Irish Fiscal Advisory Council

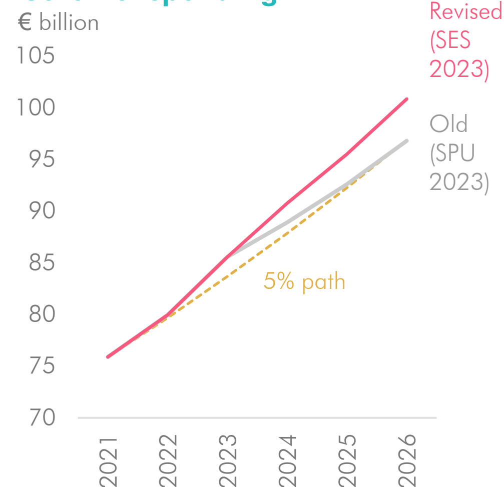
Pre-Budget 2024 Statement

Ireland must break with its procyclical past

September 2023

Key Messages

The Government now plans to repeatedly breach the National Spending Rule every year out to 2026. The Government's intention is to go beyond plans set out in April, and repeatedly breach the National Spending Rule every year out to 2026. The Rule sets a 5% limit for core spending increases net of new tax measures — a speed broadly matching trend growth that would help stabilise the economy and avoid fuelling price and wage pressures. Core net spending is now expected to be €4 billion higher by 2026 compared to previous plans.



These breaches are a serious cause for concern.
1) They risk repeating Ireland's past mistakes, with employment already high and windfalls boosting the Exchequer. This would represent a continuation of procyclical fiscal policy.

2) The stance adopted undermines the National Spending Rule at a time when EU fiscal rules are not binding and likely to be distorted by GDP if and when new proposals are enacted.

3) The manner in which plans were revised weakens the credibility of Government projections, lacking transparency and not factoring in overruns and costs related to population ageing and the climate transition.

The Council recognises pressures for additional spending, but these pressures should be funded sustainably. Pressures in health, housing, infrastructure and climate-related areas are likely to need ongoing multi-year funding. If the Government wishes to ramp up spending across all these areas, it should ensure that the outlays can be maintained on an ongoing basis and not just based on receipts expected to prove temporary.

Looking to Budget 2024, the Council assesses that:

- **The Government should adjust its plans to stick to its National Spending Rule.** This would ensure more credible and sustainable fiscal plans. It could be achieved by introducing offsetting tax increases or spending adjustments elsewhere. To this end, there is a role for developing more comprehensive reviews of existing programmes.
- **There is little to no justification for further temporary non-core measures in *Budget 2024*.** Energy prices are falling and temporary measures risk adding to price pressures. Additional unfunded measures, given the existing pressures and low unemployment, would represent a further shift toward a more procyclical fiscal policy.
- **The Government needs to improve its long-term planning.** The Government's fiscal plans only go to 2026, right before new estimates from the

Council suggest climate costs will mount (Casey and Carroll, 2023). Ageing pressures will also begin to deepen towards the end of this decade.

- The Council welcomes proposals for a new Savings Vehicle — temptations to spend more resources immediately should be resisted, without offsetting measures elsewhere. There are substantial pressures for additional spending and there is a good case to be made for additional public investment. However, the State already has ways to achieve that. The National Spending Rule allows additional spending provided this is offset elsewhere, while the National Development Plan provides a framework to plan longer term capital needs. The rationale for an investment fund is weak. It risks simply being used as a means of ramping up capital spending in the short term even more than currently planned, and at a time when getting value for money is challenging.
- The Government should reinforce its National Spending Rule as a "first line of defence". The Government's National Spending Rule could continue to prove a useful tool to ensure the public finances are managed sustainably. But it needs to be reinforced and adhered to.

Latest Government Projections

% GNI* unless otherwise stated; projections are derived from the Government's *Summer Economic Statement* and the *Stability Programme Update (SPU) 2023*

	2022	2023	2024	2025	2026
Macro forecasts (SPU April 2023*)					
Real GNI growth (%)	9.3	1.6	2.1	2.5	2.3
Nominal GNI* growth (%)	15.3	5.2	4.9	5.1	5.1
Nominal GNI* (€bn)	269.8	283.7	297.6	312.9	328.9
HICP	8.1	4.9	2.5	2.0	2.0
Budgetary Forecasts (Summer Economic Statement July 2023)					
Balance	3.0	3.5	3.9	5.2	5.6
Balance (€ billion)	8.0	10.0	11.7	16.3	18.5
Balance excl. one-offs and windfall CT	2.0	1.2	0.1	1.7	1.9
Balance excl. one-offs and windfall CT (€ billion)	5.5	3.4	0.4	5.2	6.1
Revenue excl. one-offs and windfall CT	39.1	39.3	39.4	39.5	39.4
Expenditure excl. one-offs	37.0	38.2	39.3	37.8	37.6
Primary balance excl. one-offs and windfall CT	3.3	2.4	1.3	2.7	2.9
Revenue growth excl. one-offs and windfall CT (%)	12.1	5.9	5.2	5.3	4.9
Primary expenditure growth excl. one-offs (%)	7.4	8.5	8.3	1.3	4.5
Net debt ratio (% GNI*) [1]	68.7	64.7	57.7	49.7	41.7
Net debt (€ billion) [1]	185.4	183.5	171.8	155.5	137.0

Sources: CSO; Department of Finance forecasts; and Fiscal Council workings.

Notes: This table uses the latest available data for 2023. Figures are inferred from the Summer Economic Statement forecasts by updating SPU projections. One-offs that the Council considers relevant are excluded to assess the underlying fiscal position. SPU general government expenditure figures are updated to reflect the latest outturn data and the increases in expenditure in the Summer Economic Statement. General government revenue figures are derived using the updated expenditure figures and the general government balance forecast in the Summer Economic Statement. [1] Net debt projections were not provided in the Summer Economic Statement, and so are estimated as $\text{Net Debt}_t = \text{Net Debt}_{t-1} - \text{General Government Balance}_t$.

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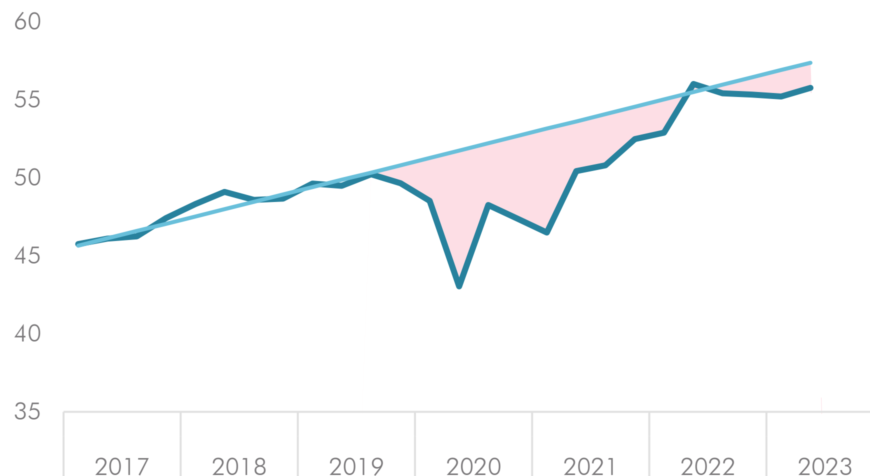
1. The Macroeconomic Context for the Budget

The Irish economy has continued to grow rapidly despite high inflation and the rise in interest rates.

Modified domestic demand has recovered strongly from the pandemic. The measure is near its pre-pandemic trend (Figure 1). Indeed, it briefly exceeded this in 2022 thanks to exceptionally high levels of business investment linked to multinational activities (Casey, 2023).

Figure 1: Modified domestic demand near its trend

€ billion, 2021 constant prices, seasonally adjusted



Sources: CSO, and Fiscal Council analysis. Get the data.

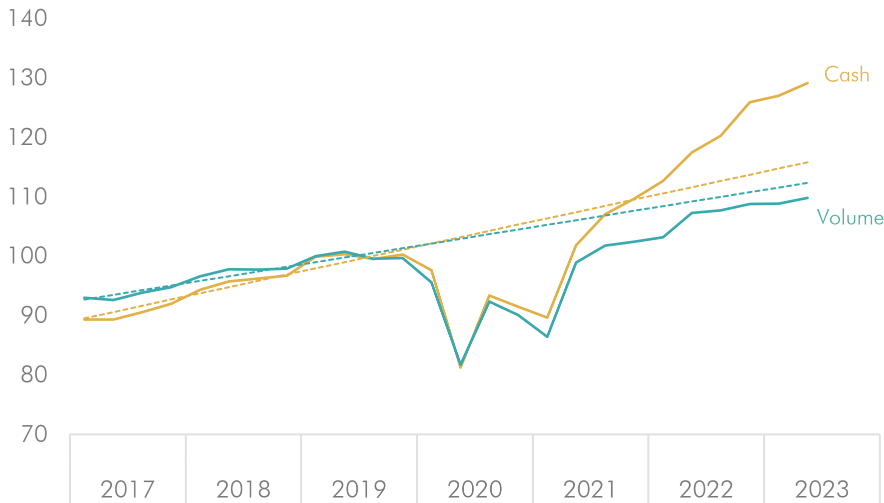
Consumer spending has also recovered close to its pre-pandemic trend. This is despite the impacts of higher inflation over the past two years. Consumer spending is expected to expand in real terms in the coming years as inflation eases and as real wages pick up. This should see a reversal of the recent pattern, with above-trend cash spending driven by higher prices, giving way to higher volumes of purchases as price pressures alleviate (Figure 2). The high stock of pandemic savings could support future activity further. Revised household data suggests savings rates have reverted towards pre-pandemic rates and have thus already boosted activity to some extent.

