Box A: Household income and Macro-Fiscal (in)consistency

The Department of Finance aims to have its macroeconomic forecasts, such as its household income forecasts, consistent with its fiscal forecasts. In practice however, there are challenges to achieving this. The fiscal forecasts typically do not assume social benefits (pension payments and unemployment benefits) are uprated as this requires a formal budgetary decision, even if history suggests this is likely. But for the Department's forecasts of consumer spending and household savings to be realistic, some recognition of these likely changes are needed. In practice, achieving realistic macroeconomic forecasts in this context can lead to inconsistencies with less realistic fiscal forecasts. The Council has highlighted credibility issues with the Government's expenditure forecasts on numerous occasions. This box examines the macro-fiscal consistency of the Departments *SPU 2022* forecasts.

Macroeconomic forecasts

As part of the Council's endorsing of the Department's macroeconomic forecasts, the Department sends the Council its projections of household income. These include "net transfers": mainly social benefits received less social contributions paid.

Households receive social benefits mostly from the government, but also from the financial sector (in the form of pensions for example) and from overseas. Households pay social contributions to both the government and the financial sector.

The bulk of social benefits households receive (82 per cent) and contributions they pay (68 per cent) are from/to the government. As a result, the social benefits households receive should move broadly in line with the social payments paid by the Government. Likewise, social contributions received by the Government should move broadly in line with social contributions paid by households.

Forecast revisions point to inconsistencies

The *SPU* 2022 forecasts saw potentially significant inconsistencies between the macro and fiscal parts of the forecasts. The macroeconomic forecasts in *SPU 2022* signal large downward revisions to net transfers to households compared to at Budget time. By 2025, the SPU has net transfers received revised down by €5 billion (Table A1). In other words, households are now forecast to receive substantially less benefits than the contributions it would pay out. However, the fiscal forecasts show the opposite.[10] Transfers from the government to households are revised up by €3.2 billion relative to *Budget* 2022 forecasts.[11]

These revisions do not appear consistent with each other. And the difference is large by 2025 at €8.2 billion (5.3 per cent of personal disposable income). For this to be consistent, it would have to imply that households pay substantially more net contributions to the financial sector by 2025, compared to the Budget forecasts. This seems implausible.[12, 13]

What does this disparity mean? It means that either Budget 2022 forecasts were inconsistent, SPU 2022 forecasts are inconsistent, or both. Whether *Budget* 2022 forecasts were inconsistent

[10] Since the Department compiled their macroeconomic forecasts, which used the latest national account and institutional sector account data, there have been some revisions to the data based on the latest Government Financial Statistics release. However, these revisions do not meaningfully alter the analysis in this box.

[11] Social transfers in kind (via market producers) (D.632), does not form a part of household disposable income so is removed here to ensure a direct comparison with the figures from the macroeconomic forecasts. An example of a social transfer in kind (via market producers) would be a payment under the housing assistance payment scheme.

[12] The Department did not incorporate the impact of the proposed auto enrolment scheme into their macroeconomic forecasts.

[13] Alternatively, a steep increase in "net" other current transfers paid would have to explain the difference. The largest component of other transfers is net non-life insurance premiums/claims. The extent of the increase necessary would be implausible.

is hard to say. The Department did not provide the Council with the gross flows that underly their "net transfers" figure in the macroeconomic forecasts from Budget 2022.

Table A1: How net transfers to households were revised in SPU 2022

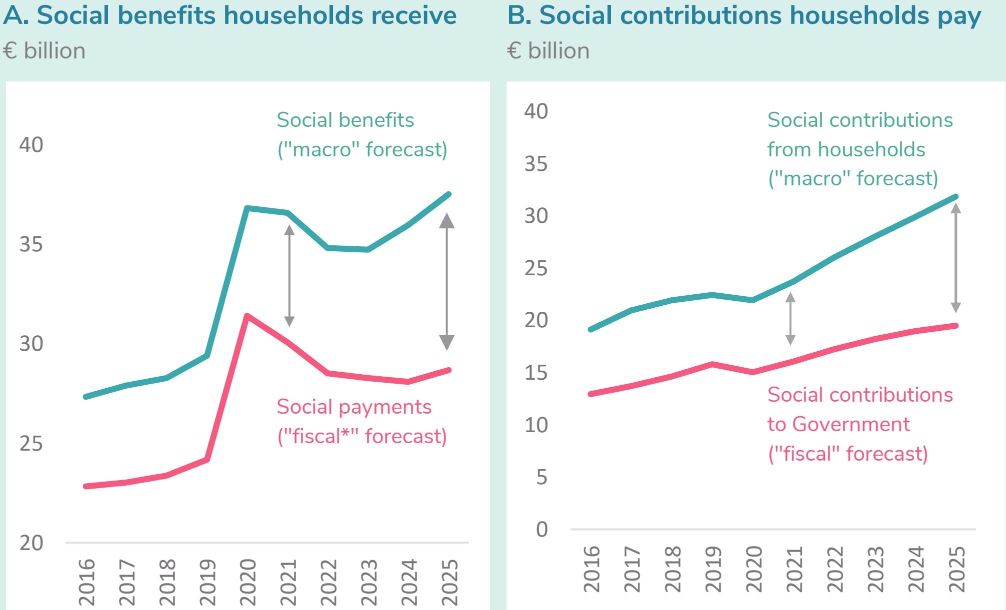
€ million, *SPU 2022 – Budget 2022*

	2021	2022	2023	2024	2025
Macroeconomic forecast revisions	-2,449	-3,099	-4,057	-4,576	-4,992
Fiscal forecast revisions	672	3,111	3,893	2,845	3,177

