Fiscal Stance

Managing the energy crisis and preparing for the future

3. FISCAL STANCE

Managing the energy crisis and preparing for the future

Growth is being undermined by the cost of living, the war, and the ongoing impacts of the pandemic

Growth in the Irish economy and in its major trading partners is being undermined by sharp increases in the cost of living amid the war in Ukraine and ongoing impacts of the pandemic. However, Ireland is expected to continue to benefit over time from its exposure to sectors that have fared better than others during downturns, including the digital and pharmaceutical sectors. Unemployment, though expected to rise slightly in the coming months, is projected to remain low by historical standards.

The Government struck a balance with *Budget 2023*

The Government struck a balance with *Budget 2023*, supporting those impacted by rising prices while avoiding boosting price pressures excessively. It sensibly allowed for a slightly faster-than-planned increase in permanent spending for 2023, given the substantial pressures from rising prices. The temporary deviation from the 5% Spending Rule is limited, especially relative to the increase in inflationary pressures, with core spending rising by 6.8% instead for 2023. The Government plans imply core spending increases reverting to 5% in later years in line with the rule.

Budget 2023 was supplemented with a large package of temporary support measures. These measures help limit the impact of the sudden rise in the cost of living on businesses and households. While there is still scope for these measures to be better targeted, the impacts on inflation are limited by virtue of their being temporary in nature. This approach is welcome.

The 5% Spending Rule, introduced last year, appears to be guiding policy in an effective way. The rule's anchoring effect will be essential for the years to come. It ensures a more sustainable path for core spending, sets the debt ratio on a steady downward path from current high levels, and provides some certainty to various arms of government about future overall budgetary resources. This should help with planning, which is vital when major, interconnected challenges are looming.

However, the Government now needs to start planning further ahead

While there are many positives to take from *Budget 2023*, the Government now needs to start planning further ahead. It should extend its forecast horizon and lean more heavily on the national Spending Rule as a means to develop realistic and fully-costed plans further into the future. These plans should reflect the full costs associated with an ageing population, achieving the State's climate targets, other major policy objectives, and the risk of excess corporation tax receipts unwinding.

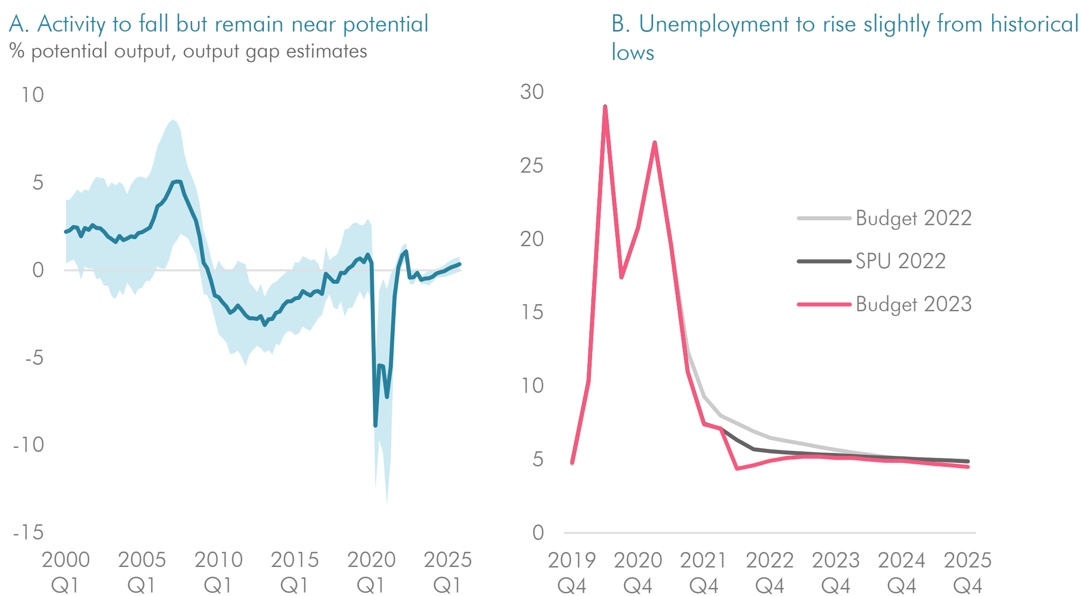
In this section, the Council assesses the prudence of the Government's overall fiscal stance. Its assessment is informed by (1) a broad economic assessment that

considers how to appropriately manage the economic cycle as well as the sustainability of the public finances, and (2) an assessment of compliance with the legislated domestic and EU fiscal rules.

3.1 Assessment of the cyclical position

High inflation and rising interest rates are expected to depress growth in the domestic economy and internationally. However, the Irish economy is still likely to be supported by the relative strength of digital and pharmaceutical activities. Domestic spending could also be supported by exceptional levels of savings built up during the pandemic and by increases in wages.

Figure 3.1: The economy is slowing but from a position of strength



Sources: Fiscal Council workings (based on *Budget 2023* forecasts). Get the data.
Notes: The figure shows a range of output gap estimates (the shading) and the mid-range of these estimates (the line). The estimates are produced using a variety of methods based on the Council's supply-side models (Casey, 2019) and the Department's forecasts. Given distortions to standard measures like GDP and GNP and the relative importance of domestic activity to the public finances, the measures focus on domestic economic activity, including quarterly Domestic GVA.

A contraction in activity is projected for this winter

The Government's official projections in *Budget 2023* imply a contraction in activity towards the end of this year. Overall activity in the economy is set to weaken briefly relative to its potential, before recovering over the course of 2023 (Figure 3.1A). Unemployment rates are projected to rise by about one percentage point before recovering from next summer onwards (Figure 3.1B).

This comes at a time when Ireland's economy has been performing relatively strongly up to now

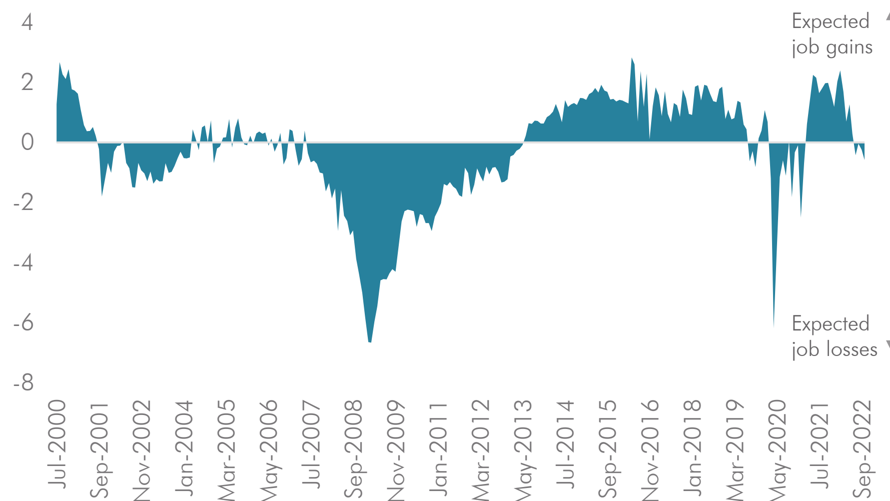
The projected contraction in activity arrives at a time when Ireland's economy has been performing very strongly. Overall activity is estimated to have been operating slightly above its potential in Q2 2022. This implies labour shortages or slight overheating in the economy. Similarly, unemployment rates fell to record lows, with readings averaging just 4.2% over the summer — their lowest in over two decades.

Risky imbalances in the economy also appear to be offsetting at present. Moderate lending, lower levels of indebtedness, high savings, and the large current account surplus point to fewer pressures on the domestic economy and resources. However, high energy costs and labour shortages could yet feed into other price pressures, spelling risks to growth. The exceptional flows of refugees could add to these pressures.

As a small open economy, Ireland is unlikely to withstand international pressures for long. Downgrades to forecasts among Ireland's trading partners will weaken export demand, while the same pressures, in terms of rising prices, are moderating demand at home as well. Job hiring expectations and individuals' expectations about their own employment prospects have proven to be a useful bellwether for recessions in the past. These expectations have softened materially from late summer into autumn (Figure 3.2).

Figure 3.2: Irish job expectations have softened

Composite survey-based jobs indicator, + balance suggests job gains, – suggests job losses



Sources: DG ECFIN; Eurostat; and Fiscal Council workings. Get the data.
Notes: The jobs indicator is a composite measure of surveyed expectations for employment in Ireland in the coming months across various sectors, including consumers expectations related to their own employment. A positive value suggests that, on balance, an increase in employment is expected as compared to a decrease in employment when negative.

A broadly neutral fiscal stance is appropriate for now

Current economic conditions therefore suggest that a broadly neutral fiscal stance was appropriate for *Budget 2023*. That is, the Council assessed that a large-scale stimulus over the years to come would not be appropriate.

But things could change, and the Government should stand ready to act

This assessment could change, and the Government should stand ready to act. While there is a tight labour market at present and a reasonably positive growth outlook, there are clearly large risks looming. The risks around the path for the economy are unusually wide and the prospects for growth are highly uncertain. Further impacts from Russia's war in Ukraine, Covid-19 and international price pressures pose major risks. Yet it is also possible that shortages of workers and ongoing pressures to expand in areas such as housing and public investment

could add fuel to pressures in the economy if growth continues. The Government should stand ready to act if domestic economic activity slows markedly or if other risks materialise.

3.2 Assessment of sustainability of the public finances

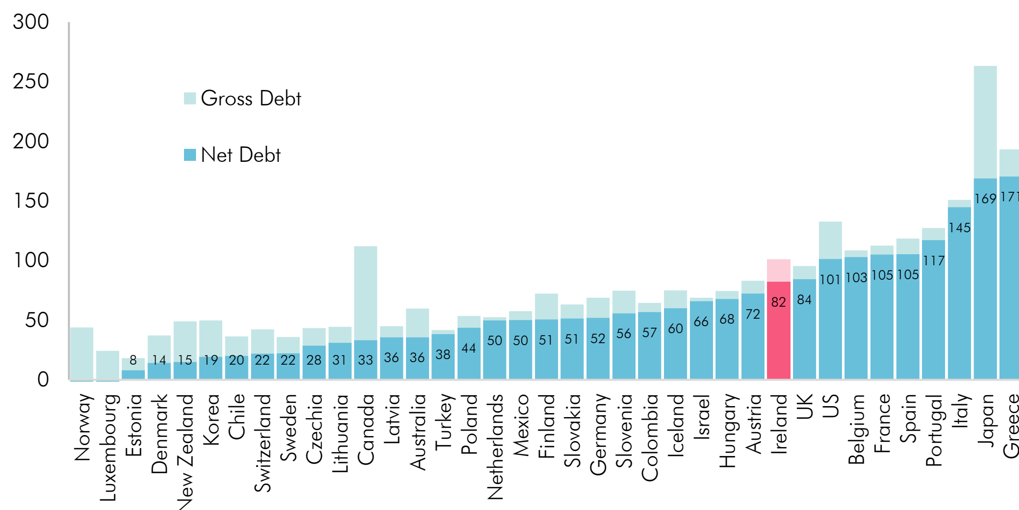
As well as assessing the economic cycle and the possibility of major imbalances, the Council assesses fiscal sustainability as part of its broad economic assessment.

Ireland's debt ratio remains high, especially compared to other small open economies

Ireland's debt ratio remains high by international standards. At the end of 2021, the Government's net debt ratio was 82% of GNI*. This put it as the tenth highest in the OECD (Figure 3.3). Only three other small open economies in the OECD have larger debt burdens: Greece, Portugal and Belgium. A higher starting debt ratio tends to amplify the sustainability risks that can arise from recessions, slower growth or increases in borrowing costs (Barnes, Casey, and Jordan-Doak, 2021).