Construction activity and business investment has moderated in recent months. Although higher interest rates are likely to continue to weigh on real estate market developments, housing starts have picked up again recently and supply shortages are likely to mean demand for investment will not moderate too much.

The evidence of strong momentum in the economy is supported by tax receipts. Non-corporation tax receipts and PRSI are up by 7.8% for the first seven months of the year. If sustained, this would suggest some upside to the Government's projections for 5.2% growth in nominal GNI* this year.

Figure 2: Consumer spending volumes also close to trend

€ billion, personal consumption expenditure, seasonally adjusted

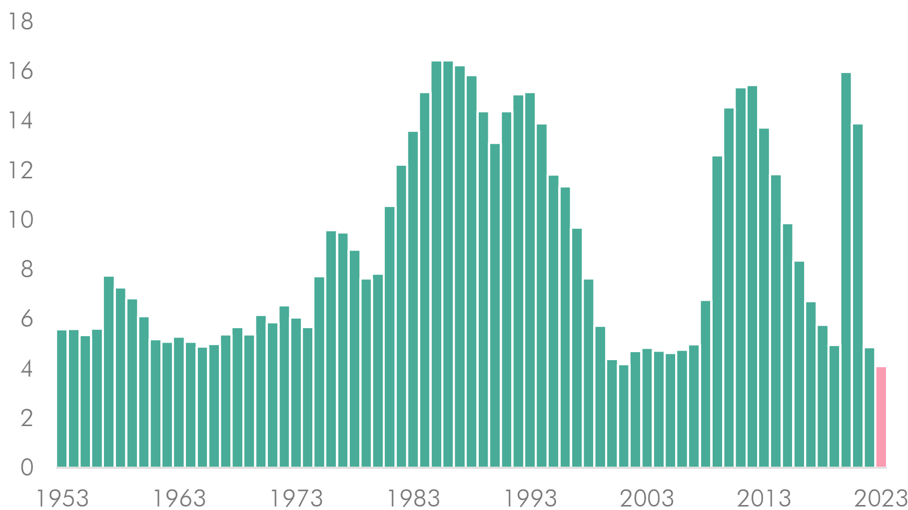


Sources: CSO, and Fiscal Council analysis. Dotted lines denote pre pandemic trends. Get the data.

At the same time, Ireland's labour market remains exceptionally tight, notwithstanding the rise in participation. Unemployment rates are close to all-time lows (Figure 3). Participation in the labour market has increased significantly since the pandemic, helped in part by remote working, though the rapid rise in the cost of living could also be a factor.

Figure 3: Unemployment rates remain at record lows

% of labour force, ages 15–74, adjusted for Covid-19 period



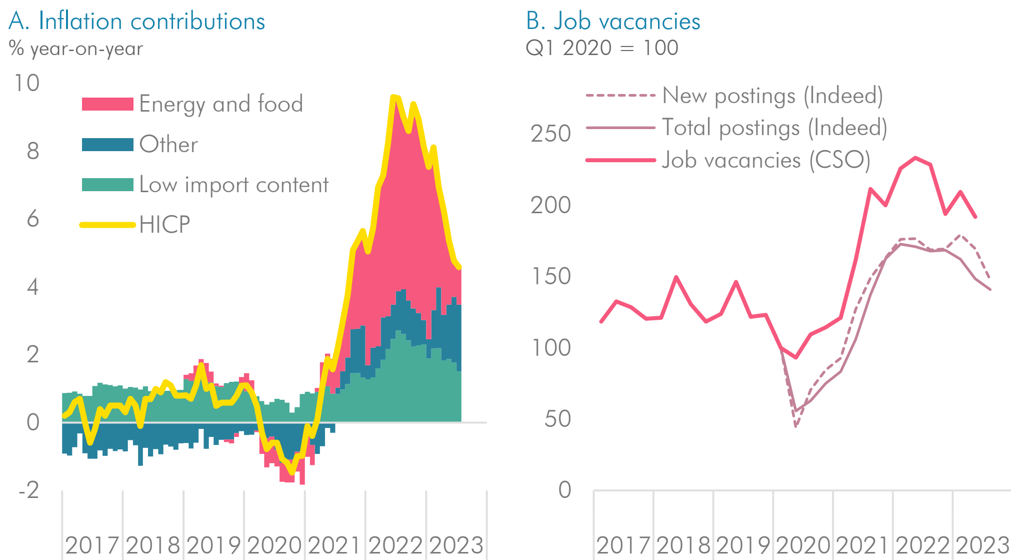
Sources: CSO, and Fiscal Council analysis. Get the data.
Notes: Data are extended back from 1997 using ILO compatible AMECO and ESRI datasets. The 2023 value is the to date figure for 2023 using monthly data up to July.

Inflation remains high, though it has declined from 2022 annual rates of close to 10%. Figure 4A shows that energy and food prices have driven both the increase and subsequent decline in inflation. Some reduction in electricity prices is expected in the winter months from recent falls in wholesale prices, but electricity prices will remain elevated.

Inflation has also declined for items with a low import content.[1] As such, inflation is being kept high by "other" items, including industrial goods other than energy. Prices for these items had been falling for many years prior to mid-2021 helped by technological advances and globalisation.

The recent moderation in prices bodes well for attempts to tame persistently high rates of inflation. High levels of demand for workers, as signalled by high levels of job vacancies, also appear to be moderating a little (Figure 4B). This could bode well in terms of Ireland avoiding a wage-price spiral.

Figure 4: Inflation and job vacancies have declined



Sources: CSO, Indeed, and Fiscal Council analysis. Get the data.

While the recent moderation in prices is welcome, there are risks that inflation could yet persist at high rates.

[1] See the December 2022 Fiscal Assessment Report.

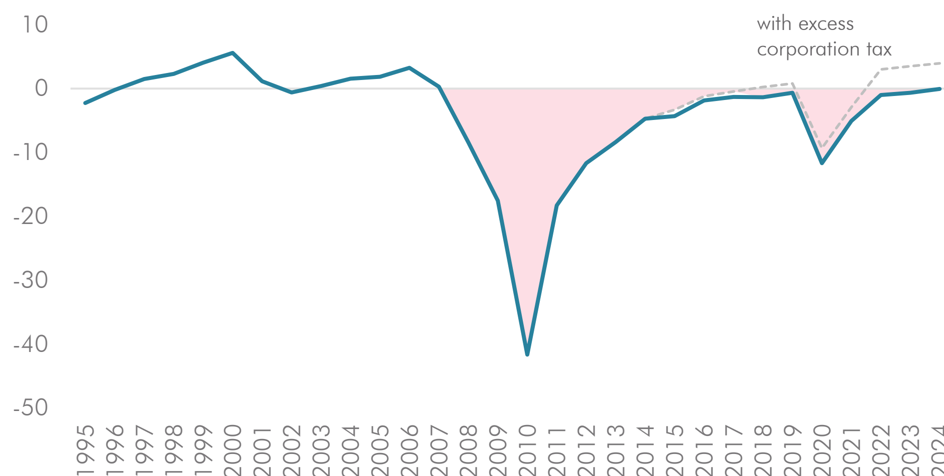
2. The Public Finances ahead of the Budget

The public finances continue to be boosted by exceptional levels of corporation tax, strong labour market conditions, and robust domestic demand.

The *Summer Economic Statement* forecasts a marginal deficit of €1.8 billion (0.6% GNI*) for 2023 when excess corporation tax receipts are excluded (Department of Finance, 2023). This would be the seventeenth year in a row that Ireland has run a deficit without the help of excess corporation tax receipts, and it comes at a time of strong economic conditions where stimulus is less warranted.

Figure 5: Government plans 17th year in deficit without excess corporation tax

General government balance excluding excess CT receipts, % GNI*



Sources: SPU 2023, CSO, and Fiscal Council workings. Get the data.
Notes: For excess corporation tax, SPU 2023 figures are used for 2021-2026. For 2014-2020, Fiscal Council estimates are used (see Box D).

The latest monthly Exchequer data suggest that the deficit excluding excess corporation tax receipts will likely be even larger than expected in the Summer Economic Statement. While some taxes continue to perform well, spending overruns have been mounting over the course of the year and could surpass additional non-corporation tax receipts.

Revenues are performing well

Revenues continue to perform well in a number of areas. Reflecting the strength of the labour market, income tax receipts are up 8.2% year on year, while PRSI receipts are currently 5.7% ahead of profile for the year.

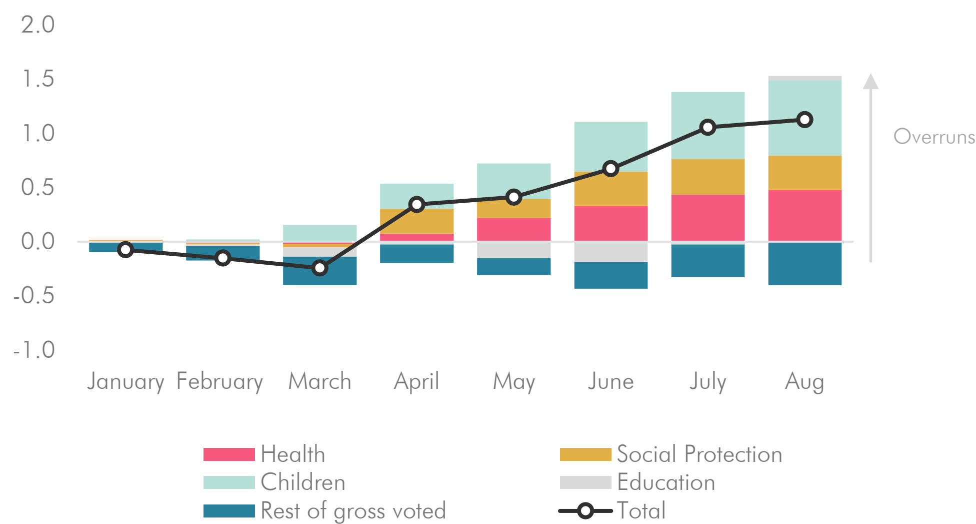
VAT receipts are up 11.2% year-on-year. Corporation tax is up €864 million (7.3%) on last year, but may fall short of SPU 2023 forecasts.

