Budgetary Assessment

Medium-term commitments need more clarity

2. BUDGETARY ASSESSMENT
Medium-term commitments need more clarity

Budget 2022 forecasts a deficit of 5.9 per cent of GNI* in 2021. This would present a significant improvement since 2020 (almost 3 percentage points of GNI*), driven by stronger tax revenues from the economic recovery and lower Covid-related spending. The deficit could be lower than projected however, with revenue likely to be higher-than-forecast and possible underspends.

Under current spending plans, the general government balance is forecast to improve over the medium term, taking into account the cost of providing existing commitments, the National Development Plan and the Government's spending rule. Falls in Covid spending, steady increases in core spending and the continued recovery in revenues will yield a significant improvement in the balance over the coming years.

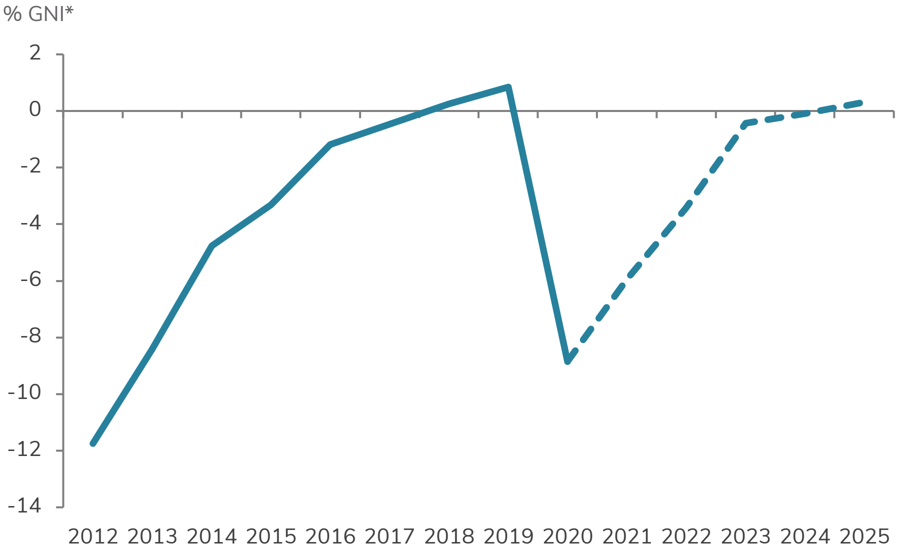
Over the medium term (2023–2025), *Budget* 2022 forecasts of core current spending growth are slightly above the level required to maintain existing service levels. While revenue could also be higher than forecast in *Budget* 2022 over the medium term, there are large uncertainties around the costs of major policy reforms such as Sláintecare and the costs of the Government's commitments to significantly reduce greenhouse gas emissions by 2030. This implies limited scope for new spending measures or improvements to service levels consistent with these projections.

With the low-interest environment and improving general government balance, the government debt ratio is projected to fall at a steady pace, but it will remain at high levels. By 2025, gross general government debt is forecast to be 89.5 per cent of GNI*.

2.1 The recent budgetary context

Prior to the Covid-19 pandemic, the budget deficit had narrowed over many years, finally reaching a small surplus in 2018 and 2019 (Figure 2.1). As a result, the public finances were somewhat better placed to absorb the pandemic's impacts in 2020 and beyond. However, "excess" corporation tax receipts – unexplained by the performance of the domestic economy – have boosted the budgetary position since 2012 (see supplementary information S6 on Corporation tax).

Figure 2.1: The Government's budget balance reached a surplus in 2018



Sources: CSO and *Budget 2022* projections. Get the data.
Note: Dashed line indicates *Budget 2022* forecasts.

Current estimates suggest that a general government deficit of €18.4 billion (8.8 per cent of GNI*) was recorded in 2020, compared to a surplus of €1.8 billion in 2019 (a deterioration of €20.2 billion). This deterioration was driven by increased spending of €15.7 billion. The increase was almost exclusively temporary or pandemic-related spending (€14.8 billion), with €1.0 billion of permanent increases. Overall revenues were relatively stable, falling by €4.5 billion, of which about €1.4 billion reflects tax supports adopted. Nonetheless, some tax heads were remarkably resilient.

VAT and income tax receipts were stronger in 2020 than headline (cash–basis) Exchequer figures would suggest. This is because some liabilities (€1,131 million for VAT and €442 million of income tax) were warehoused and are to be repaid over 2021–2024.[13] *Budget 2022* forecasts are made on the assumption of a 75 per cent recovery rate, with repayments expected out to 2024. [14]

2.2 The short-term outlook

Forecasts for 2021

Budget 2022 forecasts a general government deficit of €13.3 billion in 2021, an improvement of €5.2 billion compared to 2020. The improvement is driven by increases in the proceeds from corporation tax (€2.1 billion) and other revenues (€7.4 billion), as well as by a reduction in Covid/temporary spending (€1.0 billion).

Improvements in the general government balance in 2021 are driven by recovering revenue

Table 2.1: Fiscal forecasts from Budget 2022

€ millions unless otherwise stated

	2020	2021	2022	2023	2024	2025
General Government Revenue	83,616	93,110	96,715	102,100	106,570	110,880
Change in General Government Revenue	-4,493	9,494	3,605	5,385	4,470	4,310
General Government Expenditure	102,033	106,360	104,975	103,175	106,840	110,005
Covid/One-off Expenditure	14,762	13,804	7,510	1,505	695	410
Change in Covid/One-off Expenditure	14,762	-958	-6,294	-6,005	-810	-285
"Core" General Government Expenditure	87,271	92,556	97,465	101,670	106,145	109,595
Change in "Core" General Government Expenditure	985	5,285	4,909	4,205	4,475	3,450
General Government Balance	-18,417	-13,250	-8,260	-1,075	-270	875

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

Notes: For 2020, €14,762 million of general government spending is considered to be pandemic related, as per CSO estimates. Covid/one-off spending in 2021 is mainly made up by €13,360 million of spending given in Table 8 of the Economic and Fiscal outlook. A sum of €444 million for CRSS payments is added to this estimate, as that would also be counted as expenditure in general government terms. Covid/one-off spending in 2022 is made up of €6.8 billion of Covid spending, €500 million from the Brexit adjustment reserve fund and €210 million from the National Recovery and Resilience Plan. One-off amounts for 2023 to 2025 are made up of Covid automatic stabilisers, National Recovery and Resilience Plan, and the Brexit Adjustment Reserve Fund in 2023 only.

The extent of these improvements is, however, partially offset by large permanent increases in spending (€5.3 billion, see Figure 2.2). With the unexpected duration of Covid-related spending in 2021, the contingencies set out in *Budget 2021* have largely been used during the year, but spending will be lower than anticipated in the April SPU. This is because the number of claimants on the main support schemes has been lower than

[13] Warehousing here refers to firms being allowed to defer payment of tax liabilities until they are in a better position to repay. This is done to assist those with cash flow and trading difficulties during the pandemic.

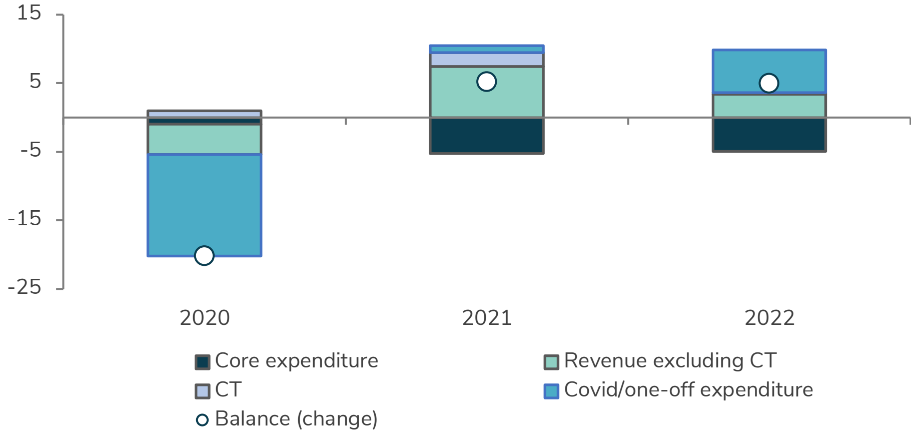
[14] In general government terms, revenue is accrued to the year where liability arose (2020 and 2021) as opposed to the year in which it was paid to the Exchequer (2021-2024).

anticipated and a number of government departments are likely to underspend relative to expectations.

Budget 2022 forecasts for this year are based on the first nine months of returns that were available at the time. As a result, *Budget 2022* forecasts three months of receipts and expenditures.[15] Revenue forecasts for 2021 were arrived at in consultation with the Revenue Commissioners. For 2022 and beyond, a typical forecasting approach was applied, using macroeconomic drivers and elasticities. Section S6 shows how the forecast levels of receipts could be arrived at.

Figure 2.2: Improvements in the budget balance are driven by revenue increases and falls in temporary spending.

€ billions annual change



Sources: CSO; Department of Finance; and Fiscal Council workings. Get the data.
Notes: Changes in expenditure are recorded as their impact on the balance (i.e. expenditure increases are recorded as negative, as they worsen the balance). Covid/one-off expenditure as outlined in Table 2.1. CT = Corporation Tax.

The recovery in revenues is broad based across the various tax headings. Annual changes are flattered by policy interventions such as warehousing and periods of economic restrictions in 2020, but revenues have been performing well relative to profile too throughout the year.

Several revenue headings have been revised up at each forecast round since *Budget 2021* (Table 2.2). Compared to what was expected at that time, total Exchequer revenue for 2021 has been revised up by €6.5 billion, with corporation tax proceeds €0.9 billion higher, partially reflecting some one-off settlement payments (€630 million), which are not expected to recur.

[15] In the meantime, the level of receipts and expenditure for October has been published.

