



# **Irish Fiscal Advisory Council**

Explaining the Fiscal Space Calculator  
June 2021

# **What is Fiscal Space?**



# What is Fiscal Space?

- Money that is available for new spending or tax cuts
  - the Council defines this in terms of the real value of public services benefits, and taxes
- Fiscal Space is the amount that is sustainable in the long run
  - based on the economy's underlying growth rate and inflation
- The Calculator links Fiscal Space to the path for national debt
  - spending must ensure that the debt ratio is falling steadily to reduce risks

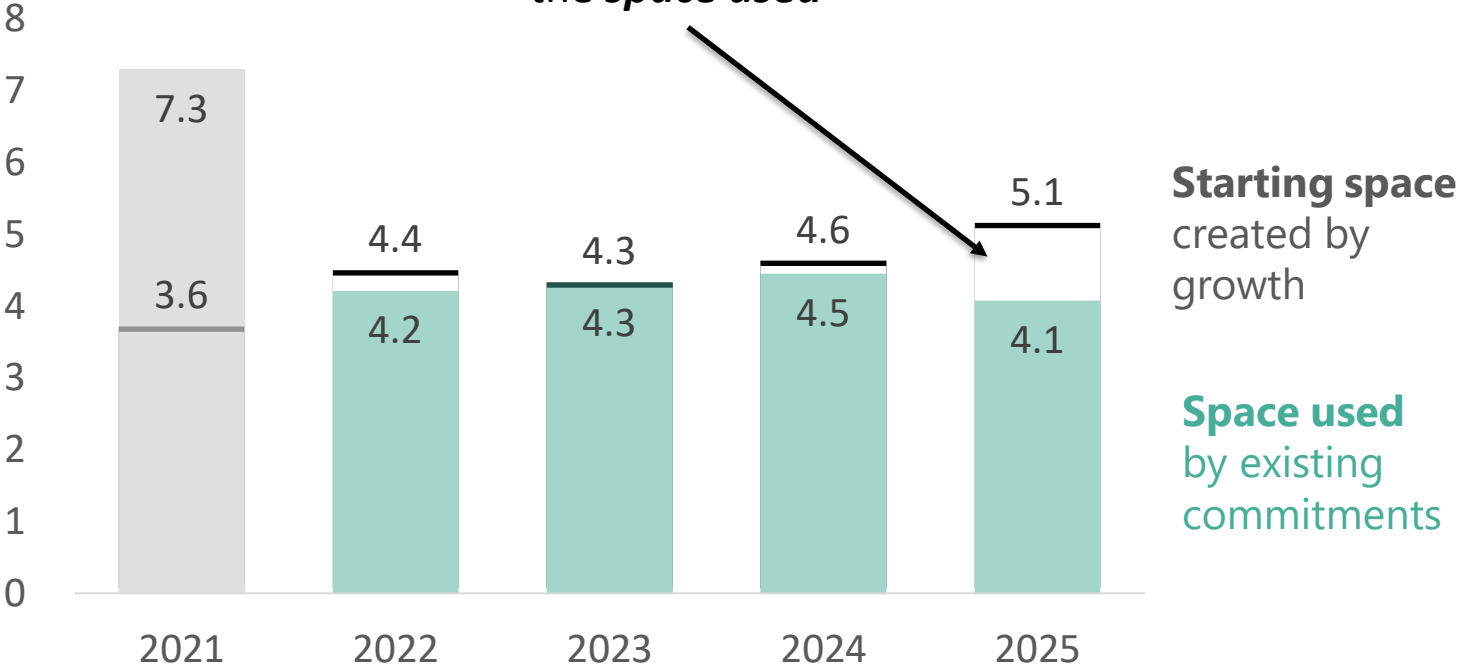
# What is Fiscal Space?

- Fiscal Space is calculated based on a framework similar to the Expenditure Benchmark in the fiscal rules
- The spending base for 2021 is equal to
  - non-interest spending excluding one-offs
  - less spending co-financed with the EU
  - less cyclical unemployment expenditure
- The Calculator makes a simplifying assumption for the use of space that does not account for capital smoothing

# What is Fiscal Space?

## Fiscal Space

€ billions





# **Key assumptions**

# Key assumptions: growth

- What is Ireland's "sustainable" growth rate?