But spending overruns are also mounting

Current spending is now ahead of forecasts by €1.1 billion. Overruns in Health (€0.48 billion), Social Protection (€0.32 billion) and Children (€0.69 billion) have risen in recent months. The overrun in Children is likely to be driven by spending related to Ukrainian refugees. With a contingency of €0.4 billion earmarked for Ukrainian refugee spending, these developments imply that budgeted funds have already been exhausted.

Figure 6: Spending overruns are growing

€ billion, current spending



Sources: Department of Public Expenditure and Fiscal Council workings.
Notes: Figures for July reflect the transfer of the Disability function from the Department of Health to the Department of Children. Figures for the previous months do not reflect this transfer. Get the data.

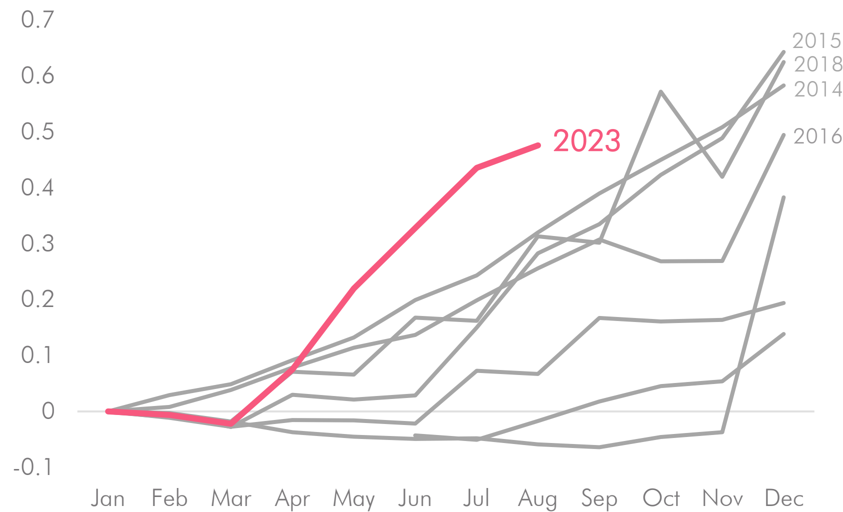
If health overruns progress in line with recent norms, an overrun of €500 million to €1 billion seems feasible.[2]

These developments point to the deficit excluding excess corporation tax receipts being larger than was projected in the Summer Economic Statement.

[2] Reports suggest that absent any additional financial control measures, the HSE was facing a €2.2 billion deficit this year. See for instance: https://www.businesspost.ie/news/cutting-e2-2bn-overrun-cannot-be-done-at-cost-of-care-hse-warns/.

Figure 7: Health Spending overruns are growing

€ billion, cumulative monthly health spending overruns in years 2014 – 2023



Sources: Department of Public Expenditure and Fiscal Council workings.
Notes: Figures for July and August 2023 reflect the transfer of the Disability function from the Department of Health to the Department of Children. Figures for the previous months do not reflect this transfer. Get the data.

And the Christmas Bonus has not been budgeted for

The cost of paying the Christmas Bonus, likely to come in December, has not been budgeted for yet. If paid, it will be the tenth year running that the bonus has been paid in some form.[3] It would be estimated to add €350 million to expenditure this year.

The Christmas Bonus should be included by default in budget projections. The precedent for it being paid has clearly been established.

Further ahead there are risks of even higher spending

There are several areas where ongoing spending could be higher, even in the short term, than is currently allowed for in budgetary projections.

The current public sector pay deal runs out at the end of 2023. A new public sector pay deal is currently being negotiated. Any early implementation of a new deal could pose risks to estimates of the budget balance for 2023.

Much of non-core spending appears to be long-lasting. The Summer Economic Statement outlined non-core spending of €4 billion in 2024. €2.5 billion of this relates to humanitarian support for Ukrainian refugees. A further €0.75 billion relates to Covid-19 expenditure.[4] Any health

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[3] In 2014, the Christmas Bonus was paid at 25% of a normal weekly welfare payment, before rising to 75% in 2015, 85% in both 2016 and 2017, and then to the full 100% from 2018 on.

[4] The final €750 million is covered by the Temporary Business Energy Support Scheme, the Brexit Adjustment Reserve and the National recovery and resilience plan.

expenditure related to Covid-19 that is still ongoing is likely to be permanent. As a result, this expenditure should be treated as core expenditure. Given the likely continued need for expenditure on humanitarian assistance for refugees, this expenditure looks increasingly like it should also be counted as core expenditure.[5]

Expenditure on the auto-enrolment pension scheme has also not been incorporated into government spending plans to date. The scheme appears to be delayed — it is now likely to start in the second half of 2024, rather than early 2024. We estimate that a half-year cost in 2024 could be around €62 million, with a full year in 2025 costing around €127 million.[6]

Corporation tax impacted by sector-specific factors and the introduction of a minimum effective tax rate

At a global level, there is evidence that profits will be lower this year among those pharmaceutical companies most exposed to a fall-off in Covid-19 vaccine sales. It remains to be seen what the lasting impact of this will be, including on Irish corporation tax receipts. However, the pharmaceutical sector is one of the two most important sectors for corporation tax receipts.

The rate of corporation tax for large corporate groups is to be increased from January in line with BEPS Pillar Two. This will see an effective rate of 15% applied to these companies. No precise estimates have been produced on how much revenue this could yield, but it could be substantial. In time, however, this yield could be partially offset or outweighed by revenue losses due to the implementation of BEPS Pillar One, which seeks to reallocate some of the taxable profits of large firms to where their sales take place.

An important consideration is whether this increased corporation tax rate should be considered as a discretionary revenue-raising measure. On the one hand, in the absence of behavioural change, it should lead to a permanently higher level of revenue. On the other hand, it is levied on large firms, hence it is likely to raise additional corporation tax on relatively few large multinationals. In time, these multinationals could respond in unexpected ways that offset any additional corporation tax receipts collected, implying a largely “excess” or “windfall” nature to these.

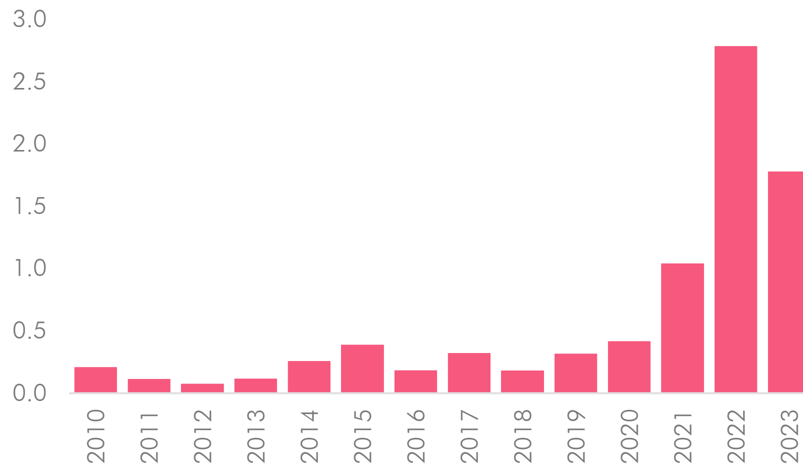
[5] The official macroeconomic projections underpinning the 2023 Stability Programme Update assume no major outward flow of Ukrainian migrants between now and 2030. Depending on how supports evolve over time, this could be seen to conflict with the non-core assessment of associated supports within the fiscal projections.
[6] See Box B, June 2023 Fiscal Assessment Report (Fiscal Council, 2023).

August's corporation tax receipts highlights unpredictability

In August, corporation tax receipts fell by 36% year-on-year. Figure 8 shows how unpredictable these receipts have become in August. Such volatility highlights the risks posed by relying on these revenue flows to fund permanent measures.

Figure 8: Unpredictable corporation tax receipts in August

€ billion, corporation tax receipts collected in August



Source: Department of Finance. Get the data.

Firm- or sector-specific shocks are a key risk to the sustainability of corporation tax revenues. Relatively few companies pay corporation tax in August. Indeed, most of these tax receipts are concentrated among a handful of large, foreign-owned multinationals in the ICT sector.

There is wide uncertainty around how much corporation tax is excess

Without the exceptional levels of corporation tax receipts being collected, the Government would still be running a deficit. Official estimates from the Department of Finance put the windfalls at €11.8 billion in 2023 — close to half the €24.3 billion of total corporation tax receipts expected to be raised this year. This is equivalent to more than one-in-every-four euros of tax receipts anticipated.

However, the exact amount of corporation tax receipts that can be considered "excess" is uncertain. Reflecting the uncertainties involved, the Councils' estimates a range for the excess between €10.2 to 15.4 billion (Figure 9), but there is still uncertainty around this range.

