

Public services after COVID and how to pay for them



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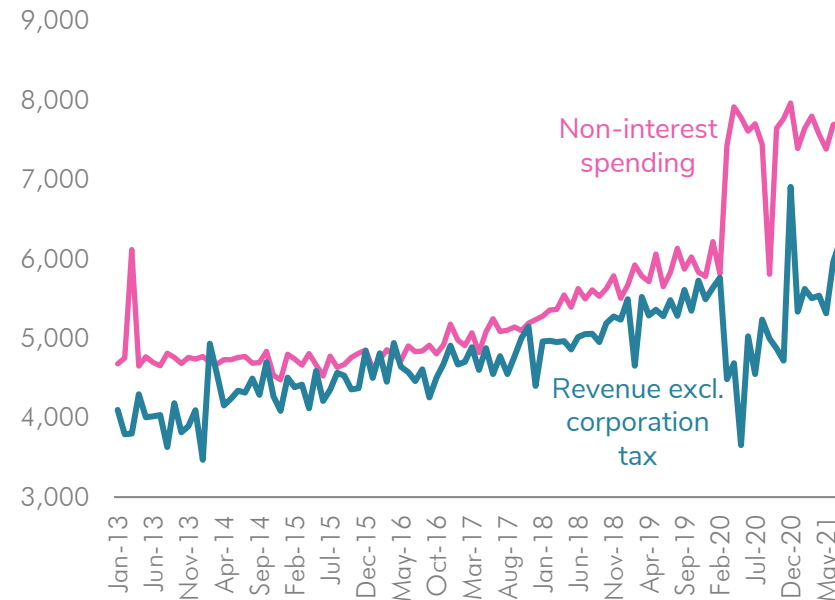
<https://www.fiscalcouncil.ie/>

Dublin Economic Workshop September 2021

Covid spending has been huge, but the effects should be temporary

Taxes recovering; spending unwinding

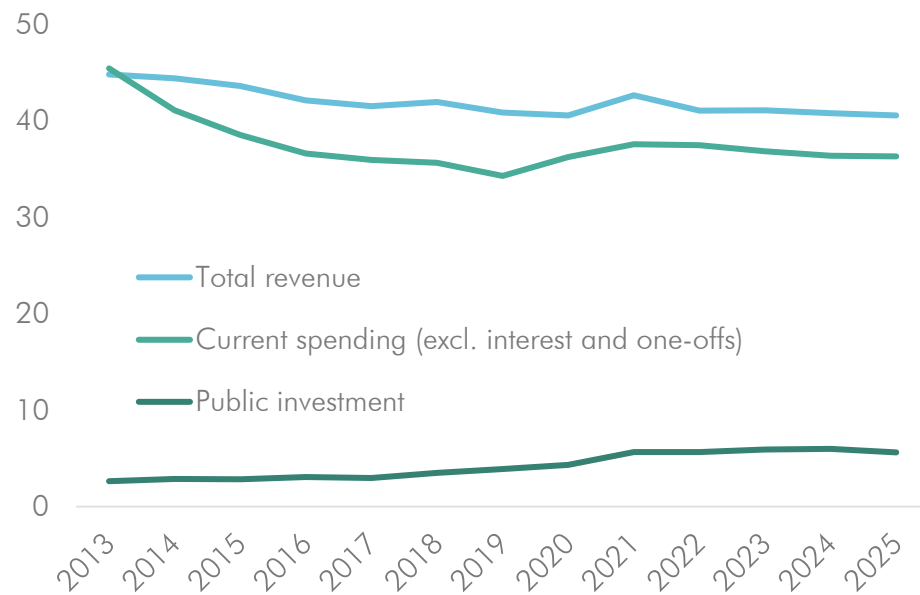
Seasonally adjusted monthly levels € 000



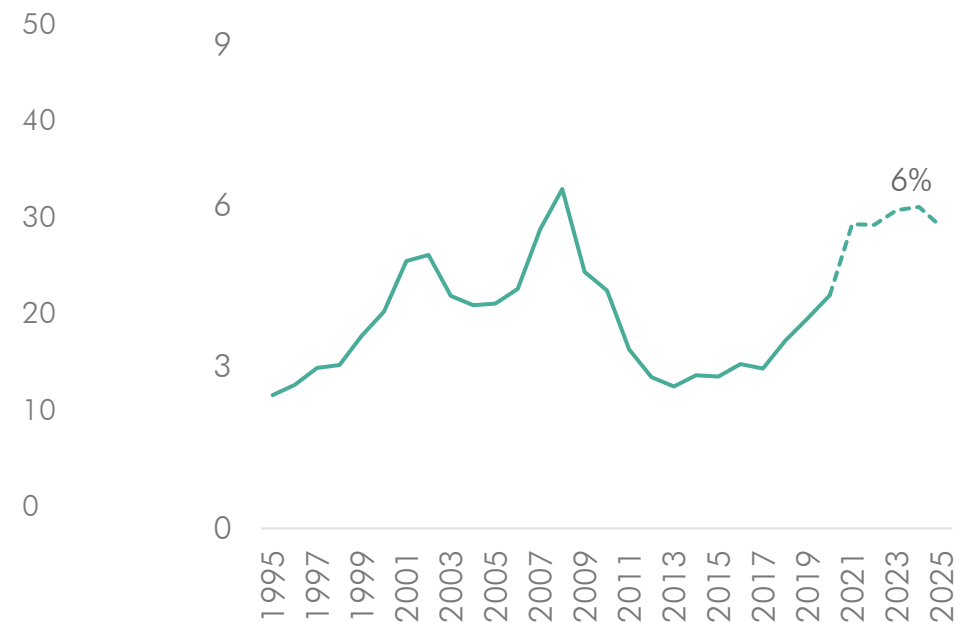
- Revenue is recovering
- Covid spending is lower than in 2020 and should be winding down
- 2021 spending increase partly due to €5-8bn of permanent measures
- Risk of “temporary” spending becoming permanent

The *Summer Economic Statement* medium-term plan to 2025

% GNI*, general government basis



Public investment, % GNI*



- Spending rule for permanent voted spending to rise at 5% annually
- Investment is growing much faster
- Higher current spending, tax cuts, some on-going gains from falling interest costs
- This will lead to a significant structural budget deficit