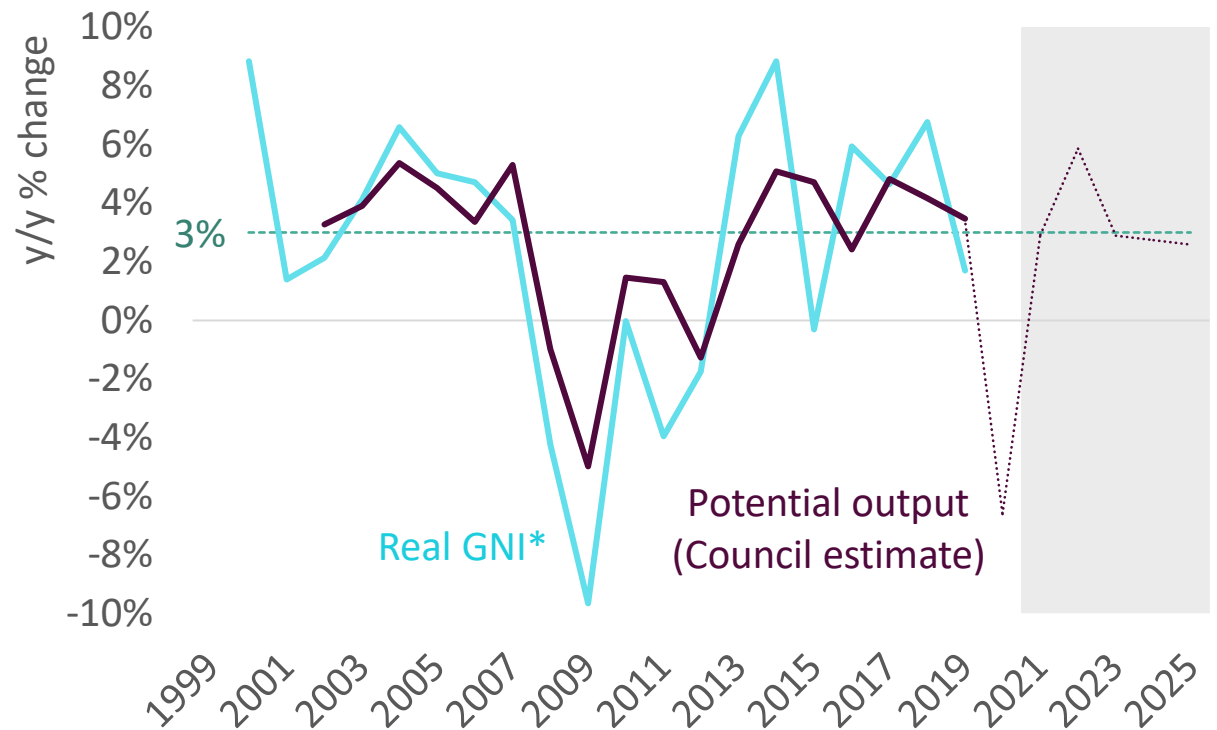
- based on model estimates by

- Fiscal Council
- Department of Finance
- ESRI

McQuinn, K., D. Foley, and E. Kelly (2017).  
 ESRI Quarterly Economic Commentary, Spring 2017.  
 Available at: <https://www.esri.ie/pubs/QEC2017SPR.pdf>