Since the publication of *Budget 2022* forecasts, a further month of Exchequer revenue and spending data have become available. October saw another strong month of Corporation tax receipts, and receipts for the year appear likely to exceed the levels forecast in *Budget 2022*.

Table 2.2: Revenue Developments 2021

€ billion, Cumulative difference to October for year-to-date column

	Budget 2022 (€bn)	Revision from Budget 2021 (€bn)	Year to Date (€bn, y/y)
Exchequer Tax	66.1	5.7	8.3
Exchequer Tax excl. Corporation tax	52.2	4.8	6.5
Income Tax	26.0	3.3	3.7
VAT	15.4	1.5	2.5
Corporation Tax	13.9	0.9	1.9
Excise Duty	6.0	0.0	0.3
Other Taxes	4.7	0.1	0.0
PRSI Receipts	12.2	0.8	1.0
Other Revenue	5.1	0.7	0.3
Total	83.4	6.5	9.7
Total Excl. Corporation Tax	69.5	5.6	7.8

Sources: Department of Finance and Fiscal Council workings.

Notes: Other taxes include stamps, capital taxes, motor tax, customs, and other unallocated tax receipts. Other revenue includes the National Training Fund, other A-in-As, non-tax revenue, and capital resources. PRSI and National Training Funds include their corresponding excess as indicated in the memo items.

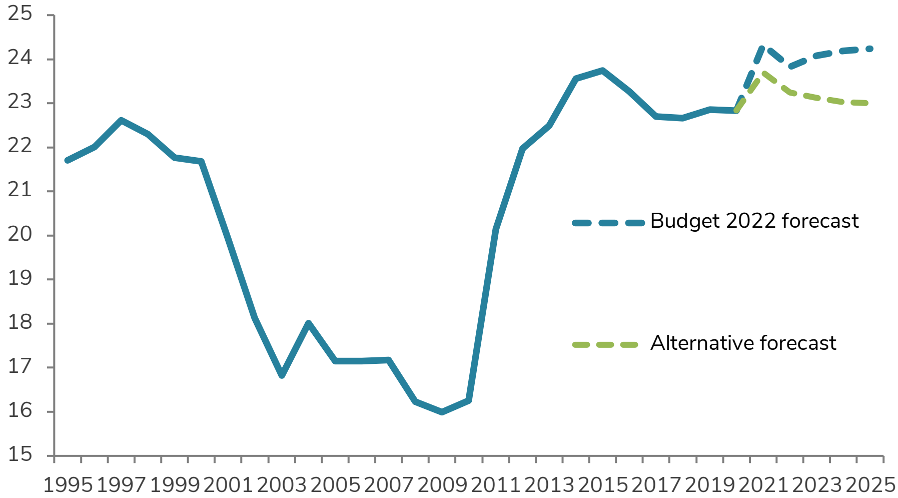
Income tax receipts have also been revised up significantly, with a strong performance in the year to date. Income tax now appears to be above its pre-pandemic trend. It is likely that income tax will exceed *Budget 2022* forecast levels for this year.

Budget 2022 forecasts of income tax and compensation of employees for 2021 imply a sharp rise in the income tax to compensation of employee's ratio (Figure 2.3). As discussed in Section 1, compensation of employees could be significantly higher in 2021 than *Budget 2022* forecasts. Figure A.3 shows an alternative forecast for compensation of employees, based on stronger hourly earnings.

Were income tax receipts for 2021 to be broadly in line with *Budget 2022* forecasts (which were made with 9 months of returns), then this alternative forecast would imply a more modest increase in this ratio in 2021 and then a reversion to a more normal level thereafter. The tax forecasts appear more consistent with recent developments than the compensation forecasts. Nevertheless, there remains significant uncertainty for the medium-term.

Figure 2.3: A more realistic forecast for compensation suggests that the ratio of income tax to the pay bill should return to close to its pre-crisis level

Income tax to compensation of employees ratio



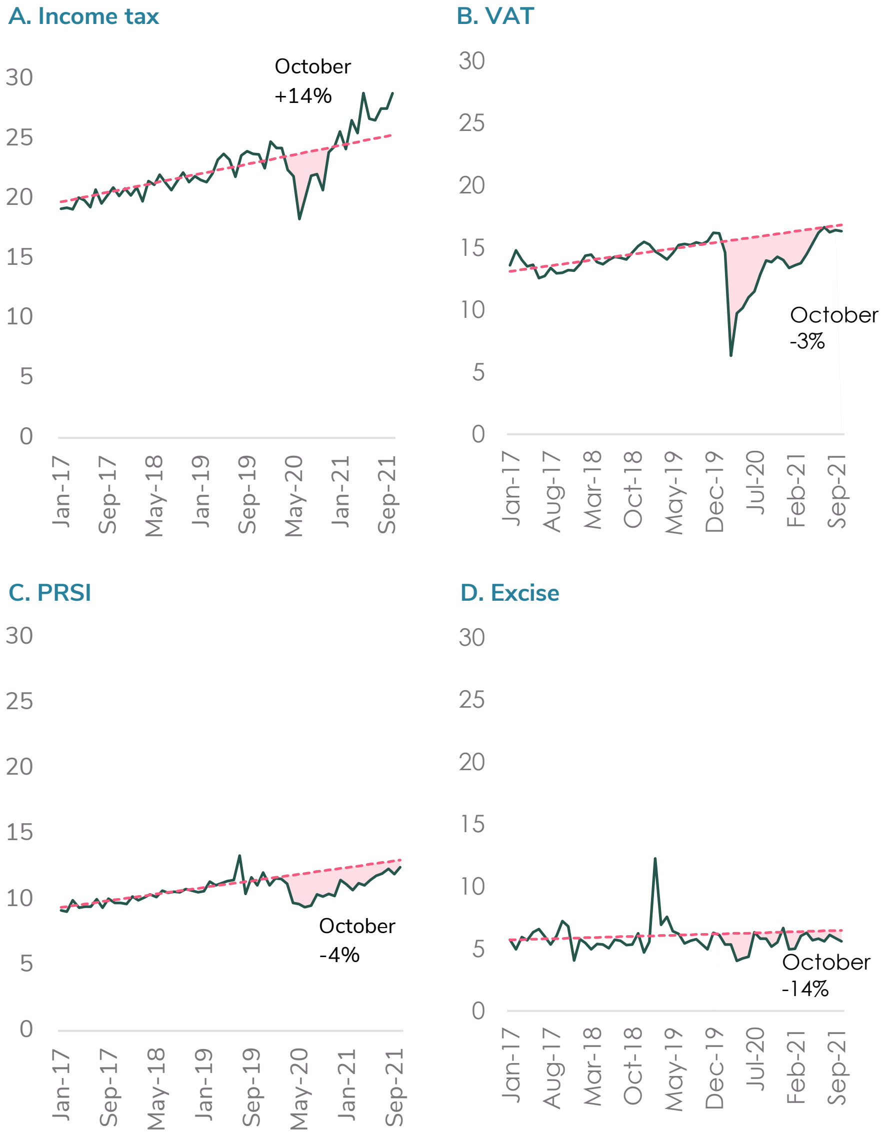
Sources: Department of Finance and Fiscal Council workings. Get the data.
Notes: Exchequer income tax forecasts from *Budget 2022* are adjusted for warehousing and repayments, so that these figures are more in line with general government treatment (75 per cent repayment is assumed). The sharp increase in 2011 is due to the introduction of the Universal Social Charge. "Alternative forecast" shows the income tax to compensation of employee's ratio if income tax forecasts from *Budget 2022* were unchanged, but the "alternative forecasts" of compensation of employees shown in Figure A.3 were used.

VAT receipts have also been revised up significantly since *Budget 2021*. A strong recovery in consumption is reflected in VAT receipts for 2021, which have almost reached their pre-pandemic trend (Figure 2.4).[16] Excise receipts are also benefitting from the recovery in consumption, as well as policy changes (mainly an increase in the carbon tax).

[16] The underlying performance of Income tax and VAT are understated in cash (Exchequer) terms in 2020 and 2021 relative to revenues on a general government basis. This is because some Income tax and VAT due has been warehoused. This results in Exchequer tax not being collected in 2020 and 2021, but rather in 2021-2024. *Budget 2022* forecasts are based on 75 per cent of income tax and VAT receipts warehoused in 2020 and 2021 being repaid. In general government terms, the amount of receipts collected would be accrued back to the year liability arose (in this case 2020 or 2021), rather than the year the money reaches the Exchequer (2021, 2022, 2023 and 2024).

Figure 2.4: Taxes have largely recovered to their pre-pandemic trend levels

Annualised seasonally adjusted levels € billion



Sources: Department of Finance; and Fiscal Council workings. [Get the data.]()
Notes: Monthly tax data are seasonally adjusted and annualised (× 12). The pre-pandemic trend is calculated as a linear trend from January 2015 to December 2019.