<https://www.fiscalcouncil.ie/pre-budget-2022-statement/>

Medium- and long-term pressures on the public finances

Overreliance on corporation tax

Population ageing

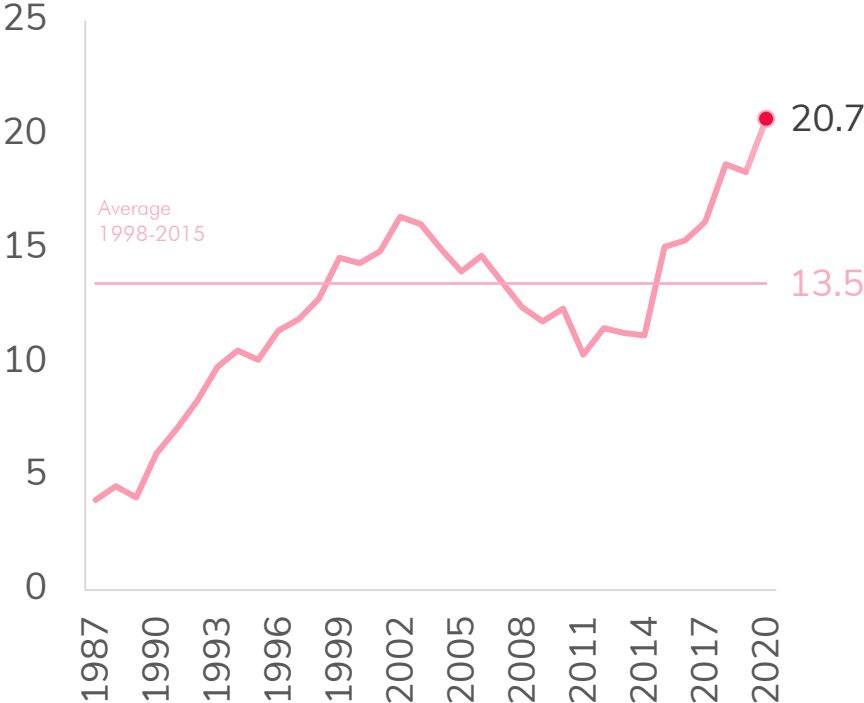
Climate change

Sláintecare

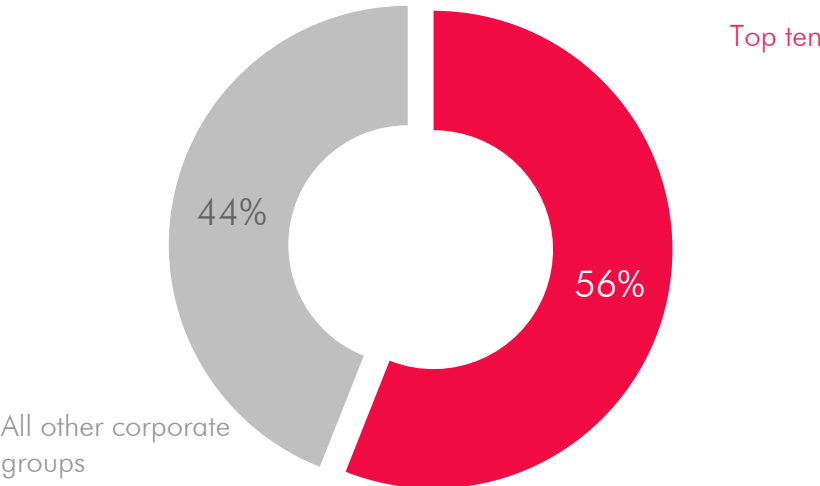
Lower growth

1. Need to reduce overreliance on corporation tax

% total Exchequer tax from corporation tax



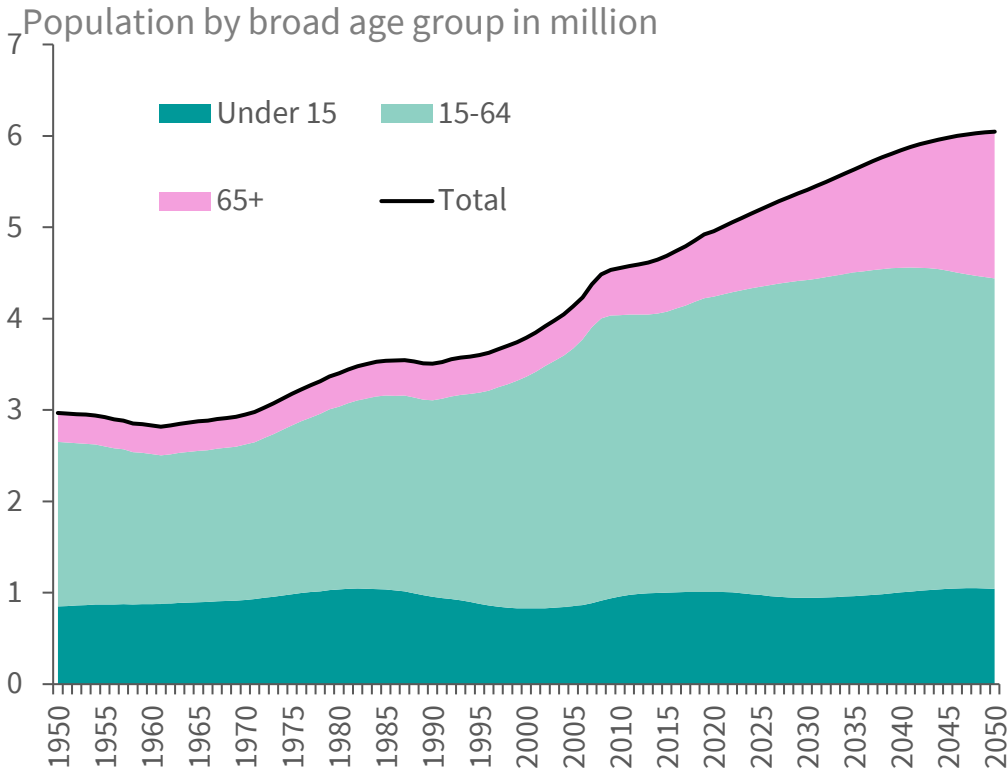
% total corporation tax receipts



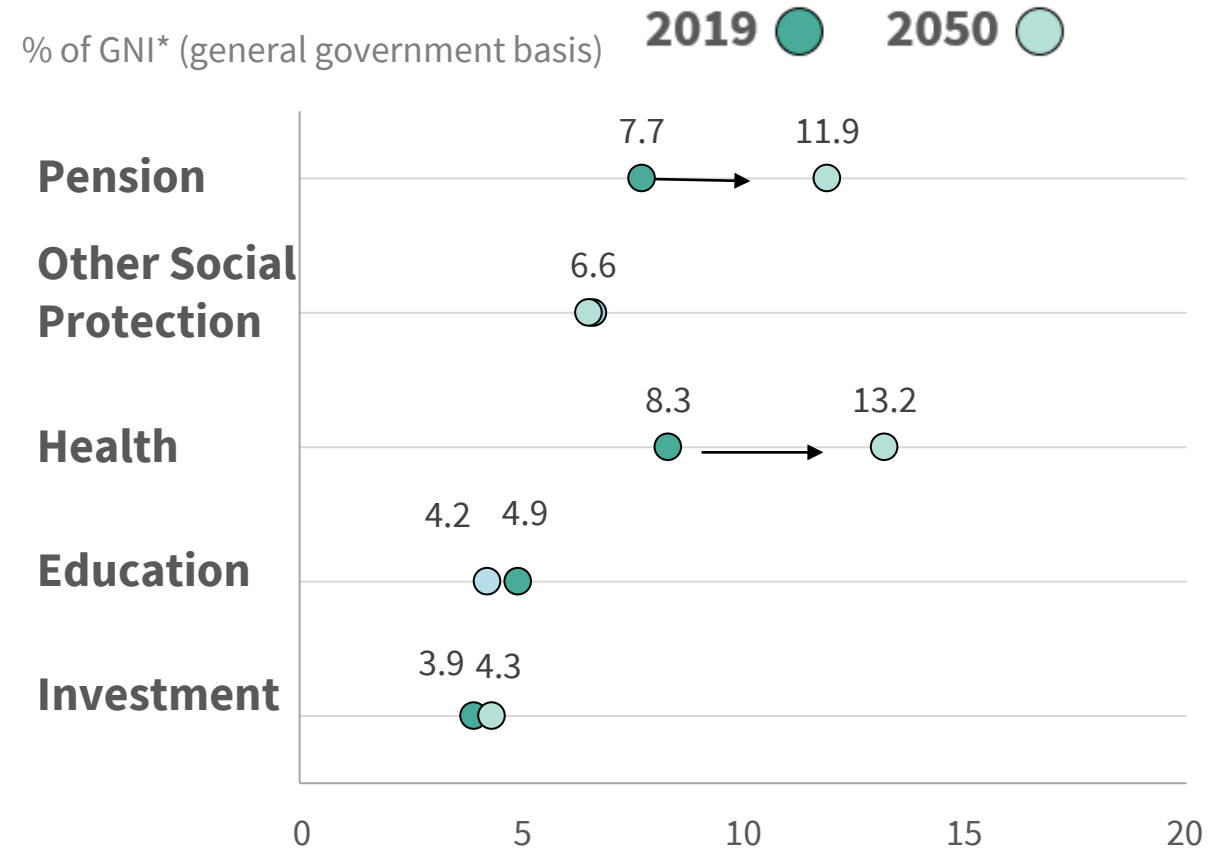
Sources: Department of Finance; Revenue (2021); and own workings.