**3%**  
 "Sustainable  
 Growth"

in real GNI\* terms

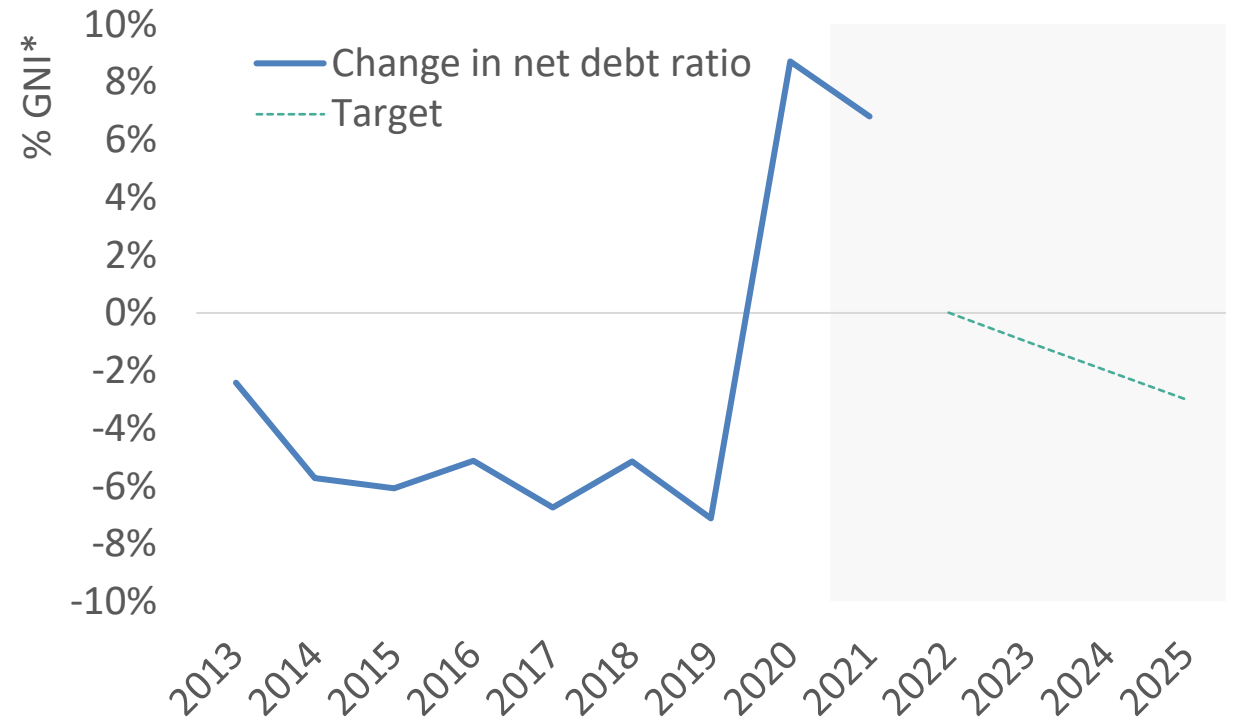


# Key assumptions: debt ratio

- What is an appropriate path for Ireland's debt ratio?
  - unchanged in 2022
  - -1 percentage point in 2023
  - -2 percentage points in 2024
  - -3 percentage points in 2025

**-3pp**  
Debt ratio  
reduction by  
2025

as % GNI\*





**Maintaining  
current policies**



# Maintaining current policies

- Stand-still costs
  - social benefits
  - pensions
  - public-sector pay
  - other (due to rising costs of goods and services)
- Indexing income tax bands
- Increasing the pension age

# Maintaining current policies

## Stand-still costs

- Choices for (a), (b) and (c)
  - Selecting “Yes” will increase social benefits, pensions, and public sector pay in line with economy-wide growth
  - Otherwise, no space is allocated, as below:

	2020	2021	2022	2023	2024	2025
<b>2) How do you want to maintain current policies?</b>						
(a) Do you wish to maintain existing social benefits?						
No, I wish to keep them constant in cash terms, or decrease them			0	0	0	0
<i>Note, this means that you are going to cut benefits in relative terms. That is, they do not keep pace with general wage changes</i>						

# Maintaining current policies

## Tax bands indexation

- Choice for (d)
  - Selecting “Yes, I want bands to rise if wages rise” will index tax bands, meaning less fiscal space
  - Otherwise, extra space is generated, as below:

	2020	2021	2022	2023	2024	2025
(d) Will you raise or "index" tax bands in line with wages?						
No, I don't want bands to rise if wages rise			715	985	992	1,005

*Note, this means you are going to raise taxes in real terms. By not keeping pace with wage changes, people will drift into higher tax bands*

