## Box E: New fund could be a landmark reform

In May 2023, the Government set out an ambitious vision for how to address tomorrow's spending pressures, including from ageing, while saving today's windfall corporation tax receipts. While the proposals have yet to be enacted and details will be key, the Council welcomes the broad approach.

The official paper (Department of Finance, 2023) looks at how unreliable excess corporation tax receipts could be saved to part-fund substantial future costs as Ireland's population ages. It is described as a scoping paper and sets out various options: namely, how much of the windfall corporation tax would be saved, and how withdrawals would work.

### Why windfall corporation tax receipts should be saved rather than spent

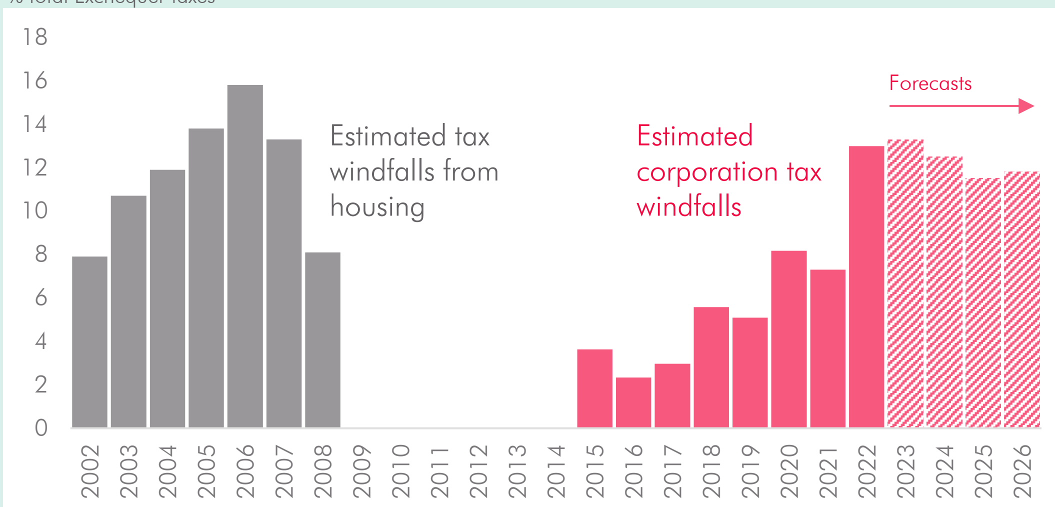
The rationale for saving windfall corporation tax receipts is clearcut.

First, these receipts are exceptionally unreliable and have a high risk of suddenly reversing (Box D). The increase is linked to the stellar performance of a handful of foreign-owned multinationals generating profits overseas but paying tax in Ireland. Making permanent budget commitments on the basis of potentially temporary revenues would create risks.

Second, using these receipts now would be particularly destabilising for the economy. The receipts represent a net injection into the Irish economy as compared to conventional receipts that take from domestic resources. The labour market is exceptionally tight, notably in construction, and appears unable to respond to additional demand without fuelling further price and wage pressures.

### Figure E1: Windfalls then and now

% total Exchequer taxes




Source: Addison-Smyth and McQuinn (2010); Department of Finance; and Fiscal Council workings.

Ireland has had painful recent experiences in using windfall receipts to fund permanent spending increases. Repeating these past mistakes should be avoided. Over the period 2004 to 2008, the public finances benefited from about €7.5 billion in windfall stamp duty and VAT receipts linked to the property bubble (Addison-Smyth and McQuinn, 2010). These receipts were used to fund tax cuts and permanent spending increases. Fiscal policy was not the main cause of the boom-to-bust experience Ireland had in the 2000s though it contributed to the need for austerity measures precisely when the economy most needed support. The exceptional levels of corporation tax being collected by the Government has some parallels with the experience of the 2000s. The receipts are substantial in size and disconnected from economic fundamentals, and there is considerable uncertainty about how long they will last.