2. Pension and health costs will rise

The share of older cohorts in the population will increase significantly



Sources: CSO; and Fiscal Council projections. See [2021 Long-Term Sustainability Report](#).

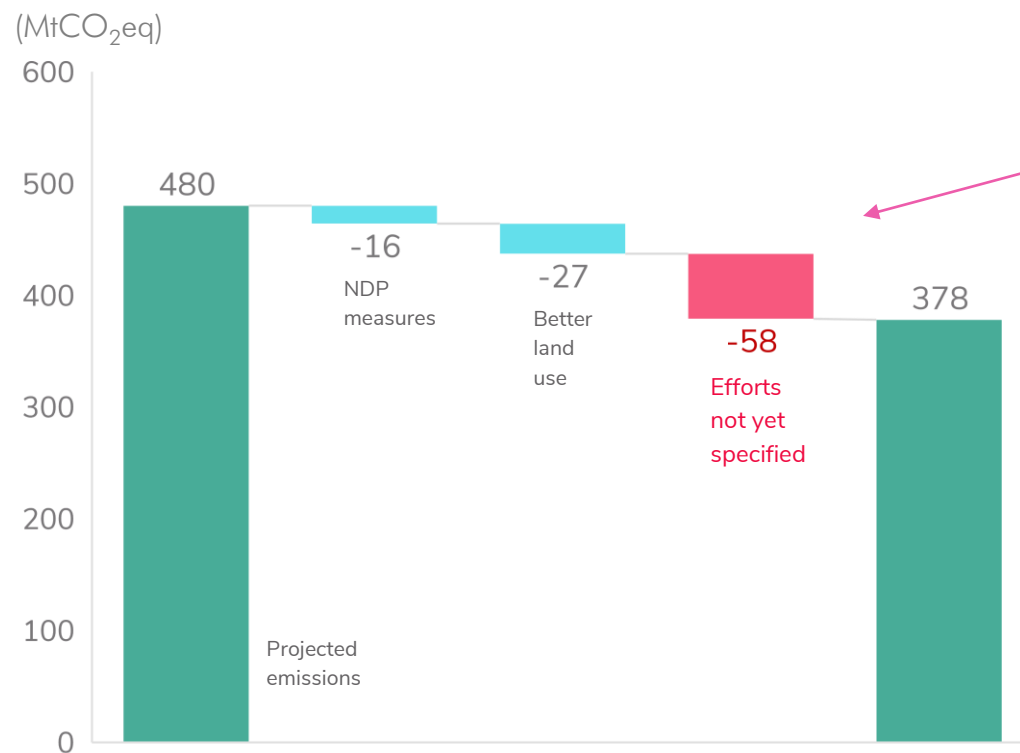


Sources: Eurostat; CSO; Department of Public Expenditure and Reform; Department of Finance; Fiscal Council projections. See [2021 Long-Term Sustainability Report](#).

Note: Figures assume a pension age of 68 by 2050, in line with the legislation at the time that the Long-term Sustainability report was published.