# Maintaining current policies

## Increasing the pension age

- Choice for (e)
  - Selecting “No, I don't want to increase the pension age” will keep the pension age at 66, as assumed in SPU 2021
  - Otherwise, extra space is generated (via lower expenditure in 2022), as below:

	2020	2021	2022	2023	2024	2025
(e) Will you increase the pension age as previously planned?						
Yes, I want to increase the pension age			-575	-25	-25	-25



# **New Budget policies**

# New Budget policies

- The top right of the calculator shows the total fiscal space available over 2022 – 2025, and the budget balance

**Fiscal Space 2022-2025: €1,249 million**  
**Budget balance in 2025: 0.1 % GNI\***

- Policy changes include:
  - current spending
  - capital spending
  - taxes
  - the Rainy Day Fund

	2020	2021	2022	2023	2024	2025
<b>3) What are your new budget policies?</b>						
Enter the amounts in €m that you intend to change spending and taxes <u>every year</u> after by same amount once introduced <a href="#">Here are some examples of illustrative tax and spending changes</a>						
New current spending changes €m	0	0	0	0	0	0
New capital spending changes €m	0	0	0	0	0	0
New tax measures €m (negative = tax cuts)	0	0	0	0	0	0
How much to put in the Rainy Day Fund each year €m	0	0	0	0	0	0
Amount in the Rainy Day Fund at year end €m	0	0	0	0	0	0

# New Budget policies

- In line with previous Council research, **short-run multiplier** estimates are used as follows:
  - tax changes = 0.3
  - current spending = 0.5
  - capital spending = 1.1



# New Budget policies

- For example, a tax cut costing €100 million adds €30 million to nominal GNI\* in the year it is introduced
  - a technical assumption is made that there is no long-run impact on the level of GNI\*

	2020	2021	2022	2023	2024	2025
New tax measures €m (negative = tax cuts)			-100	0	0	0
Nominal GNI*	202,825	210,081	227,031	238,248	249,530	260,655
Nominal GNI* with no changes to taxes or spending		210,081	225,966	237,368	248,957	260,501
Multiplier impact of selected stand-still costs			821	666	455	132
Multiplier impact of indexing tax bands			215	224	128	32
Multiplier impact of discretionary change to taxes or spending			30	-10	-10	-10
Nominal GNI* growth rates		3.6	8.1	4.9	4.7	4.5

- However, the faster GNI\* growth rate also generates some revenue
  - so the net reduction in revenue is €87 million, despite the €100 million cut in tax