### Ageing costs will be substantial

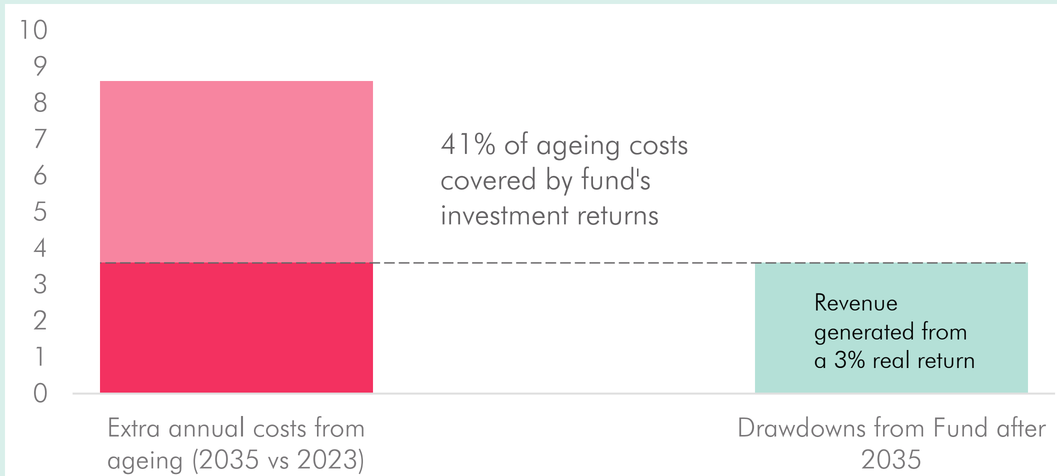
By contrast, Ireland faces predictable increases in public spending in the coming decades due to the rapid ageing of its population. The decision to abandon planned increases in the pension age adds to projected costs. The Department estimates that, in today's terms, the increase in annual spending related to ageing will be about €8½ billion by 2035, when compared to 2023 levels. Presently, there is no credible plan to address the likely shortfalls in funding. However, the new fund could go some way towards addressing these shortfalls, even if additional measures are still likely to be required.

### The fund could generate returns to cover a large portion of ageing costs

The Department's scoping paper explores a range of options for how much of the windfall corporation tax receipts to save and the potential returns generated. A 3% real — or inflation adjusted — return would be reasonably plausible. It is in line with what is used by Norway, Canada, and, more generally, in OECD (2021) modelling. If the windfall receipts were fully saved from 2024 to 2030, the Department estimates that returns along these lines would be sufficient to cover 56% of new annual ageing costs in 2030 and 41% in 2035 (Figure E2).

## Figure E2: A substantial share of ageing costs could be covered

€ billions




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.

### The Council sees the fund as a major tool for addressing ageing challenges

The Council welcomes the fund proposals and the scoping paper set out by the Department. It presents a clear vision for how to tackle some of the major challenges facing the public finances both today and over the coming decades.

There are several ways in which the Council assesses that the proposals should be reinforced:

1) The fund should seek to use all the windfall corporation tax receipts. The justification for using any of these receipts for other purposes is weak and poses substantial risks to the economy and public finances.

2) The fund should invest in international assets, outside of Ireland, and aim to limit exposure to areas that Ireland is already vulnerable to, including through corporation tax receipts—namely the tech and pharma sectors with operations in Ireland.

3) The Government should specify what areas are to be covered by the fund. It would make sense to focus on cost areas clearly related to ageing, such as pensions, which have a high likelihood of materialising and around which the costs are relatively more certain.

4) The fund should not be seen as an end in and of itself. The challenges faced by Ireland related to ageing costs are substantial. Broader reforms and a longer-term horizon will be needed. As shown by Carroll and Barnes (2023), adjustments to the tax system could be reduced substantially if reforms were introduced sooner rather than later. This could potentially take the form of PRSI adjustments, which would appear to be in line both with Government proposals and the Pensions Commission options that omit changes to the pension age, though it could also take the form of spending cuts elsewhere.