Irish Fiscal Advisory Council

Fiscal Assessment Report

December 2023

The Government needs a serious fiscal framework

Foreword

The Irish Fiscal Advisory Council was established as part of wider reforms of Ireland's budgetary architecture. It was set up on an administrative basis in July 2011 and was formally established as a statutory body in December 2012 under the Fiscal Responsibility Act. The Council is a public body, with the terms of its funding set out in the Fiscal Responsibility Act.

The Council's mandate is to:

- Endorse, the Department of Finance's macroeconomic forecasts in Budget and Stability Programme Update.
- Assess the Department's official forecasts.
- Assess compliance with the Budgetary Rule.
- Assess whether the government's fiscal stance is conducive to prudent management of the economy and public finances.

The Council's Acting Chairperson is Professor Michael McMahon. Other Council members are Ms Dawn Holland, Dr Adele Bergin, and Mr Alessandro Giustiniani.

The Council's Secretariat consists of Dr Eddie Casey, Mr Niall Conroy, Mr Kevin Timoney, Mr Killian Carroll, Ms Karen Bonner, and Mr Brian Cronin.

The Council would like to acknowledge the kind help from staff at the Central Statistics Office (CSO), Central Bank of Ireland, Economic and Social Research Institute (ESRI), and the National Treasury Management Agency (NTMA).

The Council submits its Fiscal Assessment Reports to the Minister for Finance and within 10 days releases them publicly. This report was finalised on 5 December 2023.

More information on the Irish Fiscal Advisory Council can be found at www.FiscalCouncil.ie.

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Contents

Chapters

1 Macro Assessment Capacity constraints and overheating risks	9
2 Budgetary Assessment Spending forecasts are inadequate and opaque	31
3 Fiscal Stance A time for restraint	65
4 Fiscal Rules Exceptional circumstances set to end	89

Boxes

Box A: The inflationary impact of *Budget 2024* tax cuts	14
Box B: Revisions to Irish consumption data	17
Box C: What does “core” and “non-core” mean?	36
Box D: Fiscal gimmickry strikes back	38
Box E: Are health pressures predictable?	45
Box F: What is happening Ireland’s corporation taxes?	55
Box G: Ireland’s green transition can be managed	78
Box H: The Future Ireland Fund	84
Box I: The Infrastructure, Climate and Nature Fund	87
Box J: The latest developments towards EU fiscal rules reform	95

Summary Assessment

Summary assessment

The Irish economy remains strong. Economic activity has broadly recovered, and the jobs market is exceptionally tight. This is despite numerous pressures: high prices, the rise in interest rates and international risks. The economy looks to have been performing above its normal capacity. As such, prices are at risk of staying higher for longer. This is clearly not a time to add too much stimulus to the economy.

With Budget 2024, the Government opted to introduce another large, untargeted budget package. The budget package in total was about €12 billion (3.9% of GNI*). This puts it in line with other post-Covid budget packages. The package is substantial. It is about three times larger than pre-Covid budget packages, which typically amounted to €3 to 4 billion.

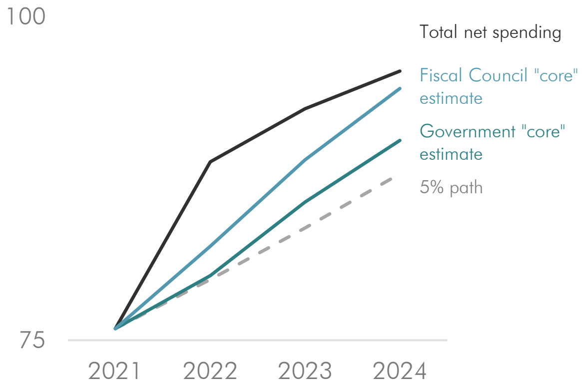
Cost of living supports will help many but were largely untargeted. Less than one-third of the cost of living supports introduced by the Government in Budget 2024 were targeted. Universal energy credits and child benefit payments featured once more. A smaller package of targeted measures could have supported those most vulnerable at less cost. The lack of targeting is also unhelpful for dampening price pressures.

This Budget will add to price pressures in the economy. Instead of prioritising areas most in need, the Government opted to raise current spending, ramp up capital spending, cut income taxes, and introduce another substantial package of cost of living supports. This "everything now" approach repeats past mistakes of using temporarily strong tax receipts to expand the budget quickly. If the National Spending Rule and the Council's recommendations to dispense with temporary supports had been followed, it would have meant consumer price inflation in 2024 closer to an estimated 2.2% rather than 2.9%. The larger package risks keeping inflation higher for longer. And new evidence in this report suggests tax cuts could fuel price pressures by more again.

Taking the budget figures at face value, the Government looks set to repeatedly breach the National Spending Rule. The pace of expansion in terms of spending increases and tax cuts is about 5.8% in 2024. This compares to the Rule's 5% limit. Since the Rule was introduced in 2021, the level of budgetary measures is cumulatively €6.6 billion (7.5%) above what would be implied by a 5% path.

Repeat breaches of National Spending Rule

€ billion, core net spending



The Government employed fiscal gimmickry to flatter its numbers. Measures introduced in *Budget 2024* lacked transparency. The Government used many techniques to present lower spending than is likely. Many of the measures labelled as "non-core" or presented as one-off in nature look likely to persist beyond 2024. This includes the Ukrainian supports and Covid spending in health. Some of the cost-of-living measures introduced, such as mortgage interest relief, also look likely to stick around. A widely anticipated health overrun for 2023 was ignored in the budget figures. And a new category of capital spending labelled "windfall capital investment" is clearly just additional capital spending but was treated as outside of both "core" and "non-core" spending.

These deliberate attempts to game fiscal assessments are deeply concerning. Gimmicks like this tend to crop up when governments want to make budgetary figures look more favourable than they really are. The National Spending Rule's focus on core spending is also likely to have prompted this. The Government should not continue this gimmickry.

The reality is that pressures to spend more will be substantial. The Council estimates that "Stand-Still" costs are far higher than is allowed for in official projections. These are the costs of providing existing public services, given an older and growing population and higher prices. The pressures in health are particularly acute. The Budget ignored this year's health overruns and the health allocation for 2024 was barely sufficient to cover Stand-Still costs. The pressures in these areas are largely predictable and should not come as a surprise. They follow the ageing of the population and the tendency for prices to rise faster in healthcare. Not dealing with them head on risks further overruns in future.

Notwithstanding that, revenues also face upside risks and the immediate debt path looks sustainable. Revenues could prove stronger than forecast in *Budget 2024*. While there have been concerns around corporation tax receipts falling of late, and there are risks around how long they will remain strong, there are several reasons windfalls could continue to grow in the near term.

The Future Ireland Fund is an important milestone. While the Council is highly critical of many aspects of *Budget 2024*, the development of the Future Ireland Fund is something it strongly welcomes. The Fund puts risky corporation tax receipts to good use and has the potential to grow substantially. This should lessen the need for higher taxes or deep spending cuts on future generations. Our simulations suggest that the Fund could potentially offset more than half of Ireland's ageing costs in 2041 and a quarter by 2050.

