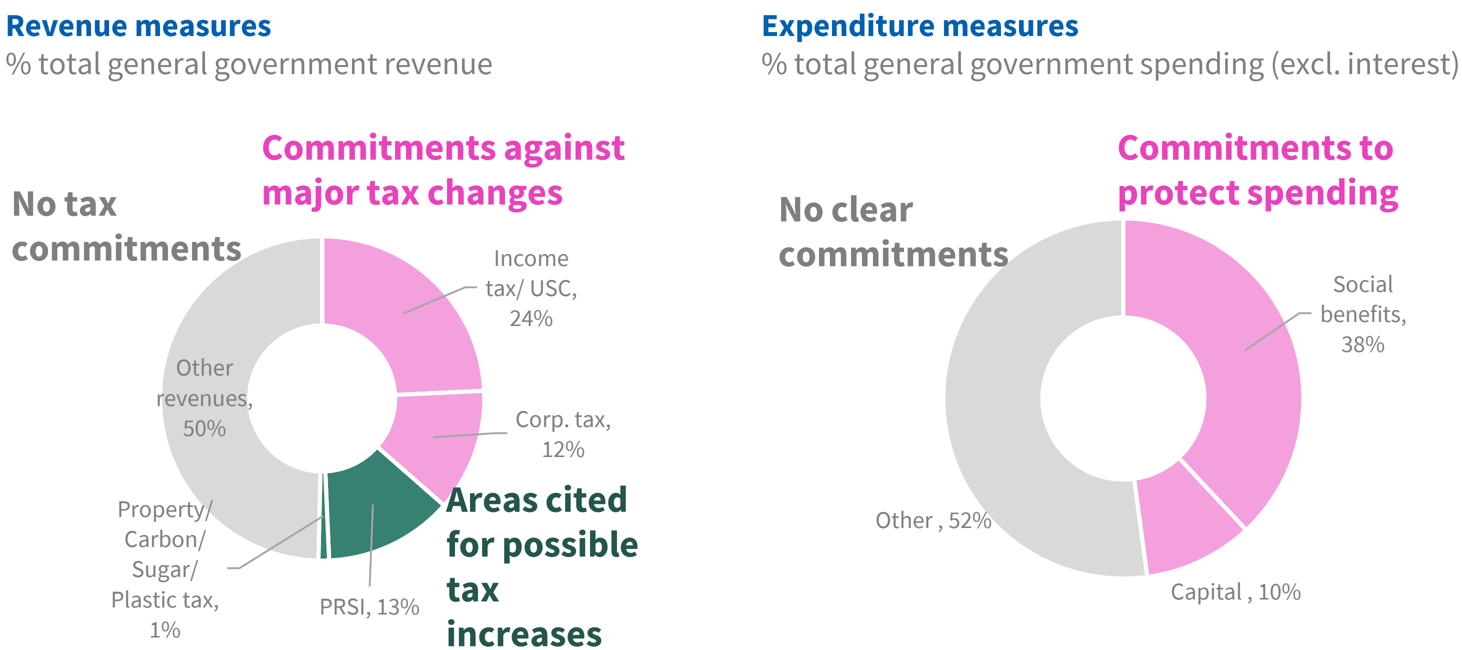

**Core health spending play a key role**

€ billion




## The 2021 increase in net policy spending is the highest in recent years

# The Programme for Government rules out many revenue or spending adjustments