Table 2.3: Exchequer revenues growing strongly this year

Growth rates

	2020	2021	2022	2021(YTD)	Required growth rate**
Exchequer revenue	-4.6	9.6	4.2	14.2	-9.1
Tax revenue	-3.6	15.6	6.2	19.6	4.1
Income tax	-1.0	14.6	5.8	21.5	-6.2*
VAT	-17.8	24.0	9.6	24.3	22.8
Corporation tax	8.7	17.4	1.4	24.6	4.2
Excise duties	-8.3	10.7	10.3	7.4	23.2
Other tax revenue	7.1	0.3	6.1	0.4	-0.3
PRSI	-8.3	11.5	6.4	12.1	8.9

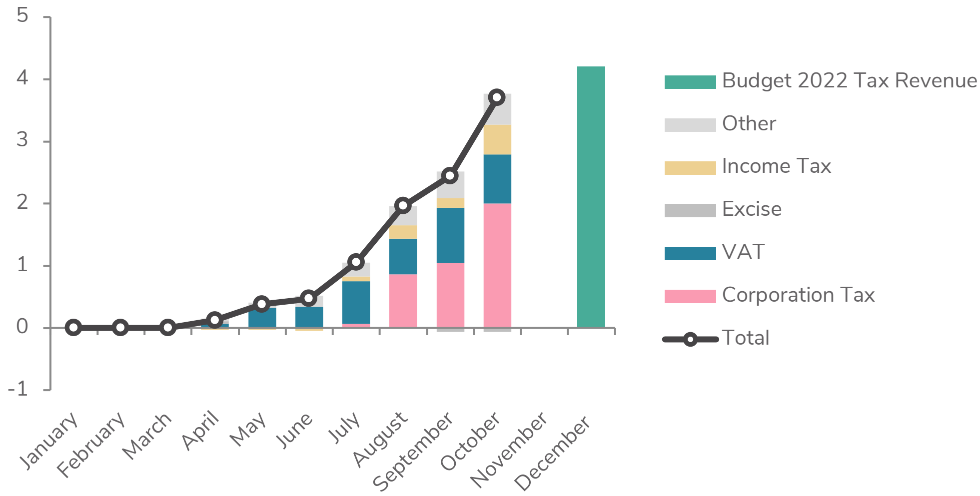
Sources: Department of Finance.
Notes: 2021 (YTD) column shows the year-on-year performance of various revenue headings for the first 10 months of the year compared to 2020. **The Required growth rate column shows the year-on-year growth rate required for the final 2 months of the year to achieve full year Budget 2022 forecasts. *The y/y comparisons are obscured by unusually high outturns of self-employed income tax receipts in the final two months of 2020.

Taken together, total tax revenues currently stand 8.1 per cent ahead of expectations formed at the time of the Government's *SES 2021* in July, the latest available monthly profiles (Figure 2.5). *Budget 2022* forecasts of taxes in 2021 are €4.2 billion higher than in *SES 2021*. The strength of the October returns means that only a slight overperformance, and less than the overperformances observed in recent months, is required for November and December to achieve the *Budget 2022* tax forecasts. As a result, it is likely that tax revenue will exceed the levels forecast in *Budget 2022*.

Tax revenue looks likely to exceed budget day projections for 2021

Figure 2.5: Taxes have exceeded expectations in 2021

€ billion (cumulative over-performance compared to SES profile)



Source: Department of Finance and Fiscal Council workings. Get the data.
Notes: Monthly profiles were not produced for *Budget 2022*, so *SES 2021* profiles are the latest available. *Budget 2022* forecasts of tax revenue are €4.2 billion higher than in *SES 2021*, so that is the level of "overperformance" needed in this chart to reach *Budget 2022* forecasts.

General government spending is the most comprehensive measure of spending. While this is mostly covered by Exchequer spending, about onefifth is non-Exchequer spending. Non-Exchequer spending includes spending by local government (including Approved Housing Bodies), non-commercial semi-state bodies (like Irish Rail, Irish Water, RTÉ, Solas, Tusla, the aggregate institutes of technology, etc), and Extra-Budgetary Funds (such as the Irish Strategic Investment Fund).[17]

In general government terms, the increase in spending (excluding one-offs) foreseen for 2021 is now €3 billion smaller than what was assumed in *SES 2021*. The bulk of this revision, however, falls in areas outside of the Exchequer where detailed information is lacking.

Significant government spending occurs outside the Exchequer, where there is virtually no transparency

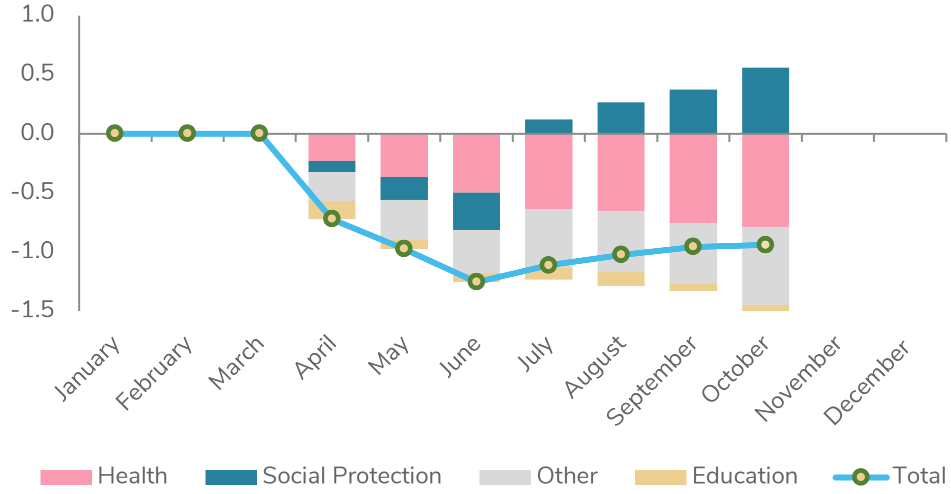
Overall expenditure is expected to be higher than 2020 levels. This is driven by the large increase in core current and capital spending, only partially offset by the reduction in Covid-related spending. Current primary spending is below expectations set in the June SES by 1.6 per cent, driven by underspends in key areas like healthcare and also in other government departments (Figure 2.6). Should spending on health continue to track below expectations for this year, it would represent one of the few instances in which expenditure on health was under profile.[18] However, it is unclear as to whether these underspends will be reversed by the end of the year through unexpected increases in the final months of 2021 as both Covid-19 continues to require active management through the winter and as pent-up demand for regular treatments is addressed. Casey and Carroll (2021) show that overruns in health have tended to be focused in the final quarter of the year.

As regards health underspends and those in other Departments more generally, these reflect both lower–than–expected Covid-related spending in contingencies built into Departmental budgets, and Departments not using the full amount of current spending allocated in 2021. Taken together, these mean an underspend of around 1.5 per cent for the year. The reasons for these underspends in core spending are not clear but may reflect some of the logistical challenges and uncertainties related to Covid-19. As a result, there is some uncertainty as to whether or not these underspends might be expected to reduce pressures for 2022.

[17] Expenditure by non-commercial semi-state bodies is often a mixture of Exchequer and non–Exchequer spending.
[18] See Casey and Carroll (2021) for a more comprehensive overview of historical expenditure trends on healthcare in Ireland.

Figure 2.6: Most departments have underspent in 2021

€ billion (cumulative performance compared to SES profile)



Source: Department of Finance; and Fiscal Council workings. Get the data.
Notes: Data refers to cumulative monthly gross voted current spending outturns relative to the monthly profiles produced as part of the SES 2021, which contain the latest available set of monthly profiles.

Capital spending is forecast to increase this year (7.3 per cent), before much larger increases in spending in later years (see Section 2.3 below and Conroy, Casey and Jordan-Doak, 2021). However, gross voted capital spending is currently well below profile for the year to date, with October's outturns showing a cumulative underspend of 22.9 per cent relative to profile (€1.5 billion). Underspends are largest in areas such as housing (€0.4 billion or 24.8 per cent). While capital spending typically accelerates in the later months of the year, it seems unlikely that underspends of this magnitude will be totally reversed. It is also unclear whether this pattern will extend into 2022 and beyond. Capital spending plans may have been disrupted due to Covid, but it may also point to the difficulties in ramping up investment at speed.[19]

2021 Spending could be lower than forecast in *Budget 2022*

Overall, it seems likely that the general government deficit for 2021 will be lower than *Budget 2022* forecasts. On the revenue side, corporation tax and income tax look likely to overperform. On the spending side, underspends in capital spending, along with health and other departments are possible.

[19] An amount of around €0.7bn of capital allocations unspent in 2020 was carried into the envelope for 2021, with *Budget 2022* indicating that a similar amount would follow from 2021 into 2022.

Forecasts for 2022

Budget 2022 forecasts a general government deficit of €8.3 billion in 2022, representing a €5 billion improvement relative to 2021. General government revenue is forecast to grow by €3.6 billion (with corporation tax increasing by only €0.2 billion). Temporary/Covid spending is forecast to fall by €6.3 billion (to a level of €7.5 billion). This is largely offset by permanent increases in spending of €4.9 billion (€4.2 billion of this is Exchequer spending). This is close to the size of the overall budgetary package for 2022 (€4.7 billion).

Table 2.4: Budgetary Package in 2022

€ billions

	2022
Demographics	0.7
Pay provisions	0.75
Existing Levels of Services (ELS)	0.2
Capital investment	1.1
New current spending resources	1.45
Tax measures	0.45
Total	4.7

Sources: Department of Finance and Fiscal Council workings.

Fall in the deficit in 2022 driven by reduced Covid spending and increased revenues

The fall in temporary/Covid spending reflects the continued recovery forecast for the economy and labour market into 2022. This would result in fewer claimants of income supports and unemployment payments. Further to this, the Government has outlined that the two main income support schemes introduced in March 2020, the PUP and the Employment Wage Subsidy Scheme (EWSS), will be tapered and closed in early 2022.[20] Estimates for the cost of these schemes in 2022 totals around €0.7 billion, with provisions for labour market activation measures also projected to cost €0.4 billion. Similarly, business supports such as the CRSS (Covid Restrictions Support Scheme) are set to end and the commercial rates waiver not renewed.[21]

Despite the planned reduction in Covid-related spending, the Government has (prudently) made considerable amounts of both allocated and unallocated contingency funding available to departments in 2022. These may be accessible should the public health situation deteriorate once more.

[20] The EWSS replaced the original Temporary Wage Subsidy Scheme (TWSS) in September 2021.

[21] As part of the response to the pandemic to support firms impacted by public health restrictions, commercial rates payments by businesses to local government were suspended. This amounted to foregone revenues of €0.7bn in 2020 and around €0.5bn in 2021.

Unallocated contingency funding of €4 billion has been made available, while departmental allocations for temporary Covid-19 spending totals around €1.9 billion. The Department of Health is receiving the bulk of this – a €1 billion allocation.

