Irish Fiscal Advisory Council

Fiscal Assessment Report

June 2023

Managing corporation tax inflows and capacity constraints

Key messages

Key messages

Irish Fiscal Advisory Council

After slowing over winter, Ireland’s growth is recovering as inflation falls…

… but capacity constraints have emerged, with the jobs market exceptionally tight

The Government’s underlying deficit (excluding “excess” corporation tax receipts) is projected to narrow to 0.6% of GNI* this year and return to surplus from 2024

- “Excess” corporation tax receipts add almost 3% of GNI* to the headline balance
- The debt-to-GNI* ratio is on a downward path

There are several methodological shortcomings in the fiscal projections

The public finances are being boosted by a large inflow of corporation tax receipts

- 30% of these receipts are accounted for by the same three foreign multinationals

There are major long-term challenges, including ageing and climate change

Key messages

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The Government has made important steps towards better long-term planning

- Macroeconomic forecasts now extend to 2030
- But, the fiscal forecasts end in 2026

Following the National Spending Rule is appropriate given capacity constraints

- This means saving excess corporation tax receipts
- This keeps spending in line with the sustainable increase in revenues
- But, it leaves little space for additional spending without offsetting tax increases or spending restraint

The proposed Longer-term Savings Vehicle will help to manage CT inflows

- Savings these funds will help to balance the economy now and finance future pensions

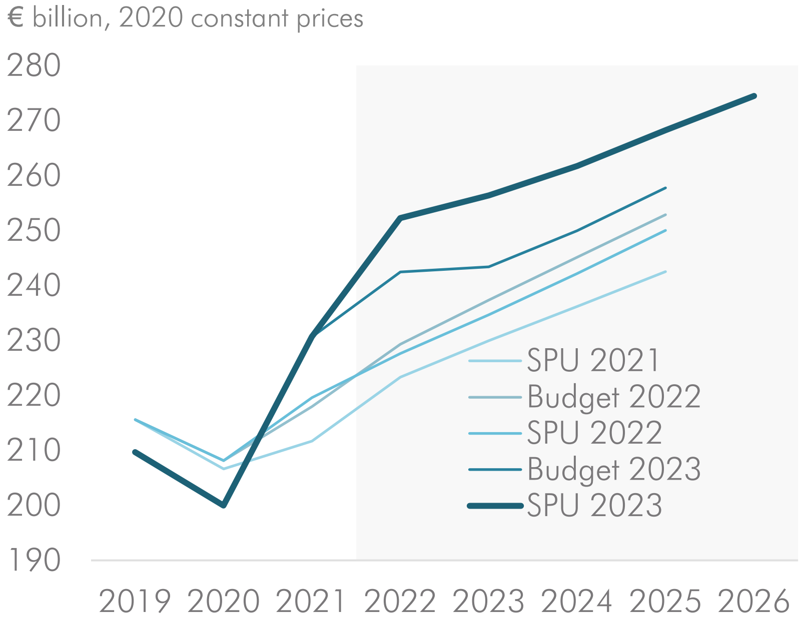
The Government should reinforce the National Spending Rule as a "first line of defence"

- Ireland is likely to fall outside the scrutiny of the new EU fiscal rules
- A spending rule helps focus on the medium-term management of the public finances

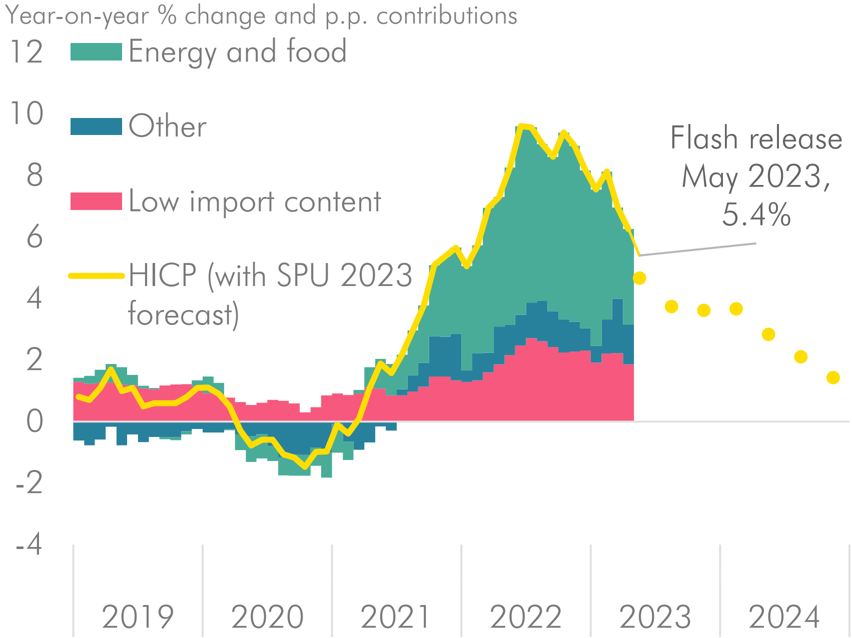
Economic outlook

The economy has been resilient

Real GNI* forecasts



Inflation forecast to fall



- Inflation is set to slow as energy prices fall…
- … but there are risks around inflation and activity

Consumer spending has been strong, likely higher than current estimates

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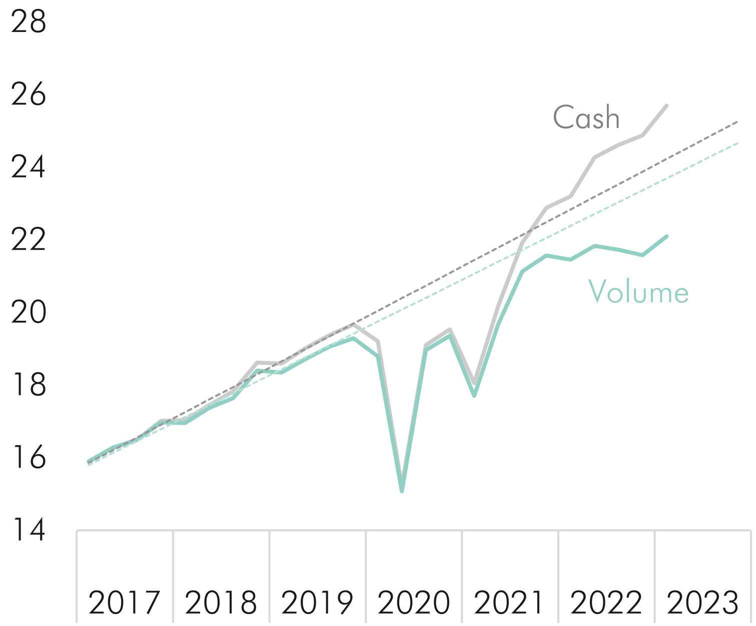
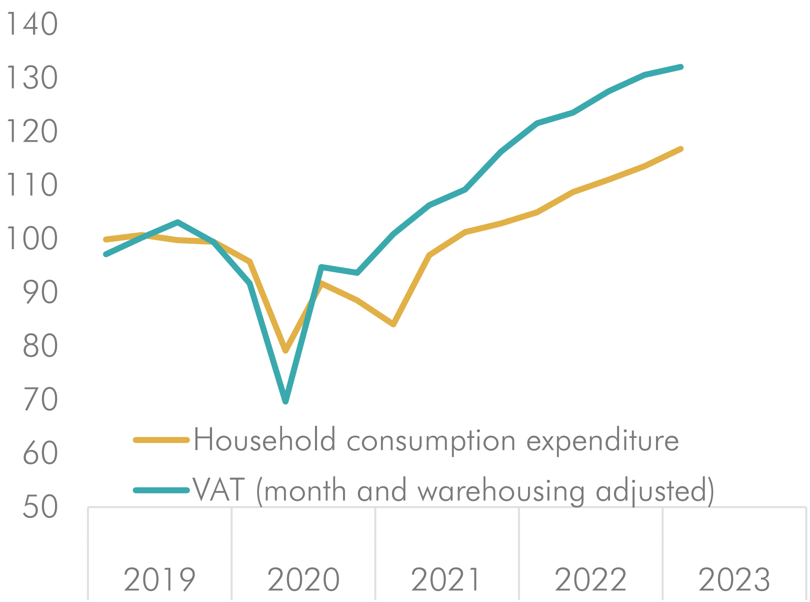
Consumer card spending

€ billion, seasonally adjusted



Household consumption and VAT

2019 = 100, seasonally adjusted



- Consumer spending has been strong in cash terms, but volume is more muted due to high inflation
- A range of indicators suggest higher spending levels than current CSO estimates imply

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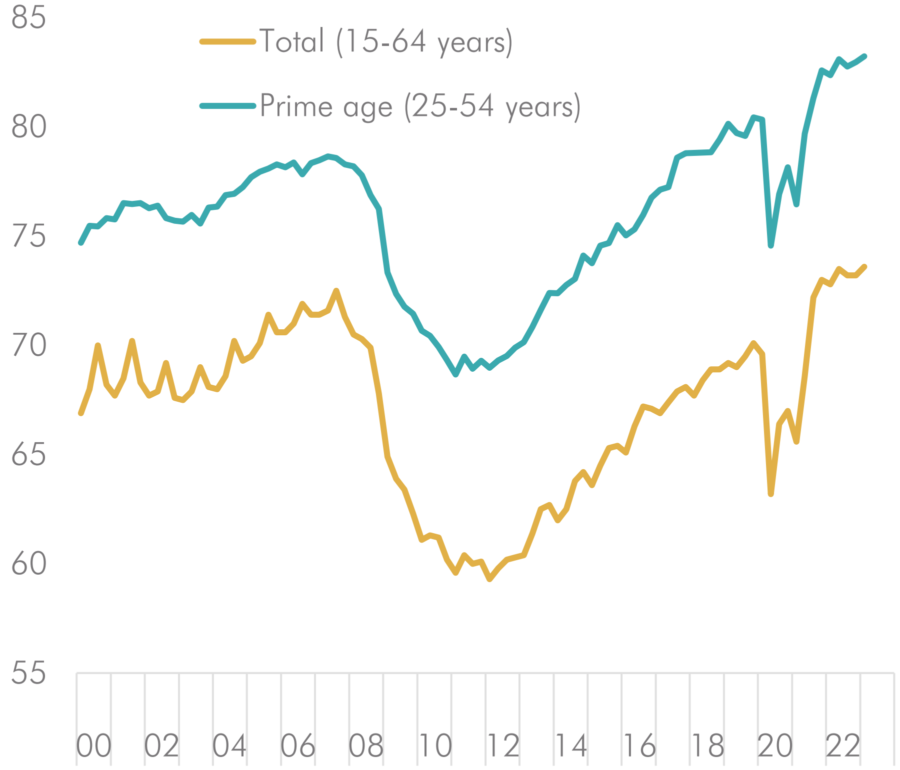
Capacity constraints are binding

Employment to population ratio

Employment as % of population

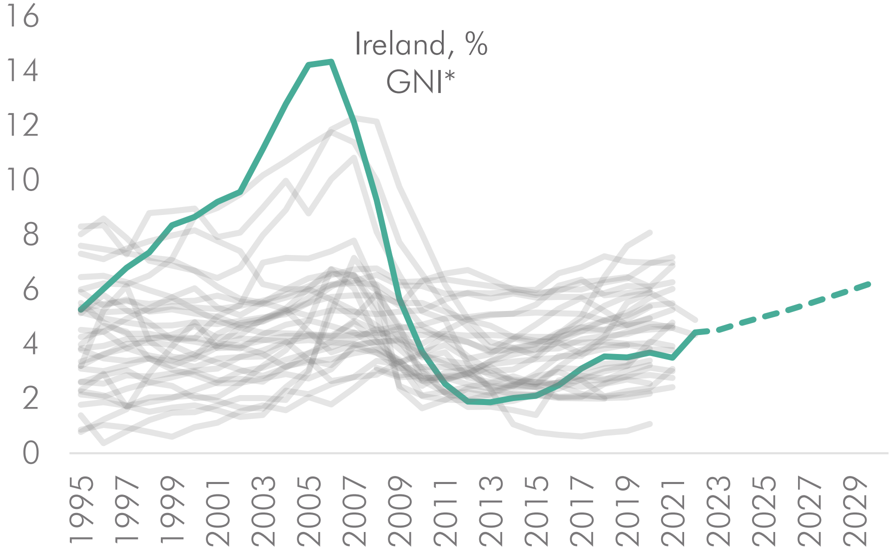


- The labour market is tight
- Domestic economic activity in Ireland is boosted by foreign-owned multinational firms
- These developments may distort the pattern of activities across sectors
- Strong demand for labour is supporting inward migration, adding both to supply and demand