Committing to the National Spending Rule is key. The Government has not shown its commitment to the spirit of the National Spending Rule. Official plans show repeated breaches, and gimmicks are being used to hide the extent of these. Ireland's public finances are unlikely to be guided by EU fiscal rules in future. This means the National Spending Rule will be key to helping guide the public finances through major challenges such as the climate transition and the rapid ageing of Ireland's population. The Rule can also help ensure that the Government is able to support the economy through future downturns rather than raising taxes and cutting spending, as it did during the austerity period. To ensure this, the Rule needs to be reinforced and, most importantly, adhered to.

Summary Table of *Budget 2024* Economic and Budgetary Projections

% GNI* unless otherwise stated

	2022	2023	2024	2025	2026
Macro forecasts					
Real GNI* growth (%)	6.7	2.0	2.0	2.1	2.2
Nominal GNI* growth (%)	17.1	7.2	4.9	4.4	4.4
Nominal GNI* (€bn)	273	293	307	321	335
HICP growth (%)	8.5	7.1	2.4	1.8	2.8
Output gap (% of potential)	1.6	1.4	1.1	1.2	1.3
Potential output growth (%)	2.9	1.0	2.0	2.2	0.0
Budgetary forecasts					
Balance excl. excess corporation tax	-0.8	-0.7	-0.9	0.8	1.1
Balance	3.1	3.0	2.7	4.4	4.4
Balance (€ billion)	8.5	8.8	8.4	14.2	14.6
Balance excl. one-offs [1]	6.0	5.5	4.7	4.5	4.4
Balance excl. one-offs [1] (€ billion)	16.4	16.1	14.3	14.5	14.7
Revenue excl. one-offs [1]	42.7	42.8	42.3	42.4	42.1
Expenditure excl. one-offs [1]	36.7	37.3	37.7	37.9	37.7
Primary balance excl.one-offs [1]	7.2	6.6	5.8	5.6	5.5
Revenue growth excl. one-offs 1 (%)	17.4	7.5	3.6	4.7	3.6
Primary expenditure growth excl. one-offs 1 (%)	7.7	9.2	5.9	5.2	3.9
Gross debt ratio (% GNI*)	82.3	76.1	72.3	68.4	64.8
Net debt ratio (% GNI*)	68.9	62.9	63.3	60.1	57.4
Gross debt (€ billion)	225	223	222	219	217
Cash & liquid assets (€ billion)	37	38	28	27	25
Net debt (€ billion)	188	184	195	193	192
Fiscal stance					
Structural primary balance[2]	1.9	1.2	1.4	1.6	1.6
- change (p.p.)	2.3	-0.7	0.2	0.2	0.0
Net policy spending growth (%)	6.8	10.4	5.6	4.8	3.4
Change in net debt ratio (p.p.)	-13.9	-5.9	0.4	-3.2	-2.8
Fiscal rules					
National Spending Rule	✓*	Breach	Breach	Breach	✓
Expenditure Benchmark [3]	xc	xc	n.a.	n.a.	n.a.
Structural Balance Rule	xc	xc	✓	✓	✓
Overall Assessment	xc	xc	✓	✓	✓

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

Notes: Output gaps and potential output estimates, including those used for the structural balances, are based on the Department of Finance's preferred alternative estimates. xc = Exceptional circumstances apply for these years, meaning that a temporary deviation from the requirements of the fiscal rules is allowed. [1] These figures exclude one-offs. One-offs that the Council considers relevant are excluded to assess the underlying fiscal position. These include Covid-related expenditure and expenditure and revenue related to the EU funds for the Brexit Adjustment Reserve and the National Recovery and Resilience Plan. [2] This is based on the Council's own "bottom-up" estimates of the structural primary balance. [3] From 2024, the Expenditure Benchmark changes slightly (Chapter 4). * In 2022, the Government set itself a 5.5% limit, even though the National Spending Rule was designed to be a 5% limit typically.

Macro Assessment

Capacity constraints and overheating risks

1 Macro Assessment

Capacity constraints and overheating risks

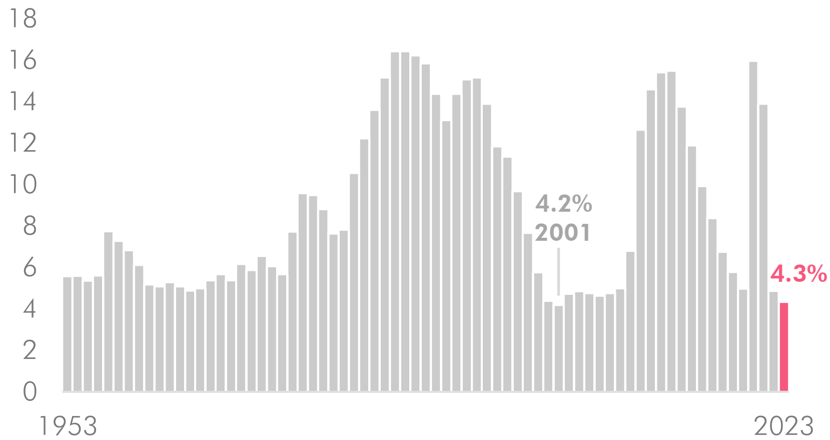
The Irish economy continues to be resilient. The jobs market remains exceptionally strong, and economic activity has recovered. This is despite numerous pressures, including inflation, increasing interest rates, and international risks.

The labour market is tight

The number of unemployed people in Ireland relative to the size of the total labour force is low (N°1). Rapid inward migration, and significant demand for labour in high-skill activities, have supported Ireland's economic growth through a turbulent period for the global economy in recent years.

Nº1 **Unemployment is close to record lows**

% unemployed in labour force, ages 15-74



Sources: CSO, AMECO, ESRI, and Fiscal Council workings. Get the data.
Notes: 2020–2022 annual data are adjusted for Covid-19 pandemic unemployment payment recipients. Data are extended back from 1997 using ILO-compatible AMECO and ESRI datasets. 2023 reflects the average seasonally adjusted monthly unemployment rate for January to October.

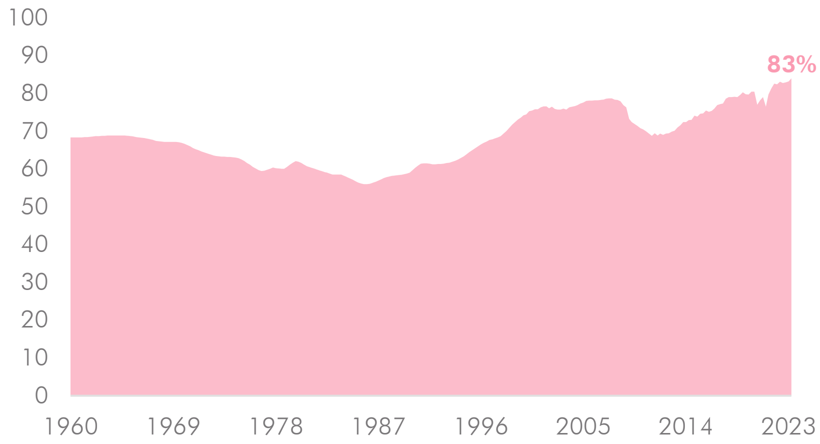
The tightness of the jobs market is also visible when we look the share of the prime-aged population at work (N°2). High participation and low unemployment rates have become a recent feature of developed economies.[1]

1 See https://www.oecd.org/sdd/labour-stats/labour-market-situation-oecd-updated-october-2023.htm

Nº2

Record high employment

% of population at “prime” age (25-54 years old) employed



Sources: CSO, AMECO, ESRI, and Fiscal Council workings. Get the data.