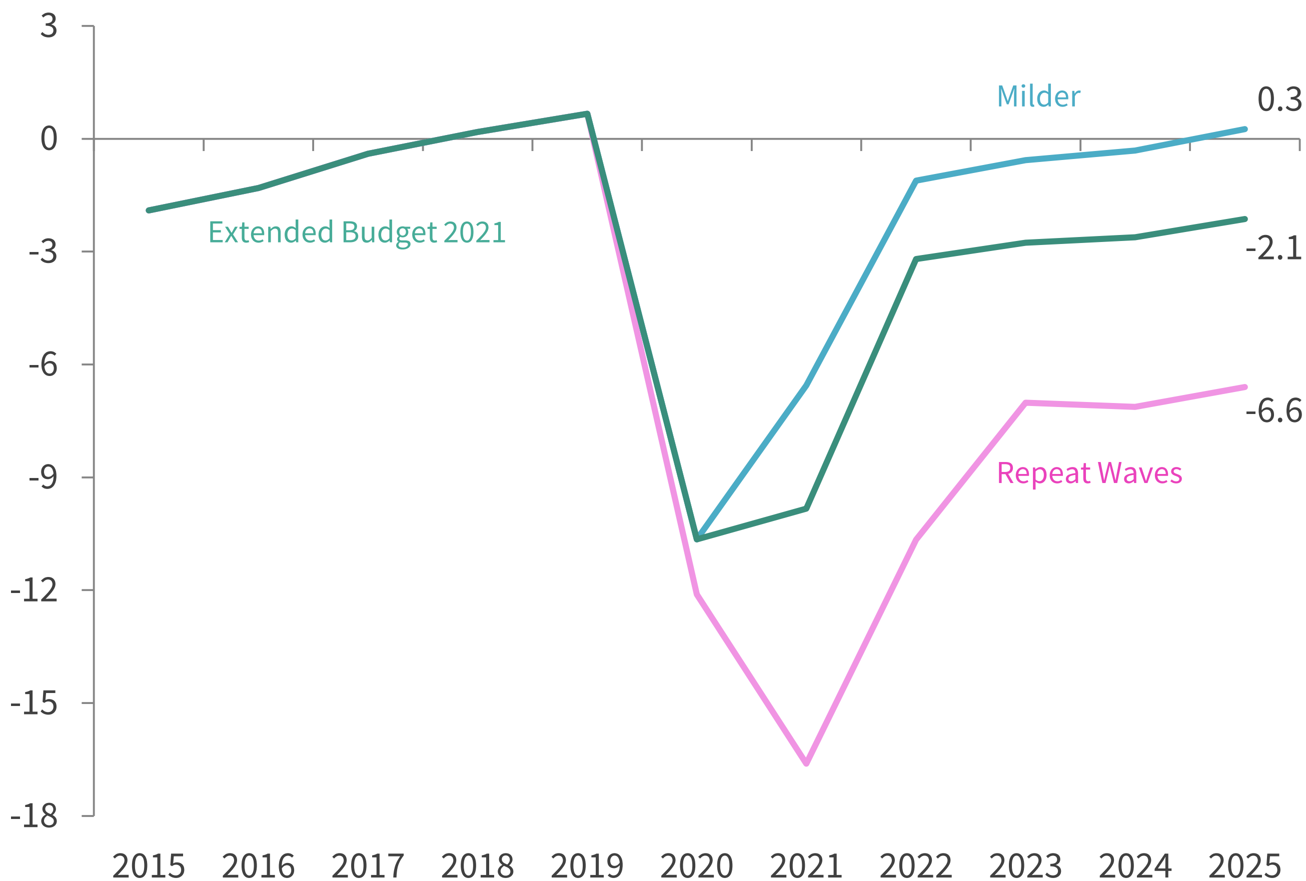



1/3 of revenue, almost half of spending has been taken off the table

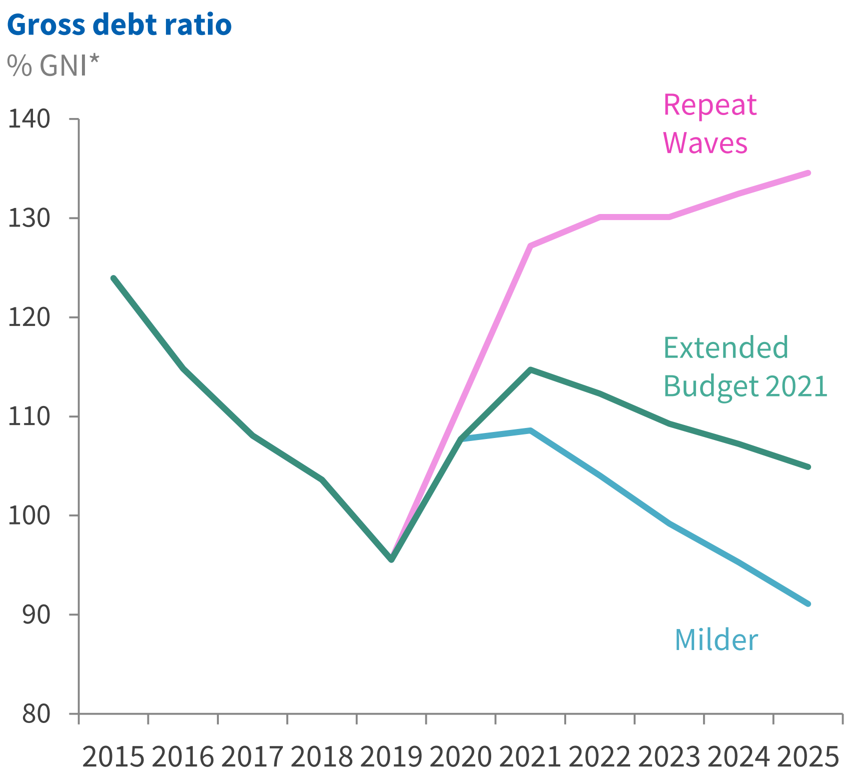
# The budget balance is expected to improve in the medium-term, but a deficit is likely to remain