The shortage of housing is a key constraint

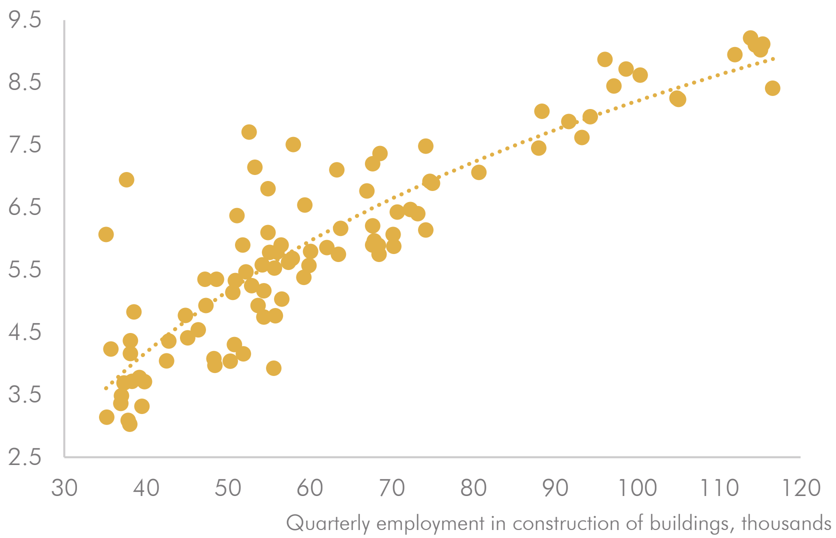
Investment in Dwellings low internationally

% GDP (GNI* for Ireland)



Diminishing marginal impact of workers in construction

Quarterly investment in building and construction,



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- Strong growth in the economy and persistent low housing investment have led to a large shortfall in the housing stock
- A large increase in the workforce would be needed to accelerate investment

It is welcome that SPU now extends the forecast horizon to 2030

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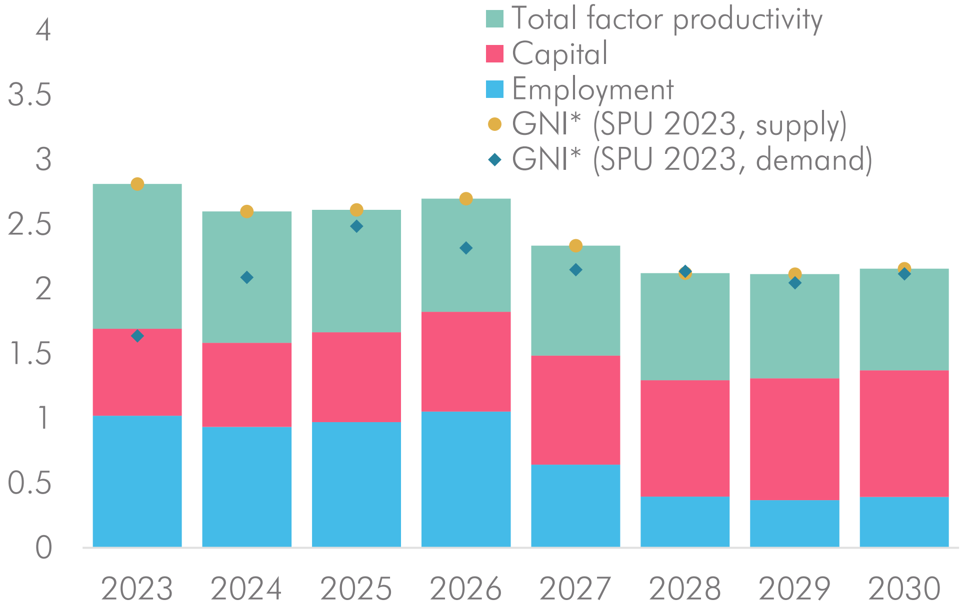
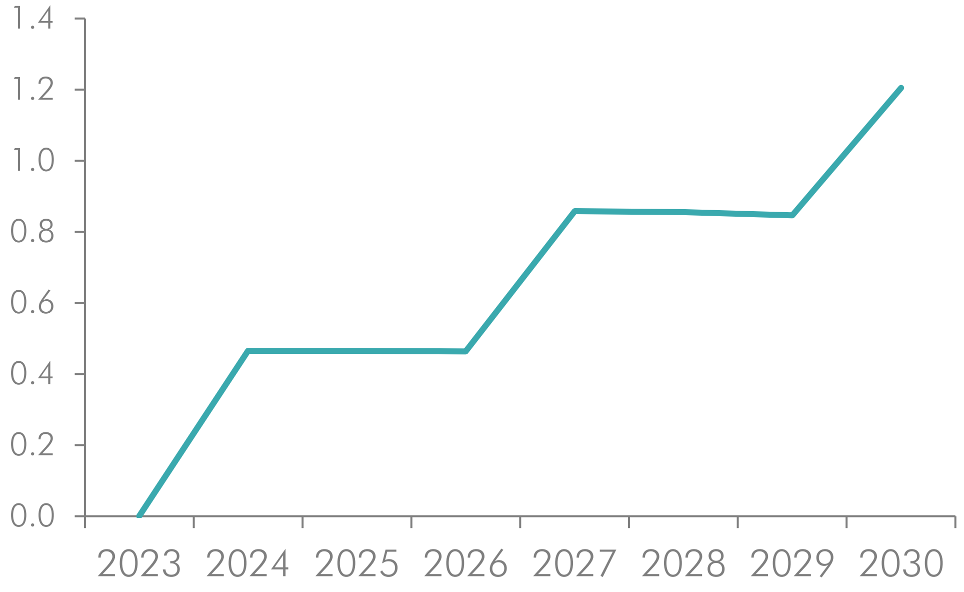
Real GNI* forecasts (supply and demand)

Year-on-year % change and p.p. contributions



Savings to increase due to introduction of auto-enrolment

Savings ratio (percentage of income) relative to a "no auto-enrolment" counterfactual



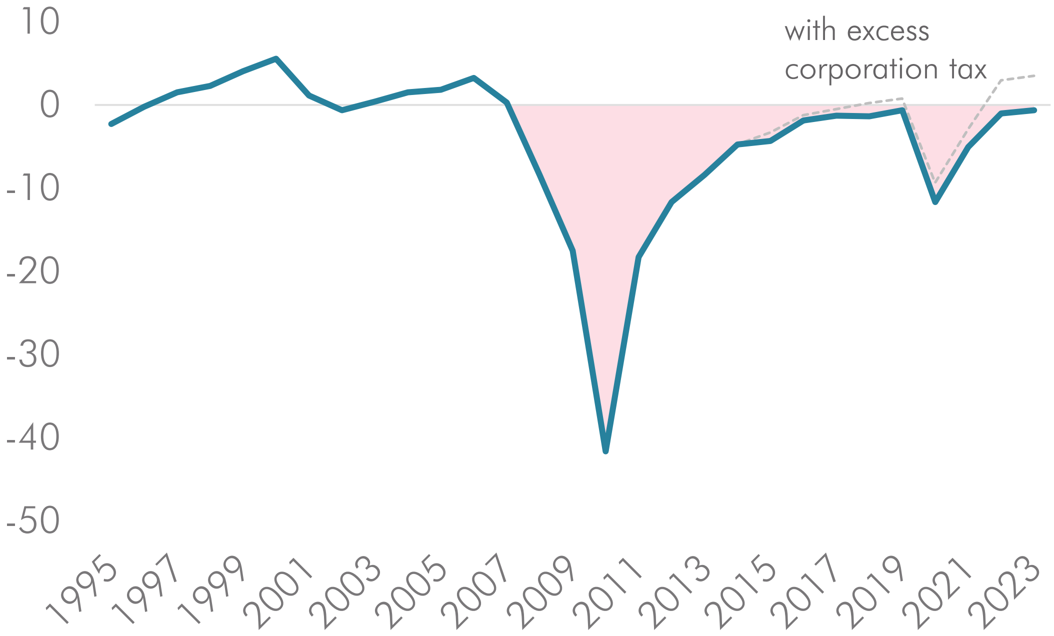
- Longer-term projections support planning and illustrate future challenges
- Real GNI* growth rates moderate to around 2% by 2030 with slower population growth
- Saving increases due to autoenrollment

Budget outlook

The public finances are improving, helped by exceptional corporation tax receipts

Government balance excluding excess corporation tax

% GNI*

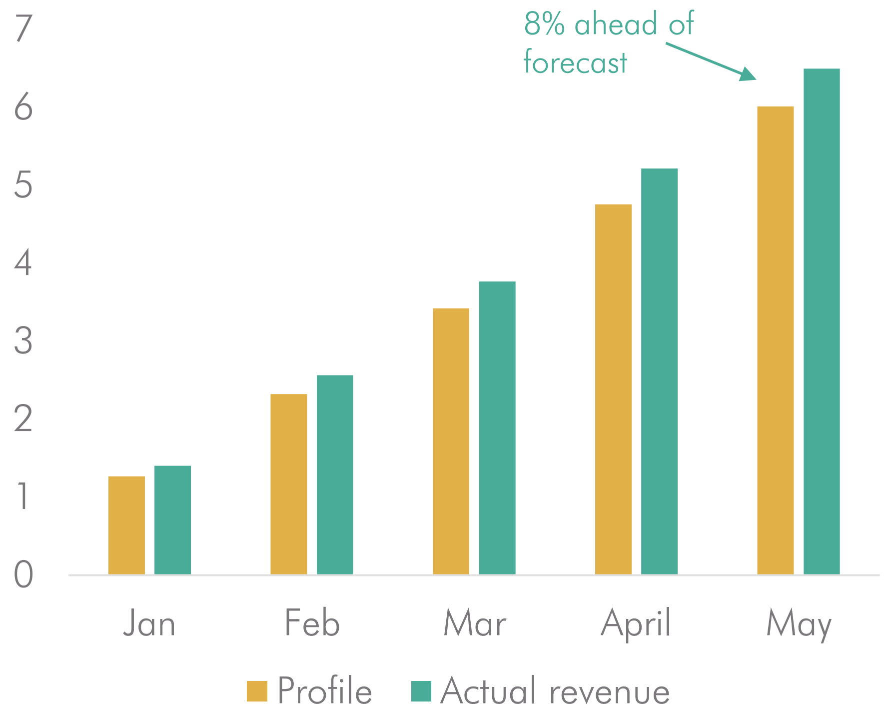


- The SPU forecasts an underlying general government deficit of 0.6% of GNI* in 2023 (excluding windfall corporation tax receipts)
- The underlying balance is set to return to surplus next year
- Excess corporation tax adds close to 3% of GNI* each year

The fiscal projections in the SPU have several methodological issues

PRSI overperforming forecasts

€ billion, cumulative revenue



- The forecast horizon for budgetary forecasts remains 2026, too short to reflect medium-term challenges
- There is no provision beyond this year for Ukrainian refugees or the MICA redress scheme
- The costs of autoenrollment and Christmas bonus are not factored in
- PRSI receipt forecasts should be updated
- The approach to social contribution forecasts is flawed, leading to large errors

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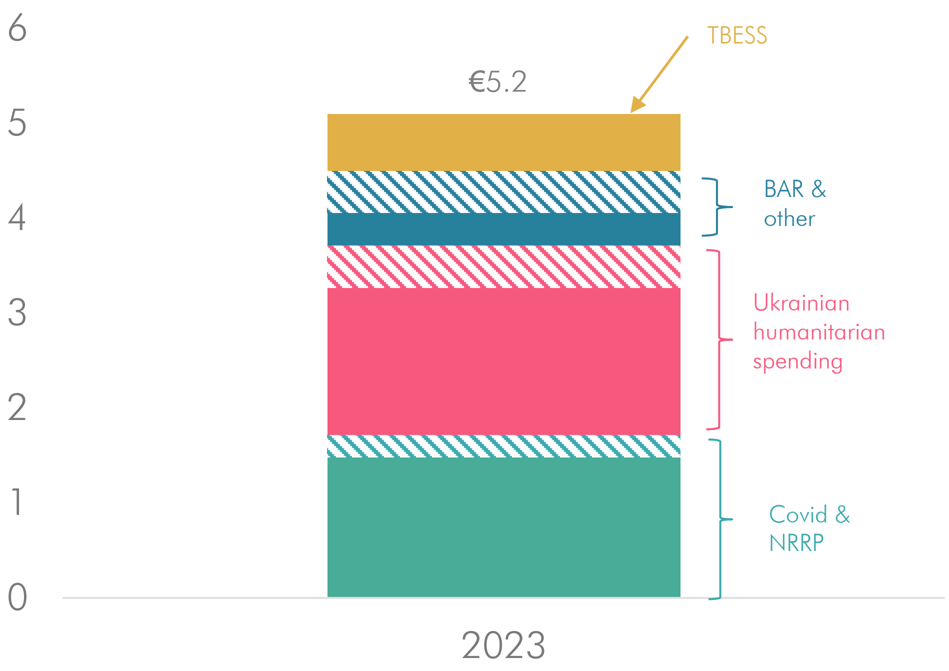
Greater clarity is needed on funding of policy announcements and contingencies