One explanation for this could be the improved work–life flexibility provided by a more widespread ability to work from home. It is plausible that such a change could mean a structurally higher participation rate. Continuing high levels of job vacancies indicate that labour demand is unusually strong, and this may be a “pull factor” encouraging more people to seek work. At the same time, an important “push factor” is that inflation has squeezed household income, while rents and mortgage interest costs have also increased. High labour force participation could therefore reflect cyclical as well as structural factors.

The economy remains resilient

The level of overall activity has recovered close to levels that would have been expected to be in place, without the pandemic-induced economic downturn. This is visible in measures of real domestic activity such as modified domestic demand and modified gross national income (GNI*) (N°3).

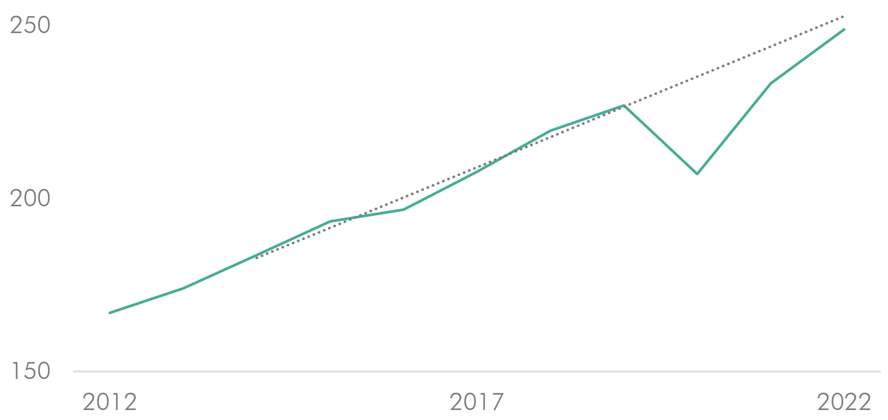
Growth has slowed somewhat in recent months, reflecting the impact of higher prices and interest rates. Nonetheless, momentum from rapid growth in 2022 has carried through, and a strong annual expansion in 2023 appears likely.

Hours worked in the Irish economy — an important input to real economic growth — increased by 2.4% for Q1 to Q3 2023, boosted by high participation and net inward migration. Capital spending has also grown rapidly, with new dwelling completions up by 8.8% for the first nine months of the year. These volume-based growth figures augur well for 2023 growth in real GNI*.

Nº3

National income has rebounded from the pandemic

€ billion, 2021 prices



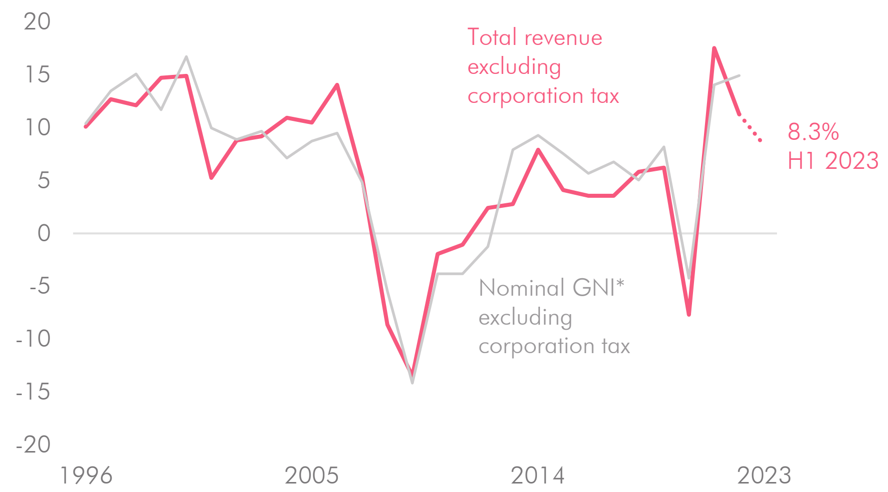
Source: Timoney (2023). Get the data.
Notes: Economic activity shown above is a bottom-up estimate of real GNI*. It is based on the income approach described in Timoney (2023). It includes all of Ireland's national income, except for gross operating surplus for three sectors whose profit flows in Irish GDP accrue predominantly to owners abroad: foreign-owned manufacturing, information/communication technology, and renting/leasing. This is shown due to the concerns regarding the deflators applied to top-down estimates of real GNI* (FitzGerald, 2023). Net exports of foreign-owned multinationals are included in real GDP with specific trade deflators, but subsequently removed from GNI* with different deflators for net factor income and depreciation. This results in a volatile and occasionally misleading real GNI* series — for example, the official growth rate for real GNI* growth is negative in 2015, despite other indicators showing robust growth that year.

Tax data also signal strong nominal growth. Government revenues excluding corporation tax grew 8.3% in the first half of 2023 (Nº4). Similarly, household and government gross national income grew by 8.1% for the same period.

Nº4

Government revenues signal rapid nominal growth in 2023

% change, year on year



Sources: CSO, and Fiscal Council workings.

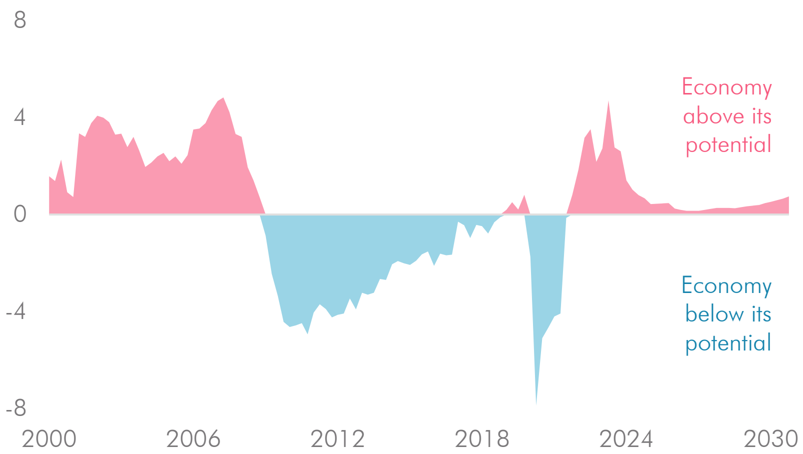
Output gap estimates point to overheating

When we apply the Council's models (Casey, 2019) to the Department's economic forecasts, we can see some evidence of overheating. In the second quarter of 2023, actual levels of economic activity are estimated to be nearly 5% above the mid-range of the economy's potential (N°5). This is the same as levels estimated by the same models for the first half of 2007.