Figure 3.3: Ireland has a high debt ratio

% GDP (% GNI* for Ireland), general government basis, end-2021



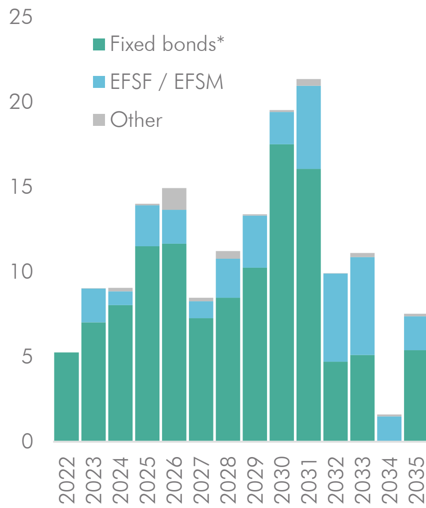
Sources: Eurostat; CSO; IMF (April 2022 Fiscal Monitor); and Fiscal Council workings. Get the data.
Notes: All OECD countries are shown aside from Costa Rica. Net debt is general government gross debt excluding assets held by the state in the form of currency and deposits; debt securities; and loans. The 60% ceiling for government debt set out in the Stability and Growth Pact is set in gross rather than net terms. Net debt does not include the State's bank investments.

But the immediate risks to debt sustainability are relatively low

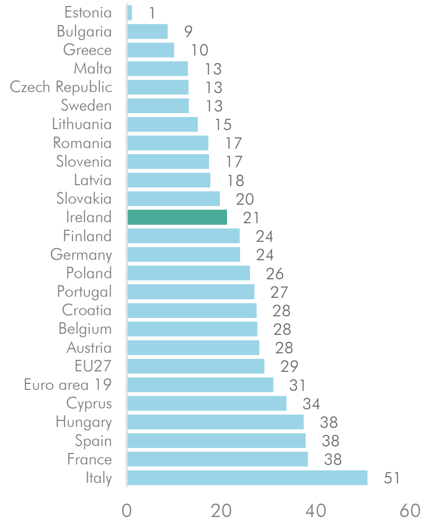
The immediate risks to Ireland's debt sustainability are relatively low. Almost 98% of debt outstanding is at fixed interest rates. The State's debt obligations are also relatively long-dated at 10.5 years weighted average maturity (by ECB calculations), with a smooth maturity profile (Figure 3.4A) and a relatively small amount of debt maturing over the next five years (Figure 3.4B).

Figure 3.4: Ireland's funding situation is in good shape

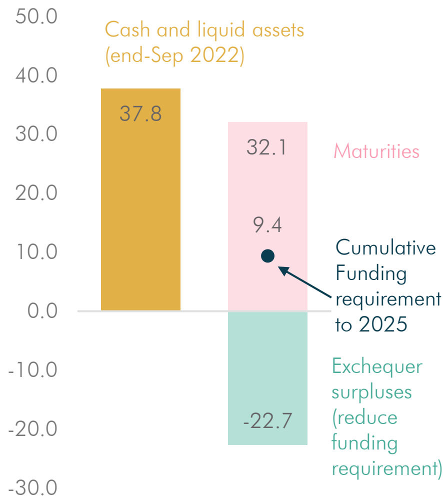
A. Maturities are well balanced
€ billions of maturing debt securities



B. Near-term refinancing risks low compared to others
% GDP (GNI* for Ireland), gov. debt maturing in next 1-5 years

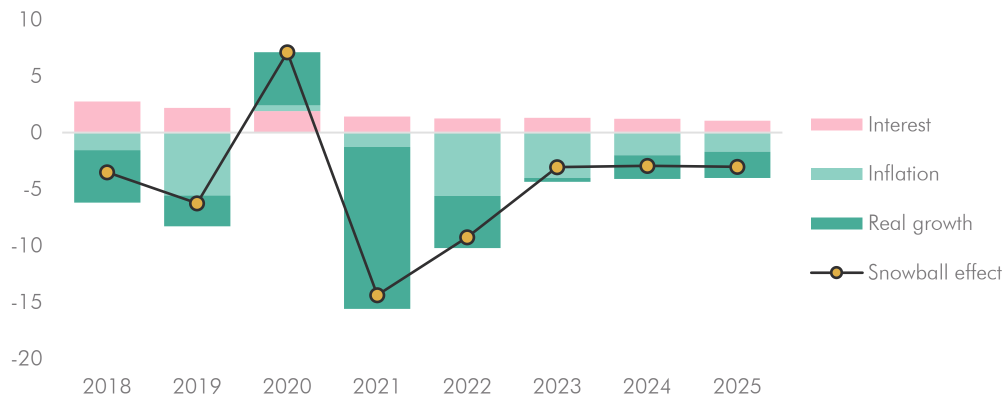


C. Cash balances large relative to needs
€ billions



D. Bond yields still low despite recent increases
% 10-year bond yields, weekly data

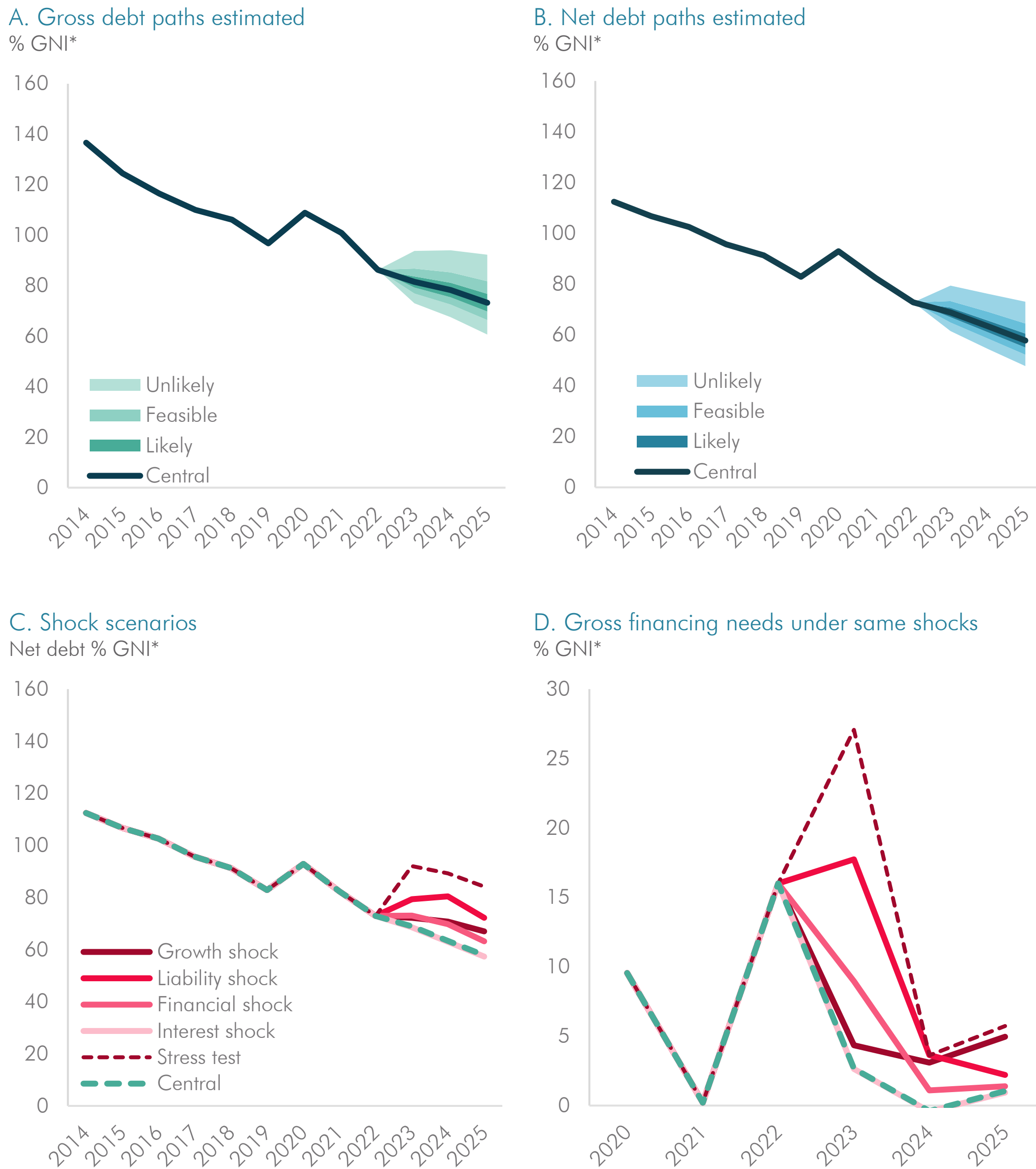
E. Nominal growth is helping reduce debt ratio
Annual change in debt ratio as % GNI* due to "snowball effect" (the differences between growth and interest)



Sources: CSO; NTMA; ECB; Department of Finance; and Fiscal Council workings. Get the data.
Notes: Spread in panel D refers to the difference between Irish 10-year yields and German 10-year yields.
The snowball effect is the debt ratio change due to nominal growth less the effective interest rate.

The State had accumulated sizeable cash balances (€26.7 billion or 10% GNI*) by end-October. This would cover more than four-fifths of the maturing debt out to end-2025 even if no Exchequer surpluses were run (Figure 3.4C). As it stands, the Exchequer surpluses projected average about €7½ billion between 2023 and 2025. This means that the total cumulative funding requirement to cover both debt maturities and the Exchequer's borrowing requirements over these years is €9.4 billion — just a third of the cash and liquid assets currently held.

Figure 3.5: Debt sustainability analysis



Sources: Department of Finance; CSO; NTMA data on debt securities; and Fiscal Council workings.
Notes: The fan chart projections show the probability of different debt paths. The "likely" range covers the 30% confidence interval, "Feasible" covers the rest of the 60% interval, and "Unlikely" the rest of the 90% interval. The "Growth shock" assumes real GNI* growth rates 3.6pp (one standard deviation, 1996-2019 excl. financial crisis) weaker than the Central scenario for 2 years (leaving output about 7% below the central scenario). The "Liability" and "Financial" shocks, respectively, assume that 15% and 10% GNI* contingent liabilities materialise, based on an historical assessment of fiscal risks internationally. The "Interest shock" assumes that marginal interest rates rise by 2pp for the full period. The "Stress test" combines all previous shocks. Get the data.

One way to assess debt sustainability is through "stochastic debt sustainability analysis". This is a way of modelling multiple debt paths with different probabilities attached to each path. This approach is proposed in Blanchard, Leandro and Zettelmeyer (2021) as an alternative to conventional fiscal rules that assume specific debt limits are sustainable.

Using the Council's macro-fiscal model (the Maq), we can assess the probability of the Government's net debt ratio rising over the forecast period (Figure 3.5A and 3.5B). It is important to note that this analysis, as with other such work, is severely constrained by the Government not having proper medium-term forecasts beyond the current three-year window to 2025. A return to five-year-ahead forecasting, as previously committed to by the Government, would allow the Council to give a proper assessment of medium-term debt sustainability.

The State looks set to be on a much more sustainable debt trajectory than previously estimated. This is thanks to the Government broadly sticking to its 5% Spending Rule, while the stronger economic recovery, higher corporation tax receipts, and a less-than-expected need for fiscal contingencies have materialised through the pandemic. The probability of an "unsustainable" debt path — defined here as a net debt ratio remaining at or climbing above its current level by the end of the forecast horizon — is estimated to be between 5% and 10%. This would almost pass the indicative fiscal standards set out by Blanchard, Leandro and Zettelmeyer (2021), which proposed a 5% threshold as a useful fiscal standard. However, such a standard does not necessarily imply that debt is "sustainable" in practice. What it implies is that some form of adjustment to the Government's fiscal plans is unlikely to be needed to achieve a high probability of debt sustainability.