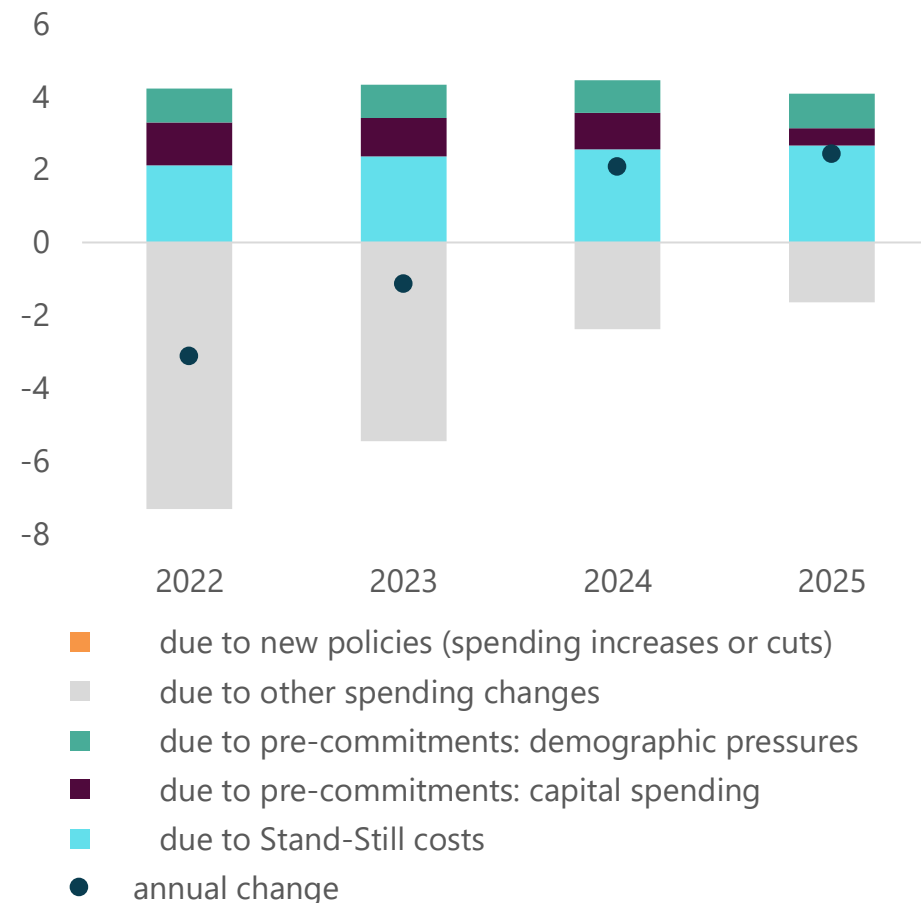
# **Budget outcomes**

# Budget outcomes

## Non-interest spending

- €17 billion is the total use of fiscal space over 2022 – 2025 that is required to pay for the costs of:
  - standing still
  - pre-committed spending for capital investment
  - pre-committed spending for demographics
- This leaves very little unused space