Nº5

The economy is showing signs of overheating

% gap between actual and potential economic activity



Sources: Department of Finance, and Fiscal Council workings.

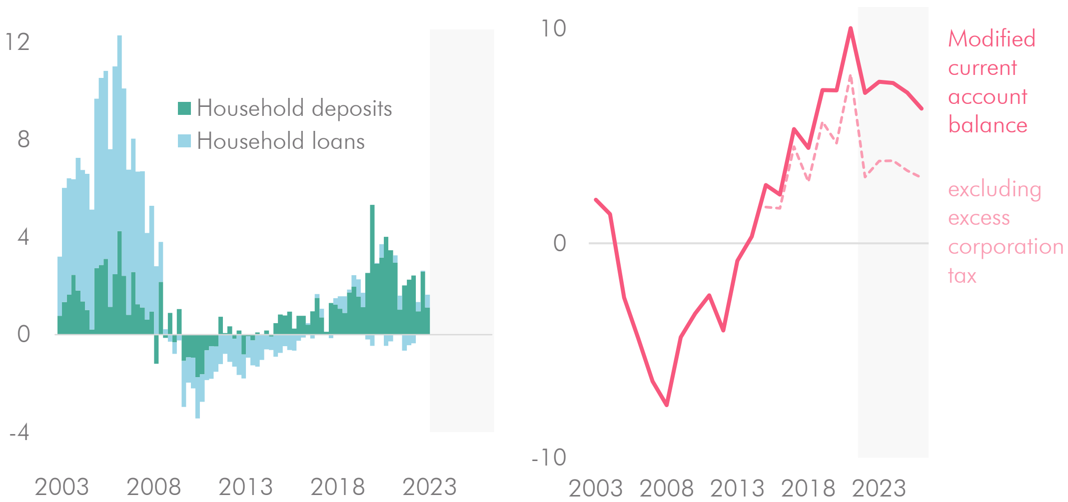
But other measures are less clearcut

Other measures that we typically assess to understand imbalances in the economy are less clearcut. The levels of debt taken on by households remain low, and savings have reverted to pre-pandemic levels (N°6). Similarly, the current account is in surplus, even when adjusted for various distortions, and excess corporation tax receipts.

Nº6

Activity is not fuelled by credit, and savings are high

€ billion quarterly net transactions (LHS), % of GNI* (RHS)



Sources: Central Bank of Ireland, Department of Finance, and Fiscal Council workings. Get the data.

This suggests that the economy is competitive — running a trade surplus and generating savings — rather than signalling a shift towards much greater domestic consumption and a rundown of savings.[2] Furthermore, higher investment levels, which would also increase imports, could increase potential output. This could be funded by a high stock of national savings and a capacity within the private sector to sustainably increase borrowing levels.

While the current account surplus suggests that the economy is not overheating, other cyclical indicators in the Council's supply-side models (including net inward migration) signal activity that is well above potential.

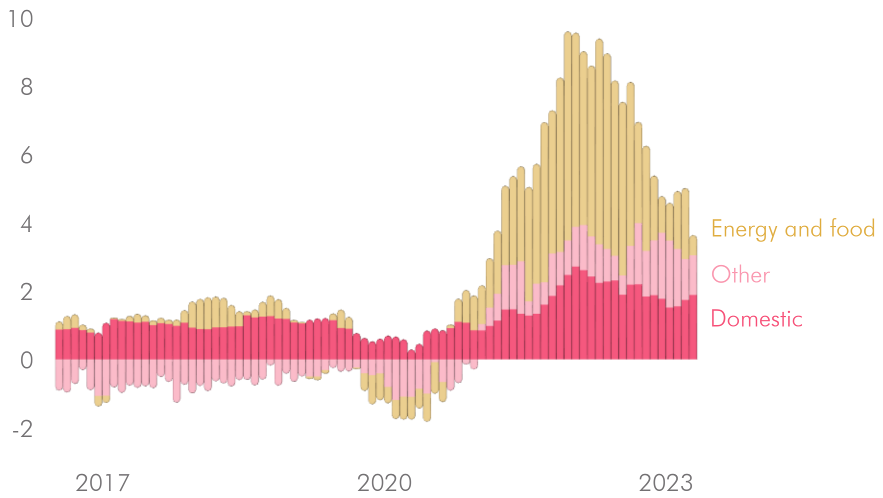
Nevertheless, price pressures have been high

Inflation has been elevated since mid-2021, and the war in Ukraine sparked faster increases in energy and food prices (N°7). These pressures have since partly abated, though in recent months, inflation has been increasingly accounted for by domestic services such as restaurants/cafés and rents.

Nº7

Domestic price pressures have persisted

% change in harmonised index of consumer prices inflation, year on year



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

Given prevailing concerns that the economy is at risk of overheating, the likely effects of fiscal policy on inflation are especially important this year. To this end, Box A employs the "Narrative approach" to investigate how tax cuts in *Budget 2024* are likely to affect inflation over the coming two years. These estimates show that Budget 2024 tax measures alone — which do not account for higher expenditure — are estimated to raise prices by a further 0.5 to 1.8% over two years.

[2] Conroy and Casey (2019) showed that revisions to the current account across the OECD are over 1% of GDP in absolute terms, and larger for open economies. They also showed that Ireland's current account can be an unreliable indicator of imbalances in real time. This analysis was based on the headline current account included in GNP. The above discussion considers the modified current account included in GNI*, and the situation for household loans and deposits.

Box A: The inflationary impact of *Budget 2024* tax cuts

Estimating the macroeconomic effect of a change in policy is difficult. The key problem in estimating an effect of a policy change is that everything in the economy affects everything else. For instance, tax changes affect GDP, and GDP affects tax revenue. They are simultaneously determined. Isolating the impact of tax changes on GDP is therefore difficult.

Often, in order to estimate the macroeconomic effects of a policy change, a policy shock—a policy change that is exogenous, uncorrelated, and uncontaminated by other macroeconomic variables— is needed. This box uses tax policy shocks to estimate the inflationary impact of tax cuts in Ireland.

The Narrative approach

One approach to estimating the macroeconomic effects of tax policy is the Narrative approach. This approach, pioneered by Romer & Romer (2010), seeks to identify tax policy shocks by analysing the motivation for each tax change, and separating out tax policy changes that are motivated with the macroeconomic effects in mind.

The Narrative approach has been used to identify tax policy changes that are exogenous to macroeconomic factors. For the US, Romer & Romer (2010), estimated the macroeconomic effects of tax changes, while Cloyne (2013) did similarly for the UK.