The results are nonetheless encouraging. They suggest that a tighter-than-planned fiscal policy would not be needed in the near future to ensure a prudent path for the debt ratio.

Fiscal policy would not have to tighten in the near future to ensure a prudent debt path

The Government's fiscal plans would also appear to be relatively robust to a conservative "stress test". The stress test assesses how the public finances would respond to a large shock occurring across several dimensions simultaneously. This includes weaker growth, higher interest rates, and the realisation of other large fiscal risks such as state-supported bailouts of the corporate sector.[52] As Figure 3.5C shows, a stress test could cause the net debt ratio to rise to about 92% of GNI* before returning to a steady downward path. Gross financing needs

[52] The stress test is described in Casey and Purdue (2021). To inform its design, it draws on a comprehensive IMF survey of fiscal risks covering 80 countries over a period of two and a half decades as well as Irish-specific information on past recessions.

would temporarily skyrocket under a stress scenario, but this could be mitigated by use of the State's cash balances.

This analysis, though useful, covers only part of what the Council assesses. An appropriate fiscal stance should take into account the wider context. This includes whether there is a need to return the economy to full employment, whether the tax forecasts on which the forecasts are based are sound, or whether spending pressures are adequately factored into current plans. The projection period is also shorter than would be desirable for an appropriate assessment of medium-term fiscal sustainability. More generally, these types of analyses may not deal well with low-probability but high-impact risks, such as the pandemic.

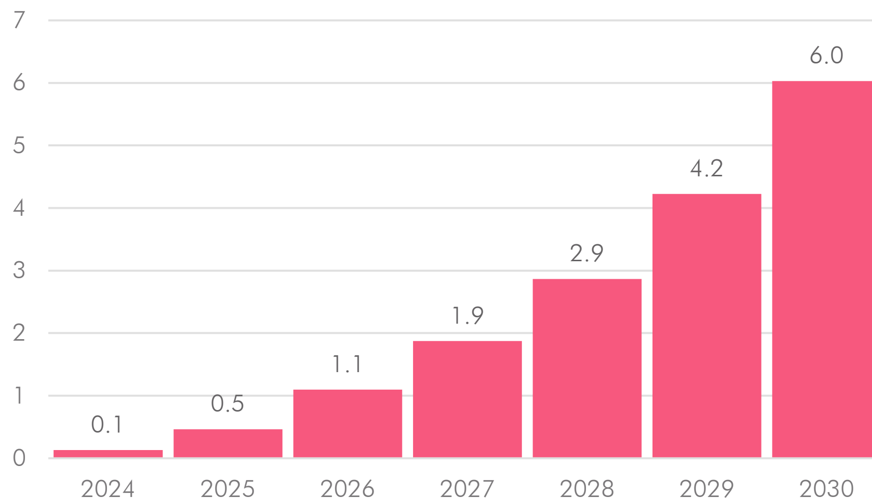
One area that the analysis would tend to suggest is of less concern is higher marginal interest rates on government debt. This can be seen from Figure 3.4C where the impact on the debt ratio is negligible in the short term.

Ireland is insulated from rising interest rates in the near term

Ireland is insulated from rising interest rates in the short term. However, if we extend the *Budget 2023* forecast horizon to 2030 mechanically, we can examine the risks from rising interest rates over a longer time horizon. If interest rates were to be permanently higher by two percentage points, this would serve to push up the gross debt ratio in 2030 by approximately six percentage points of GNI* compared to the baseline (Figure 3.6).

Figure 3.6: Higher interest rates would gradually raise debt ratios

% GNI*, Gross General Government debt (impact of 2p.p. shock on marginal interest rate)



Source: Department of Finance; and Fiscal Council workings. Get the data.
Note: The extended baseline assumes that real growth reverts to 3%, with a deflator of 1.5% beyond 2026. The marginal interest rate is solved endogenously for the baseline, with the shock scenario assuming a permanent 2 percentage-point increase in the implied rate for 2023 onwards.

There is a window now to get debt down in advance of future pressures

There is a window for Ireland to get debt down to a level where the exposure to changes in interest rates or growth is relatively manageable. This comes ahead of the likely pressures arising from an ageing population. However, it would mean that policy would have to stay on its current track.

3.3 Assessment of the Government's Fiscal Stance

Drawing on its broad assessment of the economy and the sustainability of the public finances, this section sets out the Council's assessment of the Government's fiscal stance.

Fiscal stance for 2022

The Council assesses that fiscal stance was broadly appropriate in 2022. The Government's initial plan in *Budget 2022* for core spending was broadly in line with its 5% spending rule. It responded to the impact of higher inflation with temporary spending measures, although these could have been better targeted.

The fiscal stance was broadly appropriate in 2022

The Government now expects to increase core spending — excluding temporary measures — by €6.8 billion (9.1%) in 2022 (Figure 3.7A). This fast pace of increase partly reflects a catch-up on underspends in 2021 related to confinement measures that were in place at the time (Fiscal Council, 2022). It also reflects increases in social spending and public pay implemented in the final months of the year to address higher price and wage pressures. While faster than what would be implied by sticking to the 5% Spending Rule, the pace of increase is still less than would be implied if growing in line with inflation and real growth. The Government is right to avoid adding further to inflationary pressures by compensating for price increases in full. Contingency measures were used in line with original plans, albeit directed to other one-off measures rather than Covid.

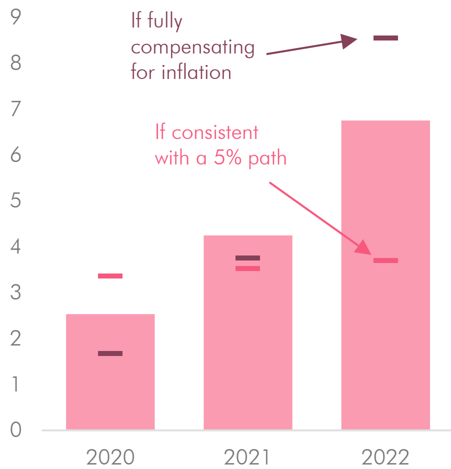
On the tax side, the Government's stance for 2022 is broadly neutral (Figure 3.7B). That is, the impact of all tax measures, not just on the income tax side, is likely to just offset what would be raised by not indexing the income tax system — as in, not raising tax credits and bands to prevent people drifting into higher effective tax rates as wages rise.

The Government used substantial contingencies and temporary measures in 2022. These helped to accommodate Ukrainian refugees, to temporarily alleviate energy and commodity price pressures facing households and businesses, and to provide for further pandemic-related supports.

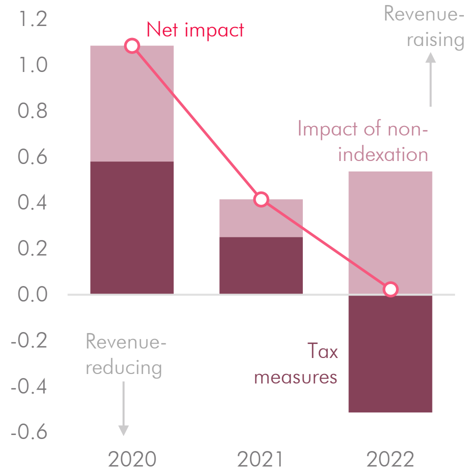
The Government's use of contingencies as a means of responding to uncertain costs has worked broadly well in recent years. However, the Department should be more transparent in terms of how these contingencies are baked into monthly spending profiles set out for the year, separating these contingencies from other spending within departments. This would allow better scrutiny of how spending is evolving month to month. The use of contingencies has partly led to overly high funding requirements being targeted by the National Treasury Management Agency (NTMA). In recent years, this additional borrowing has not been needed as these contingencies have proved unnecessary. This has contributed to a large build-up of cash balances.

Figure 3.7: A large budgetary package in 2022 but still sustainable

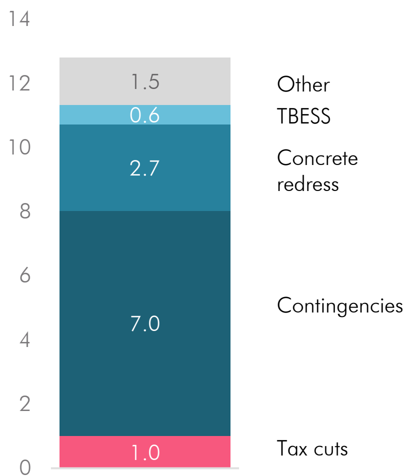
A. Core increases large but below inflation
€ billion, core spending



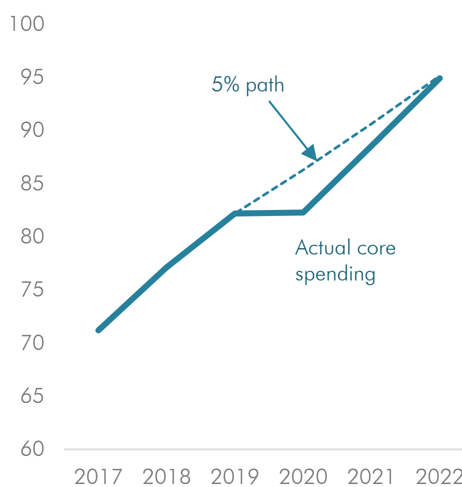
B. Tax decisions were neutral in 2022
€ billion



C. Sizeable temporary measures used
€ billion, temporary measures



D. Net policy spending path still sustainable
€ billion, net policy spending



Sources: CSO; Department of Finance; and Fiscal Council workings. Get the data.
Notes: Core spending refers to Exchequer spending in cash terms excluding temporary measures such as those related to Covid-19, and supports for Ukrainian refugees. The impact of non-indexation is the estimated additional revenue that would be raised if the income tax system did not adjust for higher wages in the economy. "TBESS" is the Temporary Business Energy Support Scheme. Net policy spending is overall general government spending, excluding temporary factors like one-offs, and cyclical spending on unemployment benefits. As a net measure, it recognises the role of tax changes; that is, a rise in net policy spending is offset by tax-raising measures but is added to by tax cuts.

While the pace of spending was fast, the Council assesses that the fiscal stance for 2022 was conducive to prudent economic and budgetary management. The path for net policy spending — a broad measure of the Government's spending path that also adjusts for the impact of tax measures over time — would suggest that the level of spending remained in line with what a hypothetical 5% spending path would have implied from 2019 on, even if there was some catching up to this path in 2022. The 5% spending path is significant as it aligns with the Government's own Spending Rule, but also with what more typical rates of inflation plus the economy's trend growth rate would imply. If such a path is broadly sustained over the medium term, this would tend to limit the risk that net

spending deviates substantially from the pace of increase in both the domestic economy and sustainable revenues.

Fiscal stance for 2023

The Government went into *Budget 2023* with an improved fiscal outlook, but with substantial pressures to provide further fiscal supports amid rising energy and commodity pressures. Higher tax receipts helped the budgetary outlook: notably higher corporation tax receipts, but also higher income tax and VAT receipts.

Budget 2023 entails a very big package by historical terms, although it reflects a relatively large temporary package and a more moderate permanent package.