Table 2.5: Contingency funding and reserves represent the majority of temporary Covid-19 spending in 2022

€ billions

Spending policy measures	2022
Pandemic Unemployment Payments	0.1
Wage subsidy schemes	0.6
Other social protection	0.4
Health spending on Covid-19*	1.0
Covid-19 contingency reserve	2.8
Other Covid-19 reserve**	1.2
Other departmental Covid-19	0.9
Total***	7.0

Sources: Department of Finance and Fiscal Council workings.
Notes: *includes €0.2bn in contingency funding as part of *Budget 2022*. **includes other measures such as labour market activation and education reserves. The latter includes €0.2bn contained as part of the NRRP.

This should provide a reasonable margin if there were to be a serious worsening of the Covid crisis, but should otherwise be left unspent. However, since this contingency planning is essentially temporary and ends in 2023, these allocations make little difference to the outlook for the public finances further ahead, although they do impact the forecast budget balance for 2022.

The Christmas bonus has again not been budgeted for 2022. This is a long-standing weakness in budgeting and implies a shortfall relative to Budget plans. Full payment of the Christmas bonus in 2021 is projected to cost €313 million, although the number of recipients is likely to be lower in 2022. Since the Christmas bonus has been paid every year in some form since 2014, this is an obvious upside risk to expenditure forecasts for 2022.

Budget 2022 forecasts of the pay bill are made in aggregate. As a result, it is difficult to ascertain how much of the growth in the pay bill in each year is due to assumed increases in pay per head versus numbers of employees. The existing public sector pay agreement is due to expire in 2022.

General government capital spending is forecast to increase by almost €2 billion in 2022 (20.5 per cent change compared to 2021), consistent with the National Development Plan. Given the substantial increase and underspends this year, it may prove challenging to achieve the level of capital spending forecast for 2022.

Increased Exchequer revenue in 2022 is mainly due to growth of income tax (€1.5 billion) and VAT (€1.5 billion). Approximately one–third of the growth in VAT receipts can be attributed to the impact of warehousing (on an Exchequer, cash–basis). The forecast continued recovery in consumption would also aid VAT growth in 2022.

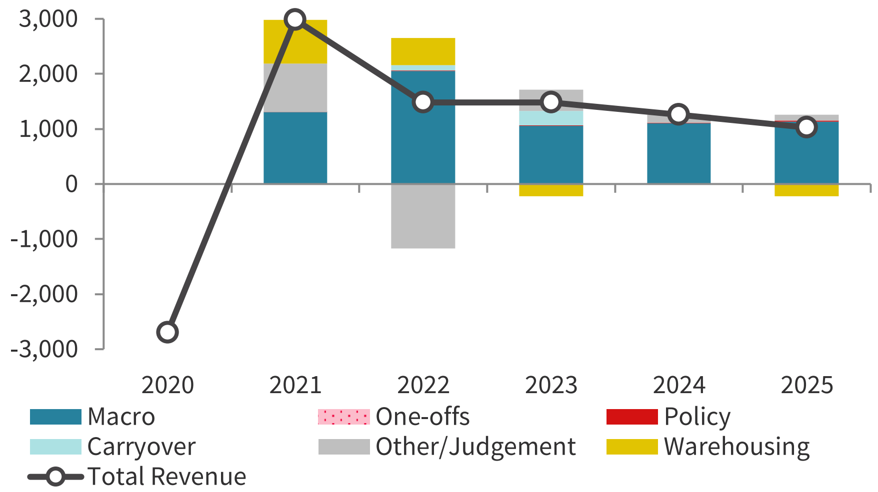
Significant negative judgement is applied by the Department to arrive at its VAT forecast for 2022 (Council estimates suggest around €1.2 billion, see Figure 2.7). This means that VAT receipts are assumed to being growing slower than the underlining drivers, even though warehousing should be adding to this (in cash terms). It is unclear why such a negative judgement has been applied. As a result, there is potential for significantly higher VAT receipts in 2022 than forecast in *Budget* 2022.

Significant negative judgement has been applied by the department to arrive at VAT forecasts for 2022

Figure 2.7: VAT forecast decomposition

Factors contributing to the y/y revenue change

€ million



Source: Department of Finance; and Fiscal Council workings. [Get the data.]

Excise is also forecast to grow in 2022, driven by consumption growth and policy changes (primarily the increase in the carbon tax). Some negative judgement is also applied (Council estimates suggest around €140 million, see Figure S.8).

Income tax receipts, when adjusted for the impact of warehousing, are forecast to grow by 3.8 per cent in 2022. PRSI is forecast to grow by 6.4 per cent (€0.8 billion) in 2022.

Various policy changes to income tax for 2022 were announced in *Budget 2022*. The impact of these policy changes, relative to maintaining current policies in nominal terms, is to reduce income taxes by €760 million, slightly more than the cost of indexing income tax bands and credits. As a result, income tax revenue in 2022 will be slightly lower than would have been the case if the only changes to the income tax system had been to index tax bands and credits.

As noted in previous FARs, the approach used by the Department of Finance to forecast income tax is currently problematic. This approach uses separate impacts from pay per head and employment to forecast PAYE and USC receipts. This may be appropriate when the composition of employment is relatively stable. However, during the forecast horizon pay per head is significantly affected by the changing composition of employment (see Section 1, Box A). As a result of these compositional impacts, *Budget 2022* forecasts pay per head to fall in 2022. Without applying judgement, this would imply lower PAYE income tax receipts.[22]

Given the methodology, significant judgement is applied by the Department of Finance to arrive at the forecasts in *Budget 2022* (Figure S.8). These are the same problems which were highlighted in Fiscal Council (2021a) when assessing *SPU 2021* forecasts. As was suggested then, a simpler and possibly more robust alternative method could be used, such as the elasticity of income tax receipts to compensation of employees.

As mentioned in Section 1, compensation of employees could be higher than *Budget 2022* forecasts for 2021, with a higher level in the later years also. Were this to be the case, and income tax forecasts were largely unchanged, the ratio of income tax to compensation of employees would fall slightly in 2022, getting close to pre-pandemic levels (Figure 2.3).

Corporation tax is forecast to grow slightly in 2022, but will remain at a high share of revenue. Allowing for one off settlements/payments in 2021 and the ending of the CRSS scheme, corporation tax would grow by €0.4 billion (2.6 per cent). This is considerably slower than the macroeconomic driver, gross operating surplus, which is forecast to grow by 7.8 per cent in 2022.[23]

---

[22] While increases in numbers employed would offset the negative impact of falling pay per head, the overall effect would be negative (see supplementary information S6).
[23] This calculation involves removing the impact of one-off settlements and the CRSS scheme in 2021.

Significant negative judgement is applied by the Department to arrive at its forecast for 2022 (Council estimates suggest around €0.5 billion, see Figure S8).[24] Uncertainty around corporation tax receipts remains high, particularly in the near-term around the profits of a small number of MNCs who contribute a large share of the revenue. As noted earlier, the overperformance of corporation tax in 2021 relative to *Budget 2022* forecasts may create upside risks for 2022, but these risks need to be seen in the context of the large uncertainty.

[24] *Budget 2022* forecasts assume that the negative impact of changes in the international tax environment only begins in 2023, so 2022 forecasts are not impacted by this.

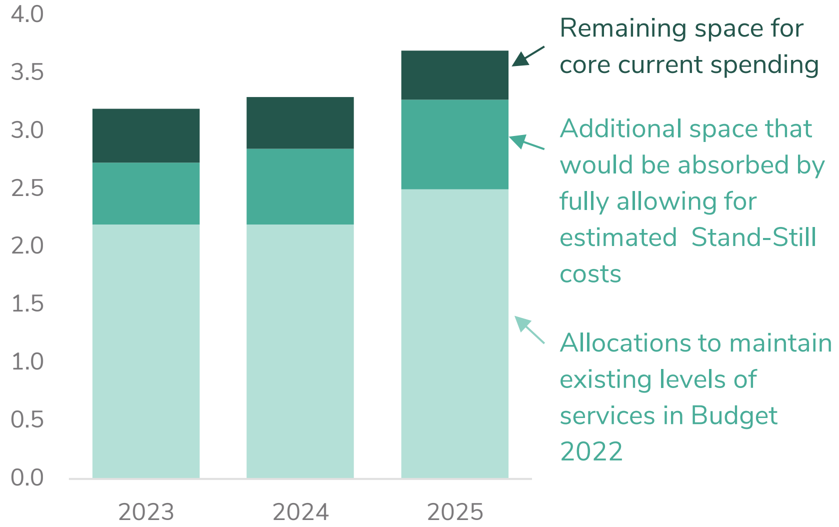
2.3 The medium-term outlook

Fiscal projections in *Budget 2022* go out to 2025, only four years ahead. The last time five-year-ahead forecasts were published was in *Budget 2020*. The Council has previously highlighted the importance of five-year-ahead forecasts to support a medium-term orientation for fiscal policy.

Budget 2022 saw the Government move towards presenting more accurate estimates of the costs of maintaining "existing levels of service" in real terms over the medium term, following the approach piloted in the June *Summer Economic Statement*. This approach, which follows in the same vein as the 'Stand-Still' analysis by the Council, is welcome and has been advocated by the Council for many years (Figure 2.8). Both techniques adjust current spending levels for future demographic and price pressures, so provide a projection based on continuing to provide existing levels of public services and welfare payments in real terms. This follows typical patterns and is consistent with Government policy that does not set out real cuts in any of these areas.

Figure 2.8: Stand-Still costs for the medium term are considerable

€ billion, year-on-year increase in current spending



Source: Department of Finance, and Fiscal Council workings. Get the data.
Notes: The Stand-Still approach estimates the costs of maintaining existing public service levels and value of welfare payments, taking into account inflation, wage increases, and demographic pressures. Core current figures relate to annual changes in the level of core current spending as per *Budget 2022*, ELS allocations represent 3% of gross voted core current spending levels as per *Budget 2022*.