Approximately €1.1 billion of non-core spending remains unallocated

€ billion, shaded regions refer to unallocated amounts

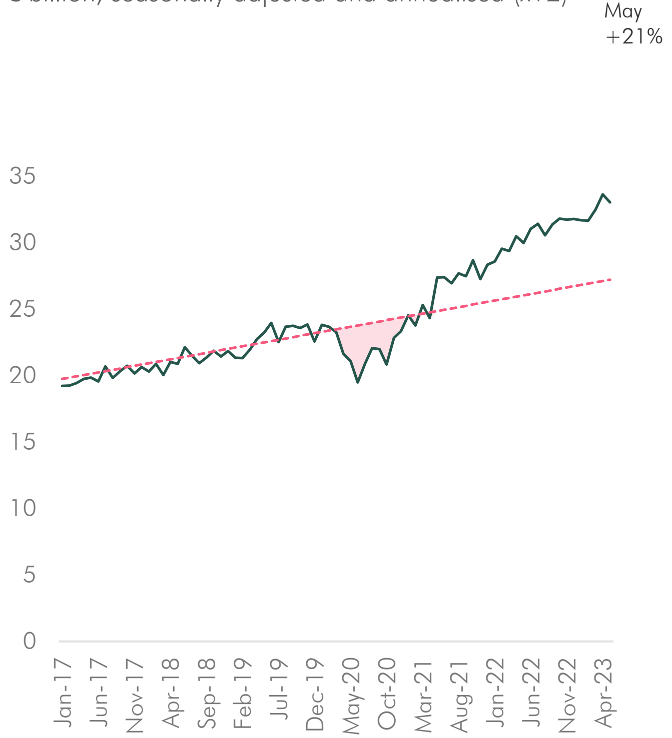


- €1.1bn of non-core spending has yet to be allocated
- The funding of the February package was initially unclear and should have been clearly based on contingencies
- The Government should be transparent on how all new announcements are funded relative to Budget plans

Revenue growth has been strong

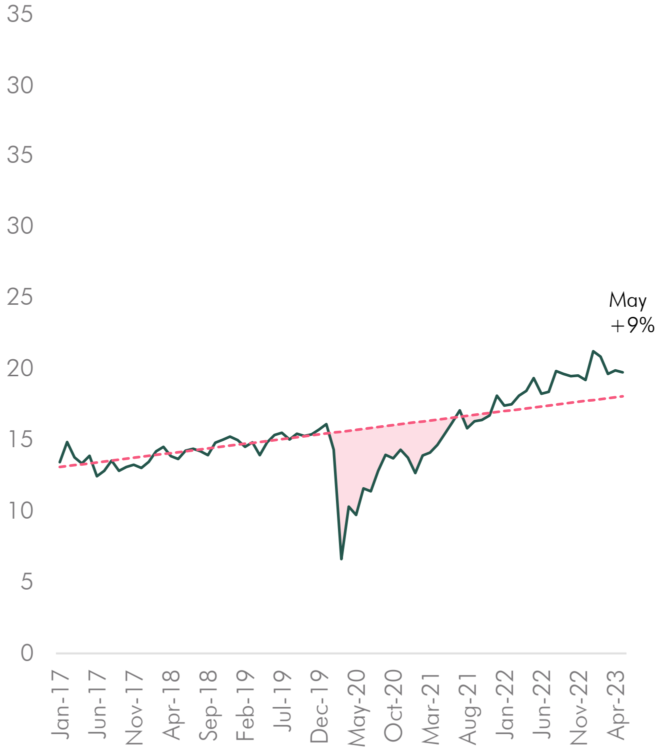
Income tax is above pre-pandemic trend

€ billion, seasonally adjusted and annualised (x12)



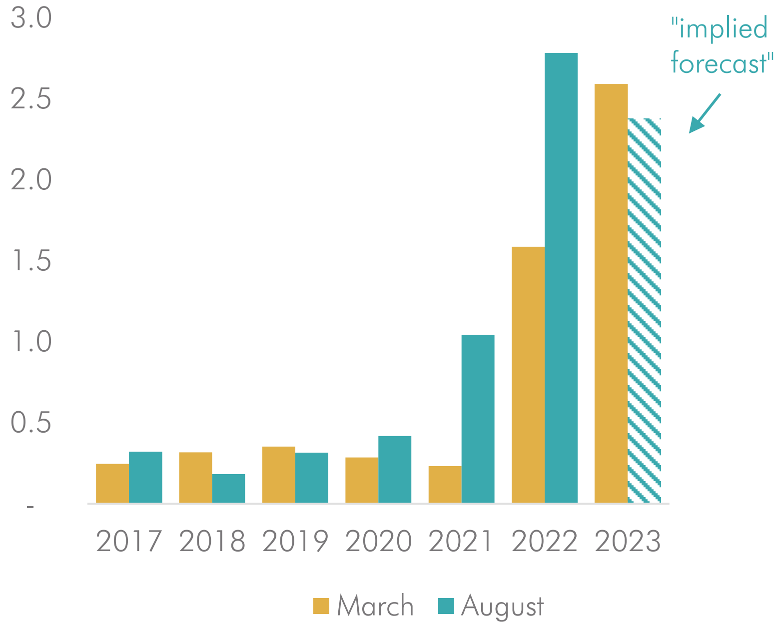
VAT receipts are above trend

€ billion, seasonally adjusted and annualised (x12)



Corporation tax likely to be high later in year

€ billion



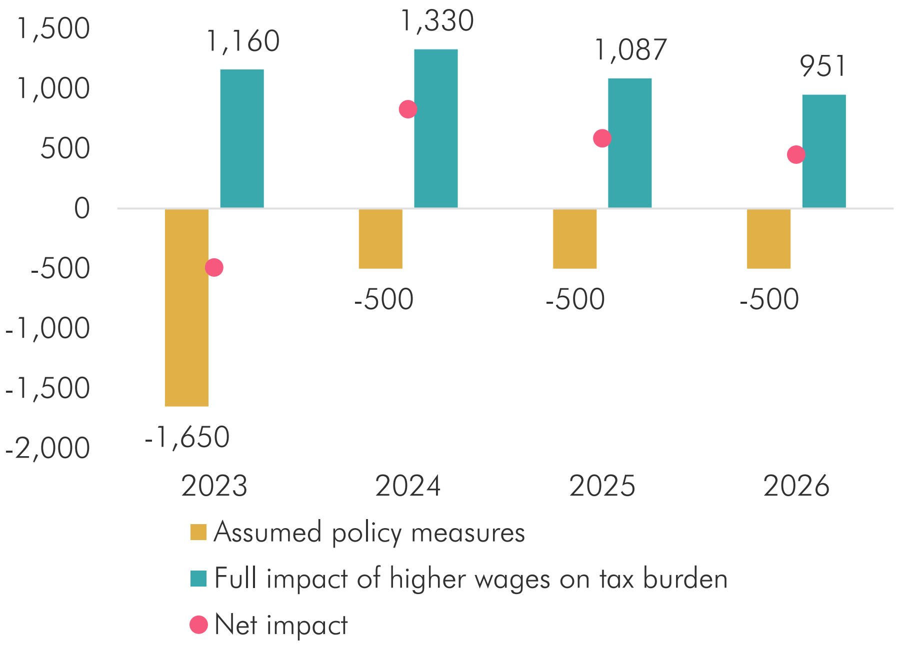
Income tax profiles are consistent with partial indexation in the coming years

Effective income tax rate to fall slightly

Exchequer income tax as a % of compensation of employees

Assumed tax cuts imply partial indexation

€ million

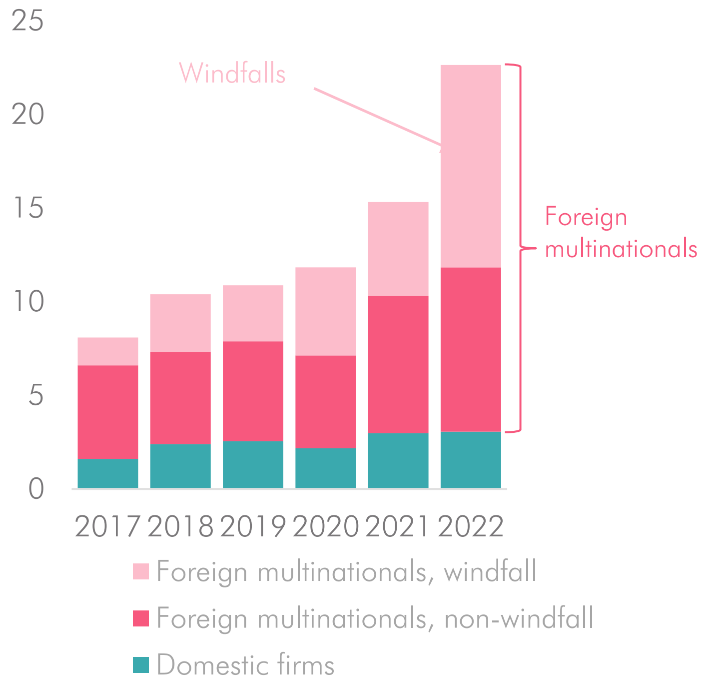


- Income tax profile implies policy measures of €500m per year, which is less than would be implied by full indexation to wages

Corporation tax receipts have increased sharply due to payments from foreign multinationals