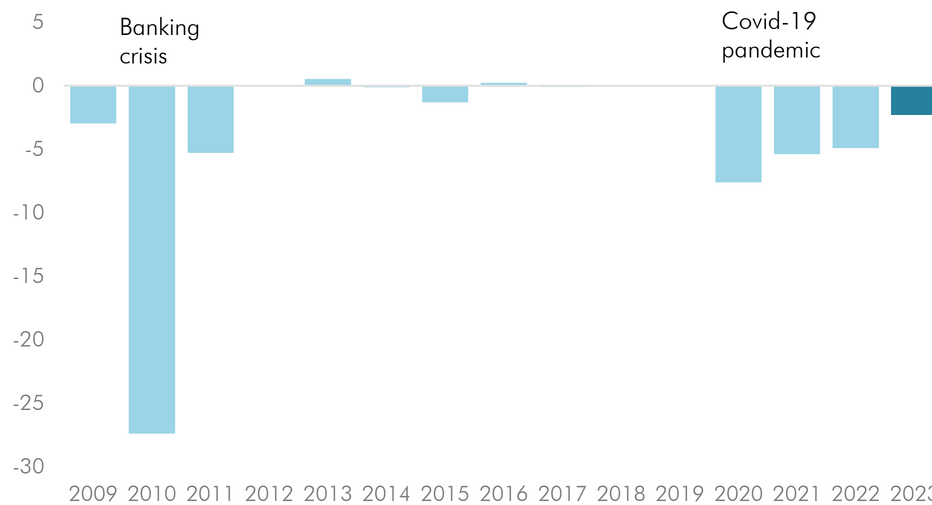
***Budget 2023* is big, but reflects large temporary measures and a more moderate permanent package**

At close to €11 billion, the budget package is exceptionally large outside of Covid times. It comprises a core package of €6.9 billion: core current spending increases of €0.7 billion in 2022, €4.3 billion in 2023, core capital increases of €0.8 billion in 2023, and €1.1 billion of permanent tax measures, primarily to update tax bands. There are also temporary measures equivalent to €3.9 billion for cost-of-living supports and supports to businesses, primarily during the winter months. Separately, there are unallocated contingencies of €2 billion for humanitarian assistance for refugees from Ukraine and €0.5 billion for Covid-related costs in 2023.

If we look at the history of temporary measures, we can see that the *Budget 2023* package entails a relatively large outlay. For 2023, this equates to 2.3% of GNI*. This is larger than temporary measures would normally be, leaving aside the banking crisis between 2009 and 2011 and the worst of the pandemic in 2020 and 2021 (Figure 3.8).

Figure 3.8: *Budget 2023* applies sizeable temporary measures

% GNI*, one-off measures



Sources: CSO; Department of Finance; and Fiscal Council workings. Get the data.
Notes: One-off measures refers to Council estimates of the various temporary / one-off items that impacted on the general government balance over this period.

The temporary measures are warranted

While large, the temporary measures for 2023 are warranted. First, about half of the temporary measures in 2023 are for contingencies related to Covid-19 and Ukrainian refugees. These outlays may ultimately not be needed but it is wise to prepare for them, given the uncertainties involved. Second, the cost-of-living measures will help to protect people from higher energy prices and wider inflation without substantially weakening the Government's overall fiscal sustainability, or adding unduly to inflationary pressures.

The Government still needs to substantially improve its targeting of temporary supports

The Government could still substantially improve its targeting of supports. Section 2 notes that only about one-third of the temporary cost-of-living spending supports directed at households were targeted. Large measures such as the electricity credit are still weakly targeted as are the extensions of the VAT and excise reductions on fuels, gas, and electricity. However, the degree of targeting has improved relative to measures introduced previously in 2022. The degree of targeting of temporary measures also needs to be viewed alongside permanent spending measures introduced. Increases in core social welfare rates are more heavily targeted at those most in need.

Permanent increases appear large, but are modest in the context of high inflation

Looking at the permanent increases *Budget 2023* implies, these appear large, but are more modest when taking account of the high inflation environment.

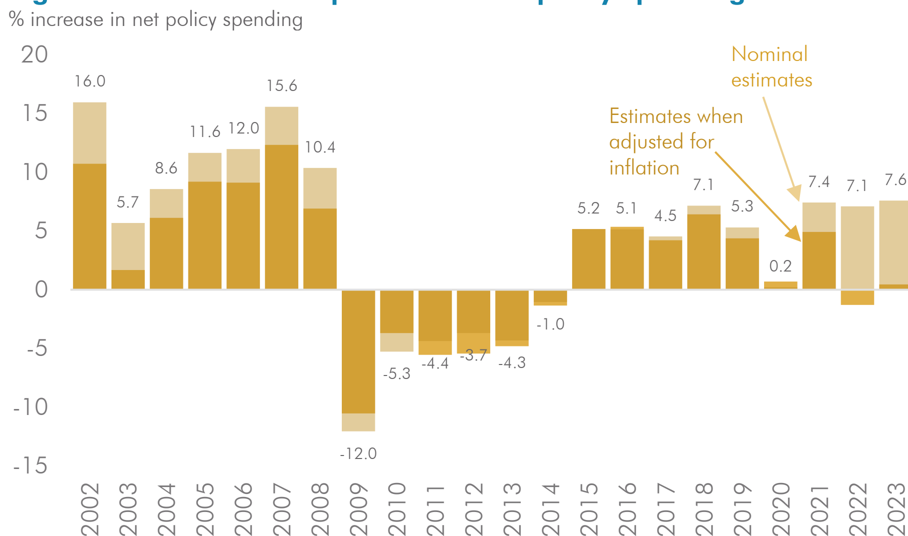
Core spending is set to rise faster than the Government's 5% Spending Rule would imply, but much less than inflation plus the real trend growth rate of the domestic economy. Core spending is to rise from an originally planned level of spending of €80.5 billion in 2022 to €85.9 billion in 2023 as a result of *Budget*

2023.[53] This equates to a 6.8% increase, and compares to a 6.5% increase set out in the *Summer Economic Statement*: a difference of just €0.2 billion. Actual inflation plus real growth of 3% — close to the trend growth rate estimated for the domestic economy in recent years — would imply a growth rate of 10.3%.

Another way to assess the pace of increase in fiscal measures, is to take on board broader measures of government spending and the impact of tax changes. In terms of the increase in "net policy spending" — basically, general government expenditure less temporary items, interest, cyclical spending on unemployment and less net tax-raising measures — the change planned for 2023 is the largest since 2008 in nominal terms (Figure 3.9). But when adjusted for inflation the increase is far smaller. The Government is right to avoid fully tracking real growth plus inflation as this would add to inflationary pressures, and it remains uncertain how much of the recent increase in price levels will be sustained.

Figure 3.9: Increases in permanent net policy spending are more modest

% increase in net policy spending



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

Notes: "Policy" spending is overall general government spending, excluding temporary factors like one-offs, and spending on unemployment benefits that are not likely to be long-lasting. The net policy spending measure used above recognises the role of tax changes; that is, a rise in net policy spending is offset by tax-raising measures but is added to by tax cuts. The inflation-adjusted measure is HICP-adjusted.

[53] Note that this 6.8% growth rate compares the updated *Summer Economic Statement* base level for 2021 (€80.5 billion) with the *Budget 2023* ceiling for 2023 (€85.9 billion), whereas the 6.5% growth rate is based on the *Summer Economic Statement* ceilings alone. This approach allows us to control for the additional spending announced in *Budget 2023* but frontloaded to 2022.

The Council assesses that the trajectory for the public finances implied by *Budget 2023* is conducive to prudent economic and budgetary management. Core spending increases are above what a hypothetical 5% path would give — in line with the Government's Spending Rule — but well below a path implied by real growth and actual inflation. By not fully indexing the tax system, tax decisions are likely to be slightly revenue-raising. Temporary measures are large but much reduced relative to last year and made up of substantial contingences, which are prudent.

The Council assesses that the trajectory for the public finances implied by *Budget 2023* is conducive to prudent economic and budgetary management

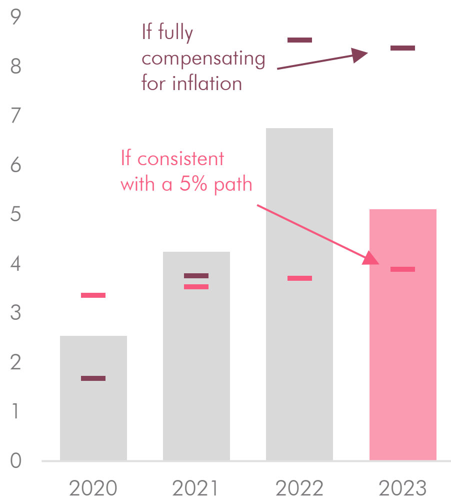
The overall path for net policy spending makes some allowance for unexpectedly high inflation, which is warranted given the exceptional and supply-side nature of the shock. The decision to pause the 5% Spending Rule in 2023 will take spending to a higher level than would be implied by a 5% path. When compared to what a hypothetical 5% path would imply, net policy spending in 2023 is €2.3 billion higher. However, this level of spending planned would still be substantially lower than if the exceptional inflation levels were allowed for in full, which is the appropriate response to a supply-side shock of this nature

With revenues faring well, a more important constraint for the public finances right now is the extent to which any further measures would add to inflation. The Government's decision to implement a larger budgetary package with *Budget 2023*, compared to the Summer Economic Statement plans, will add to existing price pressures in the economy slightly more than it otherwise would have. It will also reduce the size of the budget surplus the Government was going to run.

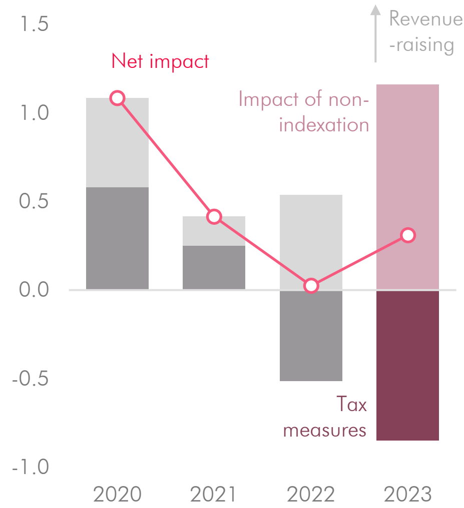
An important constraint for the public finances right now is the extent to which any further measures would add to inflation

Figure 3.10: Stance for 2023 is sensible

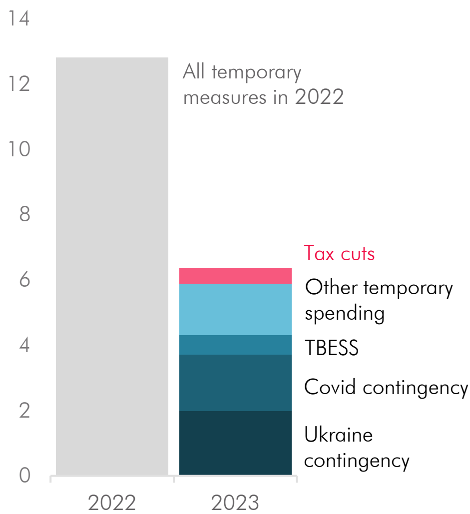
A. Core increases well below inflation for 2023
€ billion, core spending



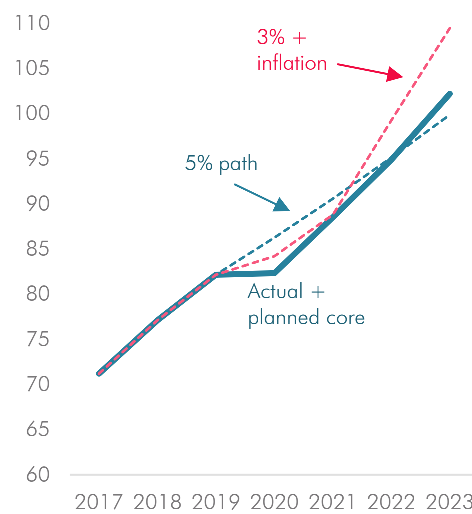
B. Tax decisions slightly raise revenues in 2023
€ billion



