

Excise receipts are forecast to grow strongly, driven by two factors. Firstly, strong consumption growth. Secondly, the rate of carbon tax is assumed to increase throughout the forecast horizon. This contributes an additional €155 million in revenue each year on average over 2023-2025.

Box E: The impact of inflation on government revenue

This box examines the impact the of revisions to projections of inflation and real growth would imply for government revenue. The box focuses on three main (nominal) macroeconomic drives: personal consumption, compensation of employees, and Building and Construction activity (B&C). Forecasts published in *SPU 2022* give updated forecasts of these variables in nominal and real terms. Hence, the revisions compared to *Budget 2022* represent the shock we use to estimate the potential impacts on three main tax aggregates, namely Income tax, Social Contributions, and VAT. Table E1 shows the revisions to nominal growth rate forecast for each of these variables.

Table E1: Forecasts of nominal growth and inflation have been revised up significantly

Revisions to annual percentage growth rates (*SPU 2022* – *Budget 2022*)

	2022	2023	2024	2025
Nominal compensation of employees	3.8	1.9	1.0	0.7
Nominal personal consumption	-0.4	1.1	0.3	-0.1
Nominal building and construction	8.1	1.6	1.2	-0.5
HICP inflation rate	3.8	1.1	0.1	-0.1

Sources: Department of Finance and Fiscal Council workings.

Notes: Revisions are calculated as *SPU 2022* forecast growth rate - *Budget 2022* forecast growth rate.

This exercise focuses on the nominal growth rates for these variables, as that is what is relevant for forecasting government revenue. Forecasts of nominal variables combines forecasts of real rates of growth, along with forecasts of inflation. While forecasts of inflation have been revised up, some real growth rates have been revised down at the same time. For example, personal consumption inflation is generally higher and nominal consumer spending is higher in most years, apart from 2022 when the contractionary effect on real consumption more than offsets the upward revision to inflation

For this exercise, to isolate the impact of inflation on revenues, it is assumed that no policy changes occur in response to the inflation shock. For example, there is no widening of income tax bands or credits to offset the higher tax burden associated with increasing nominal levels of pay.

As can be seen in Table E1, growth in the nominal compensation of employees has been revised up since *Budget 2022*. This stronger nominal growth leads to higher income tax and social contributions. The elasticities used for income tax, VAT and social contributions are in line with those estimated in Conroy (2020). For income tax an elasticity of 1.4 is assumed, while for social contributions (PRSI) an elasticity of 1 is used. VAT receipts respond to changes in the nominal growth of consumption (with an elasticity of 0.8) and B&C activity (with an elasticity of 0.2).

Table E2 shows the government revenue implications of the upward revisions to nominal growth of the relevant macroeconomic variables. The main impacts from higher nominal macroeconomic drivers would come through income taxes and social contributions. Smaller impacts are seen through indirect taxes (VAT). Overall, the stronger nominal growth implies higher government revenue. These estimates suggest that government revenue would be between 0.8 and 1.9 percentage points higher as a share of national income due to the higher inflation under the assumption that there are no changes in tax policy, including no indexation of income tax bands. However, the Programme for Government commits to indexation if wages are growing. The *SPU*

2022 forecasts incorporate a partial indexation of the income tax system, which entails some mitigation of the income tax burden over the forecast horizon.

Table E2: Higher inflation and real growth yields increased government revenue

€ million unless otherwise stated

	2022	2023	2024	2025
Nominal impact:				
Income Tax	1,425	2,345	3,008	3,601
Social contributions	613	984	1,232	1,441
VAT	202	425	546	552
Total	2,024	3,526	4,559	5,365
Total (% GNI*)	0.8	1.4	1.7	1.9

Sources: Department of Finance and Fiscal Council workings.

Notes: Real compensation of employees is defined here as nominal CoE deflated by HICP.

In SPU 2022, official forecasts of government revenue have been revised upwards compared to Budget 2022. Table E3 shows the revisions to the three main tax headings considered. These figures have been adjusted for the better-than-expected 2021 outturn. The reported results look broadly in line with estimates given in Table D2 above.

Table E3: Government projections of revenue have been revised up

SPU 2022 forecast minus Budget 2022 forecast (adjusted for 2021 outturn), € million

	2022	2023	2024	2025
Income Tax	1,325	1,790	1,935	2,205
Social contributions	509	769	1,379	1,639
VAT	835	910	750	685
GG Revenue (excluding CT)	3,859	3,649	3,994	4,099
GG Revenue (excluding CT) (% GNI*)	1.6	1.4	1.5	1.4

Sources: Department of Finance and Fiscal Council workings.

Notes: Outturns for 2021 were higher than forecast, which leads to a higher level when forecasting 2022. As a result, this table shows the upward revision, excluding the impact of the higher starting point (2021). The values given are the revision (i.e. SPU – Budget) minus the overperformance in 2021 relative to Budget 2022 forecasts. This is equivalent to SPU 2022 – Budget 2022 – (Outturn 2021 – Budget forecast of 2021).