Non-technical summary

The economy is set to bounce-back as Covid restrictions ease and as vaccines are rolled out. The pandemic continues to have major impacts. But the economy has proven more resilient to repeat waves. The Government's official forecasts assume permanent losses of output, or "scarring", of about 5 per cent due to the pandemic. While there is a lot of uncertainty around this, the Council sees growth more likely to be stronger than this. In particular, the unwinding of savings could boost consumer spending.

The Government expects a budget deficit of €18 billion this year. This results from Covid spending and sharp increases in core spending in 2021. The €5.4 billion of buffers in the budget will mostly be used up to cover the extended Pandemic Unemployment Payment and wage subsidy scheme.

The deficit should narrow as temporary measures end and as the economy recovers. The government expects the deficit to be about €12 billion in 2022 and to narrow to less than €1 billion by 2025.

However, the Government's medium-term forecasts are poorly founded. The *Government*'s spending projections for later years assume current spending grows by 3.5 per cent every year. This does not reflect the full cost of price inflation and ageing on spending. The forecasts for government investment are much higher than in the Government's capital plan. Income tax receipts are forecast to grow unrealistically fast, given plans to raise tax credits and bands. And there is little or no detail on the other policy costs beyond 2021. This includes the major Sláintecare reforms to healthcare.

Taking such factors into account, the budget deficit would be over €3 billion in 2025. However, the deficit could still close if growth is better than expected and if corporation tax receipts only reduce by as much as the Department assumes.

The Government has become even more over-reliant on corporation tax receipts. Corporation tax receipts account for one-in-every five euro of tax collected. Major changes to the global tax environment are underway and could threaten the sustainability of this tax base. The Government assumes global tax reforms will reduce corporation tax receipts gradually by €2 billion. But the impact could be faster and greater. A scenario considered in this report shows how just five firms exiting Ireland could see €3 billion of yearly corporation tax receipts lost.

The Government has been able to support the economy through Covid unlike in past episodes: it has boosted spending and other supports during the downturn. This approach may have halved the contraction in the domestic economy in 2020. The Council assesses that the Government's response in 2020 was prudent and necessary. Similarly, the Government's decision to continue temporary supports this year is appropriate.

Large permanent increases in spending, unrelated to Covid-19, were not prudent. *Budget 2021* included large permanent increases in spending of at least €5.4 billion. There was no long-term funding set out for this. It means that much of the "fiscal space" that growth in the economy would have provided by 2025 is already used up.

If the economy recovers strongly, a large-scale, untargeted stimulus to support spending in the economy would not be needed. The Government should consider a targeted approach: reducing supports only gradually, supporting those most affected, and adjusting this based on how the recovery evolves.

Ireland's net debt ratios are projected to fall steadily from high levels but there are risks. Ireland's government debt was one of the highest in the OECD even before Covid. As the State has large resources on hand and interest rates are low, this helps to sustain high debt levels and temporarily high deficits. The net debt ratio is projected to fall steadily in later years. But, higher debt levels mean a riskier debt path. There is a 15 to 20 per cent risk that Ireland's debt ratio could be on an unsustainable path by 2025 under the Government's medium-term projections. This is not alarming. But it highlights the risks. It is important to return debt to safer levels in the years ahead. This would ensure governments can respond to future crises.

This leaves no room for new policy measures unless taxes are raised or spending falls elsewhere. Closing the deficit by 2025 would help put debt on a downward path

to safer levels. This may be achievable under existing policies or it may require some modest fiscal restraint is needed in the years ahead. That could mean slower spending growth or raising taxes somewhat. To be sustainable, any additional policy measures would need to be funded by higher taxes or reducing spending in other areas.

The Government failed to publish a credible medium-term strategy as promised. A credible medium-term strategy is both essential and long overdue. The absence of realistic plans and any fiscal targets leaves the public finances without an anchor. It means that overspending in the coming years could lead to larger-than-planned deficits or further use of corporation tax receipts to mask the overspending. Three initiatives would help better anchor future budgets: credible debt targets, saving unexpected corporation tax receipts in the Rainy Day Fund, and setting spending limits based on realistic forecasts.

Ireland faces long-term challenges, which will put further pressure on the public finances. These pressures include a rapidly ageing population and potentially costly policies to meet Ireland's climate change targets, as well as paying for the policies outlined in the Programme for Government.