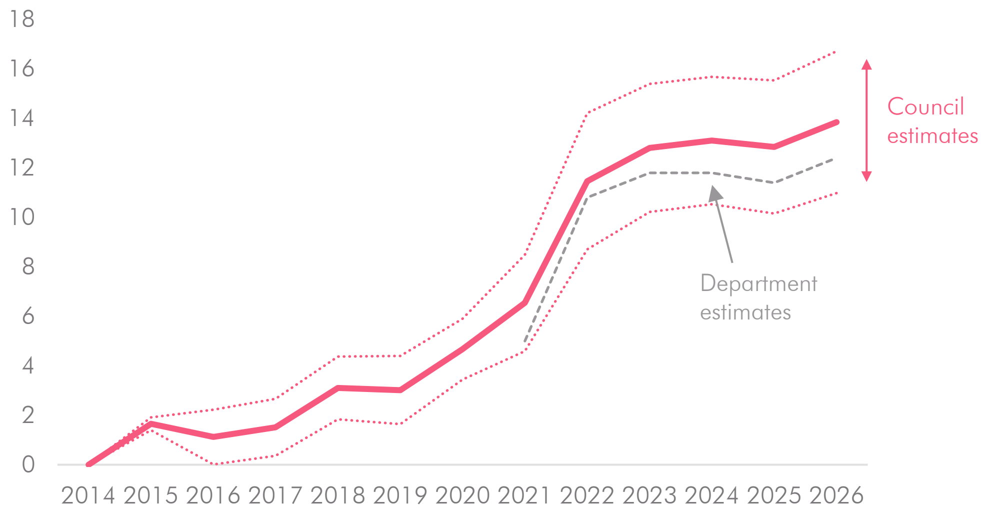
Recent research by the Council's Secretariat estimates that just three corporate groups accounted for one-third of these receipts between 2017 and 2021. Moreover, the receipts are dominated by tech and pharmaceuticals firms. The high level of concentration means there are

risks that these receipts could reverse depending on firm-specific factors and changes in the international tax environment.

These windfall receipts should not be relied on to fund permanent spending. Spending these revenues, which come from worldwide activities, risks adding to overheating in the Irish economy. Even if not excess, corporation tax receipts are still highly cyclical and so could fall depending on global economic conditions.

Figure 9: Windfall receipts could be higher than assumed

€ billion, estimated excess corporation tax receipts collected annually



Sources: Department of Finance and Fiscal Council workings. Get the data.
Notes: See Fiscal Council (2020a) for an overview of the models used to estimate windfall corporation tax receipts.

3. The Fiscal Stance ahead of Budget 2024

April's projections

In April, the Government set out plans that were consistent with the National Spending Rule. This would have meant no more than 5% growth in core spending net of new tax measures each year.

This speed of increase would broadly match trend growth rates for the economy and government revenues. Increasing permanent spending, net of tax changes, at this pace would help stabilise the economy and avoid adding to price and wage pressures.

In fact, the speed of increase planned by the Government in April was less than 5%. The plans involved a broadly revenue-raising approach. This meant that — on a net basis — budgetary increases were below the 5% rate of increase allowed under the National Spending Rule.

This would have meant that the Government gradually reverted to a hypothetical 5% path over time (Figure 9). It meant that — even with larger increases in permanent spending in recent years, the public finances would have been on a sustainable track.

Summer plans mean more tax cuts and more spending

In summer, with the Summer Economic Statement, the Government sharply revised its plans.

These plans comprise more permanent tax cuts and more spending increases than was previously envisaged. The Government now plans additional tax cuts of €0.6 billion every year out to 2026 — leading to a permanent tax reduction of €1.8 billion by 2026. At the same time, the Government plans to permanently raise the level of yearly current spending by €1 billion. And it intends to gradually increase annual capital spending such that the annual outlay is €1.1 billion higher by 2026 (Figure 10).

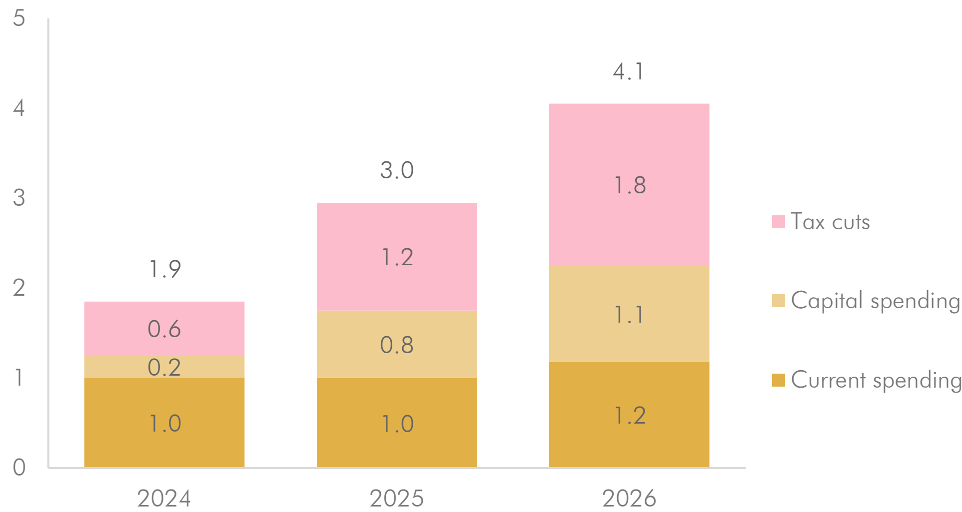
Indeed, the Government's revised plans now signal that it intends to breach the National Spending Rule every year out to 2026.[7] Cumulatively,

[7] The Council includes the additional capital spending termed "windfall capital investment" in this assessment as the additional spending as it is included in every year of the forecast horizon and is rising over time.

the planned breach is substantial at €4 billion (1.2 % of GNI*) by 2026 (Figure 11). This is equivalent to one-quarter of yearly education spending.

Figure 10: Plans for more tax cuts and more spending

€ billions, cumulative impact of new decisions

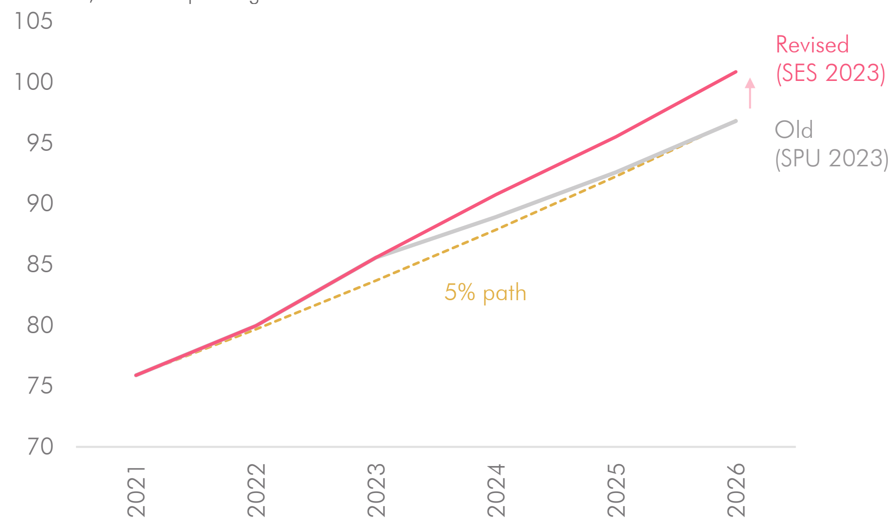


Sources: Department of Finance (SPU 2023) and the Government of Ireland's Summer Economic Statement (2023); and Fiscal Council workings. Get the data.
Notes: The Figure compares the plans as incorporated into the Summer Economic Statement and the SPU 2023 estimates published in April 2023. Capital spending includes the "windfall capital investment" allocations that the Council deems to be core spending.

The Council views the Government's revised plans for Budget 2024 as an overly expansionary stance for the coming years. More than that, the change in policy signals a worrying and lasting shift in policy. This shift reflects poorly on the planning and credibility of fiscal management.

Figure 11: The new plans mean a much higher path for net spending

€ billions, core net spending



Sources: Department of Finance (SPU 2023); Summer Economic Statement (2023); and Fiscal Council workings.
Notes: Core net spending assesses core Exchequer spending (excluding temporary or one-off spending) net of new tax measures. Specifically, it treats tax-raising measures as offsetting net spending increases and tax cuts as adding to net spending increases. The paths are assessed from 2021 onwards, taking account of cumulative tax changes in 2022 and beyond. Get the data.

The National Spending Rule currently sets a limit for core Exchequer spending net of tax measures at 5% every year. This is intended to broadly match the historical trend growth rate for nominal modified gross national income (GNI*), which total government revenues tend to grow in line with. The pace of the core net spending increase is currently projected at 6.0% for 2024, 5.2% for 2025 and 5.5% for 2026.

These breaches are a serious cause for concern

The plans to repeatedly breach the National Spending rule raise concerns on several fronts:

1) They signal a repeat of Ireland's past mistakes of procyclicality.

The economy is performing strongly, the labour market has never been tighter, there are risks of fuelling further price and wage pressures, and capacity constraints are binding.

The additional fiscal stimulus over and above what would be allowed under the National Spending Rule is particularly ill-advised at a time like this. It will add to price and wage pressures and lead to poorer value-for-money on public spending, with the economy already performing strongly. The upward revisions to policy measures also come as excess corporation tax receipts are helping drive the public finances into surplus.