3. Climate change measures required could be substantial

Levels of greenhouse-gas emissions



More than half of overall reduction unspecified

Recent [IMF \(2021\)](#) estimates suggest that ~€7 billion would be required annually over the next ten years to achieve additional targets set out in Climate Action Bill

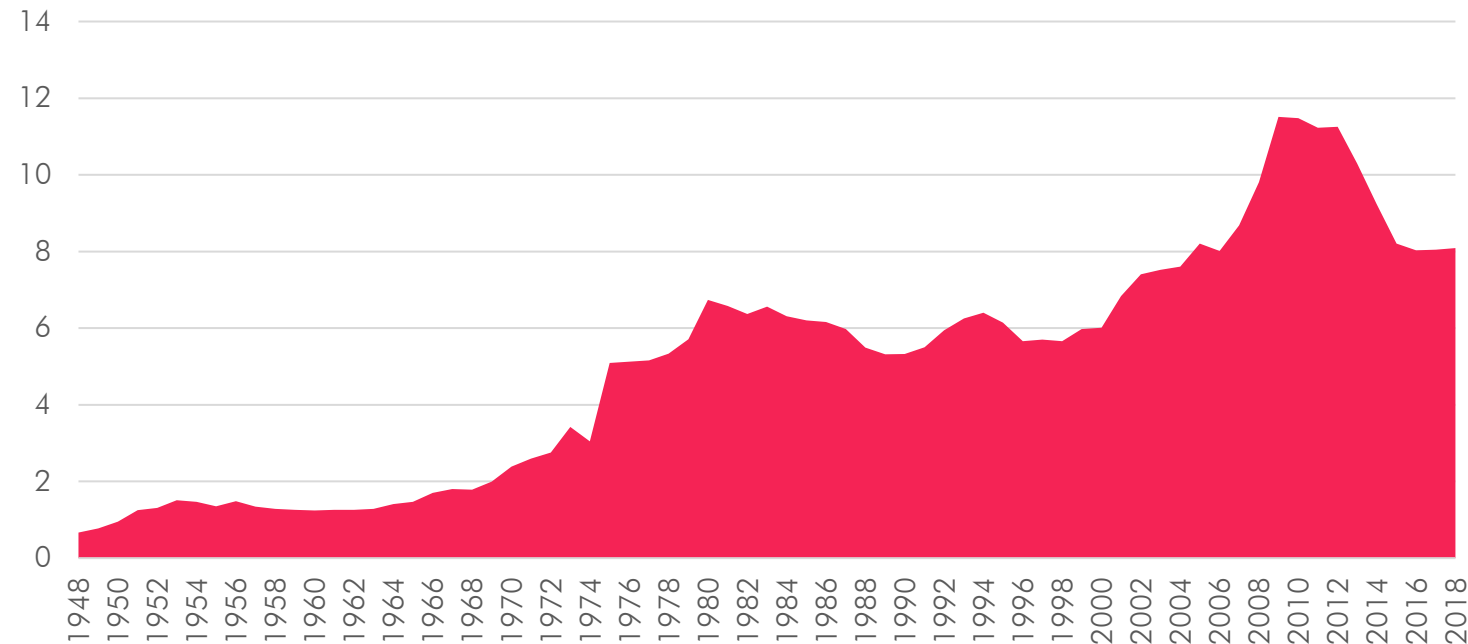
Sources: Fiscal Council (2020b); Climate Action Plan 2019.

Notes: NDP refers to the measures set out in the National Development Plan. Better land use refers to the additional carbon absorption expected from forestry over a period of years.

4. There are major pressures around health spending

Public health spending has outpaced economic growth

% GNI*

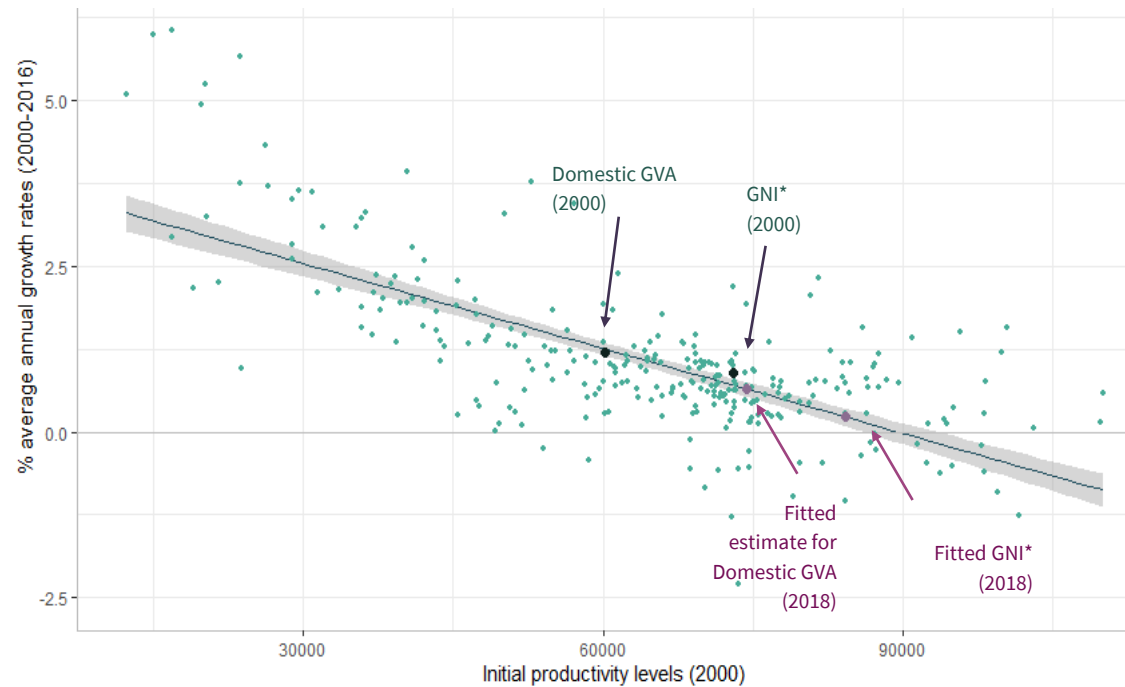


Source: Casey and Carroll (Forthcoming).