The Government has outlined that for 2022, as part of the budgetary package, approximately €1.7 billion has been allocated for accommodating demographic costs, pay increases, and for maintaining existing levels of services.[25] For the later years, the government has allocated a specific amount within its medium-term expenditure forecasts, but it is unclear what costs this covers. Figure 2.8 therefore compares the Council's "Stand-Still" estimates with the annual changes in gross voted core spending over the forecast period provided in *Budget 2022* both in terms of the level of allocated spending and the total amount provided. The Government should publish a full medium-term breakdown of the various drivers of the costs of maintaining the existing level of service and the assumptions and methodologies used. This would allow a more comprehensive evaluation of the figures provided.

Spending increases in Budget 2022 would cover stand still costs, but leaves little room for other spending increases

The Council's estimates for 2023 to 2026 show that, on average, increases in core current spending of around €3.2 billion would be required to hold service provision constant in real terms – accounting for price and demographic pressures. This is considerably higher than the amount allocated for these costs in 2022 (€1.65 billion, see Table 2.4).

Given the overall spending path, this implies that room for increasing core current spending on "new" activities, beyond the existing level of service, will be narrow in the years ahead, averaging around €0.6 billion per year from 2023. The "unallocated" space the Government has provided for these years is around €1.5 billion per year. However, an additional €0.9 billion of this could be absorbed by the estimated costs of standing still. This leaves little scope for "new" current spending in the years ahead, beyond existing service levels, within the spending rule without cutting spending elsewhere or raising taxes.

Core expenditure is assumed in *Budget 2022* to grow by 5 per cent per annum over 2023–2025 in line with the Government's spending rule.[26] Core current spending is forecast to grow by 4.7 per cent on average over 2023–2025. Core capital spending is forecast to grow by 7.1 per cent on average.

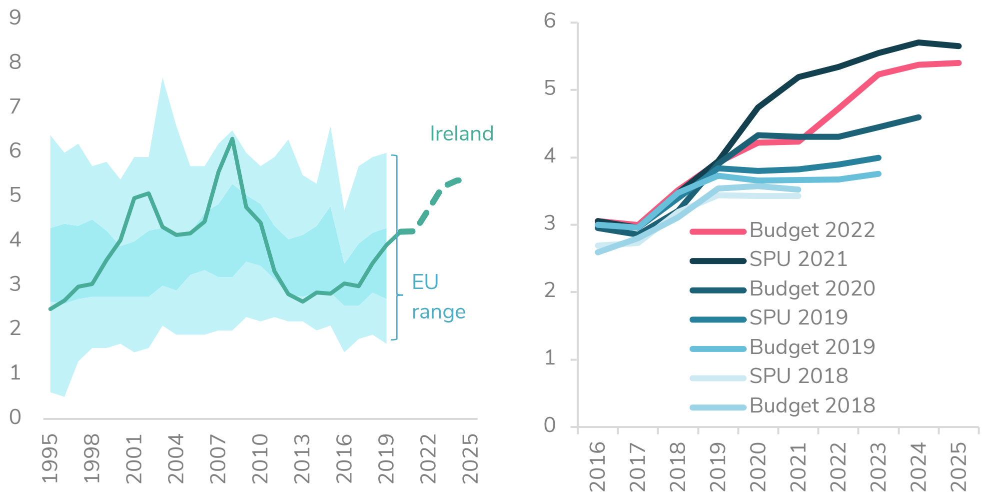
[25] These stand-still costs for 2022 are low (relative to later years) as unemployment is forecast to fall quite rapidly in 2022, with more modest falls in later years.

[26] *SPU 2021* forecasts assumed that core expenditure would grow by 3.5 per cent per annum in the medium term.

Figure 2.9: Capital spending

%GNI*

A. Capital spending is forecast to rise above EU norms **B. Forecast capital spending above previous plans, but lower than *SPU 2021* share**



Sources: CSO and Department of Finance. Get the data.

Note: The dashed line in Panel A indicates forecasts from *Budget 2022*. The EU range shows the minimum and maximum levels of public investment as a share of national income in EU countries (GDP for all countries apart from Ireland). The darker shaded area shows the inter quartile range of EU levels of investment. Darker lines in Panel B represent more recent forecasts. *SPU 2020* and *Budget 2021* are excluded due to their short forecast horizons.

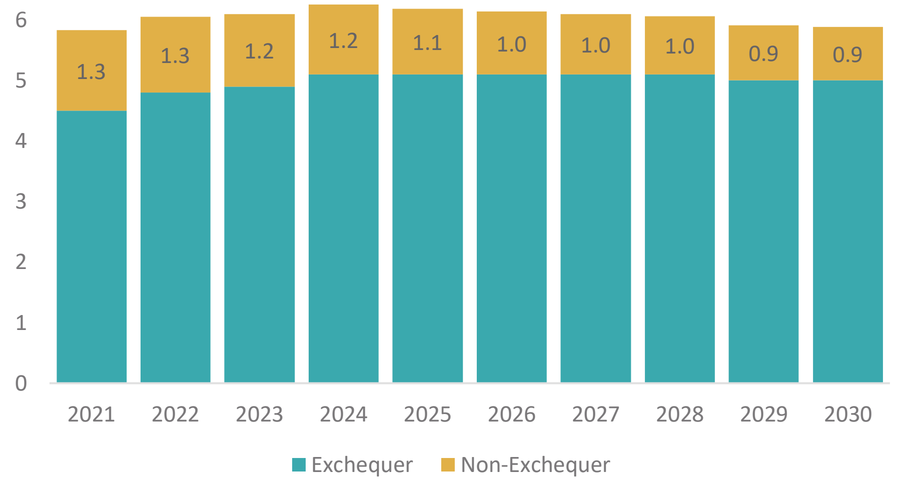
While strong increases are planned, nominal general government capital spending has been revised down for 2020, 2021 and 2022, relative to *SPU 2021*.[27] This comes with the publication of the National Development Plan. The lower forecast investment for 2021 and 2022 is largely due to the 2020 outturn being revised down. The levels of investment for 2023–2025 in *Budget 2022* are similar to those forecast in *SPU 2021*. GNI* has been revised up, so the capital spending share of national income is lower than *SPU 2021*. A recently published analytical note (Conroy, Casey, and Jordan-Doak, 2021), explores in more depth many of the issues around capital spending.

Capital spending is forecast to ramp up significantly in the coming years

[27] As noted earlier, the 2020 outturn from the Government Finance Statistics was somewhat lower than the level forecast in *SPU 2021*.

Figure 2.10: Share of Exchequer capital spending to non-Exchequer to increase

% GNI*



Source: National Development Plan 2021–2030 and Fiscal Council workings. Get the data.
Notes: GNI* is derived from the implied figures contained in the Government's National Development Plan 2021–2030.

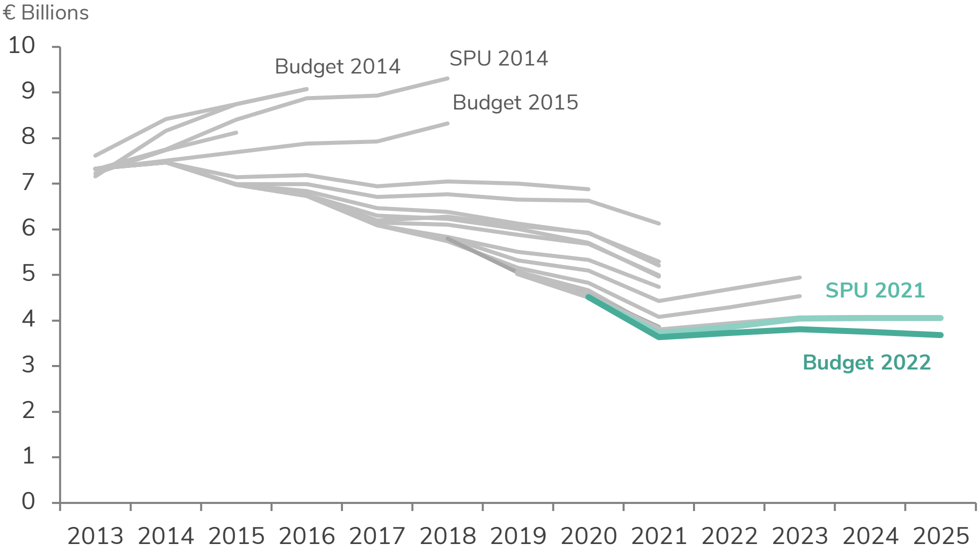
As part of the Government's National Development Plan 2021–2030, it outlined the split between Exchequer and non-Exchequer capital expenditure over the next 10 years (Figure 2.10). Exchequer capital spending rises from €9.8 billion in 2021 to €16.4 billion in 2030, staying relatively constant around 5 per cent of GNI*. However, there is less transparency around what is driving non-Exchequer capital spending, which remains constant over the forecast period at €2.9 billion per year, implying a falling share in national income.[28]

Generally, there was a lack of detailed economic information contained in the National Development Plan. While information is provided on how spending will be allocated across Departments and for some types of projects, the information remains highly aggregated and provides little detail. The NDP does show some estimates of the impact increased public investment is expected to have on the economy. Using COSMO, a structural model of the Irish economy, estimates are provided of the impact of public investment on GDP, employment and total wages. While useful, the results are highly aggregated and not very detailed. For example, no estimates are provided on the impact this investment is expected to have on the public finances, the labour market, and on specific sectors such as construction and housing. A similar lack of analysis in these areas is evident in the Housing

[28] The NDP 2021-2030 describes non-Exchequer finance as "continuing to play an important role in the delivery of infrastructure in the higher education sector".

for All strategy (Department of Housing, Local Government and Heritage, 2021).

Figure 2.11: Interest expenditure has been repeatedly revised down



Sources: Department of Finance. Get the data.