Exogenous changes are those policies that are taken without a short-term macroeconomic goal in mind. For instance, tax changes that are motivated by ideological reasons, such as certain changes to carbon tax could be classified as exogenous to macroeconomic conditions. Likewise, changes that are made to comply with court rulings or EU VAT directives, could be classified as exogenous, as they are not motivated by current or prospective economic conditions, but are instead imposed externally. Endogenous changes would be those that are taken to stimulate the economy, address a contemporaneous budget deficit, fund increased government spending, or respond to inflationary pressures.

Data

Using data from every budget speech in Ireland between 1947 and 2019, the key motivation for each policy change is identified. These policy changes are classified into changes that are exogenous to macroeconomic factors, and that are endogenous to macroeconomic factors using the classification approach of Cloyne (2013).

A first exogenous "baseline" series is constructed based on the motivation for each individual measure. But given that tax measures are often not taken in isolation, a second "alternative" series using the overall budget motivation is also considered.

Estimation

Using these exogenous series, together with quarterly data for the Irish macroeconomy, we can estimate the macroeconomic effects of tax changes. This is done using a Vector Autoregression framework:

$$\boldsymbol{Z_t} = \boldsymbol{A_0} + \boldsymbol{B(L)Z_{t-1}} + \boldsymbol{C(L)x_t} + \boldsymbol{e_t}$$

where $\boldsymbol{Z_t}$ is a vector of macroeconomic variables (GNI*, consumption, modified investment, government consumption, and consumer price inflation) and $\boldsymbol{x_t}$ is the exogenous tax series. As is standard in the literature, 4 lags of the endogenous variables are used, while 12 lags of the exogenous series are used.

Results

Figure 0 shows the response of consumer prices to a 1% of GNI* cut in taxes using the baseline exogenous tax policy series and the alternative exogenous tax policy series.

For the baseline series, following a 1% of GNI* cut in taxes, prices are 1% higher after eight quarters. However, the confidence intervals are wide and also include the possibility that the point estimates are zero or negative.

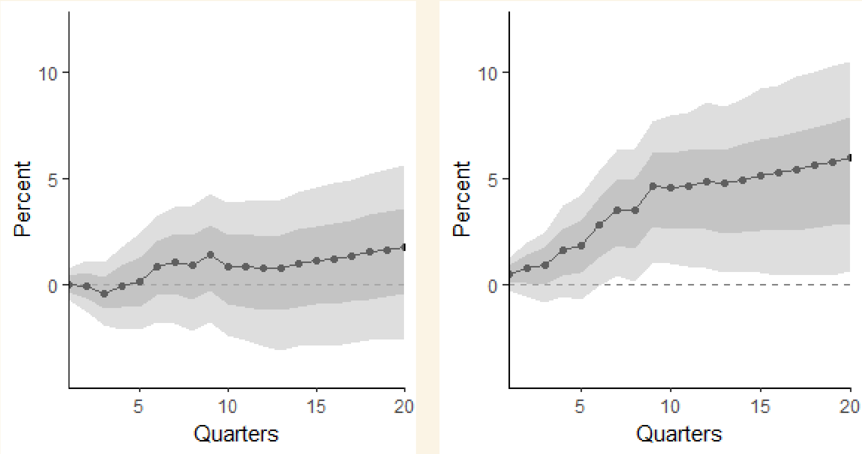
For the alternative series, following a 1% of GNI* cut in taxes, prices are 3.6% higher after eight quarters. In this case, no change in prices is outside of the 95% confidence intervals.

Nº8

Tax cuts raise prices over the medium term

Response of consumer prices to 1% of GNI* cut in taxes

A. Baseline (based on individual measures) B. Alternative (based on overall budget packages)



Sources: Fiscal Council workings.
Notes: Based on a vector autoregression (VAR) model of GNI*, consumption, modified investment, government consumption and the consumer price index, with 4 lags for endogenous variables, and 12 for the exogenous tax series. The 66 and 95% confidence intervals are based on bootstrapped standard errors.

A separate question is whether the impacts of different tax instruments have different macroeconomic impacts. For instance, do consumption tax cuts have a negative impact on prices? Or do income tax cuts have a positive impact on prices?

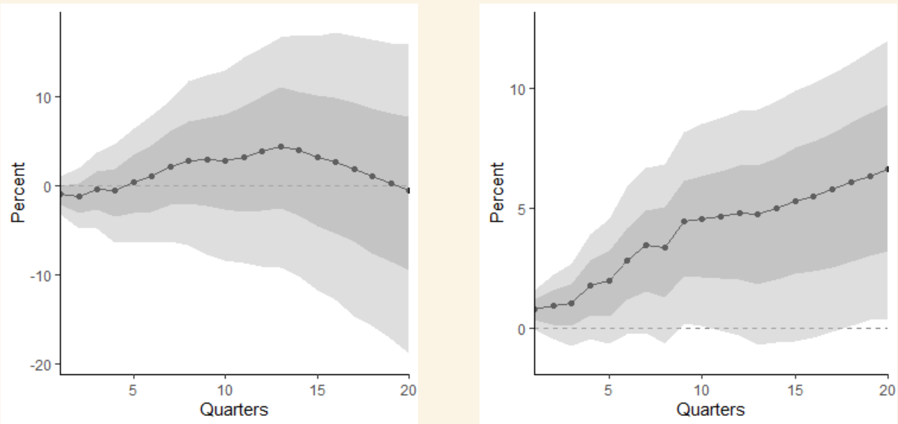
Figure Nº9 uses the alternative series and splits tax changes into those that apply to consumption (e.g., VAT and excise) and those that apply to income (e.g. income tax, USC). In this case, while most of the point estimates for consumption are positive, the impact is smaller and not statistically significant. However, for income taxes, there is a clear positive impact of income tax cuts on consumer prices.

Nº9

Income tax cuts are more inflationary than consumption tax cuts

Response of consumer prices to 1% of GNI* cut in consumption taxes

A. Consumption taxes B. Income tax



Sources: Fiscal Council workings.
Notes: Based on the same VAR specification as used for overall tax cuts.

What do the budget tax cuts mean for consumer prices?

This box illustrates that tax cuts have an inflationary impact. Using the estimates presented in this box, we can give a sense of how inflationary *Budget 2024* tax cuts were. *Budget 2024* announced net tax cuts of 0.5% of GNI*.[3] Using the above estimates, this would raise consumer prices by 0.5 to 1.8% after eight quarters, relative to a baseline in which no new tax measures were introduced in *Budget 2024*.

[3] This is based on the full-year estimates of tax and PRSI measures.

1.1 Official short-term economic forecasts 2023 to 2024

The Council is required to assess the official forecasts produced by the Department of Finance for *Budget 2024*. Here we look at the short-term forecasts underpinning the Budget, covering the period 2023 to 2024. The goal is not to give the Council's assessment of the economy, but to highlight key aspects of the Department's forecasts.