The approach adopted by the Government echoes Ireland's past mistakes of using windfalls to finance permanent expansions. This runs the risk that these expansions have to reverse in bad times as temporary revenues dry up. It is a sign of the procyclical approach that Ireland has repeatedly adopted in the past when it comes to setting budgetary policy.

2) The stance adopted undermines the National Spending Rule.

The EU fiscal rules are effectively suspended at present.[8] Crucially, Ireland is likely to face less scrutiny under the new EU's proposed new fiscal rules as well. This reflects distortions to GDP among other factors (Casey and Cronin, 2023).

In the absence of effective guardrails at European level to ensure sound management of the public finances, Ireland will have to rely increasingly on its own fiscal framework to guide it. In this respect, the National Spending Rule had taken on more importance as a tool to ensure

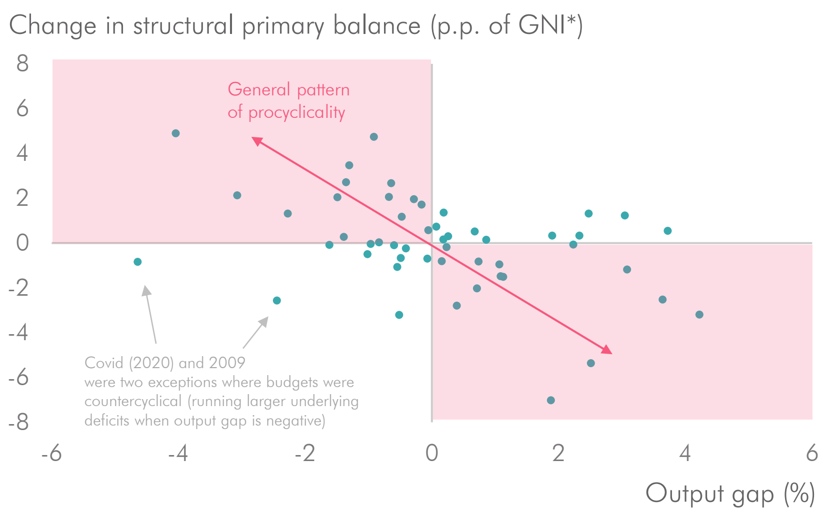
[8] The "exceptional circumstances" and general escape clauses of the domestic and EU fiscal rules were activated at the start of the Covid-19 pandemic in 2020 and will remain in place throughout 2023. This allows Ireland to temporarily deviate from requirements under both sets of rules in these years. In March, the European Commission (2023) confirmed that the general escape clause will be deactivated at the end of 2023. In addition, the Council assesses that "exceptional circumstances" will also cease to exist after 2023.

sustainable management of the public finances. Previous outturns and plans generally saw the Government sticking to the 5% limit for core net spending. However, the Government now plans to ignore the rule repeatedly. This casts serious doubts over the integrity of Ireland's own fiscal framework.

3) **The manner in which plans were revised weakens the credibility of Government projections.** As well as sharply adjusting up existing plans, the transparency around the announcements was poor. For instance, additional capital spending was presented as "windfall capital investment" and left outside of core spending. This is despite the fact that it was projected to be in place every year of the forecast horizon to 2026, with the amount of spending involved increasing over time.

   There are also strong reasons to suggest that the Government will introduce further expansionary measures at Budget time in the form of additional temporary or "non-core" measures. Spending overruns, including for health, are likely to push spending up further than projected again but are not reflected in the revised plans. And costs related to climate change, long-signalled but yet to be adequately quantified by the Government, are still not factored into plans.

Figure 12: Ireland's fiscal policy has been overly procyclical



Source: CSO, Department of Finance, and Fiscal Council workings. Get the data.
Notes: The change in the structural primary balance here excludes excess corporation tax receipts. The measure here is based on the Council's estimates of the output gap. The sample is 1971–2023. It should be noted that this is an imperfect measure of the fiscal impulse. It relies on how precise estimates of the output gap are as well as how the deficit responds to this, and one-offs are excluded here but may add to or subtract from the measured procyclicality of the fiscal impulse.

Ireland needs to break with its procyclical past. The pattern of running budgetary policy too loose in good times and too tight in bad times has been a routine feature of Irish policy for some five decades (Figure 12).

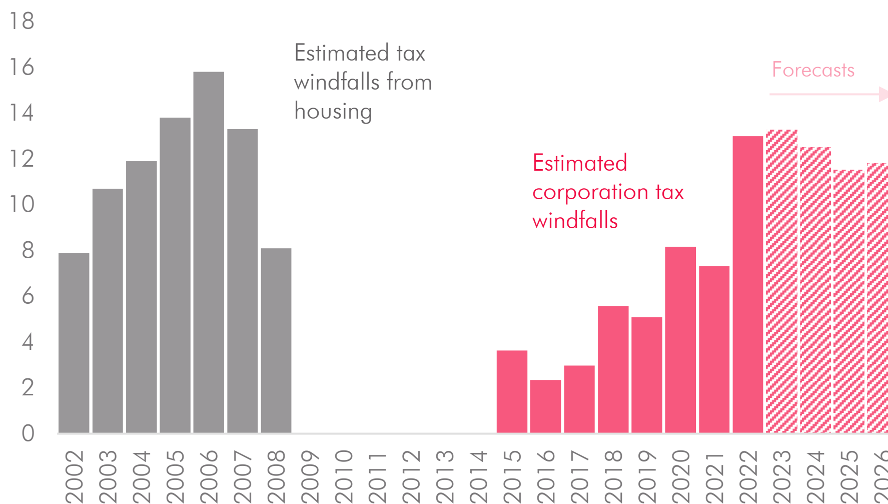
This has contributed to unsustainable policies in the past, including the size of the crash in 2008 and the years of austerity that followed (Fiscal Council, 2022).[9]

The Council recognises that additional spending in various areas may be warranted — this should be funded sustainably

There are clear pressures to increase spending across areas such as health, housing, and climate-related areas. If the Government wishes to ramp up spending across all these areas, it should do so in a sustainable way.

Even capital spending attracts ongoing commitments. For example, hospitals and schools require staffing and maintenance. As well as that, many areas of capital spending, such as on housing, are likely to be continuous rather than once off if they are to keep pace with population growth.

Figure 13: Windfalls then and now



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

Ensuring that capital outlays can be maintained on an ongoing basis well into the future means financing them in a way that is sustainable. This means ensuring that reliable revenue streams will be available in future. This would mean that the Government is not just relying on receipts that could prove temporary, such as excess corporation tax and the additional taxes raised when operating above normal levels of activity — above potential. Using these receipts, which are volatile and have a high risk of reversing, runs the risk of Ireland having to cut spending and raise taxes suddenly at some point

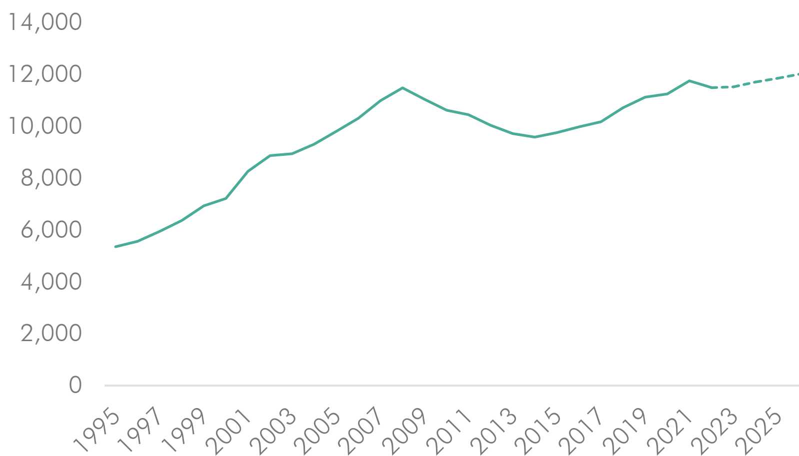
[9] While some one-third of the increase in gross government debt between 2007 and 2013 was directly attributable to the cost of capital injections to the banking sector, about two-thirds could be attributed to underlying deficits run over the same period.

in future, as was the experience following the excesses of the 2000s when windfalls rose to similar magnitudes (Figure 13).

Ireland has witnessed substantial increases in government spending since the 1990s. Having more than doubled between 1995 and 2008, non-interest government spending has broadly kept pace with population growth and price inflation since then. The level of real non-interest spending per person was the same in 2022 as in 2008, despite having been adjusted down after the financial crisis and despite having been supported by unsustainable receipts in 2007 (Figure 14). Forecasts show it continuing to outpace the growth in Ireland's population and price inflation.

Figure 14: Government spending has outpaced population growth

€ per capita, general government expenditure less one-offs and interest, constant 1995 prices



Sources: CSO; and Fiscal Council workings. Get the data.
Notes: The Figure shows total general government expenditure excluding interest expenditure, with one-off expenditure items such as banking recapitalisation amounts and Covid-related spending removed. The series is adjusted for inflation using the Harmonised Index of Consumer Prices for Ireland, with 1995 the base year, and is set on a per capita basis. Projections are based on SPU 2023 population and price forecasts and SES spending revisions (including "windfall capital investment").