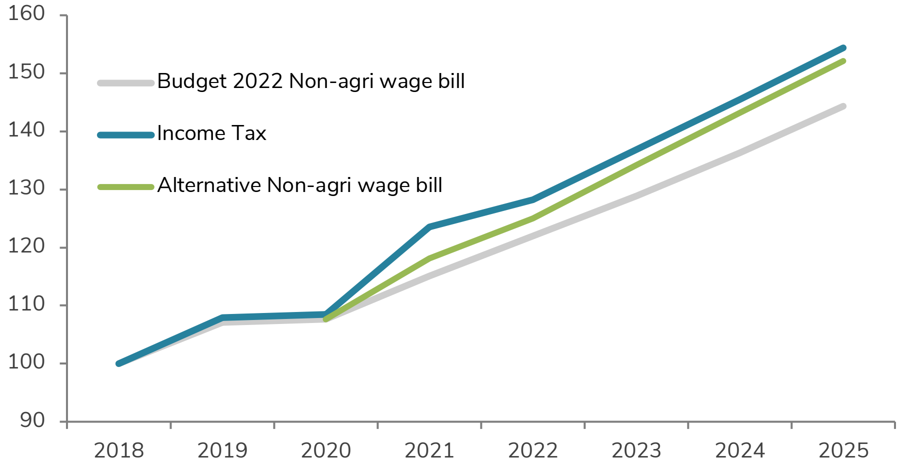
The downward revision of interest spending since *SPU 2021* is consistent with the previous pattern of repeated downward revisions to interest expenditure, reflecting both the unexpected decline in market interest rates and the cautious approach to recognising likely declines in refinancing costs. However, longer-term interest rates have risen in recent months, despite the recent change in the ECB's policy objective. This is due to higher expected inflation. This may be an indication that the interest rate cycle may be turning and that borrowing costs could begin to rise again.

As described in Section 1, *Budget 2022* forecasts taxes to rise as a percentage of compensation of employees over the medium term.[29] *Budget 2022* forecasts imply a sharp increase in the ratio for 2021 and to remain elevated thereafter. Were compensation of employees stronger than *Budget 2022* forecasts (as outlined in Figure A.3), that would imply a more modest increase in 2021, with the ratio stable and close to pre-pandemic levels over 2023-2025 (Figure 2.3).

[29] Note that the measure considered in Section 1 (taxes on income and wealth) is slightly broader than just income tax. As a result, the percentage of compensation of employees shown in Figure 1.8 is higher than that in Figure 2.3.

Figure 2.12: Income tax is forecast to grow strongly

Index, 2018 = 100

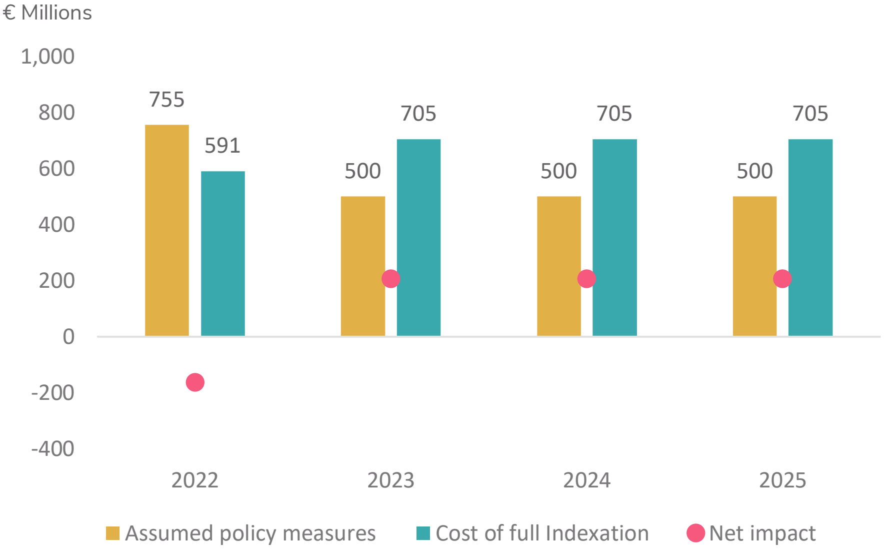


Sources: Department of Finance and Fiscal Council calculations. Get the data.
Note: Exchequer income tax forecasts from *Budget 2022* are adjusted for warehousing and repayments, so that these figures are more in line with general government treatment (75 per cent repayment is assumed). Alternative non-agri wage bill shows alternative forecasts of compensation of employees given in Figure A.3.

Budget 2022 forecasts do not explicitly assume the indexation of income tax bands and credits over the medium term promised in the Programme for Government. However, forecasts are based on €500 million of income tax reductions being introduced in each year from 2023 to 2025. If a similar approach is taken to these tax measures as in the *Budget 2022*, this amount would be broadly consistent with a partial indexation system that would have the effect of allowing the tax burden to rise modestly as incomes grow (Figure 2.13).

***Budget 2022* assumes partial indexation of income tax bands and credits over the medium term**

Figure 2.13: Assumed Income tax policy changes would modestly increase the tax burden through partial indexation.



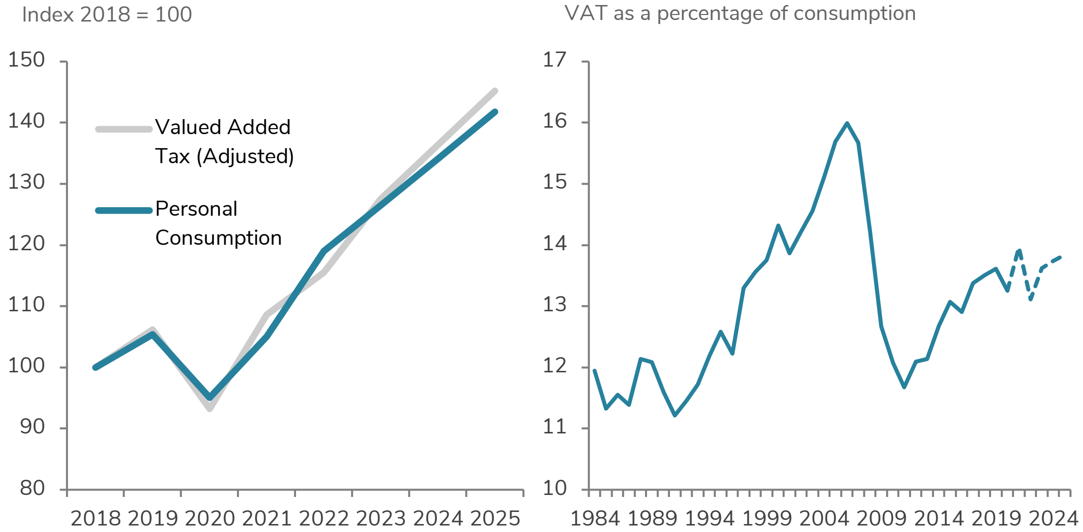
Sources: Department of Finance. [Get the data.]
Note: A net impact greater than zero indicates that assumed policy changes are less than the assumed yield from not indexing income tax bands and credits. As a result, income tax revenue would be higher than if full indexation of the income tax system were assumed.

Over the medium term, VAT receipts are forecast to grow at a similar rate to personal consumption, which is forecast to moderate after a strong rebound forecast for 2021–2022. Excise duties are also due to grow, reflecting not only consumption developments, but also policy changes, most notably the carbon tax, the rate of which is due to increase each year out to 2030.

Figure 2.14: VAT growing in line with personal consumption

A. VAT receipts and consumption forecast to grow strongly in the coming years

B. VAT receipts forecast to be a steady share of consumption



Sources: CSO and Department of Finance. Get the data.
Note: In both panels, Exchequer income tax forecasts from Budget 2022 are adjusted for warehousing and repayments, so that these figures are more in line with general government treatment (75 per cent repayment is assumed). Dashed line in Panel B shows the ratio implied by *Budget 2022* forecasts of VAT and personal consumption.

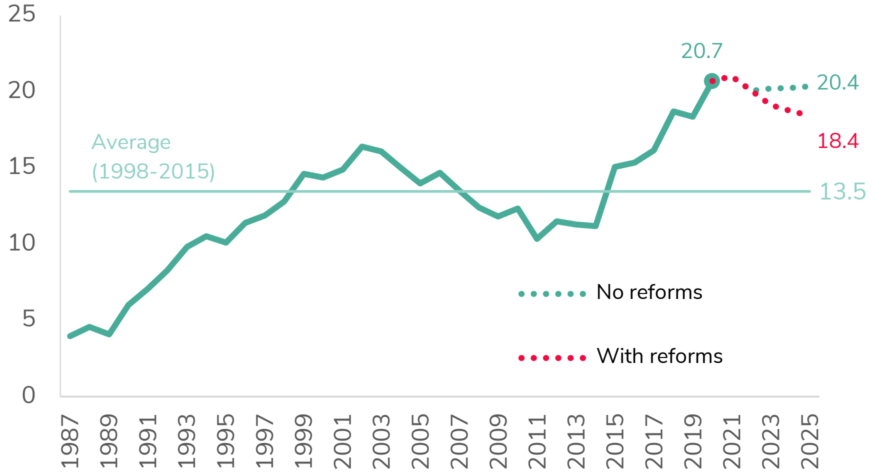
Corporation tax receipts from 2023 onward are affected by several factors. *Budget 2022* forecasts of corporation tax incorporate an assumed impact from changes to the international tax environment. The eventual impact to the level of annual corporation tax receipts is assumed to be €2 billion, as was previously the case. This estimate has been unchanged by the Department since the *Medium-Term Fiscal Strategy* was published in January 2020, despite actual and projected corporation tax receipts growing substantially in the meantime. Given that much of the increase in revenue has come from internationally oriented activities, this suggests that this cost should have increased, all else equal.

Budget 2022 incorporates a €2 billion impact on CT receipts from international tax changes

A €1 billion impact is assumed for 2023, followed by impacts of €0.5 billion in 2024 and 2025. This fall in revenues largely stems from moves to reapportion profits of global companies under Pillar 1 of the reform.

