Box G: Ireland's green transition can be managed

Climate change will have large impacts on the public finances, but these costs can be managed.

The costs of the green transition appear high

In a new report, published in October, staff at the Fiscal Council considered the potential fiscal costs related to climate change (Casey and Carroll, 2023). The area with the largest impact relates to the green transition.

If Ireland meets its targets, lower fossil fuel use would reduce tax revenues from petrol, diesel, and natural gas. Vehicle taxes tied to emissions would also reduce. The reductions in revenue could rise to 1.1% of GNI* by the end of the decade and to 1.6% of GNI* over the long run. Spending supports would also be required to encourage the transition. These could require annual outlays of about 1.1% of GNI* towards the end of the decade, eventually settling at closer to 0.7% of GNI* over the long run.

But taxes could be replaced and spending may be manageable

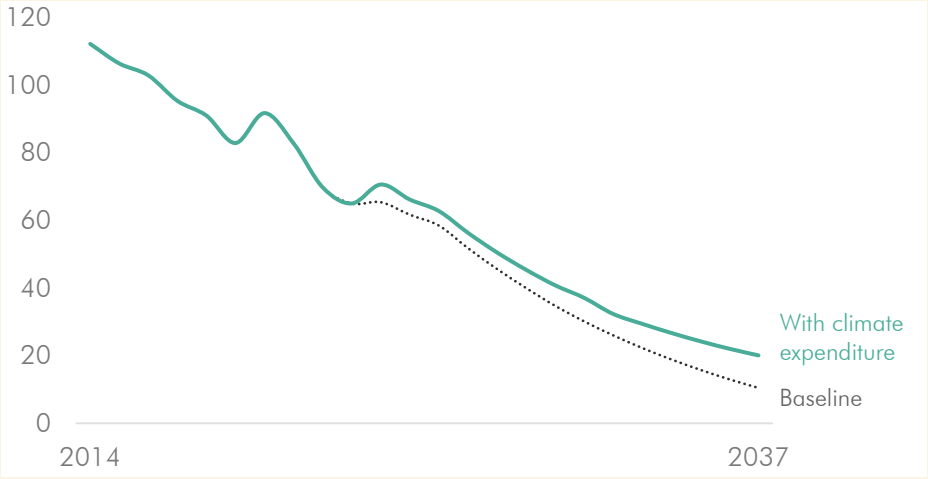
A point worth stressing is that the reductions in revenues related to the climate transition could be replaced without changing the average effective tax burden. As in, these are revenues that are already being collected today. In a sense, these could simply be replaced without adding to tax rates on average.

The expenditure impacts could also prove quite manageable. While the outlays are large initially, they are less than half the scale of the revenue losses expected over the long term. Moreover, they are not that large when compared against other long-term challenges. For instance, they are estimated to be at most one-tenth the estimated impact ageing will have on long-run spending. And, assuming that revenues are replaced and the economy avoids more severe shocks, the costs could be managed while still ensuring a steady pace of debt reduction.

We consider the impact the government's net debt ratio using the Council's Maq model. We assume that revenues are replaced in full such that there is no change in the effective tax burden related to the climate transition. As in, taxes on fossil fuels are replaced by other taxes of some form. Drawing on the expenditure costs estimated in the "high cost" scenario in Casey and Carroll (2023), we model the impact on the net debt ratio. For simplicity, we assume all expenditure is additional, financed by smaller surpluses, in the form of public investment, and that it therefore has a macroeconomic impact ordinarily associated with public investment.

№60 **Climate-related spending supports could be managed**

% GNI*, net debt ratio



Source: Fiscal Council workings drawing on Casey and Carroll (2023).
Notes: The baseline scenario is extended in line with the central scenario in Casey and Cronin (2023).

The results suggest that the path for Ireland's debt ratio would remain on slower but still steadily downward path. It is estimated to be about 10 percentage points higher by 2037, but still low at close to 20% of GNI*.

How exactly this will be managed needs to be thought through carefully

There are risks. The climate-related spending could push up price inflation by as much as one percentage point on average out to the end of the decade if it is in addition to what is allowed by the National Spending Rule. This risk would be more pronounced if unemployment remains low and if capacity constraints continue to bind.

One useful way to think of climate challenges is through the lens of its potential impacts on individuals.

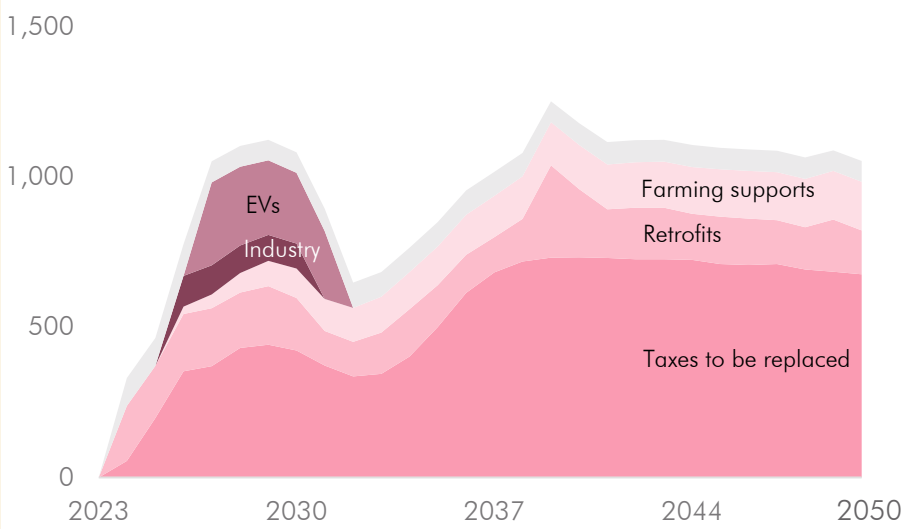
The largest single area of impact will be the taxes that dry up related to reduced fossil fuel use (N°61). This equates to about €700 of taxes per person needing replacement in some form. This could be achieved through spending cuts, by increasing existing taxes or by creating alternative tax sources.

Decisions on what spending supports might look like are also needed. Temporary costs will likely be needed to encourage the uptake of electric vehicles and to help facilitate carbon capture systems being introduced in industry. But ongoing costly supports are also likely to be needed to retrofit the housing stock. In addition, there may be a need for income supports for farmers most impacted. However, there are questions around whether these income supports will be necessary. Both impacts in these areas are of the order of €150 to €160 per person annually.[41]

N°61

Big decisions are needed on Ireland's climate transition

€ per person estimated impact of climate-related supports and revenue reductions, 2023 prices



Source: Fiscal Council workings; Casey and Carroll (2023).

Addressing these costs will require a lot of big decisions. Planning for the transition carefully will be essential to ensure a smooth transition and to guide behaviour effectively. Introducing supports incrementally or in an ad-hoc way could undermine efforts if individuals choose to delay actions, for example on retrofits or on personal transport, in the hope that more financial supports will be introduced at a later stage.

There are also large costs to inaction. Purchasing credits and transfers could prove difficult as well as costly.

[41] These costs are on a per capita basis. If set on a per worker basis, they would be larger and potentially rising more as the workforce shrinks with an ageing population.