**Change in non-interest spending**  
€ billion

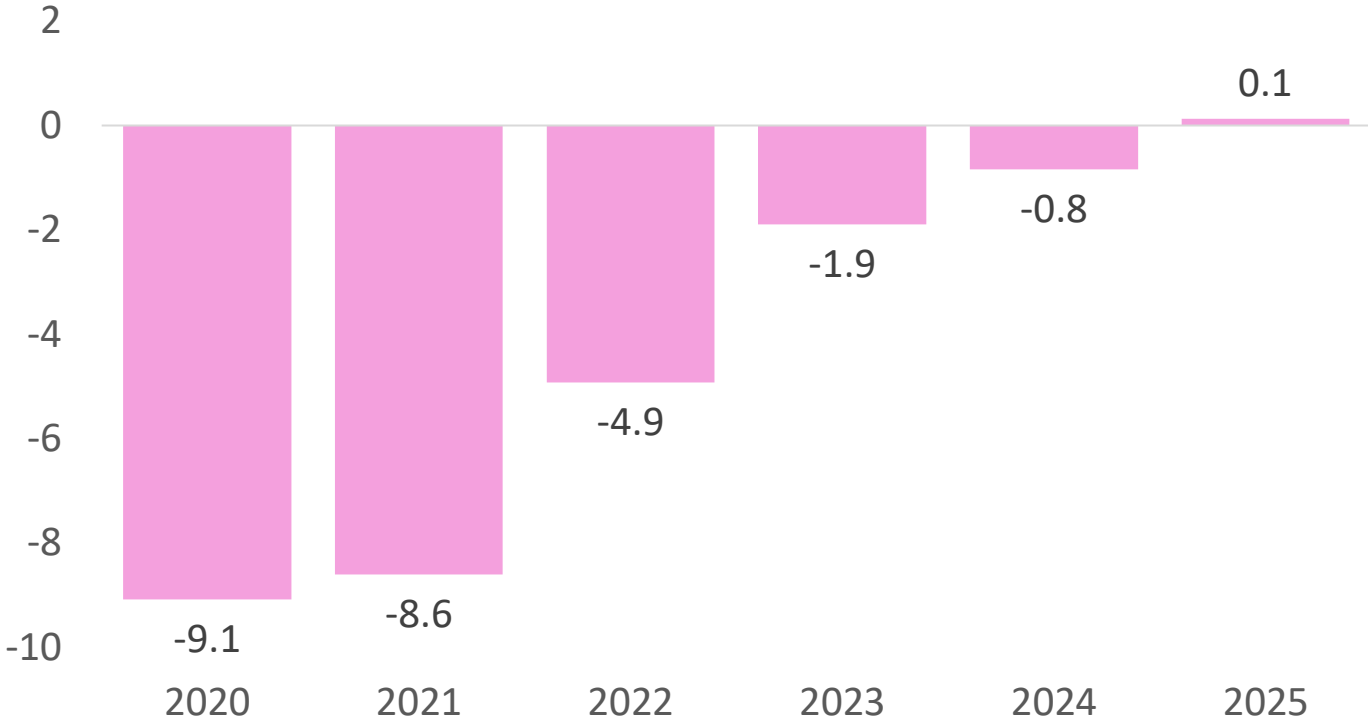


# Budget outcomes

## Budget balance

### Budget balance

% GNI\*

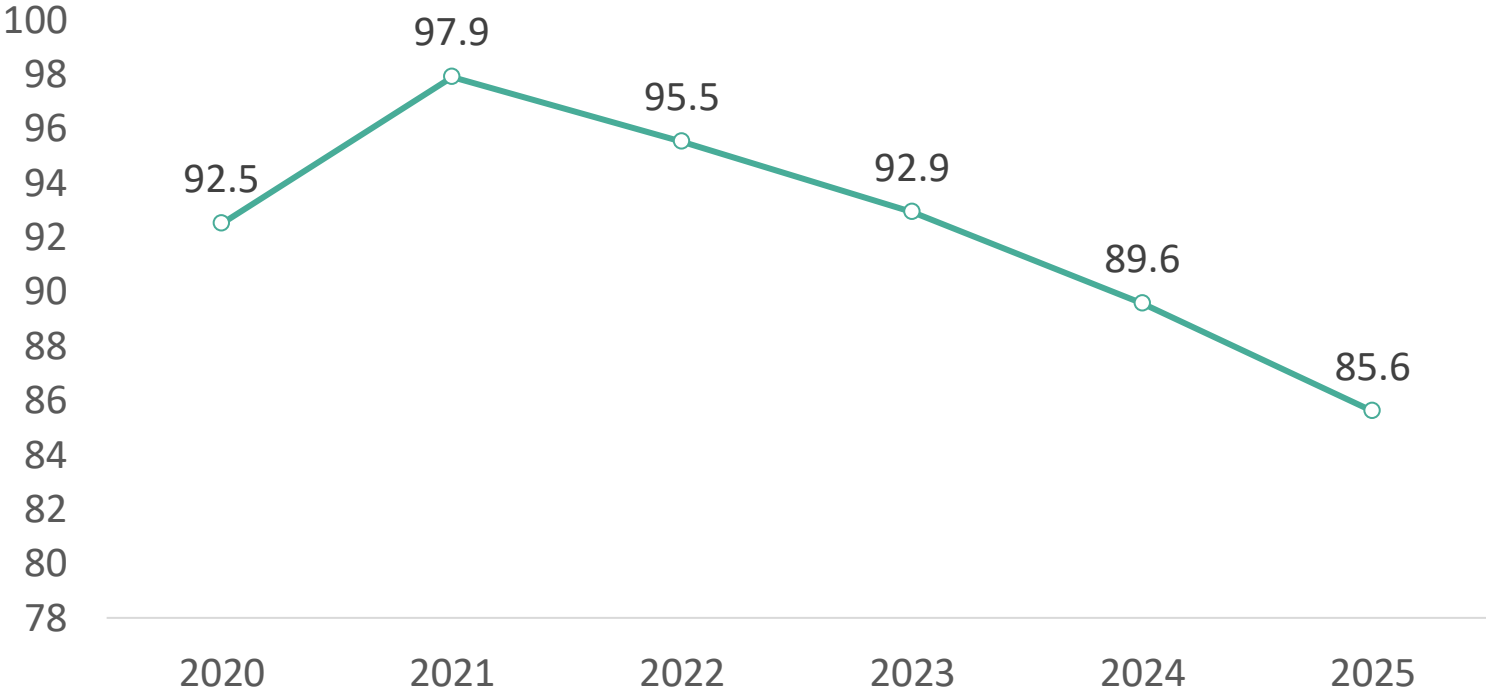


# Budget outcomes

## Net debt ratio

### Net Debt ratio

% GNI\*



Note: **net debt** evolves based on the prior-year level plus the deficit (or minus the surplus) in the current year

