Box H: The Future Ireland Fund

This box looks at the larger of the two new funds announced as part of Budget 2024, the "Future Ireland Fund". The Fund is intended to generate a savings pot with annual investment returns used to offset future costs such as ageing. The Council welcomes this initiative having called for such a vehicle in the past.

Ireland's new savings vehicle, the Future Ireland Fund

The Future Ireland Fund's aim is broadly stated as helping to "defray costs incurred by the State". The general scheme mentions several areas that could be addressed: ageing, climate, digitalisation and other fiscal and economic challenges. While its purpose is vague, it nonetheless achieves two key aims.

First, it will help to alleviate the burden on future generations from a predictable rise in ageing-related costs, such as for healthcare and pensions.

Second, it saves some of the windfall corporation tax receipts rather than using these to fund permanent budgetary outlays such as increases in recurrent spending or tax cuts. These receipts are exceptionally unreliable and have a high risk of suddenly reversing. The recent increase in receipts is linked to the 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 be risky. Furthermore, using these receipts at a time of very low unemployment would likely fuel further price and wage pressures.

For these reasons, the development of the fund is something to be welcomed.

Key features of the Future Ireland Fund [43]

Initial transfer and annual contributions

- Some €4.1 billion is being transferred to the Fund from the dissolved Reserve Fund
- Yearly contributions equivalent to 0.8% of GDP will be made to the Fund until 2035
- At that point, a decision will be made about future contributions
- A "significant deterioration" in the public finances could warrant varying contributions

Drawdowns

- Drawdowns will not be permitted until 2041
- Drawdowns cannot reduce the overall value of the Fund to below its capital
- Drawdown amounts would be advised on by the NTMA
- Drawdowns would require a Dáil resolution and government approval
- If the NTMA advises that the Fund's average returns over ten years would be less than borrowing costs, the Minister could propose to reduce the Fund's capital

Investment strategy

- The NTMA will determine the investment strategy
- Investments will be on a commercial basis in or outside the State
- The focus of investments is to be global, but since Irish assets are a feature of global indices, there is provision to allow for Irish exposures to be managed
- Investments are to be "responsible" in line with Environmental, Social and Governance (ESG) considerations
- All income, capital and benefits received from holdings and investments will be paid into the Fund and invested to its benefit to allow the Fund's value increase faster

Linking the contributions to GDP is a little surprising. Ireland's GDP has been historically volatile and unpredictable given that it is heavily distorted by the activities of foreign-owned multinationals. The rationale for using GDP is that this is a close equivalent of the tax base itself for corporation tax receipts.[44] Another option would have been to link contributions to

[43] Note that these key features are based on the General Scheme of the Bill that was published on 12 October 2023. These are subject to ongoing development in the drafting of the Bill.

[44] A closer equivalent to the tax base would be net operating surplus, yet econometric modelling of corporation tax receipts has tended to favour using GDP (Casey and Hannon, 2016; Purdue, 2016).

more appropriate measures of the economy, such as GNI*. This measure is more predictable and less volatile, but there is a weaker link to how corporation tax receipts evolve than with GDP. Another option would have been to tie the contributions more clearly to the estimated level of corporation tax windfalls actually collected. This would have meant a clearer link to windfalls. However, there would still be challenges involved in terms of defining the exact level of windfalls.

There are other implications of linking contributions to GDP. If windfalls rose more than the rise in GDP, these would not automatically be saved. This could happen if, for instance, capital assets used to offset tax payments were fully depreciated resulting in higher windfalls but lower GDP. The GDP link also means that contributions are likely to be made even in cases where corporation tax windfalls reduced.

The design of the Fund is relatively airtight in terms of ensuring contributions and limiting withdrawals before 2041. A government would likely have to change legislation for withdrawals before 2041 to occur. This is possible of course, but the logic of saving for future needs and reducing the burden on the next generation may deter future governments from abolishing the Fund or reducing its value.