- Sláintecare reform estimated in 2017 to cost about €3bn on a recurrent basis

5. Over the longer term, growth may be less favourable

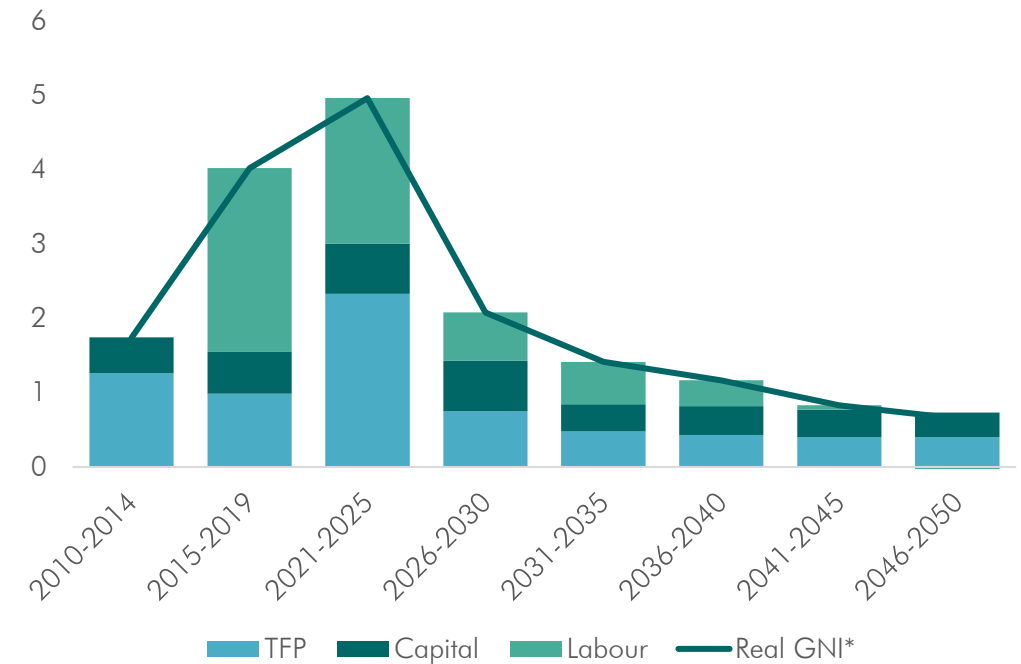
Regional labour productivity growth



Sources: OECD (Regional Database); and Fiscal Council workings (see [Long-term Sustainability Report 2020](#)).

Real GNI* growth

% change year-on-year



Sources: Fiscal Council workings (see [Long-term Sustainability Report 2020](#)).

A simple framework – using the “stand-still”

$$\Delta \text{budget balance} = \Delta \text{revenue} - \Delta \text{spending}$$

- Sustainable revenue grows in line with the economy

$$\Delta \text{revenue} = t \cdot \Delta \text{GNI}^*$$

- Spending assessed by the cost of “standing still”

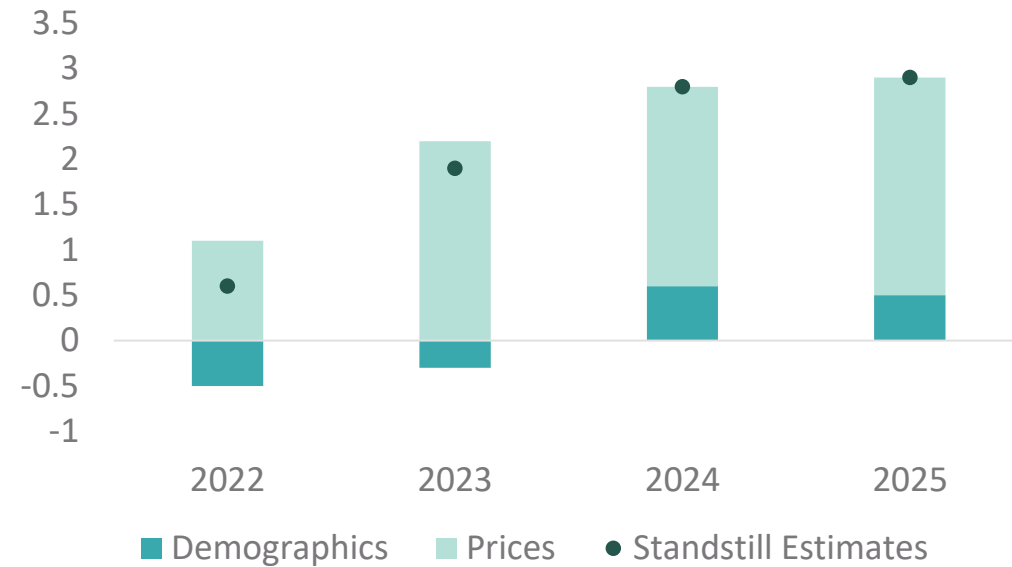
$$\Delta \text{spending} = f(\text{wages, inflation, demographics, interest rates})$$

This has typically risen slower than revenues

- So, **growth generates some (net) “fiscal space” for new projects**
- But, far less than most politicians think – cash spending increases mostly to meet rising costs

Stand-still estimates

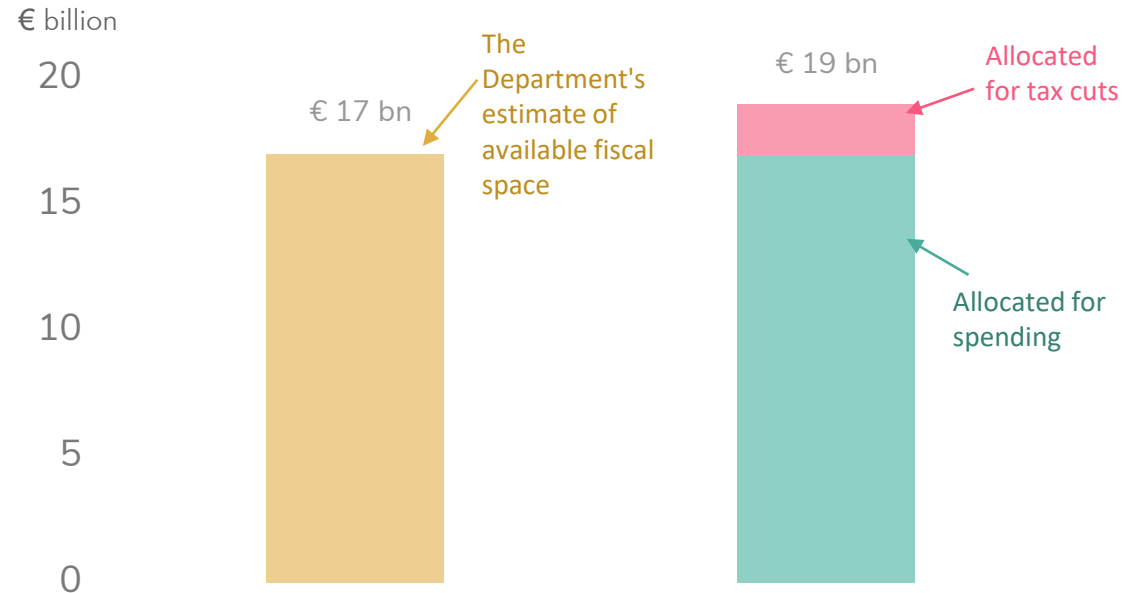
Annual change in € billion (gross voted current spending)



Source: SPU 2021, Revised Estimates 2020, CSO, Department of Expenditure and Reform, HIPE, HSE, and Fiscal Council workings.