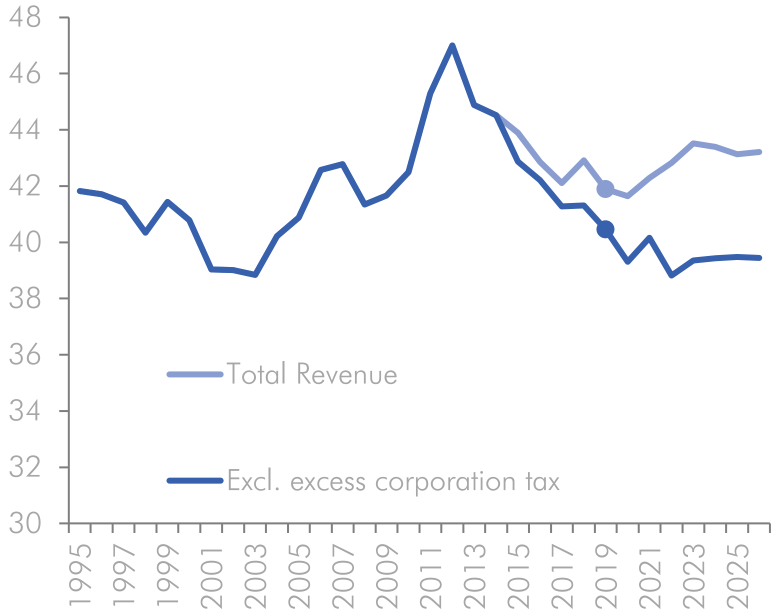
Corporation tax receipts have increased

€ billion, net payments



Headline revenue diverges from underlying revenue

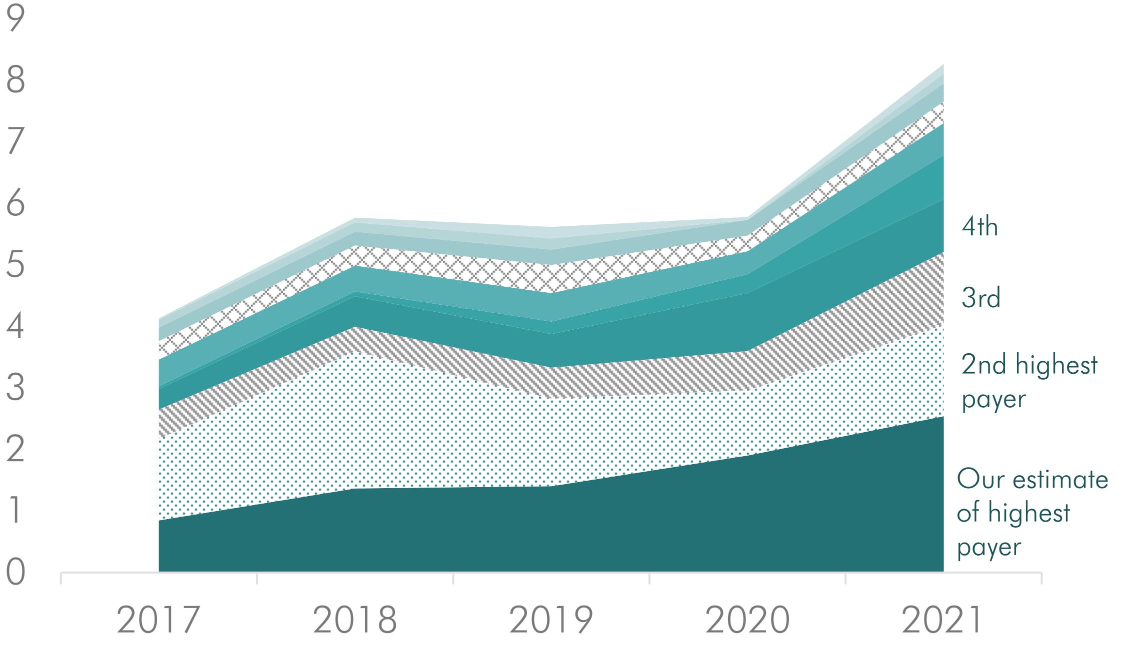
% GNI*, general government revenue



Corporation tax receipts are highly concentrated in a handful of multinationals

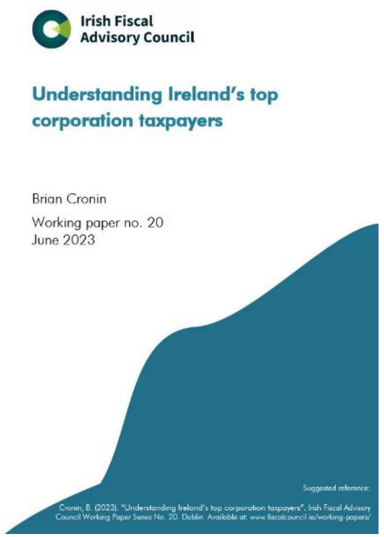
Estimated payments of top-ten groups appear highly concentrated

Estimated corporation tax payment, € billion



Sources: Company financial statements and Fiscal Council workings.
Notes: These estimates carry the greatest margin for error. Given the difficulties in identifying Ireland's leading corporation taxpayers and the challenges associated with accurately estimating the corporation tax paid by each group, we anonymise the identities of the groups.

- 3 corporate groups account for almost a third of corporation tax receipts
- Pharma-chem and ICT account for almost all the corporation tax paid by the top ten
- Risk of idiosyncratic firm-specific shocks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Understanding Ireland's top corporation taxpayers

Brian Cronin

Working paper no. 20
June 2023

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Spending is set to grow in line with the National Spending Rule

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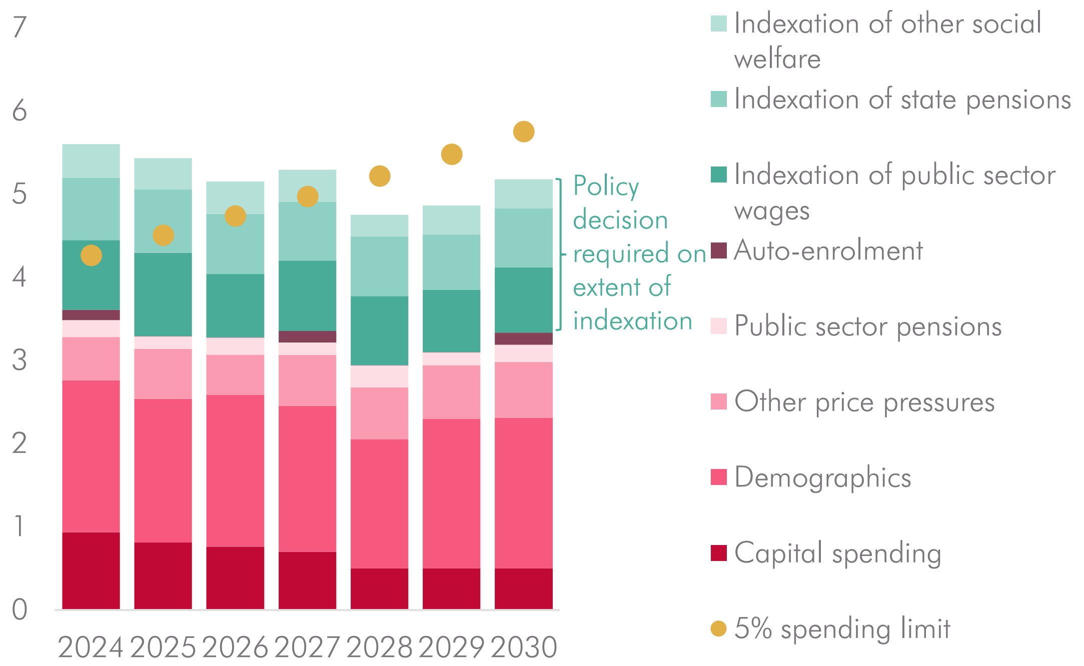
Spending plans compared to Stand-Still costs and investment plans

Annual change in € billions (gross voted spending)

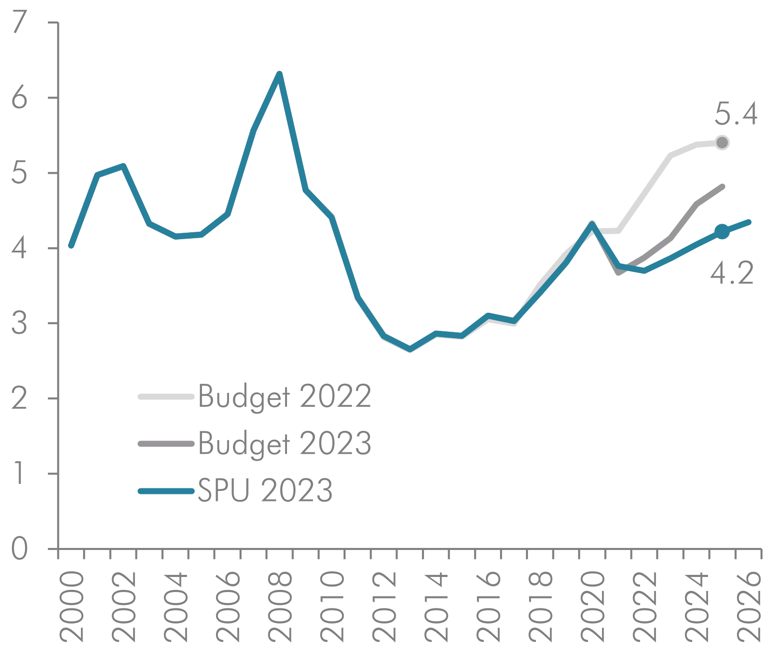


- This will be challenging given that planned spending growth is insufficient to meet “stand-still” costs and investment plans
- Choices need to be made between existing programmes, new spending and tax measures

The investment budget remains large, but has not been fully spent and plans have been revised down

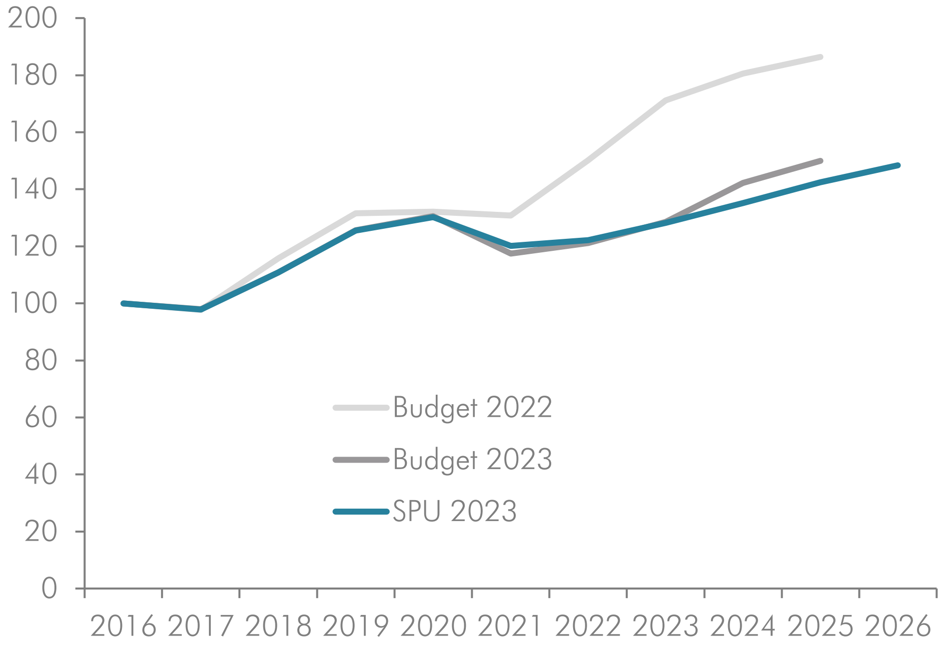
Capital spending a smaller share of GNI* than previously planned

% GNI*



Volume of government investment revised downwards

Index 2016 = 100, deflated by building and construction deflator



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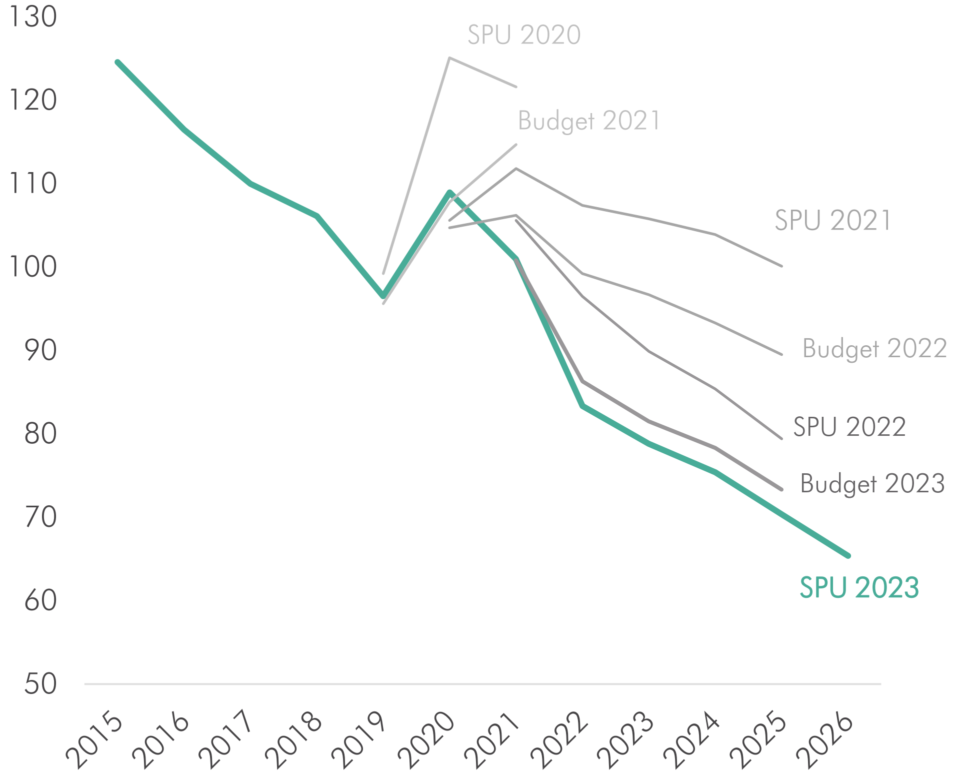
Debt is on a downward path, helped by corporation tax receipts