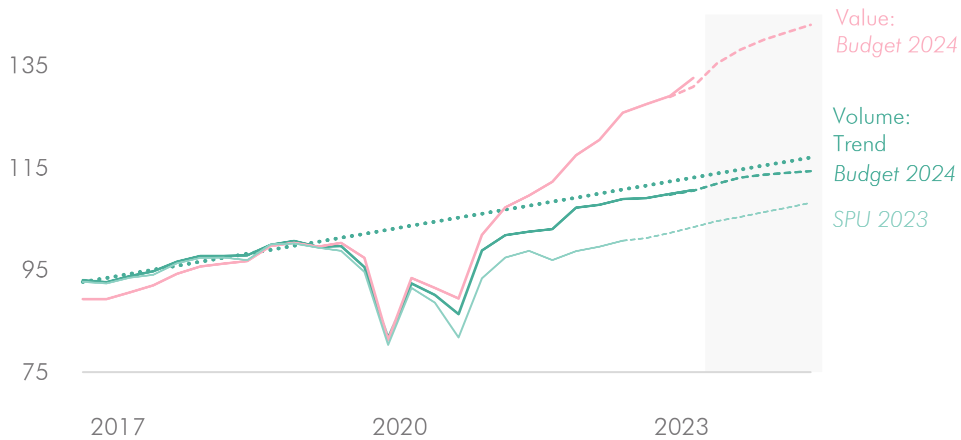
The Department forecasts growth in real GNI* of around 2% in the coming years. This reflects an expectation of no growth in labour productivity for 2022–2024, as well as a moderation in population growth. It projects that unemployment will rise slightly as excess demand unwinds, and that inflation will moderate. Higher consumer spending and investment are projected to lead to more imports and a slight fall in the still-large current account surplus.

Consumption and savings outlook

Household consumption growth has slowed in 2023, according to the latest CSO data up to Q3 2023 (N°10). The latest real spending data have softened, although nominal spending has continued to grow. Taken together, this suggests rather than a reduction in nominal spending, that inflation explains the slowdown in real consumer spending.

Nº10 **Consumption growth has slowed, reflecting higher prices**

2019 = 100, seasonally adjusted



Sources: CSO, Department of Finance, and Fiscal Council workings. Get the data.
Notes: *Budget 2024* and *SPU 2023* quarterly projections are shown in the dashed lines.

Reflecting the timing of *Budget 2024* supports, the Department forecasts that consumption will recover somewhat over the winter months. However, the Department's expected fall in inflation does not result in any further catch-up of household consumption with its pre-pandemic trend. As inflation is the most likely explanation for the slowdown in consumption, a fall in inflation could boost consumption.

In the latest *Annual National Accounts* for 2022, the CSO revised recent historical household consumption considerably higher. Given the importance of consumer spending data in assessing macroeconomic conditions, Box B analyses the performance of Irish consumption data relative to other OECD countries. The findings include that Ireland's consumption revisions over five-year periods are double those of the EU15.

Box B: Revisions to Irish consumption data

Irish macroeconomic data has tended to be among the most volatile and heavily revised macroeconomic data in the developed world (Casey and Smyth, 2015). Much of this is due to distortions created by the presence of a few large multinational enterprises. Yet the scale of revisions for parts of the economy that should be less affected by multinational distortions are also unusually large.

Because of the distortions to Irish macroeconomic data, a lot of the focus is on indicators of underlying economic activity that are not distorted by multinational activity. These indicators include modified domestic demand, modified gross national income and personal consumption expenditure. As a result, having accurate and timely estimates of these indicators is vital for informing and framing policy.

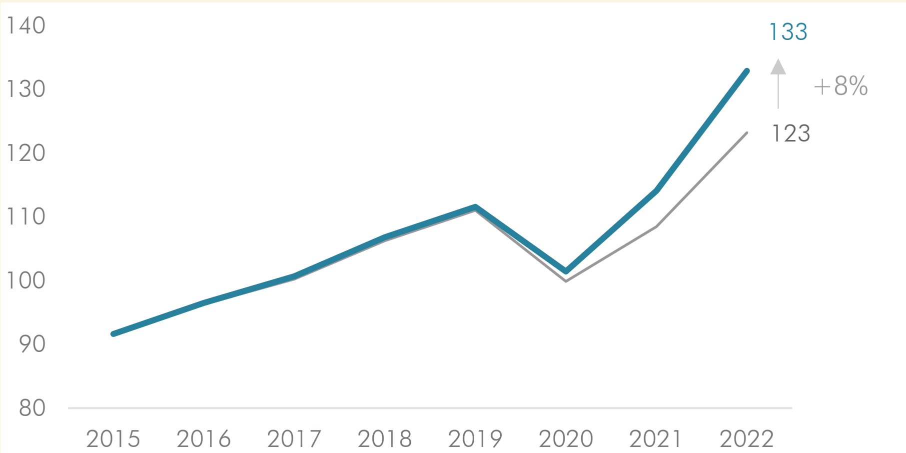
However, even these indicators of the underlying Irish macroeconomy are among the most heavily revised in the developed world. This box looks at revisions to Irish private consumption data and how this compares to international norms.

Recent revisions to consumption data

In the latest *Annual National Accounts* release, Irish consumption data was heavily revised upwards (N°11). The level of nominal consumption in 2022 was revised upwards by almost €10 billion, or 7.9%. This was somewhat predictable given that several indicators showed higher levels of consumption since the Covid-19 pandemic began, compared to official estimates (Timoney, 2022).

N°11 **Consumption data were revised up significantly for recent years**

€ billion, current prices



Sources: CSO; and Fiscal Council workings.
Notes: The pre-revision data is taken from the *Quarterly National Accounts, Quarter 1 2023* provisional release. Revised data is from the *Annual National Accounts 2022* release. Get the data.

To see how these revisions to consumption compare internationally, we follow the approach of Casey and Smyth (2015). For all OECD countries, we compare how year-on-year growth rates of quarterly real private consumption get revised from the first estimate to the latest available estimate.[4, 5]

To gauge how large the revisions are we estimate the root mean squared revision (RMSR):

$$RMSR = \sqrt{\frac{1}{n}\sum_{t=1}^{n}(l_t - p_t)^2}$$

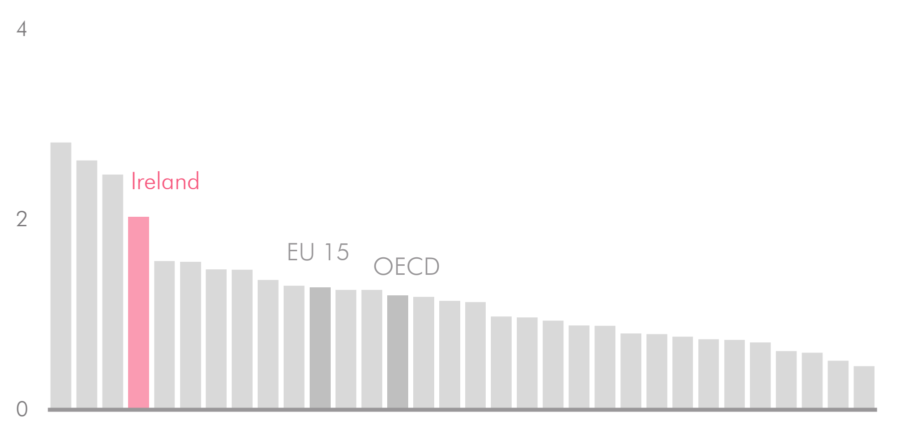
where l_t is the latest estimate for the growth rates in reference period t, and p_t is the preliminary estimate for that reference period.