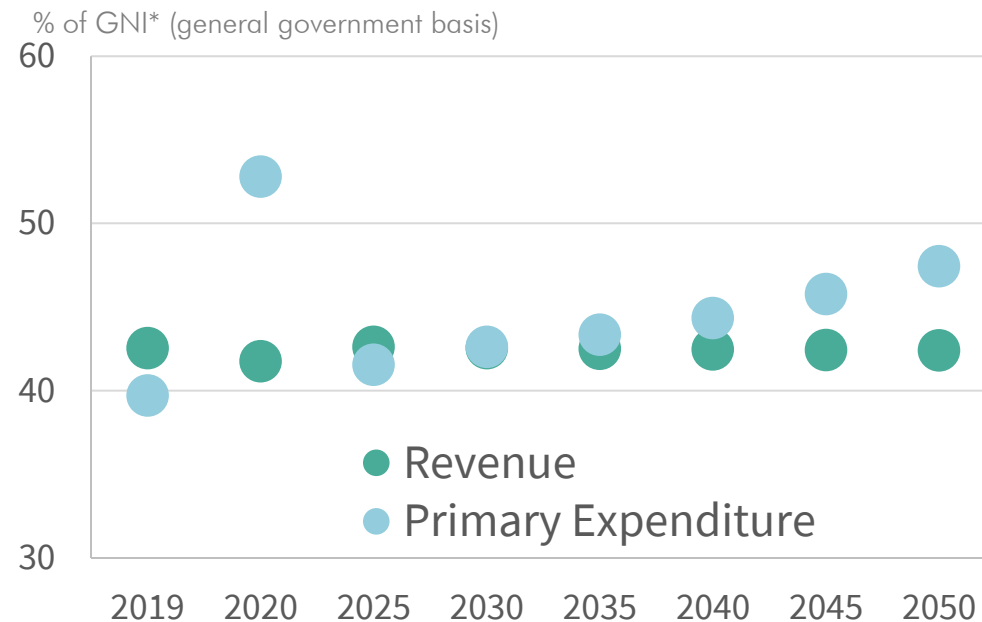
These dynamics will be more challenging in the years ahead

The Government has committed to using more than the available fiscal space for 2022-2025



Sources: Department of Finance; and Fiscal Council workings.
 Note: Available fiscal space is based on the Department's own assumption of a trend growth rate of the economy of 5 per cent, as outlined in the SES.

Long-term expenditure set to rise



Sources: Eurostat; CSO; Department of Finance; and Fiscal Council projections. (see [Long-term Sustainability Report 2020](#)).

- In the medium term, all the space has been used up already
- From the 2030s, demographic pressures will exceed what growth can finance

What does this mean for the management of spending ?

- Ireland is used to relatively favourable conditions
- The focus remains on allocating cash on Budget day
- Growth has been used to fund new activities
- It has been easy to avoid making hard choices

Net policy spending excluding investment rising quickly



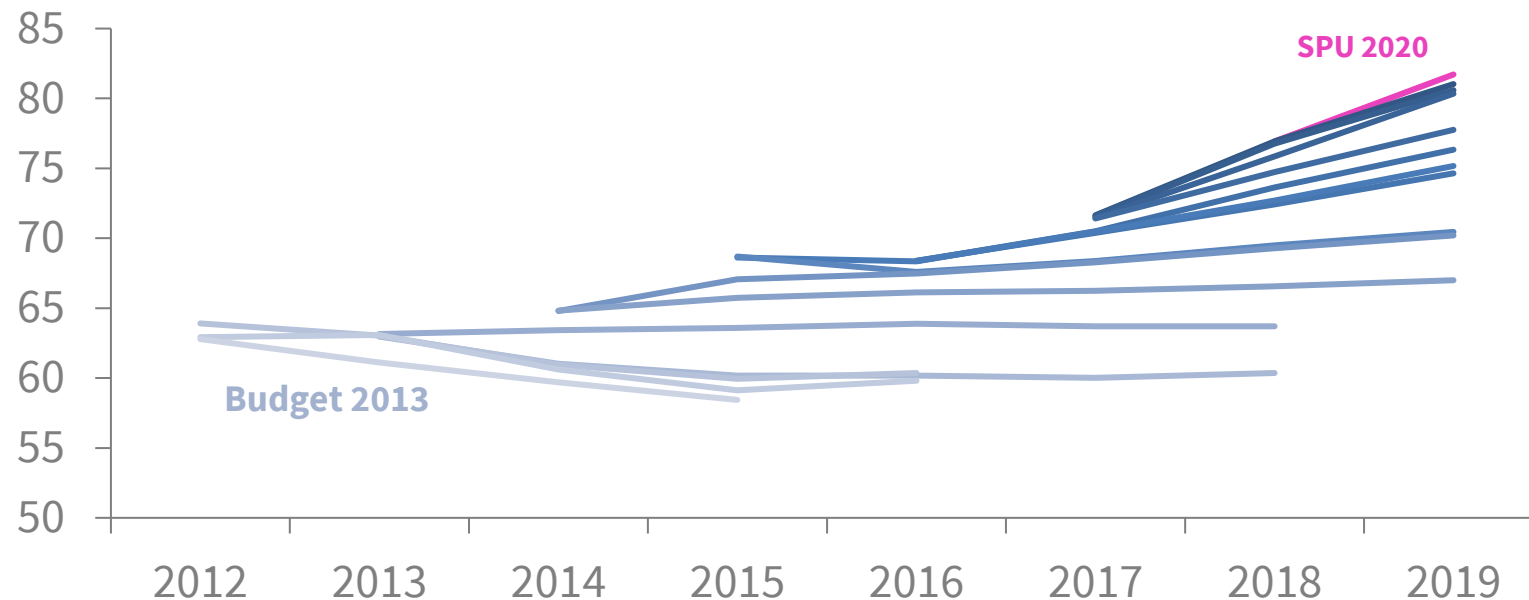
Sources: Department of Finance projections (*SES 2021*); CSO; and Fiscal Council workings.