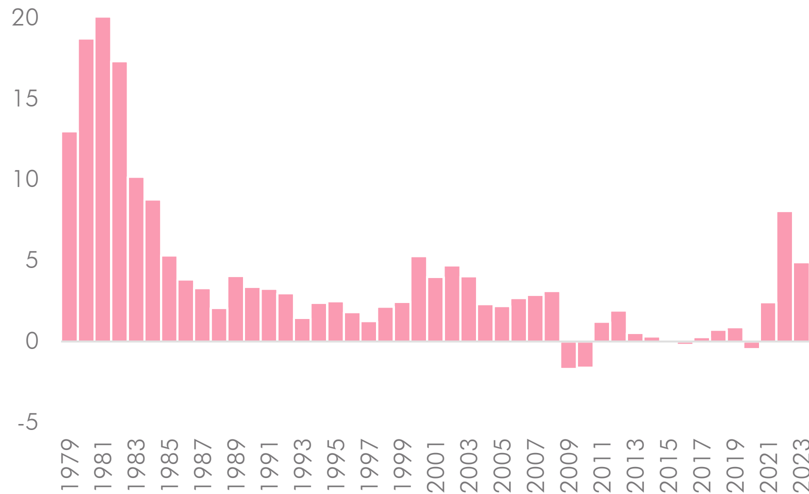
If the Government wants to continue to increase spending, it should do so in a way that does not jeopardise the overall sustainability of the public finances. This means offsetting any new spending, including for capital, in excess of the 5% growth limit set by the National Spending Rule. This offset can be achieved by raising taxes or reducing spending elsewhere.

New measures should be offset so as to stem price pressures

The Government's decision to inject more stimulus into the economy comes at a time when price pressures are high. The 2022 rate of inflation was the highest in almost four decades and the 4.9% forecast for 2023 remains high in terms of recent historical norms (Figure 15).

Figure 15: Inflation has been at historically high rates

% year-on-year change in HICP inflation



Source: CSO. Get the data.

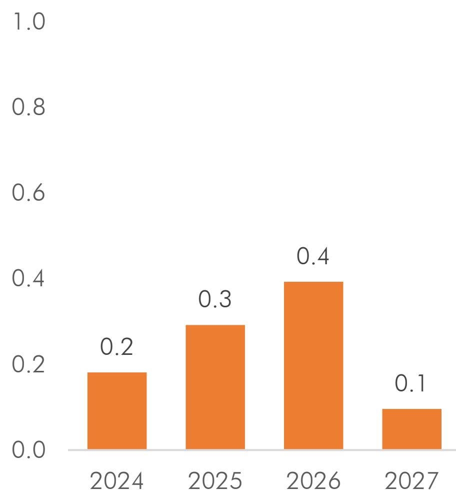
This decision carries risks. It could lead to more persistent wage, price and rent pressures. This, in turn, would tend to put a disproportionate burden on poorer households in terms of their cost of living.

The Council estimates that the additional stimulus relative to April's plans, set out in the SPU, would add about 0.2 to 0.4 percentage points to inflation rates in the short term between 2024 and 2026 (Figure 16A). This leads to the level of prices across consumer goods and services being higher cumulatively by 1% in 2026 (Figure 16B).

Figure 16: The budgetary stimulus will likely add to price pressures

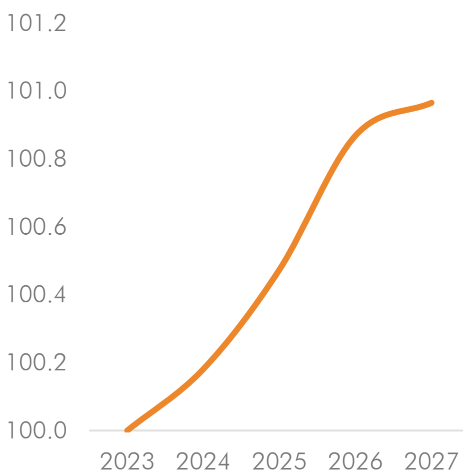
A. Impact on annual rates of inflation

p.p., impact on year-on-year rates, HICP



B. Cumulative impact on prices

Index: 100 = baseline, HICP level

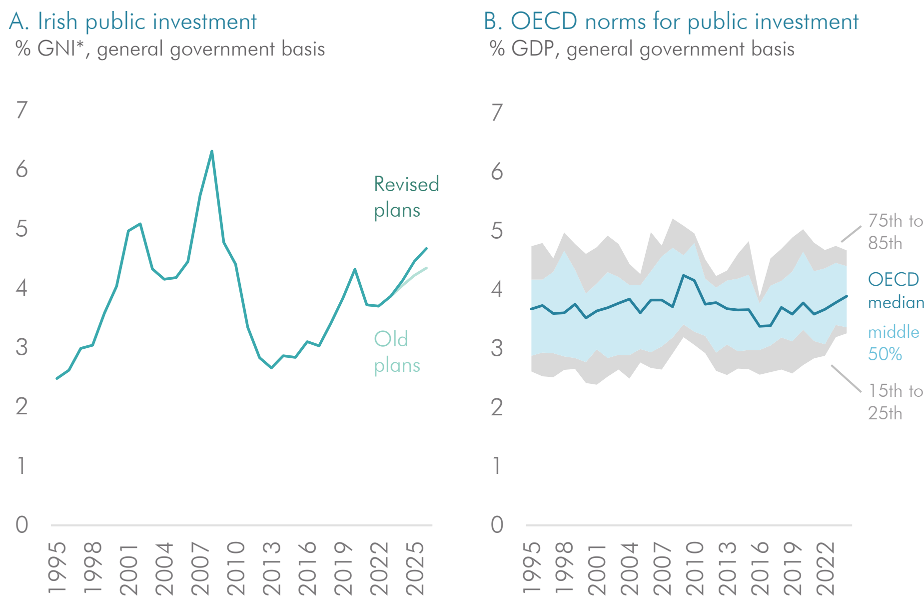


Sources: Fiscal Council workings. Get the data.

Notes: These estimates are produced using the Council's Maq model. The scenario models the difference between the SPU and Summer Economic Statement estimates for tax measures, as well as current and capital spending.

The decision to increase capital spending further comes as a large ramp-up in capital spending is already underway. The Government was on track to increase public investment as a share of GNI* to 4.3% by 2026. The new plans would be consistent with it rising to about 4.7% (Figure 17A). This would bring Ireland's public investment rate up to the 85th percentile for OECD countries over 1995–2022 — in other words to the point marking where the top 15% of spenders on public investment in the OECD stand (Figure 17B).

Figure 17: Capital spending was already being ramped up



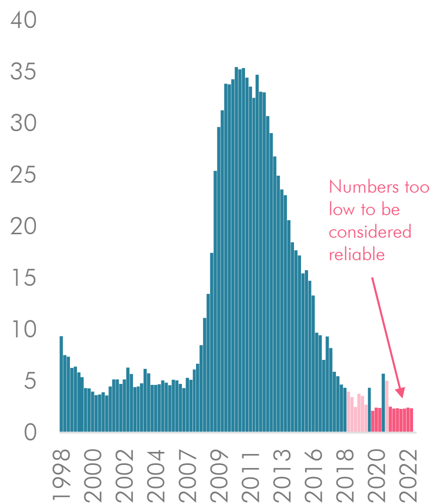
Sources: CSO; Department of Finance; OECD; and Fiscal Council workings.
Notes: The "Revised plans" in Panel A assume that general government gross fixed capital formation is revised up by the same nominal amount as gross voted capital spending was in the Summer Economic Statement. Get the data.

Bringing public investment to high rates by historical and international standards could help to address shortfalls in various areas such as housing health and climate. However, the decision to ramp up capital spending further again is likely to encounter some challenges — namely capacity constraints which will inhibit capital expansion from happening or reduce value for money on government investment.

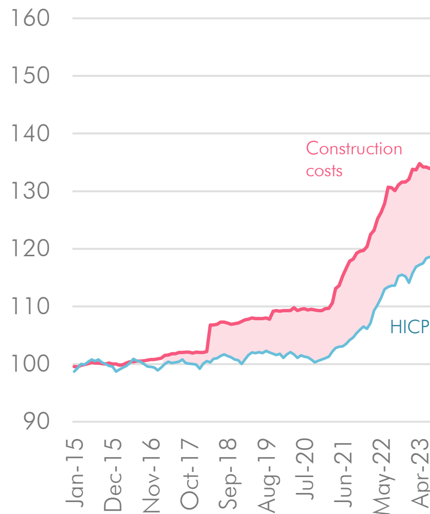
Rather than being a problem of just funding, Ireland now faces severe worker shortages in construction and pressures on materials costs. The implied unemployment rate in construction is closer to 2% — far below historical norms and the rate for the rest of the economy (Figure 18A). At the same time, construction costs for materials and workers have far outstripped other price measures in recent years (Figure 18B).

Figure 18: Capacity constraints are biting in construction

A. Worker shortages in construction
% implied unemployment rate (construction)



B. Construction cost pressures
Price index: 2015 = 100



Sources: CSO; and Fiscal Council workings. Get the data.
Notes: Panel A shows an estimated construction sector unemployment rate — defined as unemployed individuals reporting construction as their previous occupation. The rate is estimated as unemployed construction workers / (unemployed construction workers + employed construction workers + total potential additional labour force). The CSO's calculation of potential additional labour changed in 2017 so we impute potential additional labour force figures from Q3 2017 onwards based on changes in the new series. Red bars are estimates that take the lowest historically reported number of individuals responding as being unemployed and previously working in construction as the CSO reports no data where there are less than 30 respondents. The pink bars show CSO figures with health warnings attached as there are only 30-49 persons reporting. Panel B shows the price index for building and construction costs (materials and wages) as compared to a more standard measure of price inflation (HICP).