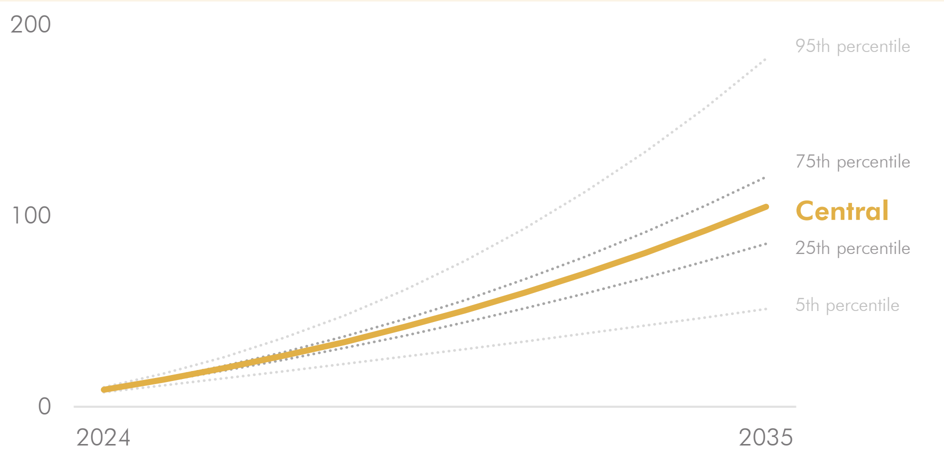
How might the Fund evolve?

The Government has suggested that the annual contributions and re-invested returns could see the Fund grow to €100 billion by 2035. This would be in line with annual returns of roughly 5% each year and nominal GDP growth averaging just over 4% annually.

There are obviously wide uncertainties. Linking contributions to GDP growth adds to the uncertainties around what returns might be achieved on investments. Using historical data on international investment returns from similar national pension funds and historical GDP growth rates, we simulate the Fund's potential returns and contributions (N°64).[45] On this basis, we estimate a 50% probability of the Fund ranging from €85 to €120 billion in size by 2035. There are strong upsides to the potential size of the Fund. Historical returns in equivalent funds have averaged higher than 5% annually and closer to 6%.

N°64 **The Fund could grow substantially over the next decade**

€ billions, potential fund reserves



Sources: Department of Finance projections and Fiscal Council workings.
Notes: The central projections assume nominal GDP growth in line with official assumptions in *Budget 2024* up to 2026, *SPU 2023* for 2027 to 2030, and Department of Finance (2023c) for 2031 to 2050. The assumed return is close to 5%.

A fund that grows to a size in this range would make a substantial dent in ageing costs in the coming decades. Extending the above simulations and assuming contributions continue after 2035, the Fund could cover more than half of the increase in ageing costs vs 2023 in 2041 and a quarter by 2050 (N°65). The range is again large, with a 90% probability that roughly 10% to 50% of additional costs could be covered by 2050. While not covering all of the

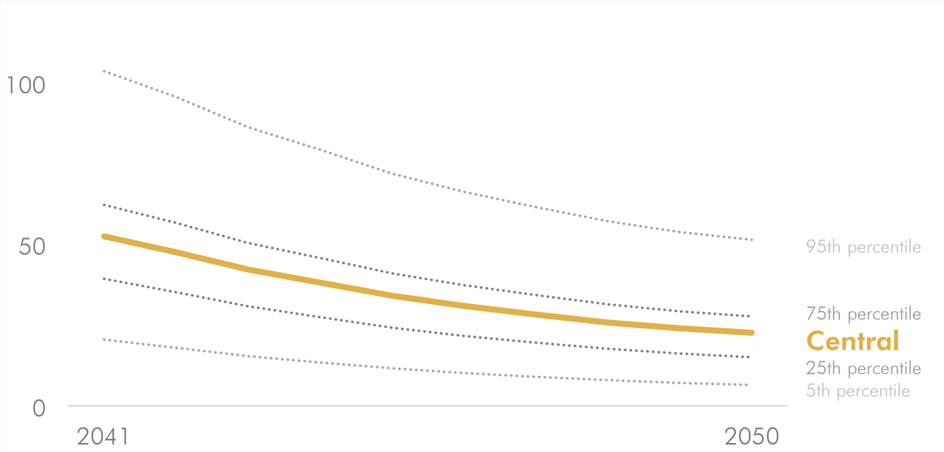
[45] Specifically, we treat nominal GDP growth as a random walk and develop 10 million simulations of the Fund's reserves drawing randomly from a distribution of the historical returns of similar pension funds (Norway, Japan, Australia). The sample used for GDP growth rates is 1990 to 2023.

additional costs associated with an ageing population, this would nonetheless reduce the need for tax increases and spending cuts for future generations.

Nº65

The Fund could cover a substantial portion of ageing costs

% of estimated additional ageing costs relative to 2023



Source: Fiscal Council workings.
Notes: The chart draws on estimates from the Council's (2020) Long-term Sustainability Report, comparing the increase in costs related to ageing for each of the years shown versus 2023.