C. More temporary measures used
€ billion, temporary measures



D. Net policy spending path still sustainable
€ billion, net policy spending

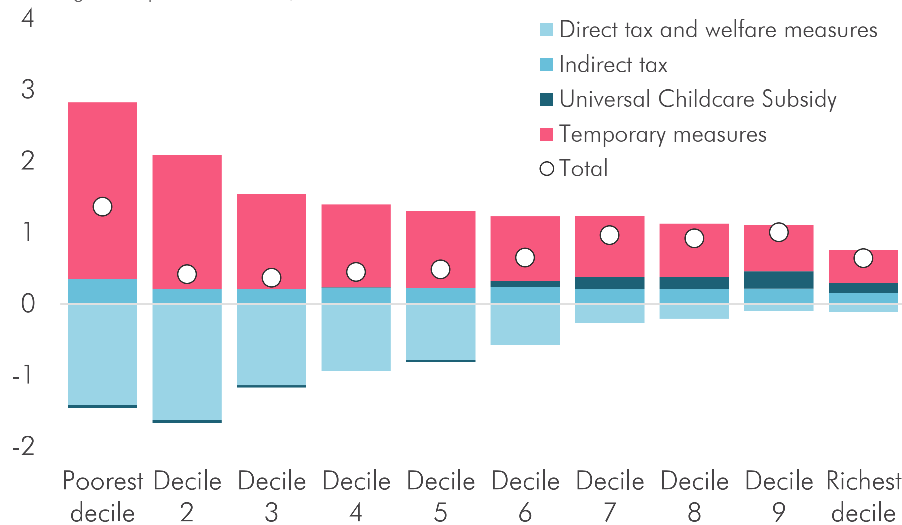


Sources: CSO; Department of Finance; and Fiscal Council workings. Get the data.
Notes: Core spending refers to Exchequer spending in cash terms excluding temporary measures such as those related to Covid-19, and supports for Ukrainian refugees. The impact of non-indexation is the estimated additional revenue that would be raised if the income tax system did not adjust for higher wages in the economy. "TBESS" is the Temporary Business Energy Support Scheme. Net policy spending is overall general government spending, excluding temporary factors like one-offs, and cyclical spending on unemployment benefits. As a net measure, it recognises the role of tax changes; that is, a rise in net policy spending is offset by tax-raising measures but is added to by tax cuts.

The permanent measures included in *Budget 2023* mostly increase core welfare rates, pensions and public sector pay. The permanent increases across these areas do not compensate for price rises in full. Instead, temporary measures play a big role. Looking at the impact of permanent welfare and tax changes, together with the temporary supports, these more than compensate for price rises, particularly for the poorest-income households (Figure 3.11). The temporary measures should add to inflationary pressures relatively less than the permanent measures. However, there is still substantial scope for temporary measures to be better targeted (Section 2).

Figure 3.11: Temporary measures protect against real income losses

% change in disposable income, 2023 vs 2022



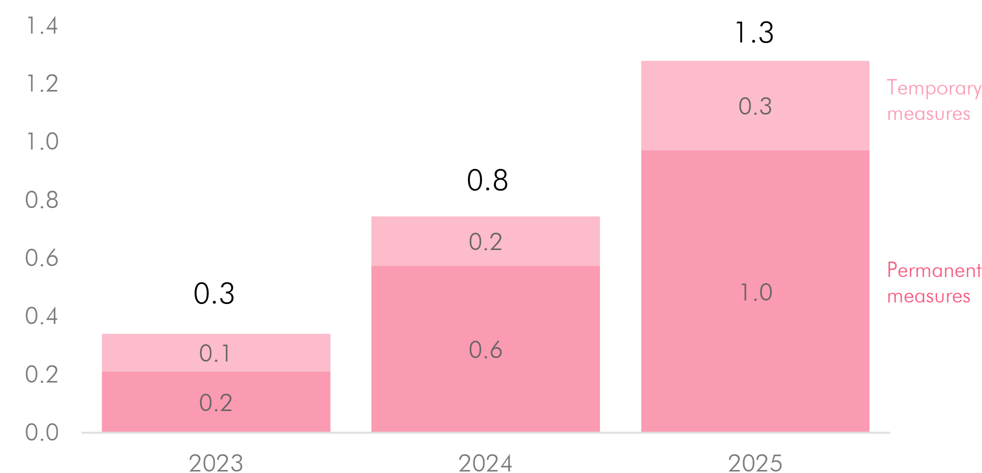
Sources: Doolan, Doorley, Regan and Roantree (2022).
Note: The analysis shows the distributional effect of *Budget 2023* compared to a hypothetical Budget that is fully indexed for inflation at an assumed rate of 7.1% in 2023 (in line with *Budget 2023* projections). The direct and indirect tax measures plus the universal childcare subsidy are compared to the hypothetical indexed budget, with the impact of temporary measures then added to the analysis.

The additional budget measures are estimated to raise prices by 1.3%

The Council estimates that — compared to a situation in which the 5% Spending Rule was followed and temporary spending was unchanged from previous plans — prices in the economy will be 1.3% higher by 2025 as a result of the larger budgetary package (Figure 3.12).

Figure 3.12: Price impact of additional budgetary measures

% HICP price level is estimated to be higher in each year due to additional *Budget 2023* measures



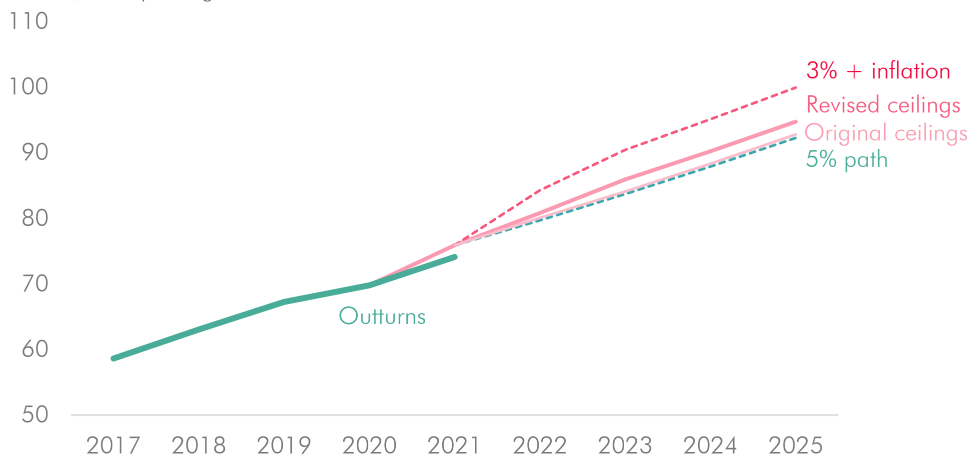
Sources: *Budget 2023*; and Fiscal Council workings. Get the data.
Notes: The figure shows a simulation of the HICP price level impact arising from the additional measures outlined in *Budget 2023* in terms of a) the difference between core spending in the Budget vs a hypothetical 5% spending path (€2.2 billion) plus the additional €0.55 billion of tax cuts introduced; and b) the difference in "non-core" or temporary spending (€4.8 billion) between *Budget 2022* and *Budget 2023* plus the additional temporary tax measures (€1.7 billion) for 2022 and 2023. It uses the Council's Maq model (Casey and Purdue, 2021) to estimate the impact on the economy of additional spending and tax-reducing measures.

Fiscal Stance for 2024–2025

In keeping with the 5% Spending Rule, *Budget 2023* sets out 5% core spending increases for 2024 and 2025. However, given the higher starting point in 2023, the level of spending for 2025 is €2 billion above the original *Budget 2022* ceilings and €2.5 billion above the level implied by a hypothetical 5% path.

While the Government has revised up its core spending ceilings compared to *Budget 2022* plans, the trajectory for core spending remains closer to the original plans and a hypothetical 5% path than what would be implied by increasing spending in line with a 3% growth rate plus actual inflation projected over the forecast horizon (Figure 3.13).

Figure 3.13: Core spending path revised up, but less than full inflation



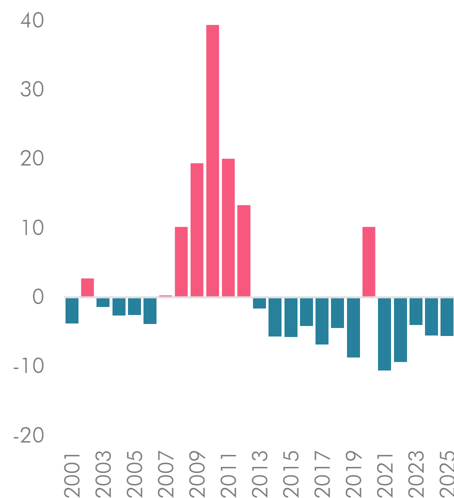
Sources: CSO; Department of Finance; and Fiscal Council workings. Get the data.
Notes: Core spending is Exchequer spending excluding temporary measures. The original ceilings refer to *Budget 2022* ceilings.

The projected path for spending, if followed, will lead to a steady pace of debt reduction in 2024 and 2025 and a structural surplus. Both years would see the net debt ratio fall by about 5½ percentage points of GNI* (Figure 3.14A). This steady reduction in the net debt ratio would bring it to 58% of GNI* — its lowest level since 2009 when it was 47%. The structural balance would rise to 1.4% of GNI* when adjusting for windfall corporation tax receipts as well as other one-offs (Figure 3.14B).

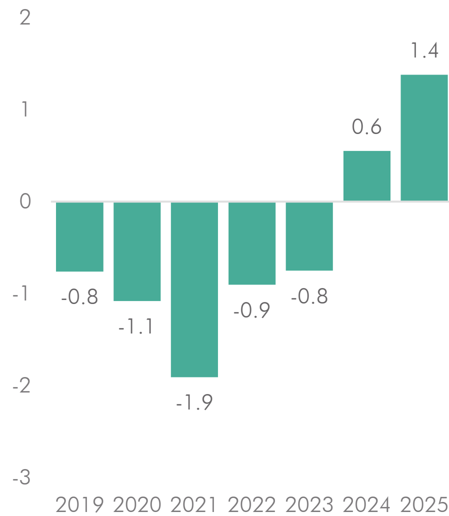
The path for spending should lead to a steady pace of debt reduction in 2024 and 2025 as well as a structural surplus

Figure 3.14: Steady pace of debt reduction and structural surplus

A. Steady pace of debt reduction projected
Percentage points of GNI*, net debt ratio changes



B. A structural surplus is implied by projections
% potential GNI*, bottom-up structural balance



Sources: CSO; Department of Finance; and Fiscal Council workings. Get the data.
Notes: The structural balance is measured on a bottom-up basis (Box I, May 2021 Fiscal Assessment Report).

The planned reduction in the Government's net debt ratio is prudent. It would bring debt ratios to safer levels, which would help to make the economy more resilient to shocks — allowing it more scope to respond to future recessions with strong budgetary support, similar to during the pandemic. Building these buffers while the window is there to do so will also help the State navigate numerous fiscal challenges that are likely to materialise in the coming years and decades.

Building these buffers will help the State navigate numerous fiscal challenges

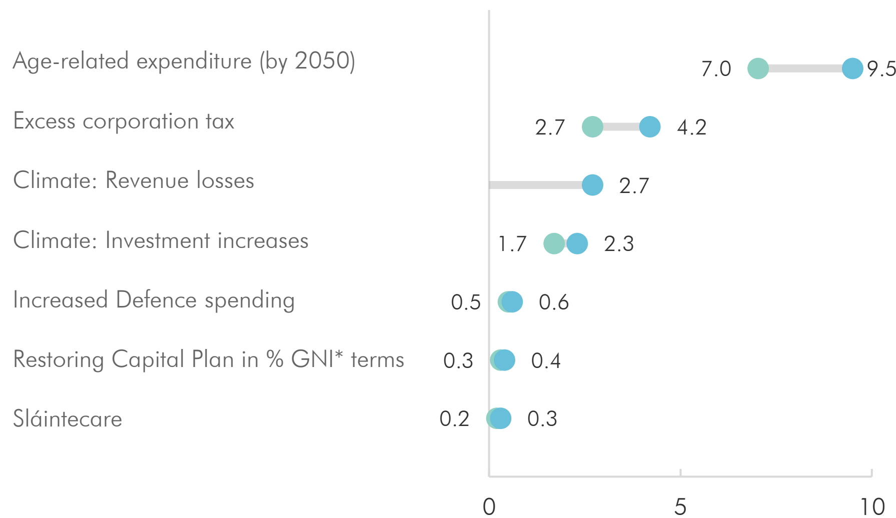
Medium- and long-term budgetary challenges

While Ireland's fiscal sustainability has improved, a number of major challenges remain that could change the outlook. This is particularly true given that many of these challenges have not been fully costed and factored into the Government's budgetary plans.