These capacity constraints are likely to be one reason why the Government has struggled to fulfil capital spending targets in recent years.[10] These issues are difficult to overcome. This is especially true given that the pressures to address shortfalls in areas such as housing and the climate transition are not unique to Ireland. Indeed, many countries are trying to address these areas at the same time.

The Government may have to find ways to alleviate capacity constraints before it can succeed in achieving its aims. This could include through fiscal tightening elsewhere, removing bottlenecks, and raising productivity in the construction sector. Developing a clear plan for addressing these needs would provide a platform to spend in areas less affected by the constraints or to accelerate spending when constraints are less binding.

The Government's ability to achieve value for money with its investment spending will be a key issue. Past findings suggest Ireland's investment spending has been less effective than in other advanced economies — falling some 58% behind the best performers (IMF, 2017). The poor "bang

[10] For example, in the area of housing, there has been a cumulative underspend of €0.4 billion over 2020-2022.

for buck" was deemed to reflect too many sector strategies, weak results frameworks, limited information on cost estimates, inadequate links between plans and funding decisions, and not enough emphasis on maintenance spending. Some of the IMF recommendations have since been implemented though Conroy, Casey and Jordan-Doak (2021) found scope for the Department of Expenditure to improve its analytical techniques, its analysis of existing assets, and its reviews of past investment projects.

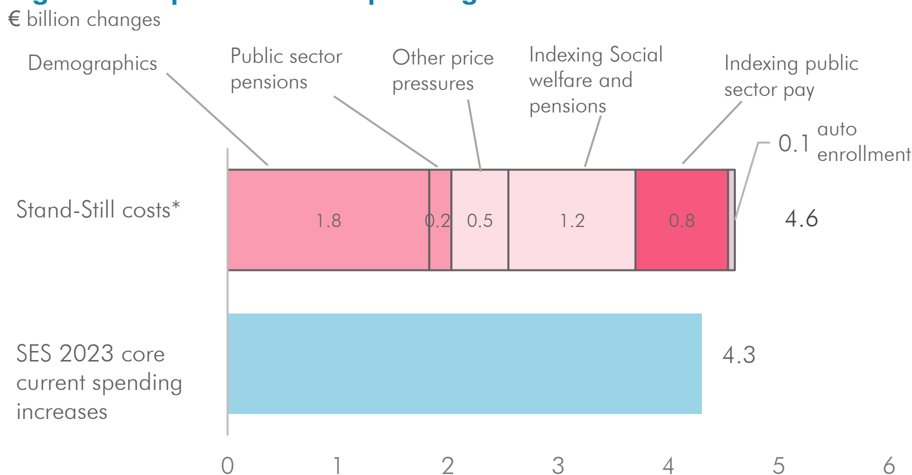
In terms of current spending, the Government is close to meeting Stand-Still costs. The Government's plans in the Summer Economic Statement signalled a €4.3 billion increase in core current spending in 2024. Of this, the Department estimates that €2 billion is available for new measures. However, the overruns expected in 2023 will absorb much of this.

The Council estimates that if the Government were to fully maintain the real value of public services and supports, this would cost approximately €4.6 billion (Figure 19). As a result, the core current spending increases outlined in the SES are close to but slightly short of covering the costs of standing still.

It should be noted that increasing spending fully in line with Stand-Still costs is not necessarily advisable in the current environment. In the context of a tight labour market and economic activity running above its potential, fully indexing all spending would run the risk of exacerbating those very price pressures. This could lead to more persistent rates of high inflation.

Figure 19: Space for core spending is close to Stand-Still costs

€ billion changes



Sources: Department of Finance; and Fiscal Council workings. Get the data.
Notes: *The Stand-Still costs are based on Fiscal Council estimates of the cost of covering demographics and price/wage pressures for inflation in 2024. Estimates of the cost of the autoenrollment scheme are lower than those estimated in Fiscal Council (2023). This is due to the expected delay in the scheme, which is now expected to begin in the second half of 2024.

One feature of the National Spending Rule worth considering is the extent to which it does not allow a government to fully meet Stand-Still costs in times of high inflation. This reflects the fact that the rule was set in nominal terms: allowing 5% increases in core spending.

At these times of high inflation, the 5% limit automatically binds more and this pushes the Government to make tough choices. Periods of high inflation are typically in periods when the economy does not require support.[11]

By contrast, when inflation is low, typically in periods when the economy could do with more support, the same 5% limit in the National Spending Rule affords the Government more space. A nominal rule therefore has the benefit of reining in fiscal stimulus when times are good and allowing more scope for stimulus when times are bad.[12]

Given the decision to pursue further tax cuts, and expand capital and current spending, the Government does not appear to have faced up to the hard choices confronting it. In its June assessment, the Council highlighted the clear choices facing the Government in terms of sticking to the National Spending Rule and following a sustainable fiscal policy. The Government faced a difficult decision in terms of how far it decided to go between choosing to maintain spending in real terms, opt for tax cuts, and ramp up capital spending more than planned. Rather than choose between these options, it has decided to expand on all fronts.

There is little to no justification for further one-off measures

A likely feature of the upcoming Budget is the continued use of one-off measures. In the Summer Economic Statement, the Government announced substantial non-core spending of €4 billion for 2024. This includes a sensible contingency for Ukrainian supports of €2.5 billion, along with Covid-related spending of €0.75 billion and a further €0.75 billion related to specific areas of expenditure supported by EU funding.

The Covid-related spending is highly questionable as a non-core measure. In fact, the Minister for Health has openly questioned this classification and noted that much of the Covid spending is no longer "once off" in nature.[13] If this non-core item was added to the core spending increases planned for

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[11] There are other approaches, including allowing for some adjustment to the rule depending on price pressures (see Box I of the May 2022 Fiscal Assessment Report for a discussion).
[12] This would be the case in general conditions, though circumstances such as stagflation — where prices are rising and output falls below its potential — would be an exception.
[13] See Business Post article dated July 16 2023.

2024 it would potentially raise the pace of increase in core net spending to almost 7% next year — a full two percentage points above the 5% limit. [14]

There is little justification for additional temporary supports beyond the €4 billion announced. Such one-offs were appropriate to address recent cost-of-living pressures, given the uncertainty around price pressures at the time. However, energy prices are now falling and uncertainties have reduced. There is now less justification for such one-off measures.

The Council will assess the one-off measures introduced carefully as part of its overall assessment of the fiscal stance underpinning *Budget 2024*.

Medium- and long-term budgetary challenges

The outlook for Ireland's public finances has improved, but there are major challenges ahead. Many of these challenges have yet to be fully costed and factored into the Government's budgetary plans.

The most substantial challenge facing the Government over the medium term is that of Ireland's ageing population (Figure 20). Ireland faces a sharp increase in pensioners relative to workers in the coming years, as well as longer life expectancies for those in retirement. This is likely to put substantial pressure on age-related expenditure, including for pensions and healthcare spending, while also contributing to a slowdown in economic growth.

Another risk not assumed in future projections for Ireland's surpluses is that corporation tax receipts continue to remain exceptionally high. The assumption underpinning the Summer Economic Statement is that windfall corporation tax receipts remain more or less constant at close to €12 billion per annum between now and 2026. However, these receipts are subject to huge uncertainties. While they could increase in the near term, they could reverse quickly depending on the international tax environment and firm-specific decisions.

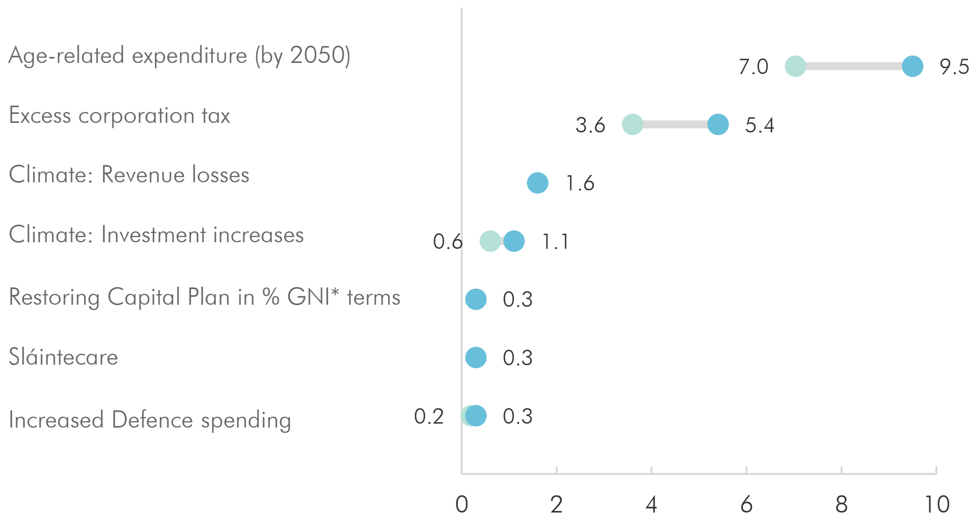
A further cost not adequately factored into the Government's projections is the costs associated with the climate transition. Together, the potential revenue losses and additional investment requirements related to the climate transition could be as high as almost 3 percentage points of GNI*. New work suggests that expenditure needs will peak in the late-2020s and

[14] This core net spending estimate treats Covid-related spending as non-core expenditure in 2023 and core expenditure in 2024. This accounts for the likelihood that some Covid-related expenditure will continue indefinitely and, thus, become part of the core expenditure base. The exact year that the additional health spending becomes "core" is unclear and so assigning it to an increase in 2024 may not be appropriate. However, the spending would still increase core spending levels by €750 million and further beyond the 5% path implied by the National Spending Rule regardless of the exact timing.

early-2030s, while steady revenue losses can be expected over the coming two decades in the absence of new revenue streams being introduced.