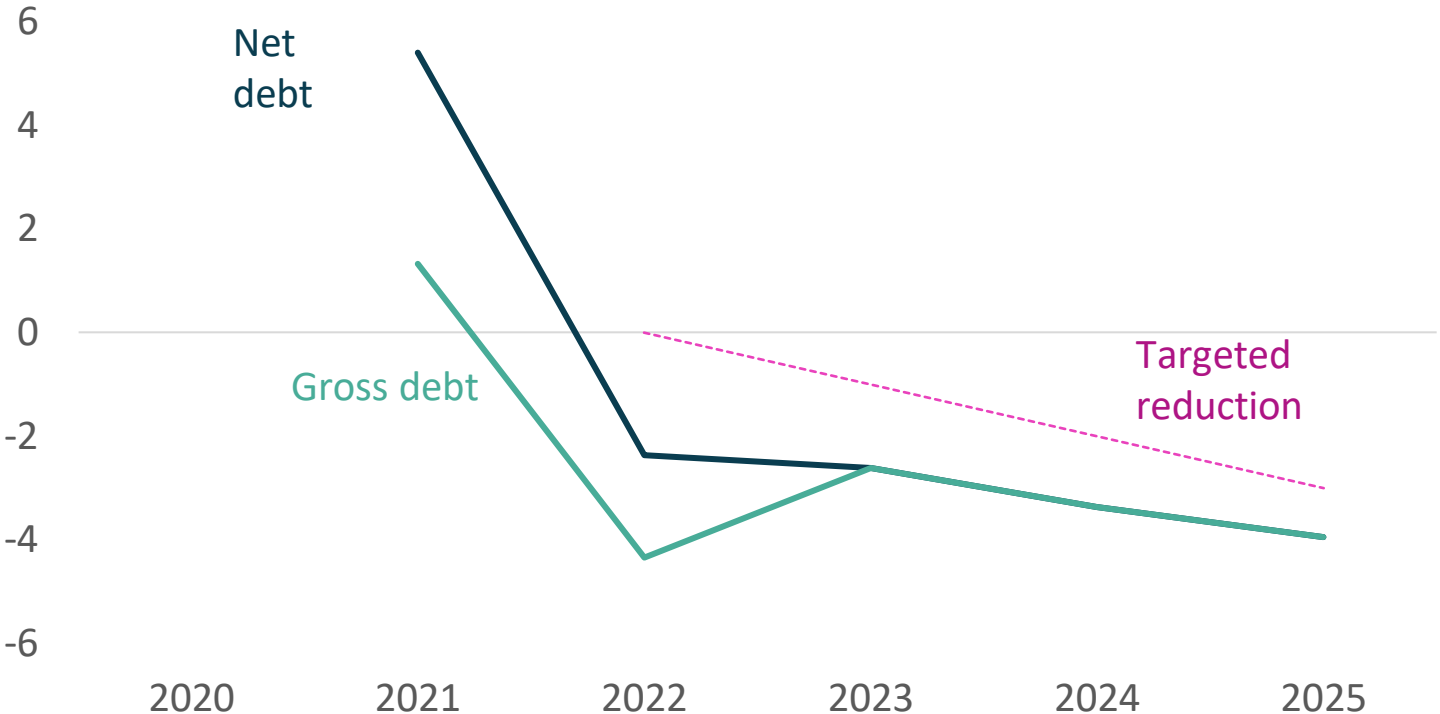
**Gross debt** evolves according to an assumed change in assets, which is sensitive to the maturity profile of debt and the calculated deficit

# Budget outcomes

## Change in debt ratio

### Change in debt ratio

percentage points



Note: the difference between the change in the debt ratio and the targeted reduction is **not the same as fiscal space**

Fiscal space is primarily related to the **sustainability of expenditure growth net of tax policies**



# **Disclaimer**

# Disclaimer

This Fiscal Space Calculator remains a “beta” version

While significant efforts have been made to develop and check it, the Council intends to develop and refine it further over time

Any feedback would be welcome ([admin@fiscalcouncil.ie](mailto:admin@fiscalcouncil.ie))

The Council does not endorse any simulations produced by users using the Calculator