The largest single source of risk to Ireland's fiscal sustainability is the pressures arising from an ageing population (Figure 3.15). These pressures will build gradually over the coming decades. As they do, the Government will also have to address its over-reliance on corporation tax receipts, meeting Ireland's climate objectives, and implementing other Government ambitions in relation to health reforms (Sláintecare), defence spending, and housing.

A number of challenges remain, many of which are not yet fully costed

Figure 3.15: Ageing pressures are at the forefront of fiscal challenges
% GNI* estimated range of annual impacts on government's budget balance



Sources: FitzGerald (2021); Commission on the Defence Forces (2022); and Council estimates.
Notes: Age-related expenditure estimates are the Fiscal Council's (2020b) pessimistic to optimistic range. Excess corporation tax receipts, potential climate-related revenue losses, capital plan restoration, and Sláintecare costs are all Council estimates. The climate-related investment increases are from FitzGerald (2021). Get the data.

Ageing pressures: The Irish population is rapidly ageing. This will put pressure on pension and healthcare spending at the same time that growth is likely to slow.[54] The annual pressures associated with a projected rise in spending on pensions and healthcare will be substantial at some 7 to 9.5% of GNI* per annum by 2050. These pressures will mount as the number of individuals reaching age 65 increases from about 50,000 each year this decade to just over 75,000 per annum by the 2040s. Over the same period, life expectancy at age 65 is set to increase from 85 to 89 by 2050 — thus lengthening the time over which pension payments are made.

The population is ageing rapidly, putting pressure on pension and healthcare spending at the same time growth is likely to slow

The Government has cancelled plans to raise the pension age from 66 to 67 — a decision originally due to take place in 2021. This is a costly decision. Keeping the pension age at 66 would add 2% of national income per year to expenditure by 2050 (Fiscal Council, 2020b), equivalent to around €5 billion today. Funding this will add significantly to future tax rises. Over the coming years, higher pension costs from ageing alone — not counting higher prices — will add around €500 million each year to public spending.

Very large increases in taxation or cuts in spending will be required to meet these challenges. By 2050, for a worker on a typical wage of €35,000 per annum in today's money, the costs associated with addressing pensions shortfalls would amount to €1,900 per annum in today's money in additional PRSI payments (Figure 3.16). About €800 of this would be due to the decision to not increase

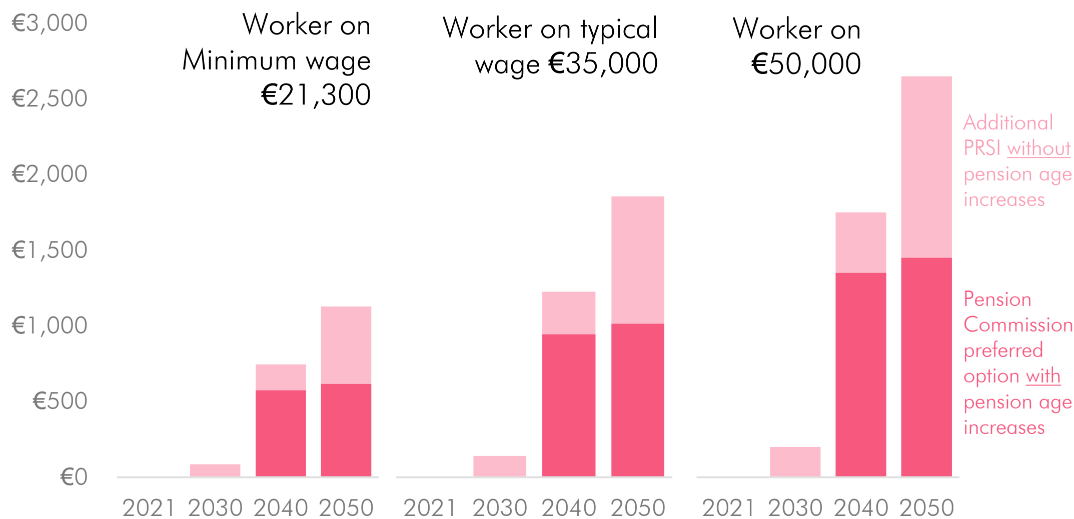
[54] Growth is likely to moderate due to both a shrinking labour force and maturing level of productivity, which implies moderating growth rates in future (see Box A in Fiscal Council, 2020b).

the pension age gradually, as recommended by the Pensions Commission. Around €1,000 would be required just to finance the larger number of people reaching retirement age and longer life expectancy.

A variety of reforms could limit the costs associated with ageing, but speed is of the essence. The Council's (2020b) analysis suggests that acting sooner would reduce costs substantially. In a scenario where policy aims to prevent debt ratios from rising above 90% of GNI* amid ageing pressures, acting earlier would entail reducing spending or raising taxes by a cumulative 0.8% of GNI*. However, delayed action would cost almost three times that, at 2.1% of GNI*. Earlier increases in taxes would help to raise revenues while a large share of the population is in work. This, in turn, would reduce the burden on future generations.

Figure 3.16: PRSI increases for workers based on proposed pension reforms

€ change implied for PRSI for workers in today's terms based on policy options



Sources: Pensions Commission (2020); and Fiscal Council workings. Get the data.
Notes: Figures are based on Package 4 and Package 3 of the Pension Commission's (2021) options using PRSI rate increases assumed out to 2050. There is still an additional "Exchequer Contribution" in both packages, which may have to be made up with further tax increases.

The Government in recent months has taken a number of steps towards reforming the pensions system. However, it has opted not to raise the pension age — something which would have had a much greater impact on the overall sustainability of the pensions system. The measures that it is likely to enact are unlikely to have a major impact on overall sustainability, with many of these netting off against each other (Table 3.1).

The Government has opted not to raise the pension age

Table 3.1: The Government has made numerous pension reforms

Reform	Detail	Budgetary impact
State pension age to remain at 66	The Government agreed to maintain the State Pension age at 66	Negative (likely to raise costs by 0.4% of GNI* p.a.)
Flexible pension age (to age 70)	The Government agreed to introduce a new flexible pension age model from January 2024 allowing workers to continue working up to age 70 in return for higher pensions	Neutral
Auto-enrolment	The Government has approved a draft Bill to introduce mandatory workplace pensions from 2024.	Official cost to State estimated at 0.1% GNI* p.a. over first ten years but could alleviate some of the pressure on the public pensions system to provide for individuals with low cover.
Total Contributions Approach	The Government agreed to shift from allowing people availing of the state pension to choose between the most favourable option of either the "Yearly Average Approach" or a "Total Contributions" approach to only having the option of the latter. The shift would be a phased move over 10 years, starting in January 2024.	Positive (estimated savings of nearly 0.1% GNI* p.a.)
Level of PRSI rate increases to be assessed every 5 years	The Government agreed to have a statutory actuarial review assess the level and rate of increase in social insurance rates required every 5 years.	Positive (but actual impact depends on whether rate increases are implemented and extent of increase)
Long-term carers coverage	The Government agreed to introduce Enhanced State Pension provision for long-term carers from January 2024.	Negative (likely to raise costs but no official estimates of this)
Modified Benefit Payment	The Government committed to explore the design of a scheme that would modify the current Benefit Payment for 65-year-olds to provide a benefit payment for people who, following a long working life (40 years or more) are not in a position to remain working in their early 60s.	Negative (likely to raise costs but no official estimates of this)

Two of the main pensions reforms of late are the auto-enrolment scheme and the decision to introduce a flexible retirement age.

First, the Government has approved the draft heads of a Bill to introduce mandatory workplace pensions from 2024 in a so-called "auto enrolment" scheme.[55] The scheme will result in contributions being paid by the State to top up employer and employee contributions. Official estimates put the cost of the scheme to the State at €3 billion in total over the first ten years (equating to €300 million per annum or about 0.1% of GNI*). The scheme should increase pension coverage in the private sector, potentially alleviating some pressure on the public pensions system. However, it could also dampen people's disposable income during their working lives. This would, in turn, be expected to reduce consumer spending, although, in the very long term, consumption is likely to be boosted by pensioners having higher income than would otherwise have been the case.

[55] Box H of the May Fiscal Assessment Report (Fiscal Council, 2022) explores the key design aspects. Many of these are unchanged as of the latest announcement: https://www.gov.ie/en/press-release/b9de4-historic-progress-on-automatic-enrolment-minister-humphreys/

Second, the Government has opted to introduce a new flexible pension age model from January 2024 that would see people being given the option to continue working beyond the pension age of 66 up to age 70 in return for a higher pension.[56] This measure is unlikely to generate substantial savings. Indeed, the Pensions Commission (2021) notes that 1) take-up in such schemes tends to be very small — as low as 2% of eligible individuals; and 2) numbers of dependents or "qualified adults" that increase pension payments are declining as higher female employment rates mean more women are entitled to the State Pension Contributory.

Excess corporation tax receipts: Excess corporation tax receipts have grown to around €10 billion, representing about one-quarter of tax receipts. They continue to be unpredictable, with receipts highly concentrated among a handful of foreign-owned multinational enterprises. Some 56% is accounted for by 10 corporate groups.

Excess corporation tax receipts have grown to about €10 billion, one-quarter of tax receipts

In a welcome development in *Budget 2023*, the Department has shifted to presenting estimates of the budget balance excluding excess corporation tax receipts as well as in headline terms. This uses the Department's estimates of how much of annual corporation tax receipts it considers to be potentially windfall in nature. The stated purpose is to ensure that such receipts are "not used to finance permanent increases in public expenditure". This is something the Department itself noted should have been introduced as early as 2019 (Department of Finance, 2019) and follows recommendations made by the Council.

To reinforce the approach that excludes excess corporation tax receipts from measures of the budget balance, the Department should also apply this approach to its monthly Exchequer balance estimates. Within year, this could be done simply by including the above-profile amounts of corporation tax as part of the excess receipts that are calculated on an annual basis, updating these estimates once outturn data for the year are available.

The Spending Rule and the adjusted budget balance help address the over-reliance on excess corporation tax receipts, but they do not unwind this over-reliance

The introduction of the 5% Spending Rule and the Department's approach to adjusting the budget balance for excess corporation tax receipts have implications for the Reserve Fund. The Government used the Reserve Fund in *Budget 2023* as a means of preventing permanent spending increases from being based on potentially transitory revenues. This is in line with the Council's recommendations in the past. However, the role of the Reserve Fund could usefully be re-examined in light of the recent changes to the budgetary framework. Box D looks at these implications.