Figure 2.15: Corporation tax to fall as a share of tax revenue

Corporation tax (per cent share of Exchequer tax revenue)



Sources: CSO Department of Finance and Fiscal Council calculations. Get the data.
Note: The "With reforms" series shows how the corporation tax share is forecast to evolve in *Budget 2022* (which incorporates impacts from Base Erosion and Profit Shifting (BEPS) reforms). The "No reforms" series shows how the forecast would differ were these impacts not assumed and the forecasts were otherwise as in *Budget 2022* (hence increasing corporation tax receipts and total tax receipts relative to *Budget 2022* forecasts).

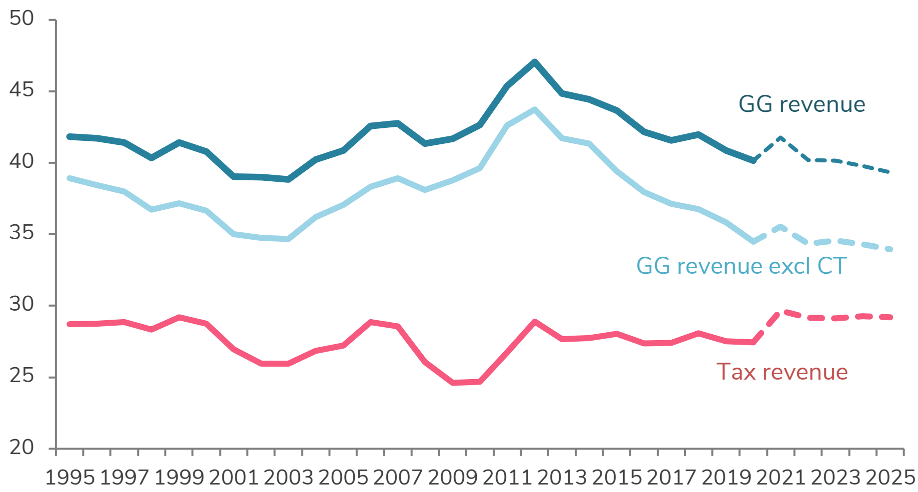
As part of *Budget 2022*, it was announced that a new corporation tax rate of 15 per cent (rather than the current 12.5 per cent rate) would apply to firms with a global annual turnover in excess of €750 million. It is expected that this change will take effect from 1 January 2023. *Budget 2022* forecasts do not incorporate any assumed positive impact to corporation tax receipts from 2023 to 2025 as a result of this new higher rate on the basis that the international agreement is not yet in place and the timing of implementation is uncertain.

The Department of Finance has not provided an estimate of the impact on revenue owing to the envisaged increase in the tax rate. If the tax base were to remain unchanged, the gain could be substantial. However, the higher rate could prompt greater efforts to avoid the tax. Furthermore, this could impact the tax base of the multinational sector on a much larger scale if firms were able to shift profits elsewhere. Given that Ireland's corporation tax rate will remain relatively low, including relative to the various rates currently applied to the income of US multinationals, it is not clear that firms would have a strong incentive to repatriate these profits.

Budget 2022 does not take into account the increased rate of CT expected in 2023

Figure 2.16: General Government Revenue forecast to fall as a share of GNI*, while tax revenue remains flat

General government revenue and Exchequer tax revenue (per cent share GNI*)



Sources: CSO and *Budget 2022*. Get the data.

Note: Dashed line indicates *Budget 2022* forecasts.

Overall, *Budget 2022* forecasts suggest that general government revenue will grow at a slower pace (4.7 per cent) than GNI* (5.4 per cent) over 2023–2025. As a result, the general government revenue-to-GNI* ratio falls over this period. Tax revenue, however, is forecast to grow in line with GNI* over 2023-2025 (5.4 per cent). However, non-tax general government revenue is expected to grow more slowly than GNI*.

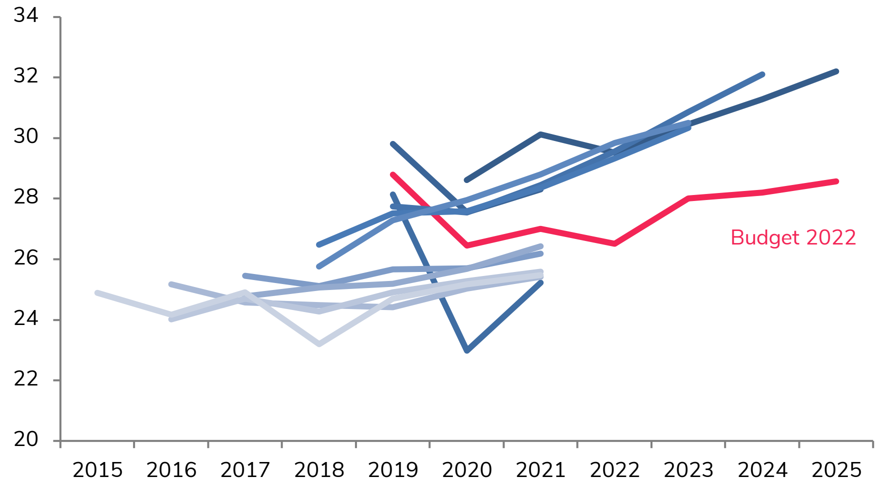
Forecasts of non-tax general government revenue look weak over the medium-term

Figure 2.17 shows recent vintages of forecasts of non-tax general government revenue. Recent forecast vintages have shown much higher growth rates and levels for this variable, particularly for the outer years of the projections.

This is an area where there is limited detail in budgetary projections. As a result, it is difficult to assess why general government revenue is falling as a share of GNI*.

Figure 2.17: Non-tax General Government Revenue forecast vintages

General government revenue minus tax revenue (€ billions)



Sources: Department of Finance. [Get the data.](#)

Note: Darker blue lines indicate more recent vintages. *Budget 2022* forecasts are shown in red.

Budget 2022 projections of revenue and spending result in an improving budget balance over 2023–2025. The forecast for 2023 sees a significant improvement in the budget balance (a deficit of €1.1 billion — a €7.2 billion improvement relative to 2022). This is driven by both increased revenue (€5.4 billion) and falling spending (€1.8 billion). By 2025, a small surplus (0.3 per cent of GNI*) is forecast.

Underlying medium-term developments in the public finances

To give a perspective on the underlying dynamics of the public finances over the medium term, Table 2.6 below compares the *Budget 2022* forecast of the level of several fiscal variables in 2025 to the last outturns before the pandemic (2019) as way of "looking through" the impact of the pandemic.

The main feature over this period (2019 to 2015) is the 80 per cent growth in public investment spending (rising 10 per cent annually, on average). The nominal increase in public investment is €6.8 billion and takes the share of public investment national income to over 5 per cent. Despite this increase in public investment, revenue and spending both grow at an annual rate of around 4 per cent so that the budget balance as a share of GNI* only slightly declines.

However, the overall picture has a number of moving parts that contribute to accommodating the increase in investment without a deterioration of the budget balance. On the spending side, current primary spending grows somewhat more slowly than the economy as a whole, expanding by 5 per cent less over the period despite population ageing. Lower interest costs as a share of GNI* also help.

General government revenue and spending are forecast to make up a lower share of GNI* in 2025, compared to 2019

Table 2.6: Comparing 2025 and 2019

2025–2019

	p.p change in GNI*	€ billion change	% Change	Annualised growth rate
GG Revenue	-1.5	22.8	25.8	3.9
Tax Revenue	1.7	23.0	38.8	5.6
Non tax revenue	-3.2	-0.2	-0.7	-0.1
IT	1.0	9.9	43.0	6.1
CT	0.3	4.3	39.3	5.7
VAT	0.3	5.6	36.7	5.4
Other tax revenue	0.0	3.3	31.7	4.7
GG spending	-1.0	23.7	27.5	4.1
Gross Fixed Capital Formation	1.5	6.8	80.0	10.3
Interest	-1.0	-1.4	-31.3	-6.1
Current primary spending	-1.5	18.4	25.1	3.8
GG Balance	-0.5	-0.9		
Level of GNI*		66.3	30.8	4.6

Sources: CSO, and *Budget 2022*.
Notes: Changes are in the format of the 2025 level minus the 2019 level. As a result, positive values indicate a variable increasing over the period or taking up a larger share of GNI* than was the case in 2019. The annualised growth rate shows what rate of growth applied for every year from 2019 would yield the 2025 level forecast in *Budget 2022*.

On the revenue side, tax revenues would rise primarily because of strong nominal growth, but some tax headings are forecast to grow even faster than GNI*. Income tax sees the biggest increase both in nominal terms (€9.9 billion) and as a share of national income (1 percentage point increase in GNI*).

Corporation tax contributes close to 20 per cent of the total revenue increase, slightly less than its current share of revenues but still a large increase from an uncertain source: the corporation tax increase is equivalent to almost two-thirds of the increase in public investment.

By 2025, general government revenue is slightly below its 2019 share of national income (Figure 2.16). This is the case both when corporation tax is included or excluded.