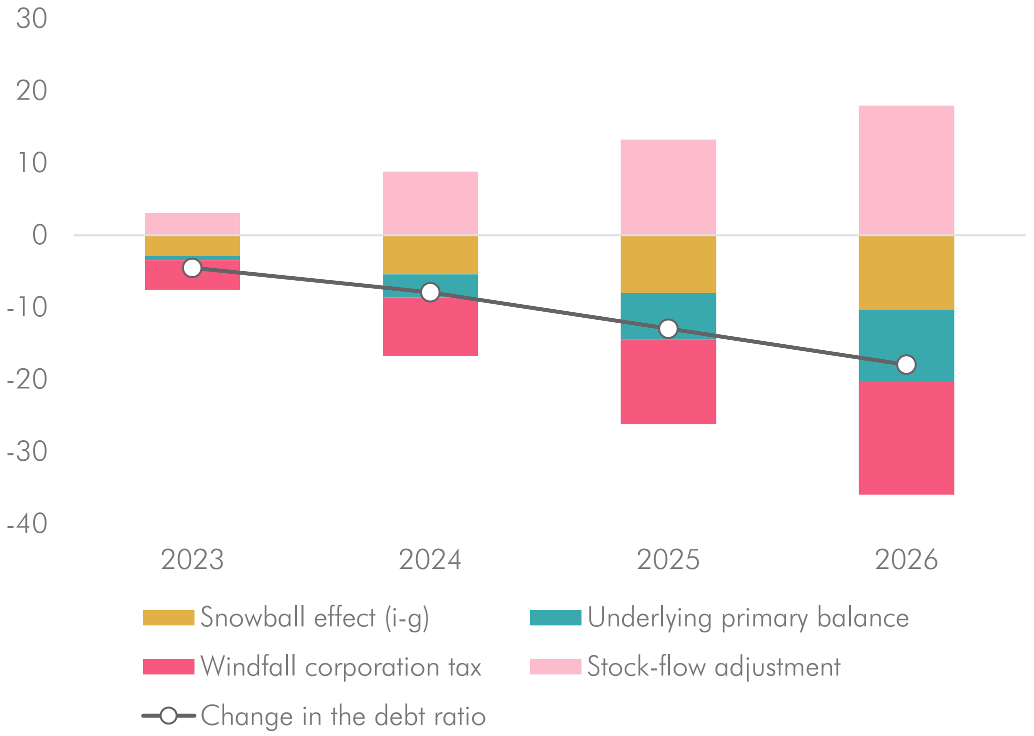
Debt forecasts repeatedly revised down

Gross debt, % GNI*



Windfall corporation tax is a significant component of the forecast reduction in the debt ratio

% of GNI*, cumulative change

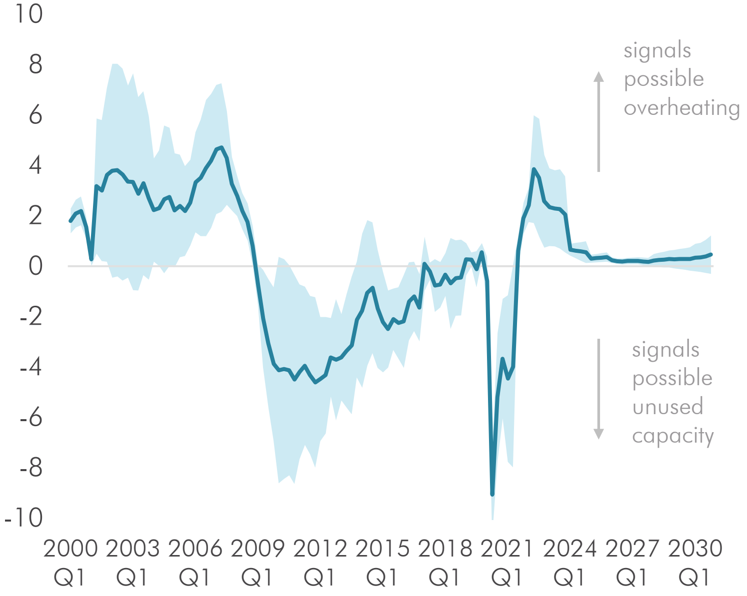


Fiscal stance and framework

The Government must manage capacity constraints, reducing debt and CT inflows

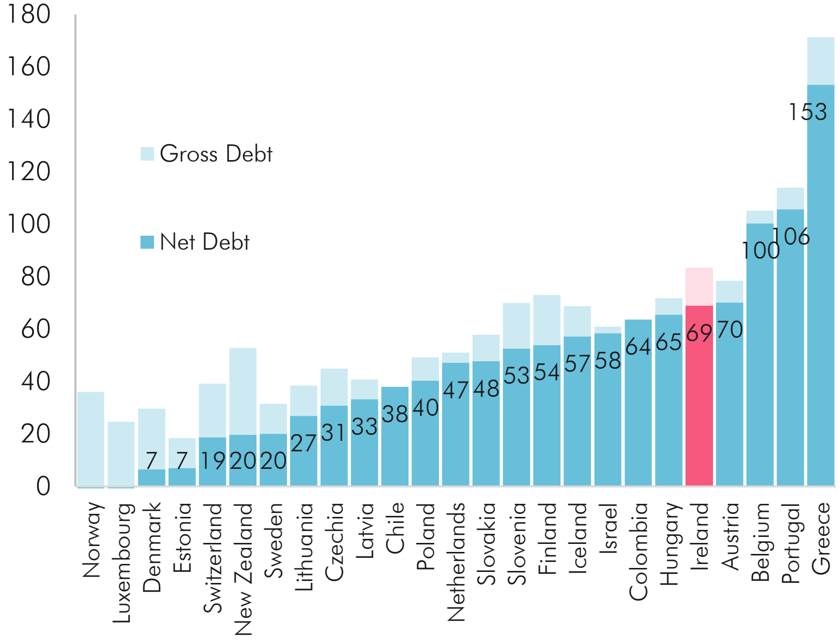
Activity to remain near potential

% potential output, output gap estimates



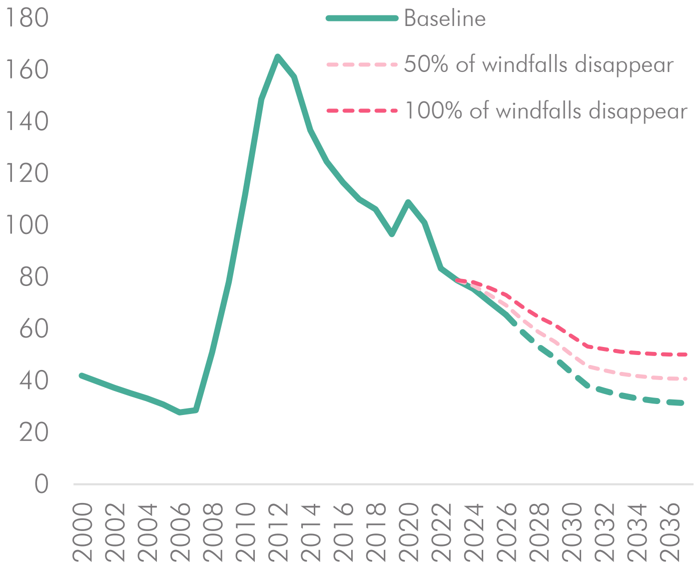
Debt ratio at upper end for small economies

% GDP (% GNI* for Ireland), general gov. basis, end-2022



Risks of loss of corporation tax windfalls

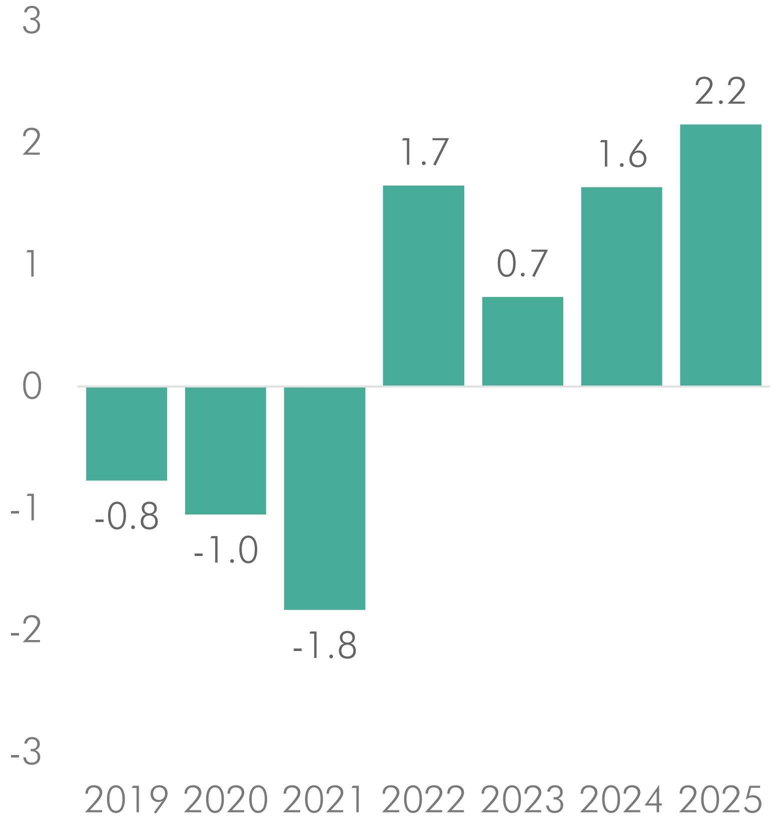
% GNI*, gross general government debt



The Government should stick to the National Spending Rule

A structural surplus is implied by projections

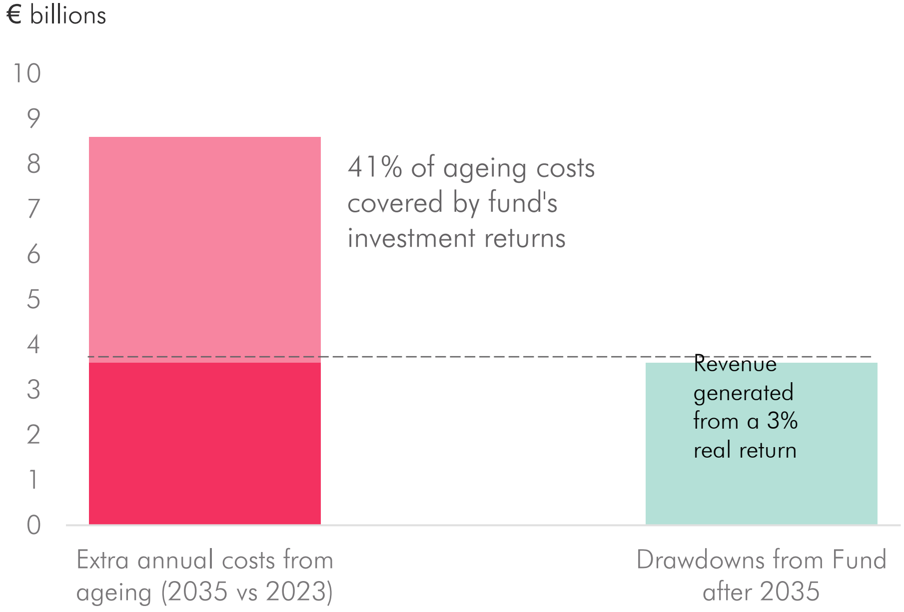
% potential GNI*, bottom-up structural balance



- Budget 2023 struck an appropriate balance between helping households and avoiding higher inflation
- For Budget 2024, the Government should stick to the spending rule
- This would avoid putting too much pressure on capacity constraints
- It will require choices between tax and spending
- Spending more of the excess CT receipts would increase risks and overheating

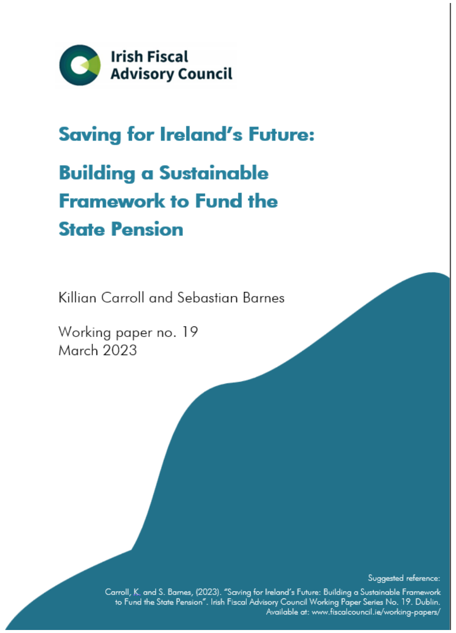
Proposals to create a new Savings Vehicle are welcome

A substantial share of ageing costs could be covered



Source: Department of Finance.
Note: This assumes that €18 billion is transferred to the fund in 2024 (€6 billion from the existing National Reserve Fund and €12 billion from windfall corporation tax), with €12 billion windfalls transferred annually until 2030.