[56] See the official announcement here: https://www.gov.ie/en/press-release/6b939-minister-humphreys-announces-landmark-reform-of-state-pension-system-in-ireland/

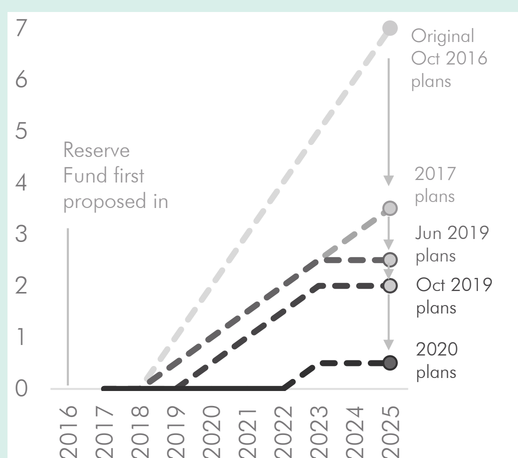
Box D: Ireland's Reserve Fund is restored but needs some rethinking

In *Budget 2023*, the Government set out plans to restore Ireland's "National Reserve Fund". The Reserve Fund was first proposed as part of the May 2016 Government programme as a way of securing "sound public finances and a stable and broad tax base".[57] But a series of policy announcements saw government ambitions for the Fund repeatedly scaled back. Until now, the State did not make any actual annual contributions to the Fund (Figure D1).[58]

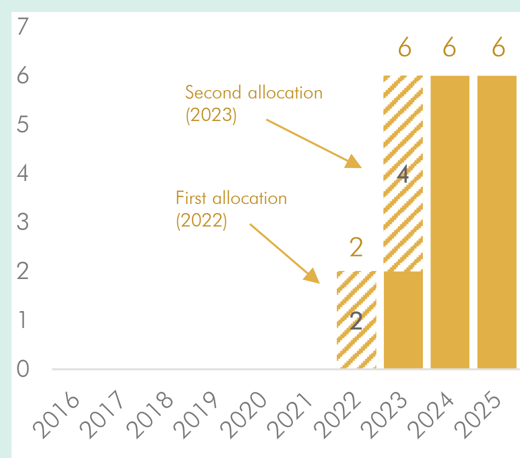
Plans for the Reserve Fund have now been scaled up significantly. The Fund is to be used to ensure that "windfall corporate tax receipts are not used to finance permanent increases in public expenditure". On Budget Day, the Government carried a motion to make a €2 billion allocation in 2022 and a €4 billion allocation in 2023. This entails €6 billion of cumulative allocations to the Reserve Fund by end-2023. It also represents a rapid catching-up on the original plans set out in October 2016, when annual allocations of €1 billion per annum were proposed from 2019 on (Figure D1).

Figure D1: Plans for the Reserve Fund were scaled back but now return

A. Old plans had been scaled back
€ billions, reserves accumulated in the fund



B. But new plans mean significant allocations
€ billions, reserves accumulated in the fund



Sources: Fiscal Council workings. Get the data.

The Council has long considered the Reserve Fund a potentially useful tool.[59] It offers a way to 1) sustain budget surpluses in good times, withstanding pressures to loosen policy as revenues grow strongly; 2) help governments avoid forced austerity in the event of losing the ability to borrow at low interest rates; and 3) access useful financial assets in the event of a crisis.

However, the Reserve Fund has several design problems:

1) **Operating with discretion rather than countercyclically** — the Reserve Fund is designed in a way whereby it does not function as a countercyclical tool. That is, it does not act in a manner that would lessen Ireland's tendency in the past to ramp up spending and cut taxes during a boom. Instead, the design assumes pre-determined allocations of €0.5 billion each year. These allocations have to be passed by Dáil Éireann. The allocations therefore depend on political discretion and do not necessarily evolve with the cycle. For example, this approach does not automatically entail larger contributions if there is a drastic upswing in the economy or if large tax windfalls suddenly arise. Similarly, withdrawals from the Fund are not linked to the cycle. These are instead intended to address only specific events or shocks — such as those arising due to very "exceptional circumstances" — rather than to smooth the impact of the cycle.

2) **Capped arbitrarily at €8 billion** — the Reserve Fund is limited to a maximum size of €8 billion. The reason for this is unclear. Simulations in Casey *et al.* (2018) and Fiscal Council (2018) suggested that, at the time, this level would be reasonable to smooth a typical cyclical downturn. However, it would not necessarily cover large downturns. Its size, which is set in nominal terms, is also shrinking

[57] At the time, the Fund was referred to as the "Rainy Day Fund".

[58] A transfer of €1.5 billion of cash assets from one arm of the State to another did benefit the Fund in 2019. This involved the State moving assets from the Irish Strategic Investment Fund to the Reserve Fund. Yet this was far different in effect to the planned savings or contributions intended for the Fund as it had no impact on the State's net asset position.

[59] See Box B, *June 2016 Fiscal Assessment Report*.

relative to the size of the economy as prices rise. When established in 2019, €8 billion was equivalent to about 4% GNI*. By 2030, assuming trend growth of 3% and economy-wide inflation of between 1½ and 2%, the Fund's maximum value relative to the size of the economy could fall to almost half that. This will gradually weaken the tool's effectiveness as a way to counteract downturns in the economy. In addition, the fact that a cumulative €6 billion is planned to be allocated by next year could see the Fund rapidly hit this cap.

3) Potential conflicts with the fiscal rules — withdrawals from the Fund could breach EU fiscal rules if they entail higher-than-allowed spending. For example, the spending rule, referred to as the "Expenditure Benchmark", sets an annual limit on how much real spending can increase by after excluding interest and temporary costs. If the Government were to comply with the fiscal rule by a small margin, any additional spending funded by withdrawals from the Reserve Fund would most likely lead to a breach of the rule. This represents a major shortcoming of the fiscal rules. Policymakers using such funds could be unfairly punished for setting aside savings in good times when these funds are eventually used. To resolve this problem, Casey *et al.* (2018) suggest treating allocations as discretionary revenue-raising measures. This would mean the allocations using up fiscal space afforded by the rule. Withdrawals could then be treated as an offset to spending increases measured under the rule. However, this would require changes at EU level and it is not clear that such changes are likely to take place.

How the allocations to the Fund are treated in an accounting sense?

The allocations to the Reserve Fund are treated as increasing the Exchequer deficit (or reducing an Exchequer surplus). However, in terms of the broader general government definition, they do not have any impact on the budget balance. Allocations to the Reserve Fund represent a transfer within Government, and hence represent neither an increase in spending nor a reduction in revenue. The allocation therefore has no impact on the budget balance.

However, the focus on the budget balance measure adjusted for estimated corporation tax windfalls means that the excess corporation tax receipts do not impact on that measure. In effect, the Fund is providing a vehicle for saving part of the difference between the headline and the underlying measure, reinforcing the overall fiscal framework in this regard.

Will the new allocations limit the risks surrounding corporation tax receipts?

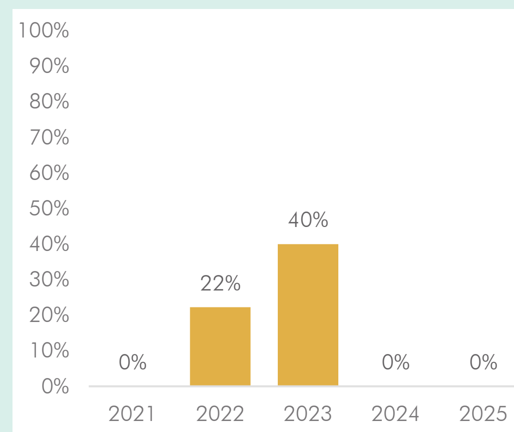
The objective of the new Reserve Fund allocations is to limit the risk that permanent increases in public expenditure are being funded by corporation tax receipts that could potentially prove to be windfall in nature. This approach is in line with recommendations made by the Council since 2017 (Fiscal Council, 2017). The Council's recommendations have been 1) to avoid using concentrated and unpredictable increases in corporation tax receipts as a basis for increasing permanent spending and 2) to redirect these to the Reserve Fund or towards debt reduction.

The allocations to the Reserve Fund, while welcome, on their own will not be sufficient to limit the risks surrounding corporation tax receipts.

Figure D2: Reserve Fund captures some but not all corporation tax windfalls

A. Windfalls estimated to be large
€ billions

B. Reserve fund allocations capture only a portion
Reserve Fund allocations as % of annual windfalls



Sources: Department of Finance; and Fiscal Council workings. Get the data.

First, the allocations are small relative to the size of windfall corporation tax receipts. The Department estimates that windfalls were of the order of €5 billion in 2021, rising to €9 billion in 2022. Further windfalls are projected for 2023, 2024 and 2025, at around €9 to 10 billion each year. However, compared to these substantial figures, the allocations to the Reserve Fund are relatively small at €2 billion in 2022 and €4 billion in 2023 (Figure D2A). For these two years, the allocations are just 22% and 40% of the estimated windfalls, respectively (Figure D2B). Beyond 2023, it is unclear whether any further allocations are planned. It is clear that the windfalls are not being fully captured by the Reserve Fund. Moreover, these excess corporation tax receipts have been building up since about 2015. The Council's own estimates of excess corporation tax receipts would suggest that excess corporation tax receipts taken in since 2015 could have amounted to a cumulative €32 billion by 2022. This is in effect the size of a Fund that might have resulted had these excess receipts been allocated in full to the Reserve Fund. Note that the uncertainty range around estimates of the cumulative excess receipts is very wide at €21 to 43 billion.

Second, the 5% Spending Rule and planned surpluses are doing more to limit risks, with the Reserve Fund playing a relatively passive role. The key change in policy in recent years helping to generate budget surpluses and to contain risks associated with corporation tax receipts is the 5% Spending Rule. By broadly following this, the Government is helping to ensure permanent spending growth is tied to more sustainable growth in revenues. In particular, by applying this in 2022 and 2023, the Government helped to limit its exposure to excess corporation tax receipts closer to 2021 levels of around €5 billion. The additional annual windfalls over-and-above this level are ending up in larger surpluses, with a portion of these, in turn, being allocated to the Reserve Fund. However, the Reserve Fund itself is not directly contributing to the additional saving, although it may play a supportive role.

The Government should continue to stick to its 5% Spending Rule

The key way to mitigate risks around how much of the excess corporation tax receipts are used for permanent spending is through the Government's 5% Spending Rule rather than through the Reserve Fund. Sticking to the 5% Spending Rule would ensure that the Government increases spending at a pace that is broadly sustainable. It would entail "looking through" the additional excess corporation tax receipts collected in a given year and limit the increase in public spending to a rate more consistent with trend growth in the economy and in government revenues.

While the 5% Spending Rule is an effective way of limiting risks associated with further increases in excess corporation tax receipts, it does not help to reduce the existing level of risk. It basically caps the Government's exposure to excess corporation tax receipts at recent levels It does not address the past build-up of excess receipts. For instance, the Government looks set to broadly stick to the spending rule in 2022 and 2023. However, doing so would only limit the exposure to 2021 levels of excess corporation tax receipts. These are estimated by the Government to be of the order of €5 billion. If the Government were to unwind its exposure, this would require it to grow core spending by less than the 5% set out in the Spending Rule or to introduce net revenue-raising measures elsewhere.

Conclusions

Using the Reserve Fund is a welcome development. It helps set aside any additional excess receipts, but it does not cover the full extent of their impact. In any case, the Government, by broadly sticking to its 5% Spending Rule, will most likely generate relatively larger surpluses. These savings would far exceed the expected Reserve Fund allocations.

The Government needs to develop its thinking on the goals and design of the Reserve Fund. The purpose of the Fund has evolved over time from a countercyclical tool in the Programme for Government to a Fund that only helps in exceptional circumstances, and now to a Fund that is limiting the risk of permanent increases in public spending being funded by excess corporation tax receipts. However, its importance as a tool is diminished by the more important roles being played by the 5% Spending Rule and the adjusted general government balance. A fund with liquid assets could prove helpful in future downturns, but the State has already amassed large cash buffers elsewhere, with further surpluses adding to these. In addition, the current design shortcomings of the Fund will limit its effectiveness.