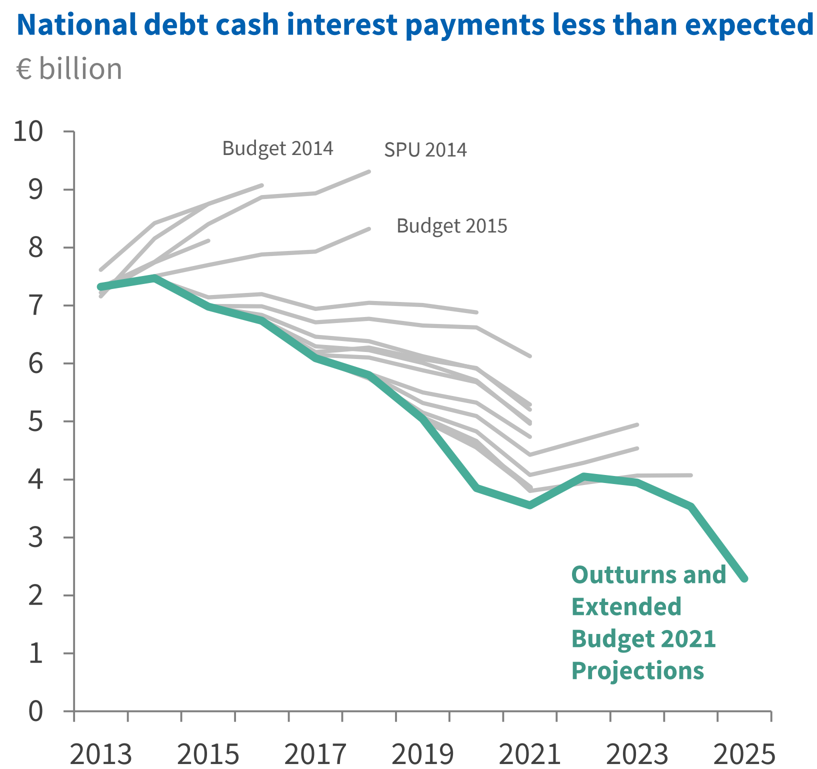
**Budget balance**

% GNI*



# The debt/GNI* ratio would fall in most scenarios, helped by low interest rates



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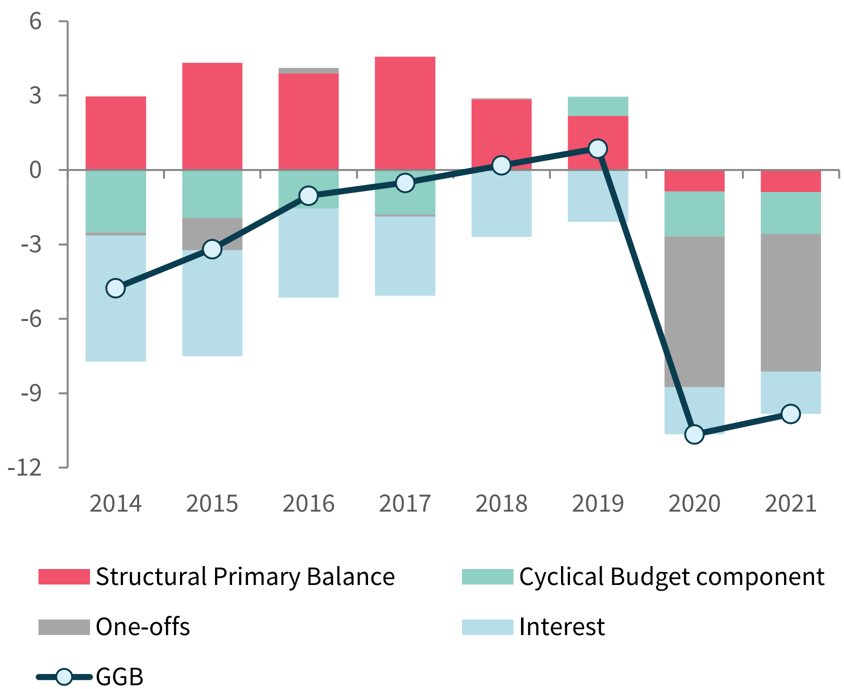
# Once the recovery is underway, 4 challenges

1. Ensuring debt is on a downward path
2. Population ageing
3. Overreliance on corporation tax