- This would avoid reliance on unstable revenues and adding to demand in the economy
- It would help to improve the sustainability of the pension system
- Ireland could build up a large fund that would help to diversity risks and benefit future generations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Saving for Ireland's Future:

Building a Sustainable Framework to Fund the State Pension

Killian Carroll and Sebastian Barnes

Working paper no. 19
March 2023

Suggested reference:
Carroll, K. and S. Barnes, (2023). "Saving for Ireland's Future: Building a Sustainable Framework to Fund the State Pension". Irish Fiscal Advisory Council Working Paper Series No. 19. Dublin.
Available at: www.fiscalcouncil.ie/working-papers/

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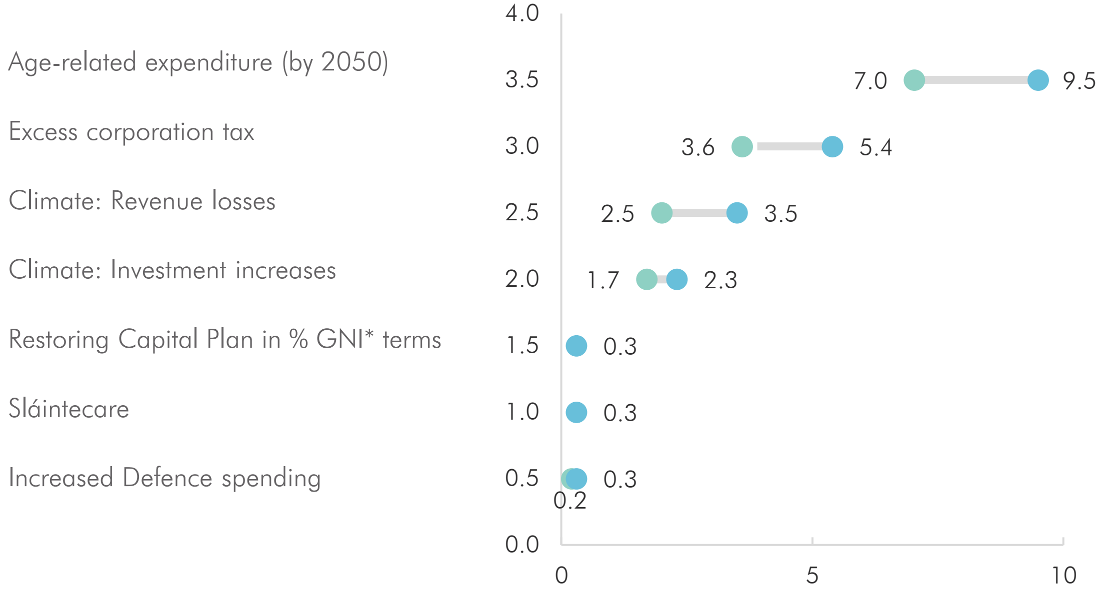
Ireland needs to improve how it plans for the long term

- Ageing and pension costs
- Climate Change
- Sláintecare
- Defence spending

Ageing pressures are at the forefront of fiscal challenges

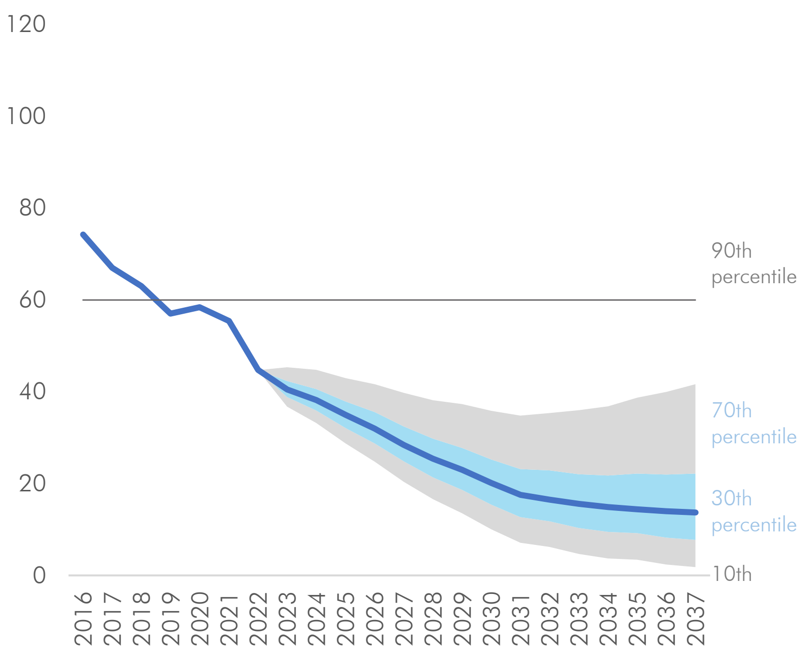
% GNI* estimated ranges of annual impacts on government's budget balance



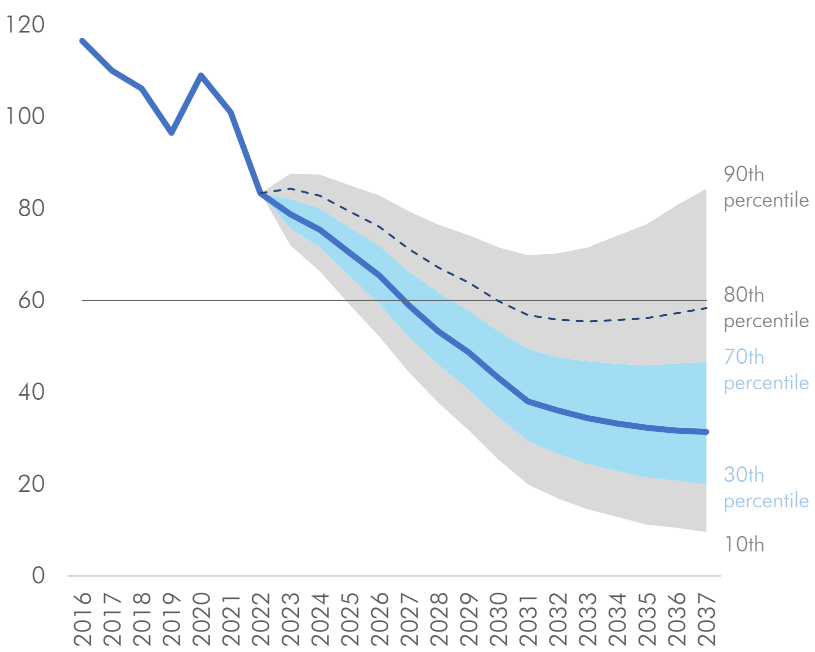
Sources: FitzGerald (2021); Commission on the Defence Forces (2022); and Council estimates.
Notes: Age-related expenditure estimates are the Fiscal Council's (2020b) pessimistic to optimistic range. Excess corporation tax receipts, potential climate-related revenue losses, capital plan restoration, and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

Ireland is likely to face less scrutiny under the revised fiscal EU rules

Ireland's stochastic debt-to-GDP projections
% GDP, gross general government debt



Using Debt-to-GNI*
% GNI*, gross general government debt



- Fiscal rules help manage economy and public finances prudently

  Ireland likely to face less scrutiny in proposed EU rules:
  - Use GDP-based measures
  - Ireland's debt ratios are on a strong downward path

See more >>>

The National Spending Rule is helpful as a “first line” of defence

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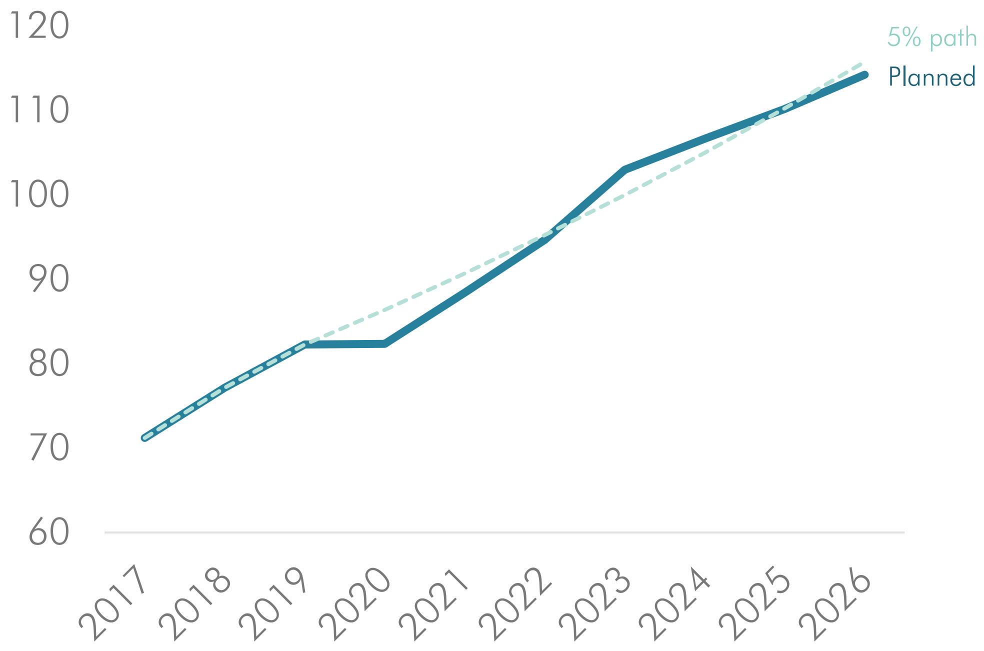
When tax measures included, path is broadly sustainable

€ billion, net policy spending



Sources: CSO; Department of Finance; and Fiscal Council workings. Get the data.
Notes: 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. Estimated proceeds from not indexing the tax system are also included.

- National Spending Rule set out in 2021 limits net spending growth to trend GNI* growth
- It is a net spending rule – raising taxes allows for additional spending
- The rule helped to anchor spending during the cost-of-living crisis
- It should be refined and key elements set out in law
- Successful examples like the Netherlands and Sweden underline the importance of political buy-in across the system

Key messages

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- The economy is set to recover, but there are capacity constraints and risks
- The Government's underlying deficit (excluding excess corporation tax receipts) is projected to narrow to 0.6% of GNI* this year and return to surplus next year
- The public finances are being boosted by a large inflow of corporation tax receipts
- There are major long-term challenges, particularly to sustain the pension system and tackle climate change
- The Government has made important steps towards long-term planning, but issues remains
- Following the National Spending Rule is appropriate for prudent management of the public finances given capacity constraints
- The proposed Savings Vehicle will help to manage Corporation Tax inflows
- The Government should reinforce the National Spending Rule as a "first line of defence"