One option for the Reserve Fund might be to redefine it as a new Pension Reserve Fund. This would set a new goal for the large assets that are being accrued; it would give it a mandate to invest in assets with potentially greater returns, and help deal with a longstanding problem — the expected shortfall in pension funding over the coming decades. In particular, it could take some of the pressure off the tax system having to raise additional revenues to meet these shortfalls.

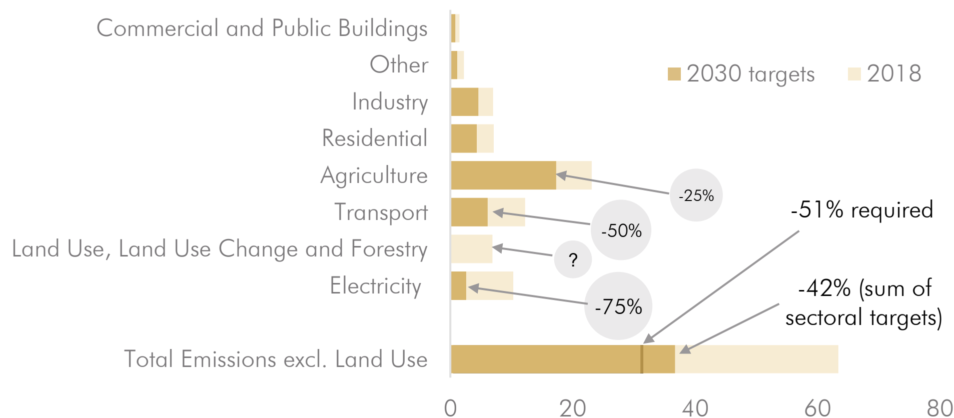
Climate-related pressures: The Government's climate targets are lacking in basic detail and are potentially short of the required ambition. The Government has yet to clarify the estimated fiscal costs of achieving its required 51% reduction in overall greenhouse-gas emissions by 2030.[60] It has also not clarified how this reduction will actually be met despite announcing "Sectoral Emissions Reduction Targets" in July.

The Government's climate targets are lacking in basic detail and are potentially short of the required ambition

The Climate Change Advisory Council (2022) welcomes the Government's new Sectoral Emissions Reduction Targets as an important milestone but points to several major shortcomings. First, the overall emissions reductions amount to only a 42% reduction — short of the 51% reduction legally required (Figure 3.17). Second, the targets do not show how the land-use sector will be included in meeting the targets. Third, the targets do not clarify how carbon budgets are to be allocated within sectors. The Climate Change Advisory Council assesses that, while the targets are a useful starting point, they will need to be revised upwards to be consistent with a 51% reduction and monitored closely.

Figure 3.17: Climate targets are short of ambition and lack clarity

Million tonnes of carbon dioxide equivalent



Sources: Climate Change Advisory Council (2022). Get the data.
Notes: The Figure compares the Government's Sectoral Emissions Reduction Targets announced on 27 July 2022 with 2018 levels of emissions in terms of million tonnes of carbon dioxide equivalent.

Achieving the overall 51% reduction in emissions would require the Government to direct investment spending of about 2% of GNI* per annum towards climate areas between now and 2030. This rough estimate assumes that the Government makes some intervention to facilitate climate investments without positive financial returns.[61] FitzGerald (2021) provides a better articulated assessment of the additional annual investment costs to meet the 2030 targets and lands on similar

[60] These legally binding objectives are set out in the Climate Action and Low Carbon Development (Amendment) Act 2021.

[61] The Climate Action Plan 2021 notes that about 40% (about €5½ billion annually or 2% of GNI*) of the total estimated €125 billion investment costs of achieving these targets — both public and private —would be unlikely to have positive investment returns. This means that the State would probably have to make some intervention, perhaps up to the full amount, over 2021–2030 to encourage these investments. It's likely that the costs would now be higher, given that they were produced at a time when inflation was lower and projected to remain so.

estimates at between 1.7 and 2.3% of GNI*. These estimates assume that the agriculture sector would cut its emissions by either 51% or, in the more costly scenario, by 33%. However, since then, the Government has announced official Sectoral Emissions Reduction Targets that involve a smaller (–25%) reduction by the agricultural sector than modelled in the more costly scenario assessed by FitzGerald (2021). This suggests that the ultimate cost could be greater than assumed in the FitzGerald (2021) analysis.

As well as involving additional state spending, Ireland's transition to a low-carbon economy will have wider budgetary impacts. It will mean lower revenues being raised on fossil fuels as people adapt their behaviour to use less of these. Revenue such as motor tax, vehicle registration tax, carbon tax, excise and VAT on fuels are all likely to be directly affected. In 2019, before the pandemic, the Government raised almost €6 billion (2.8% of GNI*) from associated taxes.

The Government's temporary cost-of-living measures more than offset the impact of the carbon tax increases introduced in 2022 and 2023. However, carbon taxes are legislated to rise further in the coming years. Current high energy and fuel prices could therefore be seen as a foretaste of some of the changes that will come in future.

Other pressures: As well as the above challenges, the Government has yet to spell out the costs of other major policy initiatives.

Other pressures include the cost of Sláintecare reforms, increases in defence spending, and rising costs for capital spending

The Government has not clarified the progress to date and ultimate cost of implementing in full its **Sláintecare** healthcare reforms. This is both in terms of how much the overall reforms have been implemented relative to initial plans and the expected increase in recurrent costs in future years that are now likely (Box B).

Updating the original Sláintecare costings would suggest that recurrent costs could ultimately be higher. A mechanical estimate, updated for wage and price pressures that have arisen in the interim, would suggest that these recurrent pressures could be close to €1 billion higher than originally envisaged in the 2017 Sláintecare Report (or between 0.2 and 0.3 percentage points of GNI*). To better inform policy and planning, the Government should produce updated costings that factor in these pay and price pressures.

Following the invasion of Ukraine by Russia, there is strong pressure across EU countries to ramp up **Defence** spending. Ireland's defence expenditure has historically been very low, in part reflecting its neutrality. However, the Minister for Defence has indicated that Ireland is likely to increase annual defence spending by at least €500 million in the coming years.[62] This broadly aligns with the

[62] https://www.irishtimes.com/news/ireland/irish-news/ireland-s-defence-spending-set-to-rise-by-at-least-50-says-coveney-1.4864427

"middle" estimate of the Report of the Commission on the Defence Forces (2022), whereby spending would rise by 0.2 to 0.3% of GNI* annually over an unspecified timeframe.

Capital spending is another area that is likely to see pressures for additional spending in the coming years. The Government's capital plans are very ambitious: capital spending is projected to reach almost 5% of GNI* in 2025, well above OECD norms of about 3 to 4%. However, capacity constraints and rising costs could undermine these plans. As Section 2 notes, the Government's capital plans are set in cash terms, but are falling in real terms as price and wage pressures rise. To restore capital spending to the same share of GNI* consistent with the original National Development Plan for 2021–2030 would require an average of €2.1 billion extra capital spending per year.

The Government needs to start planning for how it might address these pressures

Recognising the scale of the fiscal challenges it faces, the Government needs to start planning for how it might address these pressures. The report of the Commission on Taxation and Welfare (2022) makes an important contribution in this respect. It sets out a number of potential reforms with a view to sustaining the public finances over the medium and longer term. The independent assessment of options to raise revenue is welcome and it shares as a starting point the Council's assessment of the existence of medium-term fiscal pressures. A more effective spending review process would further support the sustainability of the public finances.[63]

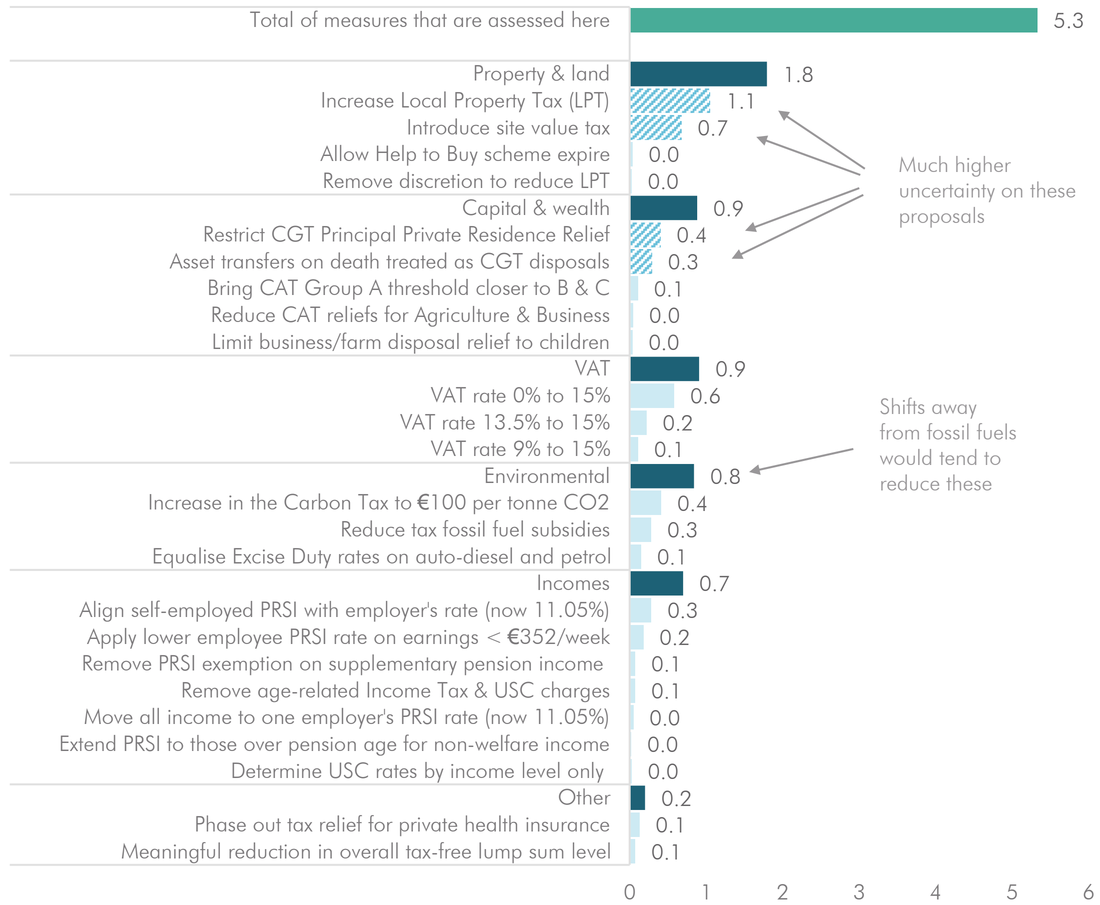
The report of the Commission on Taxation and Welfare makes an important contribution in this respect

Casey (2022) explores the Commission's recommendations, particularly on the tax side. It is difficult to assess the Commission's proposals in full — most changes are not specified in terms of precise changes. Instead, the proposals set out a broad way to guide a net revenue-raising policy that might begin to deal with challenges such as those identified above. However, assessing the measures that can be quantified in some way, Casey (2022) notes that there is upwards of 5% of GNI* worth of revenue-raising measures implied by the proposals (Figure 3.18). While property and land taxes would appear to make up the largest individual revenue-raising area, other reforms are broad-based, with capital taxes, environmental taxes, VAT, and taxes on incomes contributing.

[63] See Box E of the June 2017 Fiscal Assessment Report on spending reviews.

Figure 3.18: Potential impact of tax measures proposed by the Commission on Taxation and Welfare where estimates are available

% GNI* estimated full-year yield



Source: Casey (2022). Get the data.

Notes: The Figure is based on the author's interpretation of proposals contained in the Commission on Taxation and Welfare's (2022) recommendations. Costings are taken from a variety of sources and estimated where needed.