4. Climate change

# 1. Debt will need to be put on a downward path, which may require fiscal adjustment

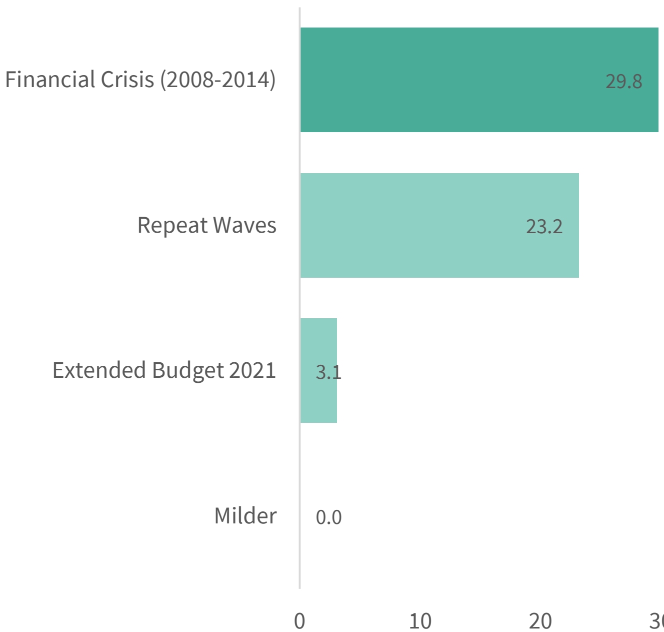
**Decomposition of the general government balance**

% GNI*




**Illustrative adjustment requirements**

€ billions

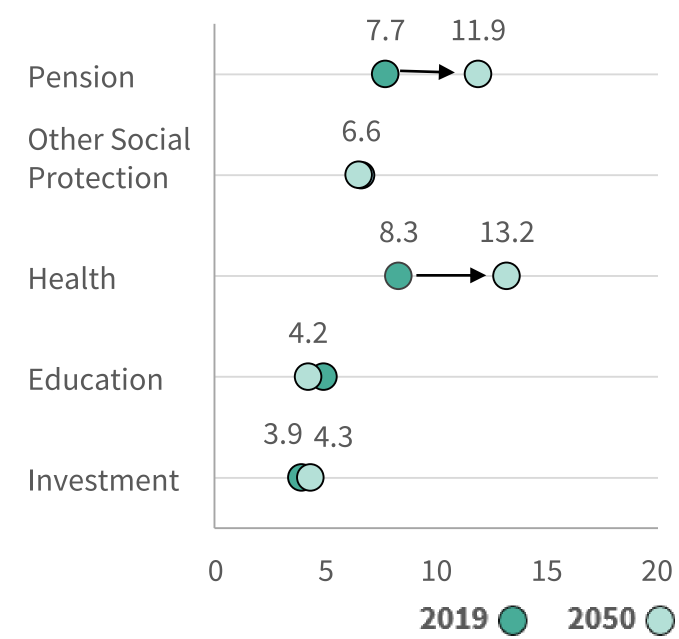



Sources: Department of Finance; NTMA; CSO; and Fiscal Council workings.