International comparisons

Figure N°12 shows the root mean squared revision to the year-on-year growth rates for OECD countries since the year 2000.[6] The revision to Irish consumption data is the fourth largest in the OECD at just over 2 percentage points.[7] This is almost double the average revision in the OECD and the EU15.

N°12 **Irish consumption revisions among highest in the OECD**

Root Mean Squared Revision, real private consumption, year-on-year growth rates



Sources: OECD; and Fiscal Council workings.
Notes: Data are from the OECD's Revision Analysis Dataset. Get the data.

However, as can be seen from N°12, revisions can also occur to data from several years previous. The cumulative result of this series of revisions can be a large level shift in the data. This may not be as apparent from focusing on year-on-year growth rate revisions. For example, while the level of nominal consumption in Ireland in 2022 was revised up by 7.9%, the year-on-year growth rate for 2022 was revised up by only 2.9 percentage points, from 13.6% to 16.5%.

To try to take account of this fact, instead of looking at revisions to year-on-year growth rates, we also look at revisions to the five-year growth rates.[8,9] On this basis, Ireland's

[4] We focus on growth rates because the reference period from which prices are held constant changes across data vintages. This results in level shifts in the data between different vintages even without any revisions to the underlying data occurring. Using growth rates abstracts from this.

[5] These data are only available on a seasonally adjusted basis. As a result, part of the revision may be down to changes in seasonal adjustment models, rather than revisions to the underlying data. However, the revisions to seasonal adjustment are likely to be greatly outweighed by the revisions to the underlying data.

[6] Only countries that have data available prior to 2010 are included. This means that eight OECD members are excluded: Costa Rica, Columbia, Lithuania, Latvia, Estonia, Israel, Slovenia, and Chile.

[7] The countries with a larger revision are Turkey, Luxembourg, and Greece.

[8] That is, we look at the revisions to the growth of consumption from year $t-5$ instead of $t-1$.

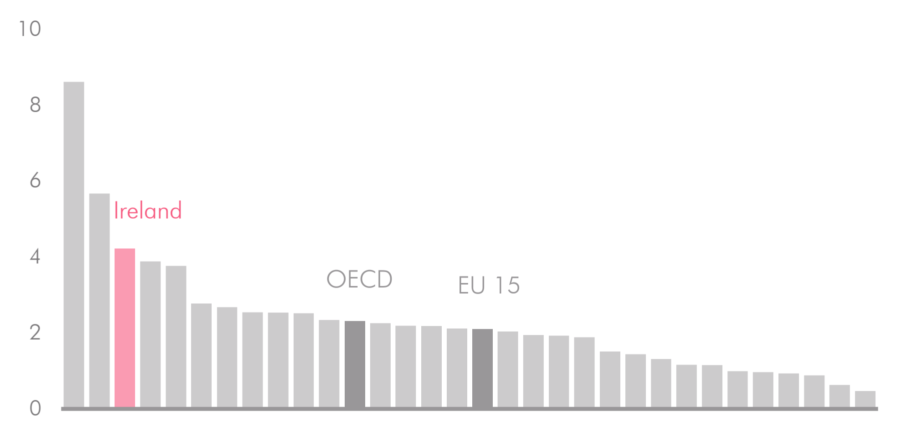
[9] As mentioned above, it would not be possible to look at revisions to the levels of consumption given that the base period from which prices are measured changes over time.

consumption data are the third most heavily revised in the OECD and double the revision of the EU15 countries (N°13).[10]

Nº13

Ireland's revision is double the EU15 average

Root Mean Squared Revision, constant prices private consumption, five-year growth rates



Sources: OECD; and Fiscal Council workings.
Notes: Data are from the OECD's Revision Analysis Dataset. Get the data.

Given the lack of distortions from multinational activity, consumption is one of the key macroeconomic indicators on the health of the Irish economy.[11] It is also an essential component in the estimation of the household savings ratio, which is an important variable for understanding sustainability of economic activity. For these reasons, timely and accurate estimation of consumption is vital for informing policymaker decisions.

Some revisions to data are expected—and indeed, welcome—as more granular and better-quality data sources become available. However, the accuracy of initial estimates of consumption is poor relative to international peers, and in recent years some of these revisions were somewhat predictable given the performance of other high-frequency indicators like VAT and bank card statistics.

Given the importance of consumption as an indicator, more resources should be dedicated to the compilation of timely and accurate consumption estimates. To that end, timelier and more frequent *Household Budget Surveys* should help. In addition, more resources should be dedicated to the potential use of administrative datasets like VAT data and Central Bank debit and credit card statistics in the compilation of consumption estimates. This could also facilitate a more granular quarterly breakdown of consumption of goods and services into categories such as durable, semi-durable, non-durable, and services, which has become the norm for published consumption statistics in other EU countries.

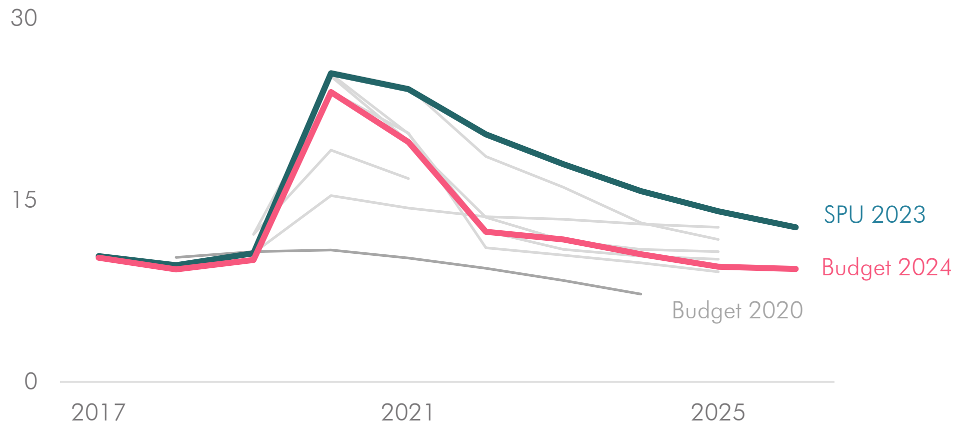
As a result of the revisions noted in Box B, household savings were revised considerably lower. Savings represent a key indicator of the sustainability of economic activity, but recent historical estimates have been too high because of underestimated consumption. At 10.5%, the Department's projected savings ratio in 2024 remains above its pre-pandemic forecast of 7.3% in *Budget 2020* (N°14). However, *Budget 2020* was based on an assumed disorderly Brexit, and this may limit the comparability of this projection with recent forecasts.