Background charts

Irish Fiscal Advisory Council

Summary Table of *SPU 2023* Economic and Budgetary Projections

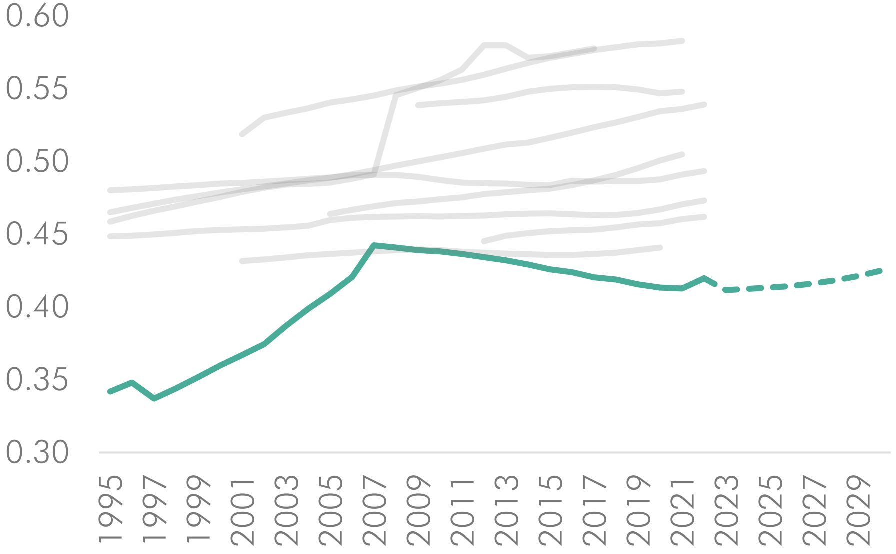
% GNI* unless stated

	2019	2020	2021	2022	2023	2024	2025	2026
Macro forecasts								
Real GNI* growth (%)	2.8	-4.6	15.4	9.3	1.6	2.1	2.5	2.3
Nominal GNI* growth (%)	8.6	-5.1	16.9	15.3	5.3	4.9	5.2	5.2
Nominal GNI* (€bn)	211	200	234	270	284	298	313	330
HICP growth (%)	0.9	-0.5	2.5	8.1	4.9	2.5	2.0	2.0
Output gap (% of potential)	3.5	-4.2	-2.5	1.6	1.4	1.1	1.2	1.3
Potential output growth (%)	3.0	-0.9	3.2	3.8	1.8	2.3	2.4	2.3
Budgetary forecasts								
Balance excl. excess corporation tax	-0.6	-11.7	-5.0	-1.0	-0.6	1.5	2.1	2.6
Balance	0.8	-9.3	-2.9	3.0	3.5	5.4	5.8	6.3
Balance (€ billion)	1.7	-18.7	-6.8	8.0	10.0	16.2	18.1	20.8
Balance excl. one-offs [1]	0.8	-1.7	2.5	6.0	5.6	5.6	5.9	6.3
Balance excl. one-offs [1] (€ billion)	1.7	-3.5	6.4	16.3	16.0	16.7	18.4	20.8
Revenue excl. one-offs [1]	41.9	41.9	42.3	43.1	43.8	43.4	43.1	43.2
Expenditure excl. one-offs [1]	41.1	43.6	39.9	37.0	38.2	37.8	37.3	36.9
Primary balance excl.one-offs [1]	3.0	0.2	3.9	7.3	6.8	6.8	6.9	7.4
Revenue growth excl. one-offs [1] (%)	6.4	-5.1	18.2	17.3	6.9	4.0	4.5	5.3
Primary expenditure growth excl. one-offs[1] (%)	6.1	1.8	7.8	7.4	8.5	4.0	3.9	4.1
Gross debt ratio (% GNI*)	96.5	108.9	101.0	83.3	78.8	75.4	70.4	65.4
Net debt ratio (% GNI*)	82.7	93.0	82.4	68.7	64.7	58.4	52.3	46.0
Gross debt (€ billion)	203	218	236	225	223	224	220	215
Cash & liquid assets (€ billion)	29	32	43	39	40	51	57	64
Net debt (€ billion)	174	186	193	185	184	174	164	151
Fiscal stance								
Structural primary balance[2]	1.4	0.8	-0.3	3.0	2.0	2.5	2.6	3.2
- change (p.p.)		-0.6	-1.1	3.3	-0.9	0.5	0.1	0.6
Net policy spending growth (%)	5.4	0.1	7.3	6.9	8.6	3.5	3.2	3.6
Real net policy spending growth (%)	4.5	0.6	4.8	-1.0	3.6	1.0	1.2	1.5
Change in net debt ratio (p.p.)	-8.6	10.3	-10.6	-13.7	-4.0	-6.3	-6.1	-6.3
Fiscal rules								
Spending Rule	✓	xc	xc	xc	xc			
Structural Balance Rule	✓	xc	xc	xc	xc			
Overall Assessment	✓	xc	xc	xc	xc			

Dwellings investment and stock are low

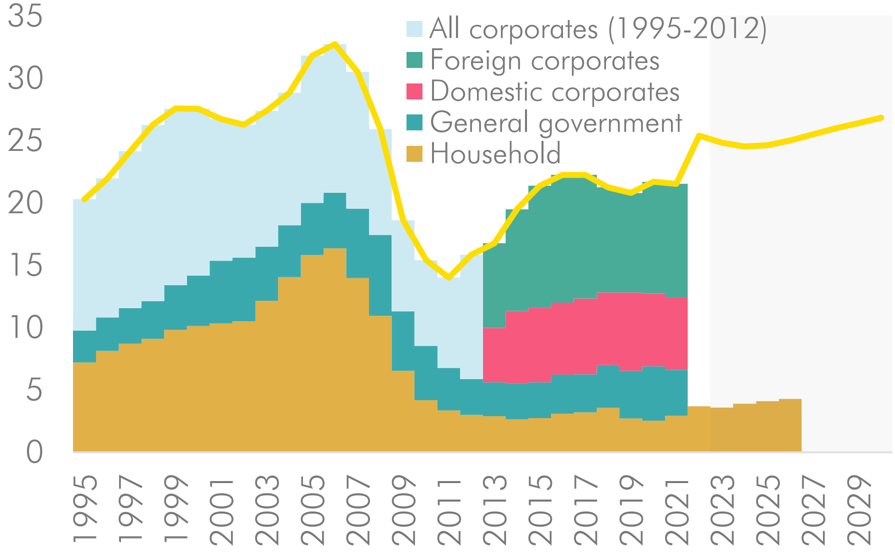
Stock of dwellings low internationally

Ireland's dwellings stock per capita compared to the EU 15



Two-fifths of investment is by foreign corporates

% of GNI*, modified investment by institutional sector



- Ireland's dwellings stock per capita is set to remain below the EU 15
- Foreign corporates accounted for two-fifths of modified investment

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The Government complied with its spending ceiling

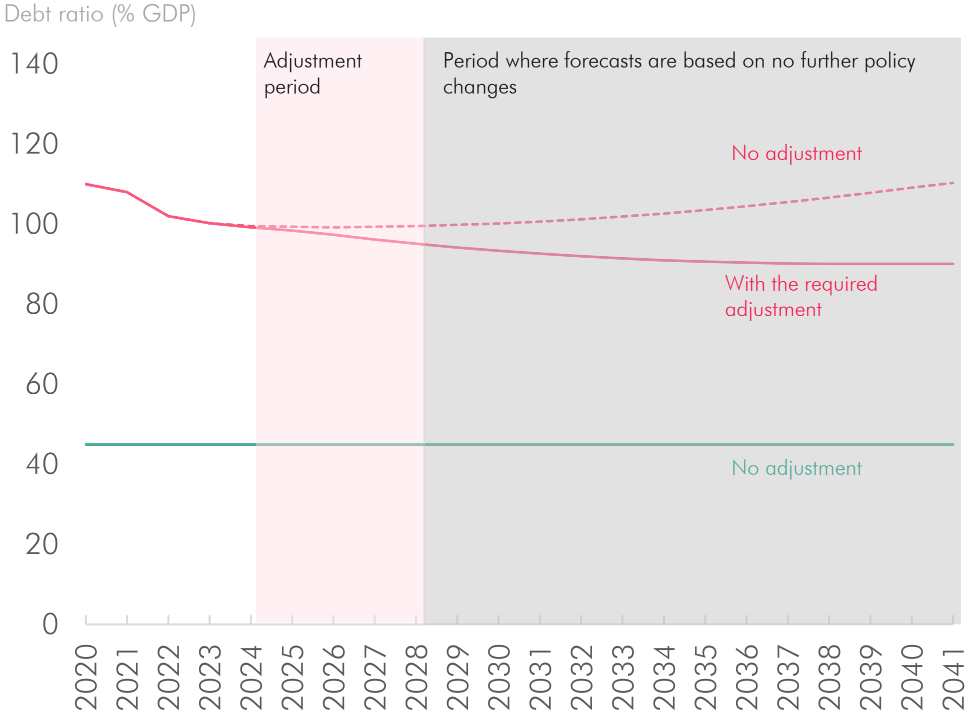
€ billions

	2021	2022	2023	2024	2025	2026
Core spending						
Budget 2022 ceilings	75.9	80.1	84.1	88.3	92.8	
Latest ceilings	75.9	80.8	85.9	90.2	94.7	99.5
Outturns	74.1	80.0				
Projections			85.9	90.2	94.7	99.5
Assessed on basis of spending alone						
Vs original ceiling		-0.1	1.8	1.9	1.9	
Vs latest ceiling		-0.8	0.0	0.0	0.0	0.0
Assessed net of tax measures						
Revenue-raising measures	0.6	1.1	1.8	1.6	1.3	1.1
Revenue-reducing measures	0.1	1.1	1.5	0.6	0.5	0.5
Net measures	0.4	0.0	0.3	1.0	0.8	0.6
Net core spending outturn	73.6	80.0				
Net core spending projections			85.6	88.9	92.6	96.8
Vs original ceiling		-0.1	1.5	0.6	-0.2	
Vs latest ceiling		-0.8	-0.3	-1.3	-2.1	-2.7

Notes: Net core spending is exchequer spending excluding one-off and temporary measures. As it is a net measure, it is adjusted for the impact of tax measures and includes the expected yields arising from the non-indexation of the income tax system. Revenue-raising measures (such as tax increases) can be used to offset bigger spending increases, whereas revenue-reducing measures (such as tax cuts) would lower the scope for spending increases. Estimates of revenue-reducing and revenue-raising measures are those judged by the Council.

Stylised example of new fiscal rules

The path for debt plays a key role in how the rules work



High debt country

Would have to adjust and put debt on a plausibly downward path after, at most, four years

Low debt country

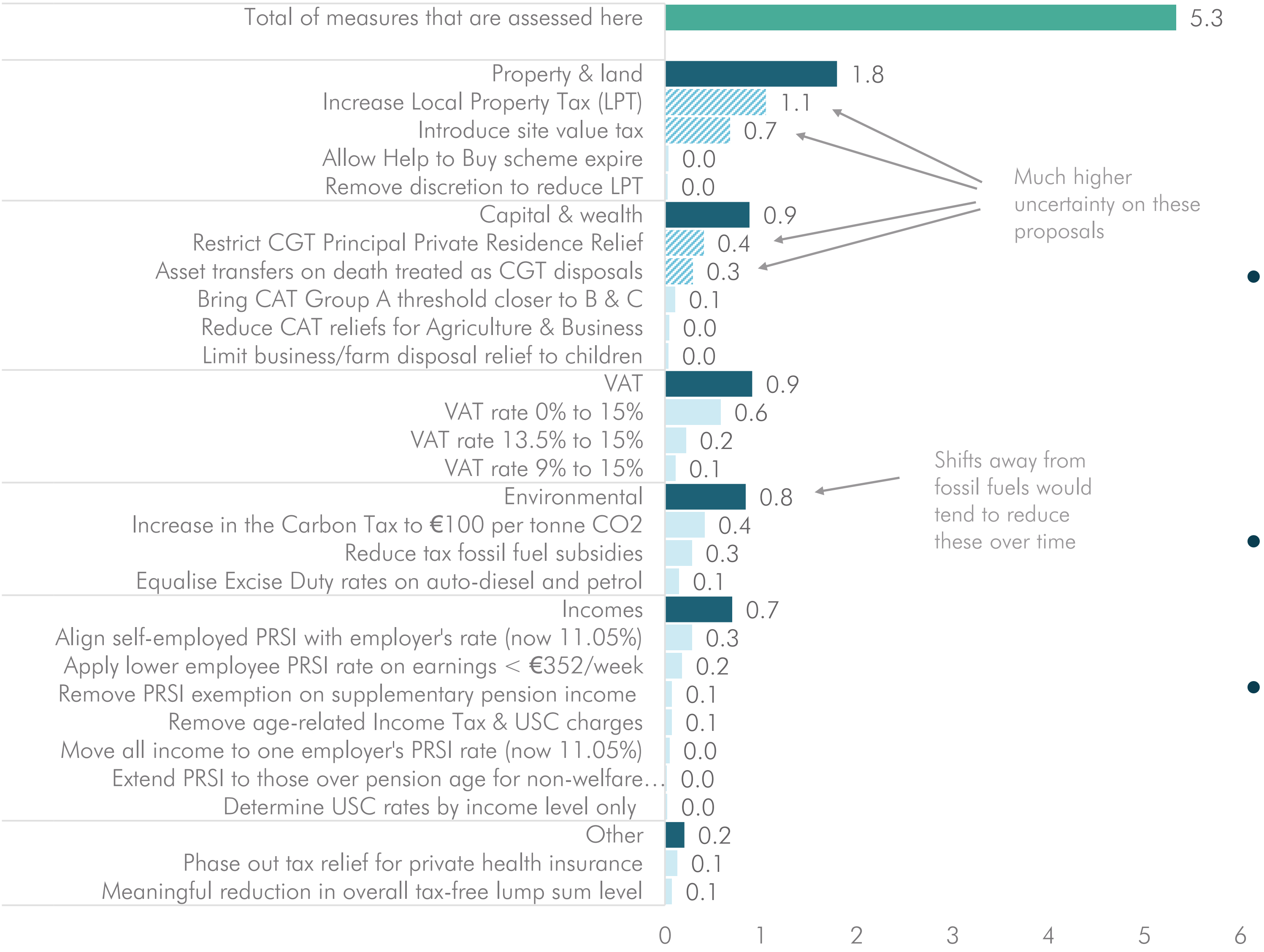
Would only have to keep debt at prudent levels (in other words, keep the debt ratio below 60%) and stay within the 3% deficit limit.

Source: Fiscal Council workings.