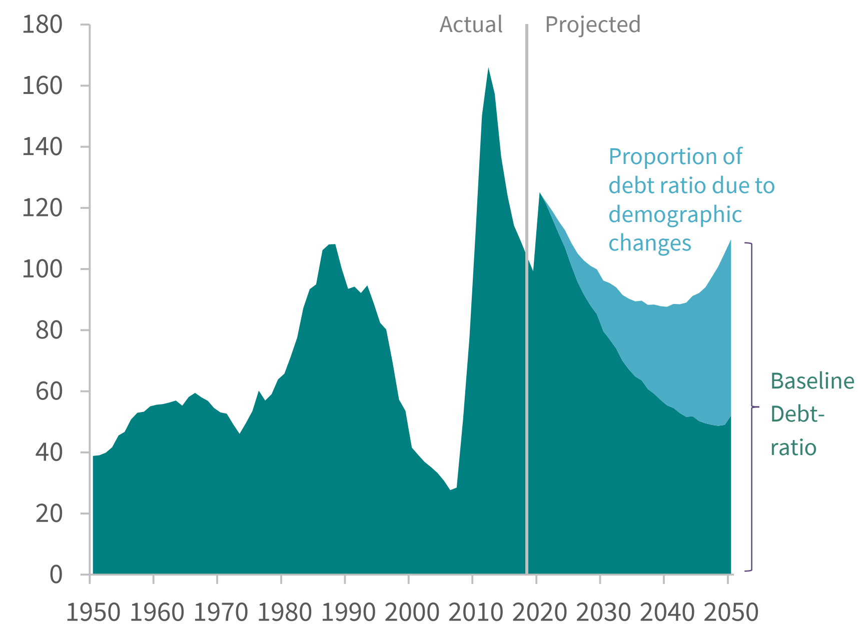
Notes: Scenarios are consistent with the macroeconomic and fiscal assumptions set out in Boxes D and G of the report. The cyclical budget component is calculated as 0.588 times the Department's GDP output gap estimates.

# 2. Ageing will add around €850m to public spending each year until 2025

**A. Health and pension spending should rise**
% of GNI* (general government basis)




**B. Ageing costs are considerable**
% of GNI*



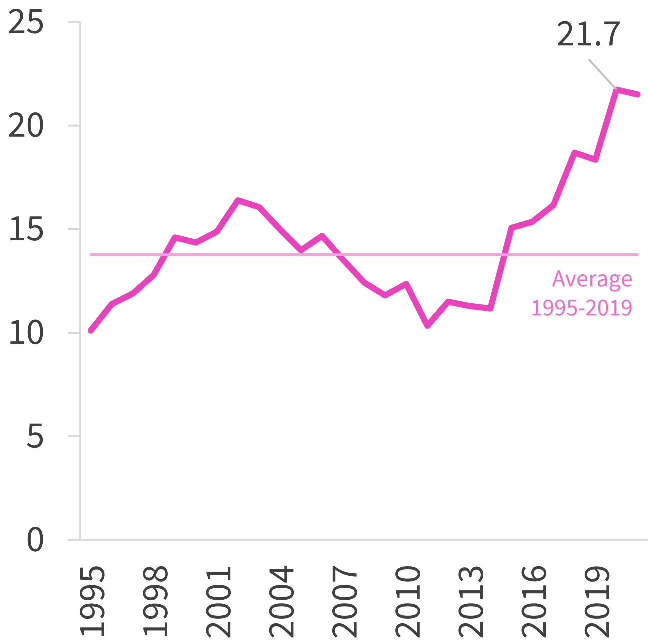

Source: Fiscal Council projections (Long-term Sustainability Report, 2020).