Notes: Net policy spending is a measure of spending that attempts to assess the Government's overall fiscal policy stance. It represents overall general government spending excluding temporary factors like one-offs and spending on unemployment benefits that are not likely to be long-lasting. It also recognises the role of tax changes: a rise in net policy spending is offset by tax-raising measures but is added to by tax cuts. The measure "adjusted for inflation" uses HICP inflation to derive a real series.

Recent budgeting practice

Primary spending

€ billion (light blue = older vintages; darker blue = more recent vintages)



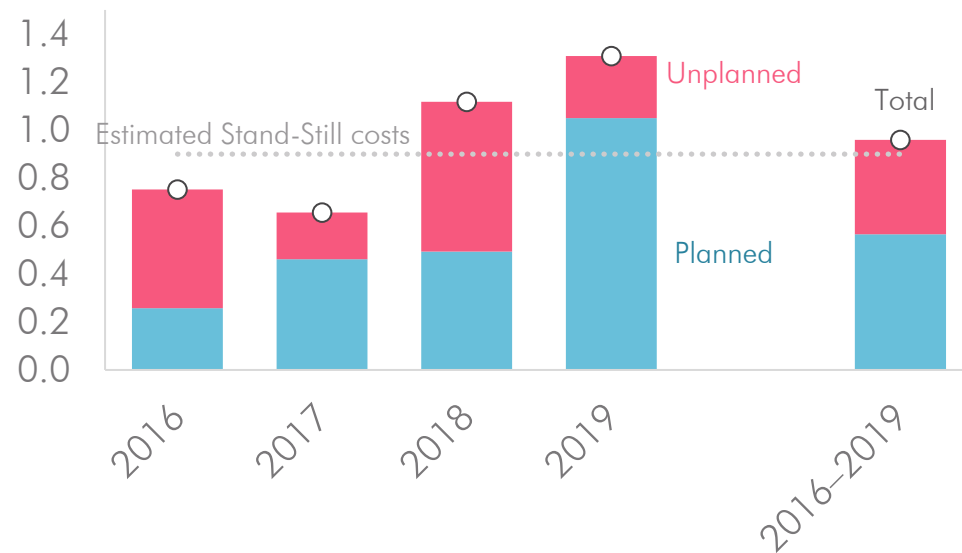
Note: Primary expenditure excludes interest payments. Prior to Budget 2017, spending forecasts were made on the unrealistic assumption of fixed nominal spending for most items. Since then, forecasts have been made on a more realistic basis, and so are a more significant signal of upward spending drift.

- Unrealistic medium-term budgetary forecasts assumed too little spending
- The spending profiles were revised up as revenues came in
- Overruns built into the base

A special case - health budgeting

Increases predictable and nearly twice that planned

€ billion increase in annual current health budget

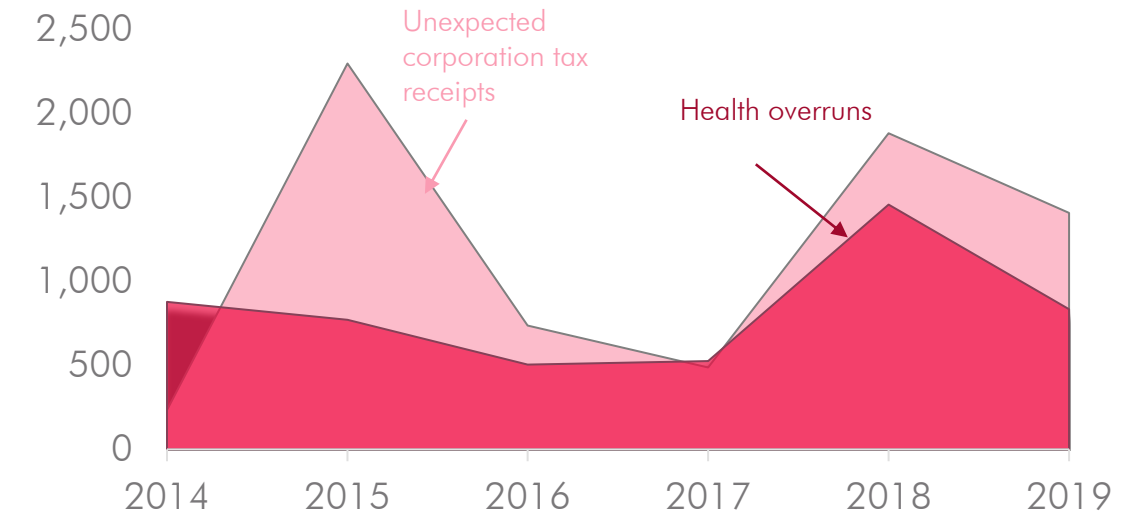


Sources: Department of Public Expenditure and Reform; and own workings.

Notes: Planned increases are defined as the forecast for a given year made one year ahead (t+1) minus the previous periods' outturn (t), while unplanned increases are the difference between that forecast for year t+1 and the actual outturn in year t+1.

Unexpected corporation tax receipts have masked health overruns in recent years

€ million



Sources: Budgets 2014-2019; Department of Finance databank; Department of Public Expenditure and Reform databank.

Notes: Figures show gross voted current spending overruns of the Health vote, as well as corporation tax receipts in excess of forecast.