Options to raise taxes over time should be explored

Potential impact of tax measures proposed by the Commission on Taxation and Welfare

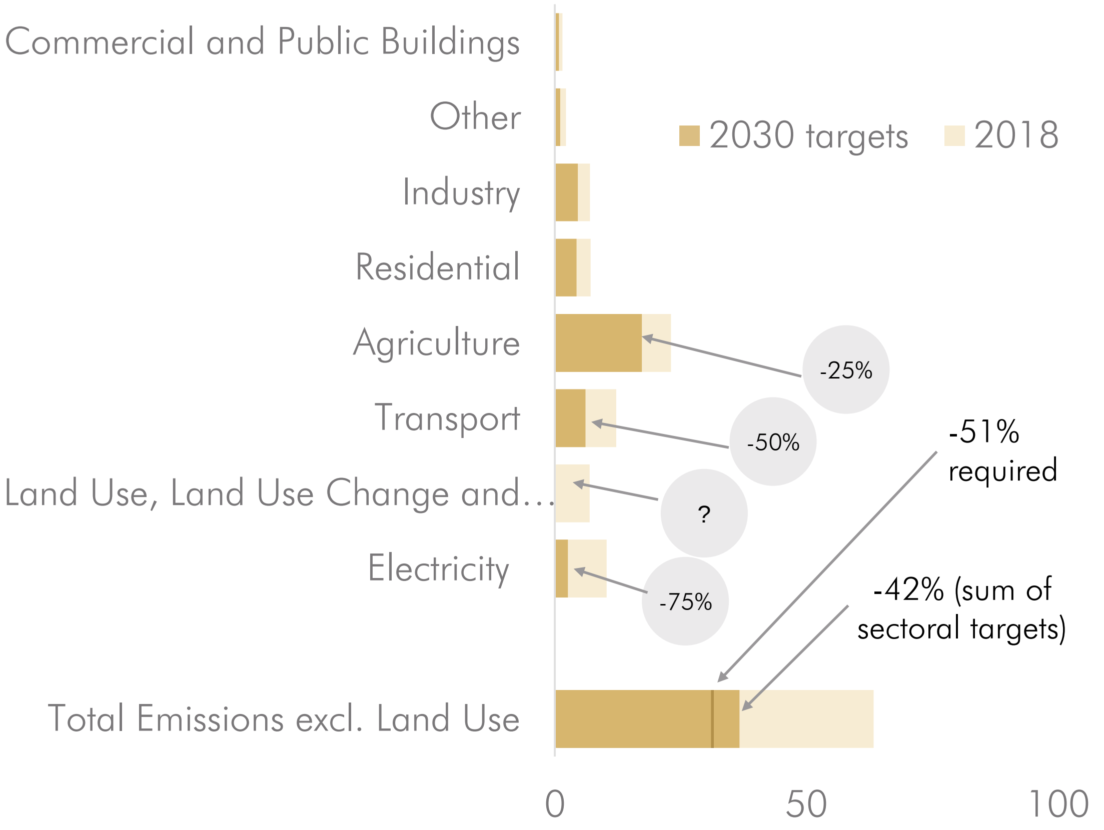
% GNI* estimated full-year yield



- The Commission on Taxation and Welfare's independent assessment of revenue-raising options is welcome
- The Government should quantify the impacts
- A more effective spending review process would also help

Climate targets are short of ambition and lack clarity

Million tonnes of carbon dioxide equivalent

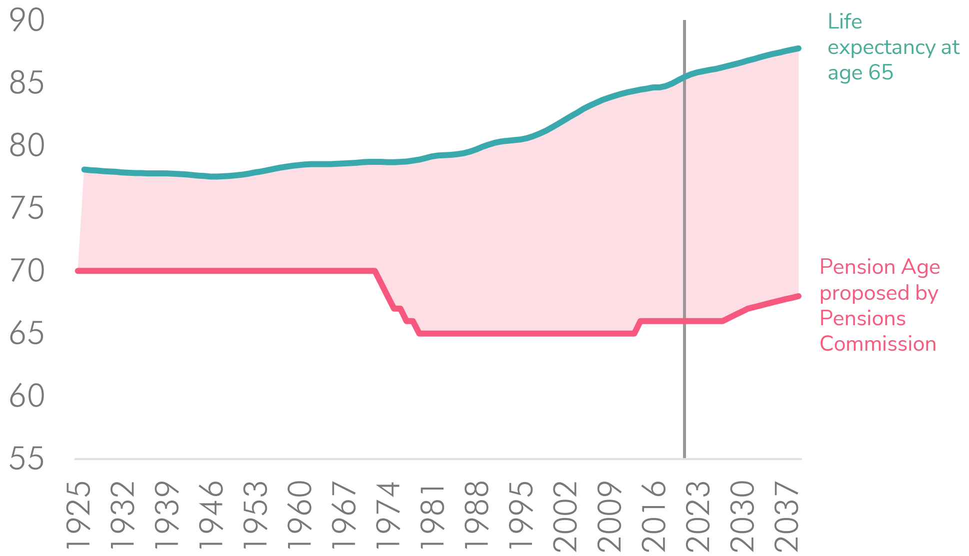


Sources: Climate Change Advisory Council (2022).
Notes: The Figure compares the Government's Sectoral Emissions Reduction Targets announced on 27 July 2022 with 2018 levels of emissions in terms of million tonnes of carbon dioxide equivalent.

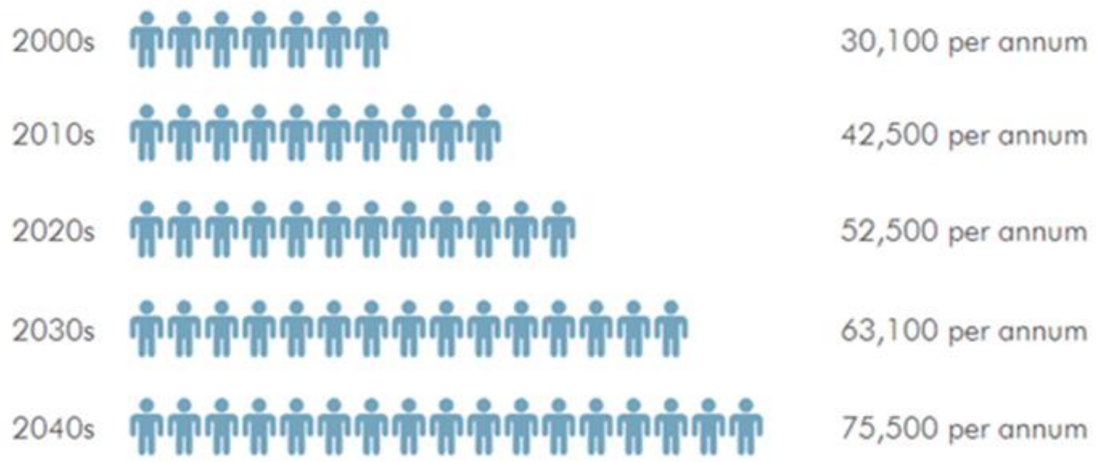
- Sectoral climate targets are a step forward
- But, fall short of overall goal
- Detail is lacking on how these targets will be achieved
- The fiscal implications could be very large, but have not been spelt out
  - Investment needs 2-3% GNI*
  - Loss of fuel taxes up to 3% GNI*

Ageing population

Expected years of retirement: the pension age and life expectancy at age 65



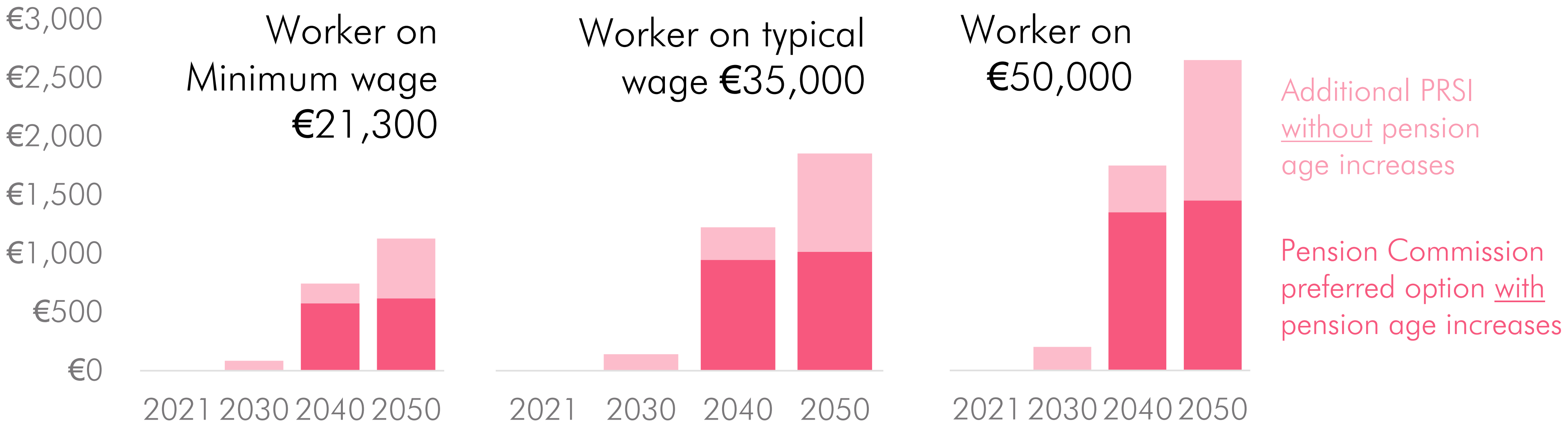
Number of people reaching age 65



Maintaining the retirement age at 66 adds to future costs and taxes

PRSI increases for workers based on proposed pension reforms

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



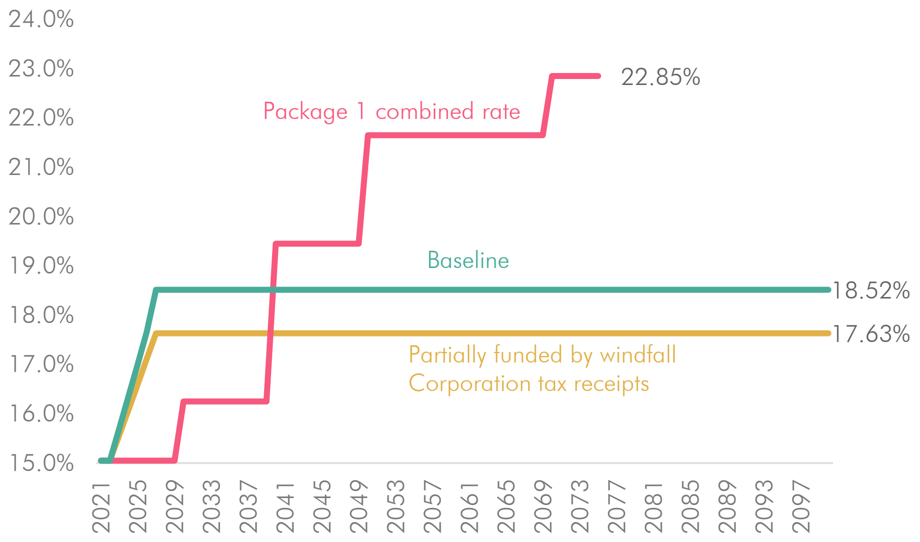
Sources: Pensions Commission (2020); and Fiscal Council workings.
Notes: Figures are based on Package 4 and Package 3 of the Pension Commission's (2021) options using PRSI rate increases assumed out to 2050. There is still an additional "Exchequer Contribution" in both packages, which may have to be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

- The Government should be transparent about these costs
- Short-term fluctuations in the Social Insurance Fund do not justify inaction

Windfall receipts can help fund pensions

Windfall corporation tax receipts can substantially reduce the required rate increase

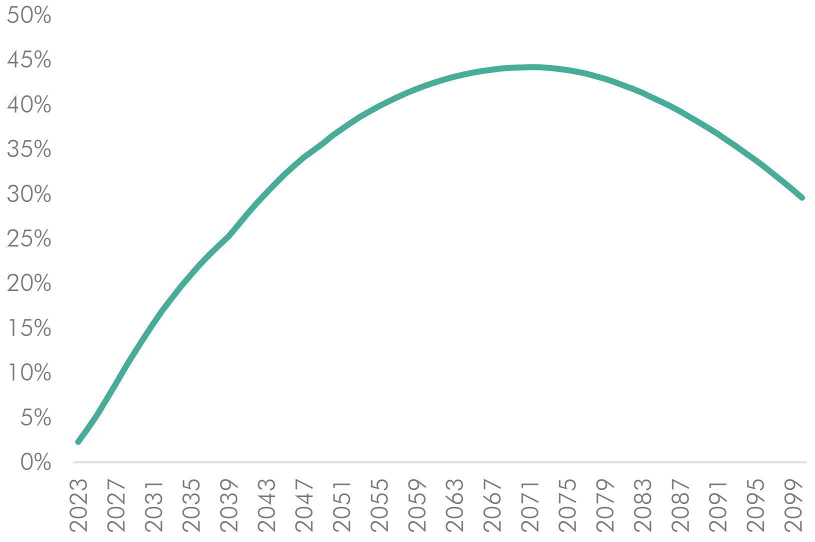
Combined Employee and higher Employer's PRSI rate



Sources: Pension Commission (2021); and Authors workings.

Reserves of the pension fund

% GNI*



Higher rates of return can reduce the required increase in PRSI

Combined Employee and higher Employer's PRSI rate