## Delaying the rise in the retirement age adds to pressures
## The creation of the Pensions Commission is welcome

# 3. Revenues and the economy is too reliant on corporation tax

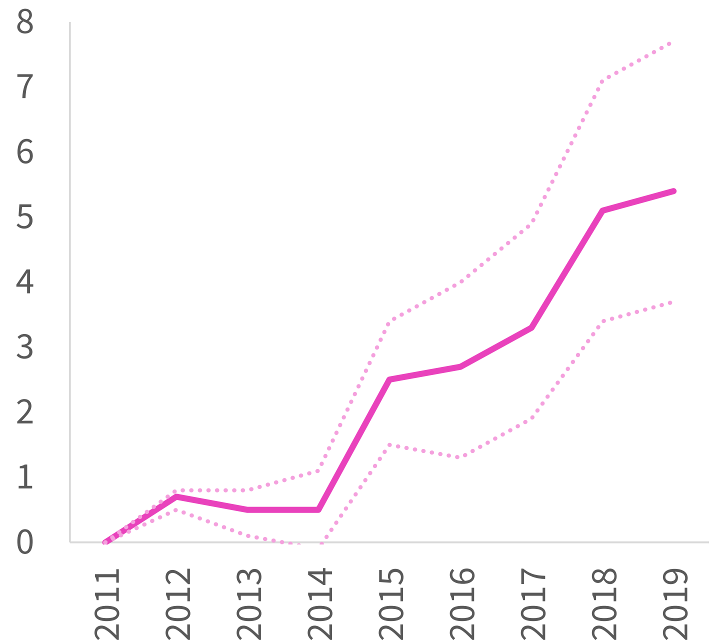
**A. Over-reliance on corporation tax**

% total Exchequer taxes




**B. Excess receipts have risen to high levels**

€ billions



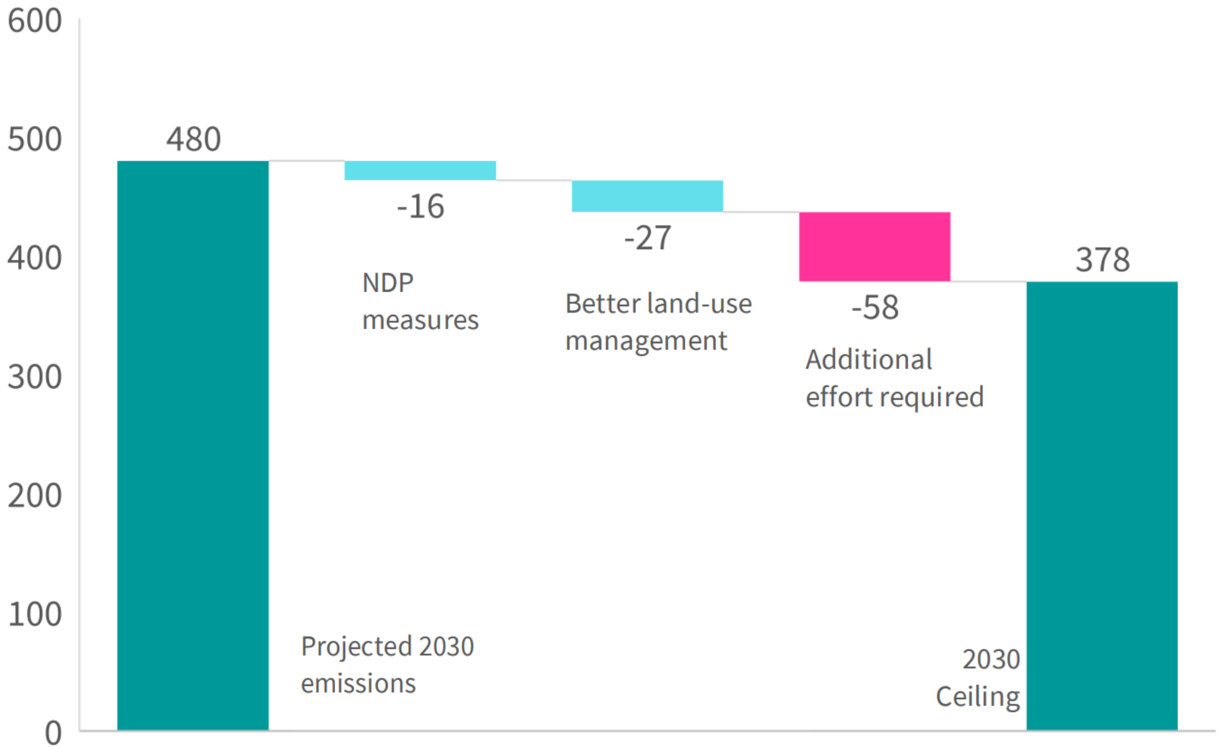

Sources: Department of Finance; and Fiscal Council workings.
Notes: See Box H of the *May 2020 Fiscal Assessment Report*.