Figure 20: Ageing pressures are at the forefront of fiscal challenges

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



Sources: Casey and Carroll (2023); Commission on the Defence Forces (2022); and Fiscal 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 costs are preliminary estimates from a forthcoming release. Get the data.

The Government needs to face up to these medium-term challenges

These medium-term challenges are sizeable and need to be addressed.

In terms of ageing-related costs, the decision to abandon pension age increases puts pressure on other areas to adjust. This means that addressing pension funding shortfalls will now require substantial future tax increases or spending cuts in the absence of other reforms.

An important takeaway from the long-term sustainability analysis carried out by the Fiscal Council is that acting sooner rather than later could reduce the costs involved substantially (Fiscal Council, 2020).

As regards costs related to climate, the Government needs to develop its work further. Specifically, the expected impacts on the public finances need to be identified both in terms of expected revenue reductions as people shift away from fossil fuels and in terms of expenditure supports needed.

The Savings Vehicle could help

The fact that Ireland is benefiting right now from exceptional corporation tax receipts presents an opportunity as much as it does a risk.

By saving these receipts, Ireland can prevent the risk that it builds up permanent spending commitments on the back of transient or uncertain revenues. At the same time, it can develop a new revenue stream that has the potential to make a big dent on future ageing-related costs. This would have the advantage of significantly improving inter-generational fairness.

With this in mind, the Government should be ambitious with its proposed Savings Vehicle. It should avoid temptations to funnel windfall tax receipts towards financing more immediate spending increases and tax cuts (see Box A).

Box A: The Savings Vehicle is a good proposal – it should not be watered down

The Government set out an ambitious vision in May 2023 for how to address future spending pressures, while putting exceptional corporation tax receipts to good use. The basic idea was to save windfall corporation tax receipts and use the investment returns from this saving as, in effect, a new revenue stream. This revenue stream could then be used to tackle a predictable rise in spending related to Ireland's rapidly ageing population.

The Savings Vehicle could help tackle future ageing pressures in a sensible way

The Council welcomed the broad approach underpinning the Savings Vehicle for two key reasons:

First, the corporation tax receipts are unreliable and risky to use for permanent budgetary measures. It is not possible to guarantee that Ireland's windfall corporation tax receipts will be available in future years. They are simply too concentrated among a small number of foreign-owned multinationals. One-third of receipts have come from just three corporate groups in recent years (Cronin, 2023). More than half of receipts come from ten groups (Revenue, 2023). Moreover, the receipts represent a net injection of funds into the Irish economy. This is unlike conventional taxes that are taken out of the domestic economy. Using these receipts now, at a time when the economy is operating above normal levels of activity and with evidence of capacity constraints, would be unwise. Worker shortages and high price pressures are widespread. Adding to activity now would add to already high rates of inflation and would lead to poor value for money being achieved on Government spending.

Second, the Savings Vehicle represents a credible way to help tackle ageing costs. Ireland's population is ageing rapidly. The Department of Finance expects yearly spending related to aging to rise by some €8-9 billion from 2035 in today's terms. The decision to abandon planned increases in the pension age means that there are substantial shortfalls in funding to be made up. The Government had committed to providing a roadmap for how it would increase PRSI rates so as to help address future pensions shortfalls. However, this roadmap has yet to be published having originally been planned for spring 2023, then more generally before the end of Q2 2023.

The future tax increases required to plug pensions shortfalls could be sizeable. A typical worker with an average salary/wage of €35,000 would stand to pay an additional €1,630 in PRSI by 2050 in today's money and €1,920 by 2070. The new Savings Vehicle could go some way towards addressing these shortfalls, even if additional measures are still likely to be required. The Council estimates that using the savings and targeting a constant PRSI rate earlier could reduce the tax increase on a typical worker to €360. Looking at just the use of windfall corporation tax receipts, the Department estimates that, if saved, these could cover 56% of new annual ageing costs in 2030 and 41% in 2035.[15]

Recent suggestions point to less ambitious savings and more immediate spending

The exact details of how the Savings Vehicle will work are yet to be determined. But there are signs that more of the windfall receipts are likely to be spent rather than saved.

In July, there was a suggestion that the Government would establish a new public investment fund. This fund would be separate from the Savings Vehicle initially proposed. It would seek to ensure that capital spending is not cut in the event of a downturn as happened after the financial crisis when annual capital spending was cut by some 60% from pre-crisis levels.

In August, there were suggestions that the Government would divert as much as €8 billion from the new sovereign wealth fund into capital spending on housing. This would be an effort to boost the supply of social and affordable homes. This reflected the view that rising building costs among other things meant that additional funding would be required to address housing shortages over and above existing allocations. Unlike the "saving to ensure capital spending is not cut in downturn" idea, this would imply clear plans for additional capital spending.

The rationale for an investment fund is weak

Redirecting the windfall receipts to capital spending in the coming years carries risks and the rationale for an infrastructure fund is weak. Increasing capital spending now would add to already high capital

[15] This assumes a 3% real — or inflation adjusted — return on savings, which is in line with what in line with what is assumed by Norway, Canada, and the OECD (2021). It also 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.

commitments. This approach would also fuel further price and wage increases and exacerbate capacity constraints, most notably in construction where workers are particularly scarce.

The Government already has the necessary tools to plan for and increase capital spending in a sustainable way. A better approach would be to build on these existing tools.

First, the National Spending Rule helps ensure that Government spending does not exceed typical growth rates for the economy and government revenues. The public finances are likely to be close to balance when excluding boomtime receipts and windfall corporation tax. Sticking to sustainable growth rates for spending increases and tax cuts would help avoid a large hole opening up in the public finances should a downturn materialise or should some corporations see their profits reduce.[16] This approach would help ensure that Ireland reduces its debt burden steadily and avoids the need for undesirable cuts to capital spending as future challenges arise. It would also take some of the heat out of the economy, through say tax increases or spending reductions elsewhere, should the Government wish to prioritise capital projects.

Second, the Government already has a framework for how to plan investment spending: the National Development Plan. This framework should be used as a means of identifying the Government's capital ambitions over a longer time frame.

Combining the National Spending Rule and the National Development Plan would yield a sustainable vision for how Ireland achieves its public investment ambitions. It would allow the Government's capital plans to be framed in the context of the fiscal space afforded by the National Spending Rule over a long time horizon and the expected costs of standing still: in other words, the costs of maintaining other existing spending programmes. If the Government wished to increase capital spending at a faster pace, this would have to be traded off against the hard choices of increasing taxes or adjusting spending plans elsewhere.

Ambitions should focus on the Savings Vehicle

In contrast to the infrastructure Fund, the Savings Vehicle presents a far more unique opportunity. It presents one solution to tackle generational challenges related to ageing and it offers a credible means of reducing the burden that will likely be placed on future generations of taxpayers. The Council has already outlined some ways it could be reinforced (Fiscal Council, 2023), but the general idea is a good one and should be pursued ambitiously.[17]

[16] Some commentators argue that capital spending will be once-off in nature and so should be exempt. This is ambiguous. Many of the pressures are in housing and are likely to be ongoing – more houses will be required as the population grows. Other pressures relate to healthcare and the climate transition where other costs are likely to recur – hospitals will have to be staffed and the commitment to a "just transition" could involve long-lasting subsidies, including for farmers.

[17] See Box E on the Savings Vehicle in the Council's June 2023 Fiscal Assessment Report.

Looking to Budget 2024, the Council assesses that:

- The Government should adjust its net spending plans so as to stick to its National Spending Rule. This would ensure more credible and sustainable fiscal plans. It could be achieved by introducing offsetting tax increases or spending adjustments elsewhere. To this end, there is a role for developing more comprehensive reviews of existing programmes.

- There is little to no justification for further temporary non-core measures in *Budget 2024*. Energy prices are falling, and the temporary measures introduced to date have been very poorly targeted, while still risking adding to price pressures.

- The Government should explore alternative ways to alleviate capacity constraints. This could include through fiscal tightening elsewhere, removing bottlenecks, and raising productivity in the construction sector.

- The Government should improve its long-term planning. The Government's fiscal plans only extend to 2026, a point in time right before new estimates from the Council suggest that climate costs are projected to mount (Casey and Carroll, 2023). This prevents a full assessment of how sustainable the Government's medium-term fiscal plans are. Ageing pressures are also likely to deepen over the course of the next decade.

- The Council welcomes ambitious proposals for a new Savings Vehicle. Temptations to spend windfall corporation tax receipts should be resisted. The Government's proposed Savings Vehicle presents a unique opportunity to put excess corporation tax receipts to good use. It could create a new funding stream that reduces the need for future tax increases or spending cuts as the population ages and as pension shortfalls arise. The Government should resist temptations to redirect windfalls to further spending in the immediate future. This would destabilise the economy, exacerbate capacity constraints, fuel inflation, and result in poor value for money on public spending.

- The Government should reinforce its National Spending Rule as a "first line of defence". The Government's National Spending Rule has proven to be a useful anchor but is at risk of losing its credibility. With Ireland likely to face less scrutiny under the new EU fiscal rules, the National Spending Rule takes on more importance as a local safeguard. It should be reinforced in several ways including by putting it in legislation, having a debt anchor, excluding cyclical unemployment spending, and widening it to capture general government spending. In addition, the Government should set the three-year expenditure ceilings in line with the spending rule on Budget Day and as part of the standard budgetary process.

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