Source: Department of Finance.
Notes: The fiscal forecasts show the net revisions of social contributions (D.61) and social payments (D.62 + D.632) from Table 12 in SPU 2022 relative to Table 10 of Budget 2022's Economic and Fiscal outlook, together with the revision to social transfers in kind (via market producers) (D.632). Social transfers in kind (via market producers) is derived from the Department's macroeconomic forecasts for Personal Consumption Expenditure and Final Consumption Expenditure of households, which the Department assume grow at the same rates.

However, the Department did provide the gross flows of their macroeconomic forecasts as part of their SPU 2022 forecasts. Figure A1 shows these gross flows alongside some of the SPU's corresponding fiscal forecasts.

Figure A1: Households social benefits and social contributions SPU forecasts



Sources: CSO; and Fiscal Council workings.
Notes: The green lines are from the macroeconomic forecasts. The pink lines are from the fiscal forecasts. *The pink line in panel A is constructed using both the fiscal forecasts for social payments and the macroeconomic forecasts for final consumption expenditure. It is derived from subtracting the social payments in kind (via market producers) (D.632). The forecasts of social payments in kind (via market producers) are obtained from the Department's macroeconomic forecasts for personal consumption expenditure and final consumption expenditure of households. Get the data.

Two things are apparent from comparing the SPU's macroeconomic and fiscal forecasts.

First, the forecasts suggest an increasing gap between the benefits households receive and the payments made by the Government to them (Figure A1.A). This implies that the share of benefits to households from the financial sector and overseas, is increasing rapidly. This could be a reasonable way to make the macroeconomic forecasts more realistic if the fiscal forecasts for social payments from government are unrealistically low. The social payments from government is falling in both 2023 and 2024 by close to €200 million, before rising by €580 million in 2025. The Council's Stand-Still scenario points to Social Protection demographic costs (including the effect of the fall in unemployment) falling by only €65 million in 2023, then rising by €470 million in 2024 and €395 million in 2025. This is without factoring in likely increases to the rates of pay of these benefits.

Second, the comparison of contributions paid by households with contributions to the Government similarly shows a gap emerging over time. This, again, implies a much larger share of contributions going to the financial sector (Figure A1.B). Total social contributions paid by households, which includes contributions to government and the financial sector, are forecast to rise at a sharp rate over the forecast horizon: up 7.7 per cent on average over 2022–2025, whereas the contributions to government are growing by 5 per cent.[14, 15]

How might inconsistencies be avoided?

In compiling the macro-fiscal forecasts, the first best outcome is that the macroeconomic and fiscal forecasts are both realistic and fully consistent with each other. However, in the absence of realistic fiscal forecasts that consider demographic pressures and the likely uprating of benefits and tax bands, some adjustments should be made to the macroeconomic forecasts. At a minimum, these adjustments would ensure that the macroeconomic forecasts are realistic. This can be done by compiling the macroeconomic forecasts on a "most likely" outcome basis, using Stand-Still-like spending pressures as an input. That is, recognising the likelihood that benefits would be uprated in line with historical precedent. This would prevent unrealistic fiscal forecasts impacting on the realism of other areas of the macroeconomic forecasts like the forecasts for consumer spending.[16]

In 2021, household taxes grew more than twice as fast as employees' labour income, leading to a sharp increase in the ratio of taxes to labour income. This outcome reflected a combination of factors. Firstly, there was an ongoing weakness in incomes for sectors worst affected by the pandemic, which typically contribute less to income taxes — see Box D in the May 2021 *Fiscal Assessment Report* (Fiscal Council, 2021a). Secondly, tax receipts were unexpectedly strong from sectors less affected by the pandemic (see Box B).

While the tax-income ratio has typically been stable over time, the Council has noted that a number of previous forecasts have shown rising ratios. The average tax rate increased rapidly in 2021 and *SPU 2022* shows that this is

[14] Of the contributions to government, PRSI receipts are forecast to grow by an average of 7.4 per cent over 2022–2025, broadly in line with Compensation of employees. This means that the social contributions from government employees and the government's imputed pension contribution for these employees are forecast to fall by an average of 2.5 per cent over 2022–2025.

[15] While PRSI may grow in line with compensation of employees (with an elasticity of 1, see Conroy, 2020), in the recent past total social contributions from households has grown at a slower rate than compensation of employees. For instance, over 2013–2021, compensation of employees grew by an average of 5.2 per cent, whereas total social contributions grew by 4 per cent.

[16] If the realism of consumption forecasts are affected, this can impact on the accuracy of VAT receipts, and by extension the budget balance.