## DOF currently expects G20/OECD BEPS to reduce corporation tax receipts by €0.8bn to €2.0bn by 2025

# 4. Climate change and the energy transition may have important fiscal costs

**Levels of greenhouse gas emissions**

Mt $CO_2$eq




Source: Climate Action Plan 2019.

Carbon tax should help reduce emissions but revenues already ringfenced for investment and welfare measures

# The Government should use its medium-term strategy in April 2021 to deliver credible plans

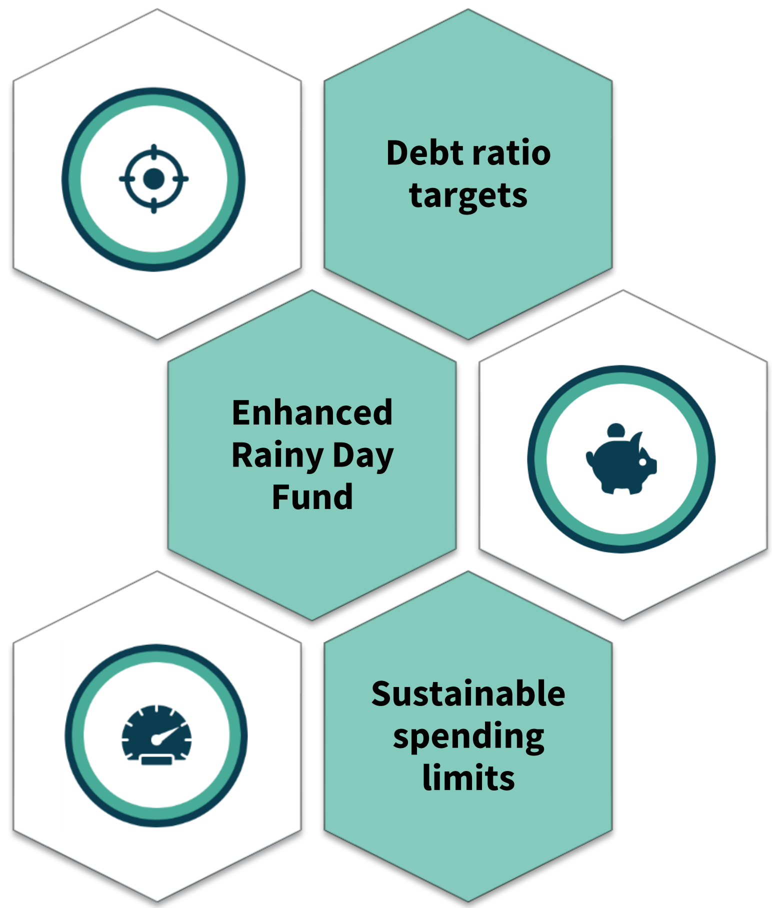
The Strategy should set out how policy objectives and competing demands will be managed and fiscal sustainability achieved:

- 5-year ***expenditure*** projections taking into account the cost of providing public services and policy changes
- 5-year ***revenue*** projections outlining how major tax heads would be adjusted
- Transparent ***costings*** of major changes in policy, including the implementation Sláintecare
- ***Medium-term fiscal objectives*** and compliance with domestic and EU fiscal rules.
- ***Guidance*** on how plans would be adapted if revenue falls short of expectations
- Develop ***annual spending reviews*** into a more comprehensive review process

# Medium-term stability should be supported by the fiscal framework

- Domestic and EU rules allow flexibility for exceptional circumstances in 2020
- This is likely to continue in 2021
- But, Ireland will enter an EU Excessive Deficit Procedure (EDP)

## Measures to strengthen the fiscal framework



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# Key messages

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  - These permanent commitments—without identifying how they will be funded sustainably—are not conducive to prudent budgetary management
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