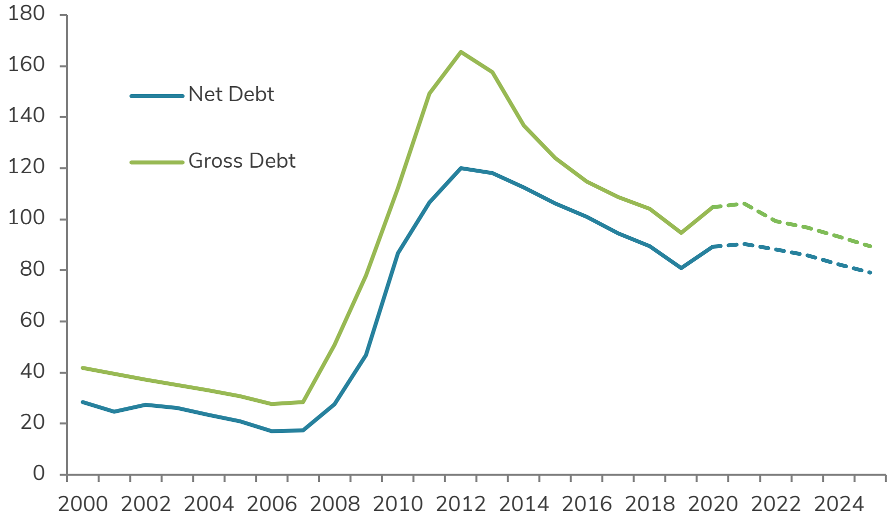
Government debt

With the low interest environment and the improving general government balance, both gross and net government debt are projected to fall at a steady pace (Figure 2.18). By 2025, gross general government debt is forecast to be 89.5 per cent of GNI*. This is a significant fall from the level projected for 2021 (106.2 per cent).[30] However, this remains a high debt level. As a result, the public finances would remain exposed to increases in borrowing costs.

Government debt is projected to fall, yet remain at elevated levels

Figure 2.18: Debt ratios set to fall but to remain at high levels

Gross and Net General Government Debt to GNI*



Sources: CSO and *Budget 2022*. Get the data.
Note: Dashed line indicates *Budget 2022* forecasts.

[30] In net terms, the 2021 level is forecast to be 90.4 per cent, falling to 79 per cent by 2025.

2.4 Risks to the outlook

In the short term, the macroeconomic and public health environments pose major risks to fiscal projections in *Budget 2022*. Were more stringent public health restrictions required again, that would imply higher levels of spending for longer, as well as depressing revenue, although the contingencies built into the budget provide significant margin for manoeuvre. The main fiscal risks are listed in Section S4, which contains a fiscal risk matrix outlining potential likelihoods and impacts.

In the medium term, significant risks to the fiscal forecasts in *Budget 2022* arise both on the spending and revenue sides. On the spending side, there is a risk that some of the spending introduced in response to the pandemic that is currently considered temporary turns out to be more long-lasting than currently assumed. This could arise in the area of health for example, where there was a significant increase in spending in response to the pandemic and had persistent overruns in the years prior to the pandemic.

Casey and Carroll (2021) examine many of the key issues related to health spending in Ireland. They find that poor staff planning is responsible for many of the overruns in recent years. While some efforts have been made to address major shortcomings in planning, basic information is still severely lacking, including for plans around Sláintecare. They suggest that more realistic, five-year budgeting could yield significant improvements.

Expenditure increases in core current spending made as part of *Budget 2022* should accommodate the costs required to maintain current service levels and to index social payments. However, there is little room implied for further increases in spending measures or improvements to services. This could make it challenging for the Government to stick to its spending rule.

A more specific risk to spending forecasts relates to capital spending. *Budget 2022* forecasts a significant increase in capital spending. One risk suggests that ramping up capital spending by such a large degree may actually be difficult to achieve due to capacity constraints in construction for example, implying lower levels of expenditure (Conroy, Casey and Jordan-Doak, 2021). However, the same constraints could be hit sooner as ambitious objectives on housing and climate action are pursued simultaneously. This scenario would likely result in higher prices and lower real output. Additionally, effectively managing the costs of large projects in the government's new NDP could be challenging, with overruns an obvious risk. Risks to the budget from the higher costs could be managed by undertaking fewer projects within a given budget or slowing down their implementation, but this would still imply lower benefits.

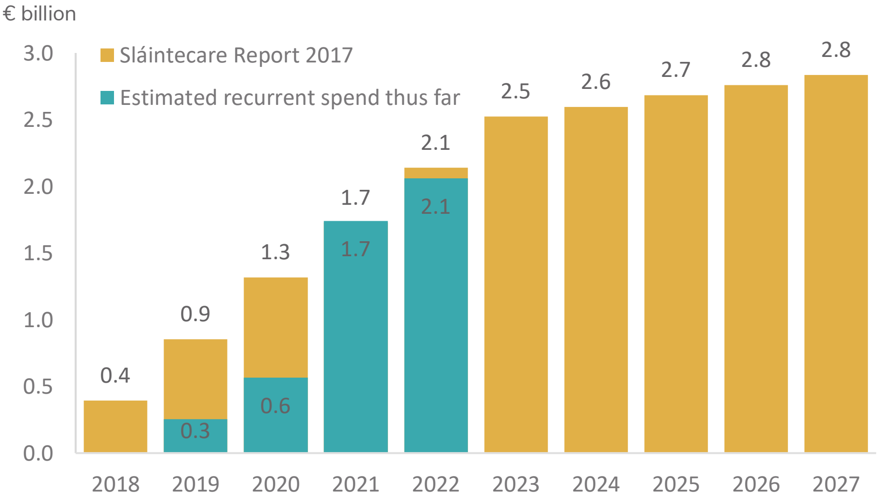
The costs and implementation of major policy commitments on health and climate change remain a key risk and an area of major uncertainty.

Regarding healthcare, the fiscal impact of Sláintecare remains unclear. As part of *Budget 2021*, over €1.1bn was made available to fund the implementation of the programme, but this detail was released only several months following the publication of the Budget. Casey and Carroll (2021) outline several areas where of information on health spending and planning is lacking.

Costings of implementing Sláintecare are old and hence unclear

The Department of Health has indicated that the contribution in *Budget 2022* towards Sláintecare was €0.3 billion, which represents the entire amount of new resources allocated to the Department as part of *Budget 2022*. The estimated cumulative total of funding directed towards the implementation of Sláintecare since 2019 is just over €2 billion (Figure 2.19).

Figure 2.19: Annual spending arising from Sláintecare is highly unclear but looks set to catch up to earlier plans



Source: Sláintecare Report 2017; Department of Health; and Fiscal Council workings. Get the data.
Notes: The "estimated spend thus far" represents the increase in recurrent annual health spending that is associated with Sláintecare as derived from budget day plans. The actual increases may vary, however, as these are plans rather than outturns, and the figures are not precise, in that costs tend to be mixed in with the costs of other more general expansions in publicly provided health services.

The most recent cost estimate available, released in 2017, indicated that the reforms to healthcare provision under the programme would entail an annual cost of €2.8 billion. It is unclear as to whether this estimate remains indicative of the overall implementation costs expected by the Government. What progress previous funding has delivered towards the implementation of the programme is also unclear.

Fiscal implications of transitioning to a low carbon economy are highly uncertain

As for transitioning to a lower-carbon economy, the fiscal and economic costs remain uncertain and represent a significant risk. Government has committed to reducing Ireland's emissions levels by 51 per cent by 2030, to be achieved through a combination of 'green' spending and revenue-raising measures such as carbon taxes.[31]

The Government's new Climate Action Plan uses around half of expected carbon tax revenues for measures over the period 2021-2030. From this amount, €5 billion is to be invested in enhancing energy efficiency with the remaining amounts to protect those on lower incomes from rising carbon prices and to assist with decarbonisation of the agricultural sector through current spending measures. The latter amounts represent new current spending initiatives outside of the NDP. Over the next decade, this amounts to a total amount of around €9.5 billion. This is factored into the Government's medium-term budgetary projections. For context, the main allocations in 2022 as part of the carbon tax expenditures of €0.4 billion are €0.2 billion for investment in residential and community energy efficiency and €0.2 billion for social protection measures.

While the capital investments associated with climate change appear to have been built into the NDP (particularly with energy investments), other spending needs have not been addressed. This includes current spending for incentives for changes in consumer behaviour and encouraging home energy efficiency. There is also little detail on the extent to which behavioural changes from the public are required to meet emissions targets, should this fall short Government expectations, further costs may be incurred. In addition, compensation may be needed for people and activities that are hit by the climate transition.

Collectively, on the spending side there is a risk that the costs of meeting climate-change targets run higher than detailed above while revenue-

[31] These emissions targets are relative to 2018 levels.

raising measures may fail to generate sufficient receipts or influence the desired behavioural changes in firms and households. If behavioural changes do occur, this would have negative implications for receipts such as excise duties, vehicle registration tax, carbon tax and VAT.

Addressing these generational challenges could be made more difficult as the Government attempts to tackle both issues simultaneously, alongside pressure from an ageing population on pensions costs. Healthcare reforms could be made more costly by a history of above-average price increases and cost overruns, while investment in climate change will require competing for construction inputs already in high demand, potentially leading to higher costs and lower real output.

Increased pension costs from an ageing population will have a significant impact on the public finances

Given that little space is implied by the Stand-Still estimates relative to how the Government expects current spending to evolve over the coming years, there is a risk that expenditure pressures make it challenging to implement the Government's recently adopted spending rule.

There are risks to corporation tax receipts in both directions. The Government has recently agreed to the OECD's proposal of a minimum global tax rate. The increased (15 per cent) rate presents upside risks to receipts assuming larger firms' pre-tax profits are unchanged and firm activity remains unchanged in the State. However, if the change to the tax rate proves disorderly, where firms suffered from reduced turnover or chose to relocate, revenues could be negatively affected.

Significant upside and downside risks apply to CT receipts

The Fiscal Council's latest estimates suggest that €3.2 to €6.4 billion of corporation tax receipts could be considered "excess" (see Supplementary information S7). Corporation tax receipts in Ireland are highly concentrated, with the top ten companies accounting for 51 per cent of net corporation tax receipts last year. A separate Fiscal Council (2021a) analysis suggested that five major foreign firms exiting Ireland could reduce Corporation tax receipts by €3 billion.

Furthermore, there are no indications as to any potential plan for reducing overreliance on corporation tax receipts for overall revenue intake. Like the share of corporation tax in overall revenue, the State's exposure to this risk has become larger: the impact of a sharp reversal is becoming potentially more severe. Increasing exposure to specific sectors adds to volatility and risk around corporation tax receipts.