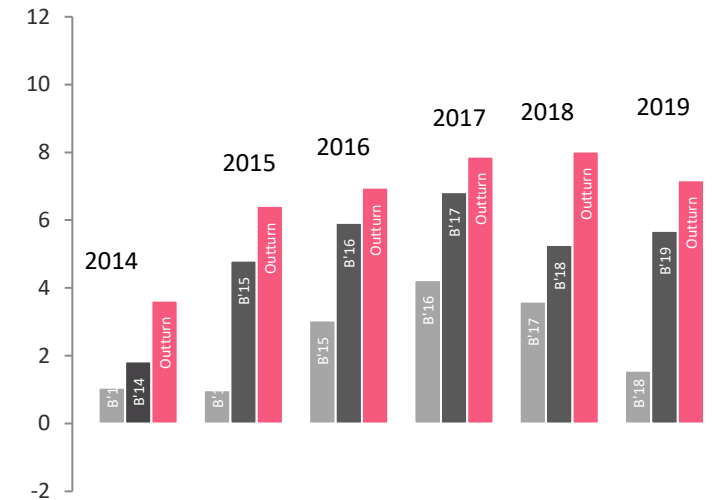
- Health stands out because planned Budget day allocations were low
- In-year, there were overruns averaging over 500m a year, often appearing only late in the year
- These were funded by corporation tax windfalls, locking in the exposure to CT

The risks of this approach

- *Procyclicality* if cyclical/temporary revenues are used to fund permanent spending increases or locking-in *windfalls*
- *Poor medium-term planning* and less focus on effective use of *existing resources*
- This increases the risks of relying too much on borrowing
- It undermines the *credibility* of budget planning – the 2013 Expenditure Ceiling framework does not work

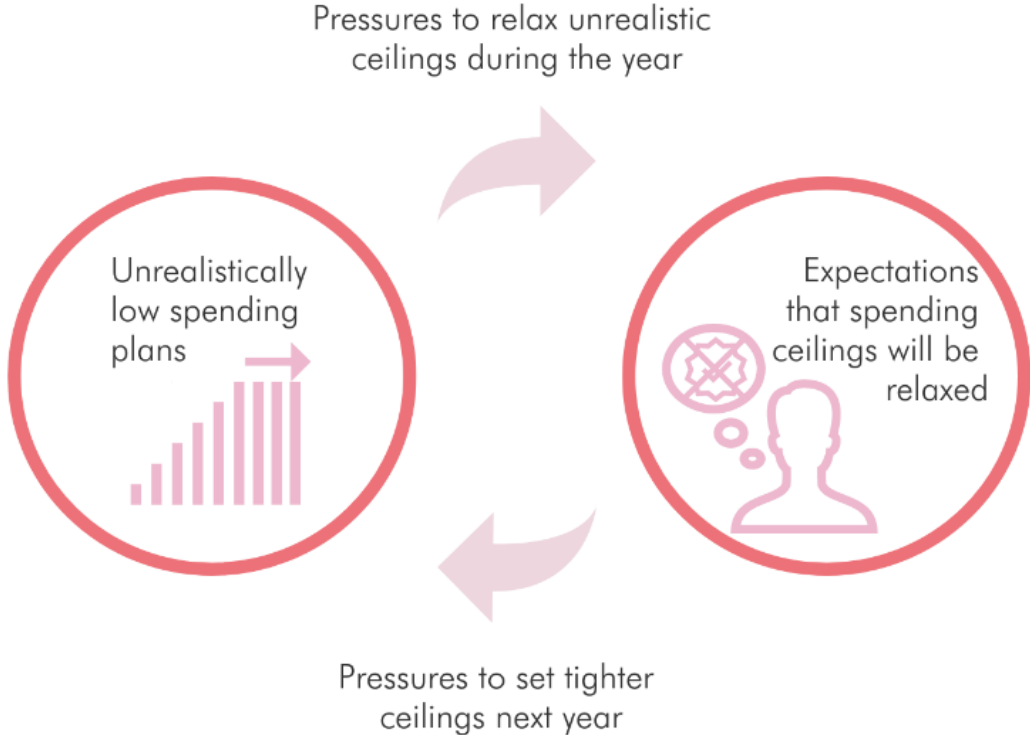
Revisions to recent ceilings have been a similar magnitude to those prior to the financial crisis

% deviation from original ceiling



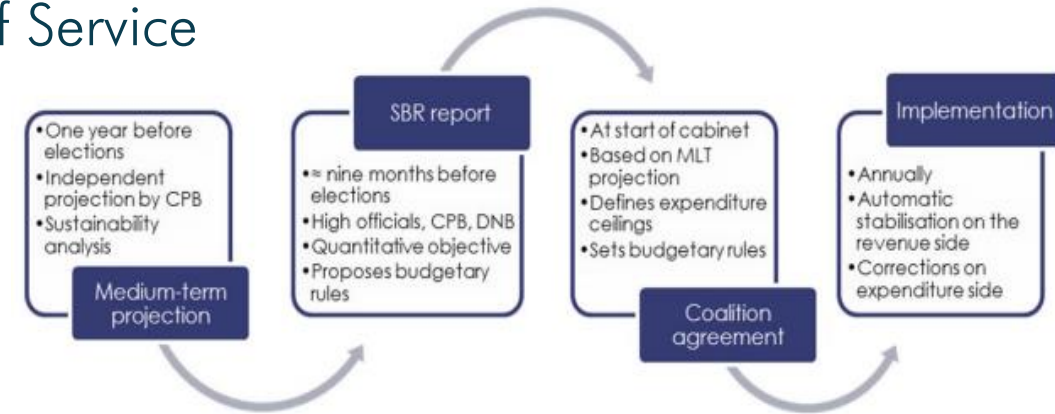
Sources: Department of Finance; Department of Public Expenditure and reform; and Fiscal Council workings.
 Note: Bars show the change in forecasts from various budgets followed by outturns, versus the earliest budget forecast for that year (e.g., B'15 = expenditure forecasts in Budget 2015 minus the earliest forecast for the specified year). Red bars relate to the change in outturn expenditure versus the earliest forecast for expenditure for the year specified above.

Soft budget constraint



An alternative approach

- Realistic aggregate spending profiles – Existing Level of Service
- Multi-year spending ceilings that don't change
- Example: the Netherlands
- This approach popular in the EU fiscal rules literature



Advantages

Less likely to be procyclical

Sets out budgetary choices more clearly

Predictable multi-year spending

Increases focus on medium-term and value-for-money ?

Supports rules-based commitments

Possible disadvantages

Profiles may be taken as a “starting point” for spending if not credible

Managing major changes in the GNI* profile

Making the best use of public resources

- The economic analysis to underpin decisions about how to allocate resources could be strengthened
 - Most recent Sláintecare costing from 2017
 - *Housing for All* has very little economic information
- Recent “Comprehensive Spending Reviews” have not looked at the allocation of resources between activities
- Budgeting practices could be improved and need to weigh more heavily in decision-making
- There are some fundamental questions to be resolved about the role of the State in the years ahead

Final remarks

- Ireland will face a more difficult environment for the financing of public services in the years ahead
- Sound management of the public finances, and efficient and fair choices about spending and taxation are mutually reinforcing
- Some hard choices will need to be made

<https://www.fiscalcouncil.ie/fiscal-space-calculator/>