[10] Turkey and Mexico are the countries with a larger revision to consumption.

[11] Consumption is also the main building block for another key indicator of the underlying economy – modified domestic demand.

Nº14 ***Budget 2024* forecasts show the savings ratio staying near 10%**

% of disposable income



Source: Department of Finance.

In *Budget 2024*, the Department forecasts a gradual return of the savings ratio to 2018 levels. This assumes that high savings built up during the pandemic will not be used to boost consumption over the medium term. Instead, the Department expects that higher deposits will be retained in household bank accounts or used for investment — including for the purchase of dwellings.[12]

However, these investments would also suggest that many households with excess savings have become wealthier. Wealth effects could therefore contribute to higher spending, even if this is not funded by higher income. While recent forecasts of the savings ratio have often shown a smooth trajectory, a more volatile path could also take place over coming years (which the Department has recognised as an upside risk). A volatile savings ratio that dips to low levels can increase the risks of overheating, especially if either lower savings or higher borrowing become persistent trends. However, household balance sheets, both before and since the pandemic, so far remain strong and mitigate against overheating risks via this channel to some extent.

Short-term outlook for investment

Modified investment fell significantly during the pandemic. It briefly recovered to its pre-pandemic trend in Q2 2022, because of extraordinary levels of investment in semiconductor-related equipment, as analysed by Casey (2023). Since then, it has fallen back considerably, and *Budget 2024* forecasts indicate limited short-term growth in modified investment overall (N°15).

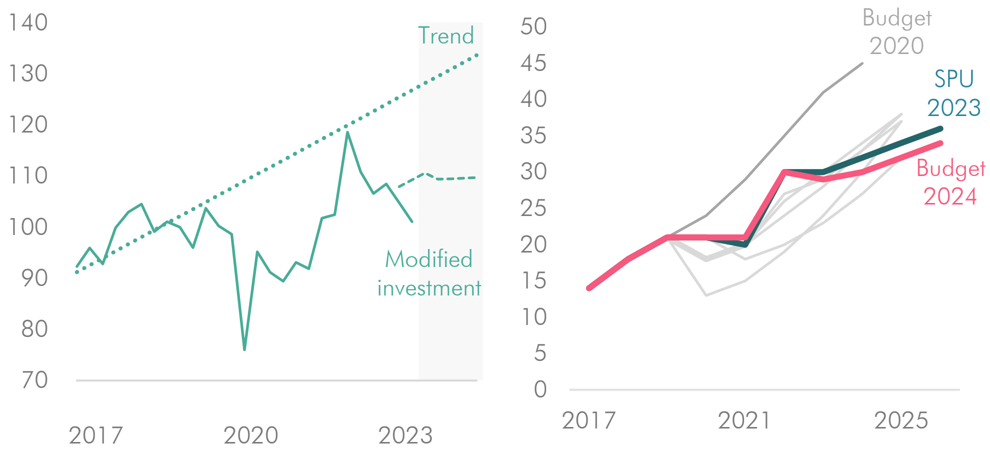
This projection includes a weaker profile for new dwelling completions relative to forecasts in *Stability Programme Update (SPU) 2023*. The Department now

[12] This is in line with recent analysis of excess savings in the euro area by Battistini and Gareis (2023), who note that holders of the excess pandemic savings are concentrated in the richest income quintile, whose marginal propensity to consume is lowest.

expects 29,000 completions this year and 30,000 in 2024, which is well below its pre-pandemic forecast in *Budget 2020* of over 40,000 units in each year.

Nº15 **Flat investment and a limited increase in new dwellings**

2019 = 100, seasonally adjusted volumes (LHS) and thousands of new dwellings (RHS)



Sources: CSO, Department of Finance, and Fiscal Council workings.
Note: Other Department forecasts for dwellings from *SPU 2020* to *Budget 2023* are shown in grey.

Labour is widely acknowledged as an important constraint affecting dwellings construction. Despite this, in Q2 2023, employment in construction reached its highest level since end-2008. This includes specifically employment related to the construction of buildings, which comprised 70,000 workers in Q2 — close to double the 2012 figure.

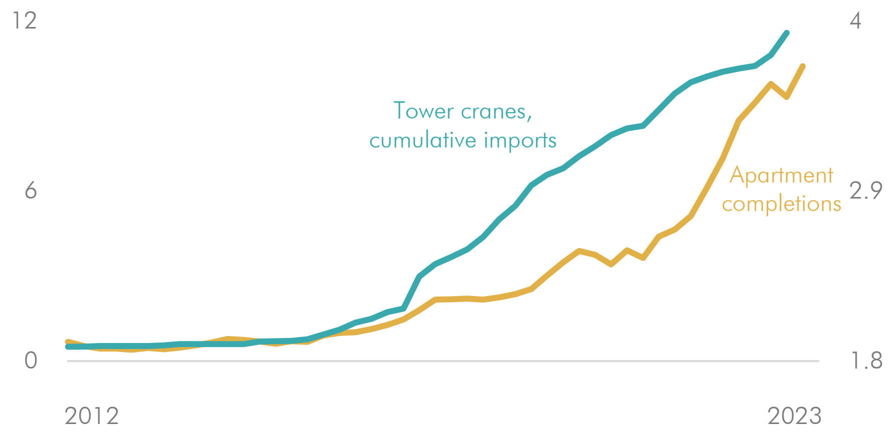
Since *Budget 2024* forecasts were finalised, data for new dwelling completion forecasts were surprisingly strong in Q3 of this year — increasing by 1,064 (14%) units compared to the same quarter in 2022. This suggests upside risk to the Department's 2023 forecast for both dwelling completions and modified investment. The annual increase in Q3 was explained by a rise of 1,083 (47%) new apartments, the construction of which are likely to be less labour intensive compared to the construction of houses. Despite a tight labour market for construction workers, a shift in the composition of new dwelling completions towards apartments could result in a larger increase in dwellings than could be expected if the share of apartments in new dwellings remained unchanged.

Given widespread work-from-home adoption has likely reduced demand for offices, a re-allocation of labour and capital away from commercial real estate and the construction of offices could benefit apartment construction. As noted by Lyons (2023), a leading indicator for construction of offices and apartments (four storeys or more in height) is imports of tower cranes.

Cumulative imports of tower cranes provide an indication of how many cranes are available for use in the construction of tall buildings. The more cranes that have been imported, the more apartment blocks and other types of tall buildings have been built (N°16). Given the potential for re-allocation within construction in favour of apartment building, a recent acceleration of tower crane imports could encourage a higher number of apartment completions over coming years.

№16 **Tower crane imports could signal more apartment completions**

Thousands of new apartments (four-quarter moving sum, LHS), and cumulative imports of tower cranes in hundreds of metric tonnes (RHS)



Sources: CSO, Eurostat, and Fiscal Council workings.

How should we think about risks to the economy now?

The Department's risk analysis in *Budget 2024* identified that there were two-sided risks but that they were tilted to the downside. Risks to inflation were characterised as two-sided and broadly balanced around the baseline.

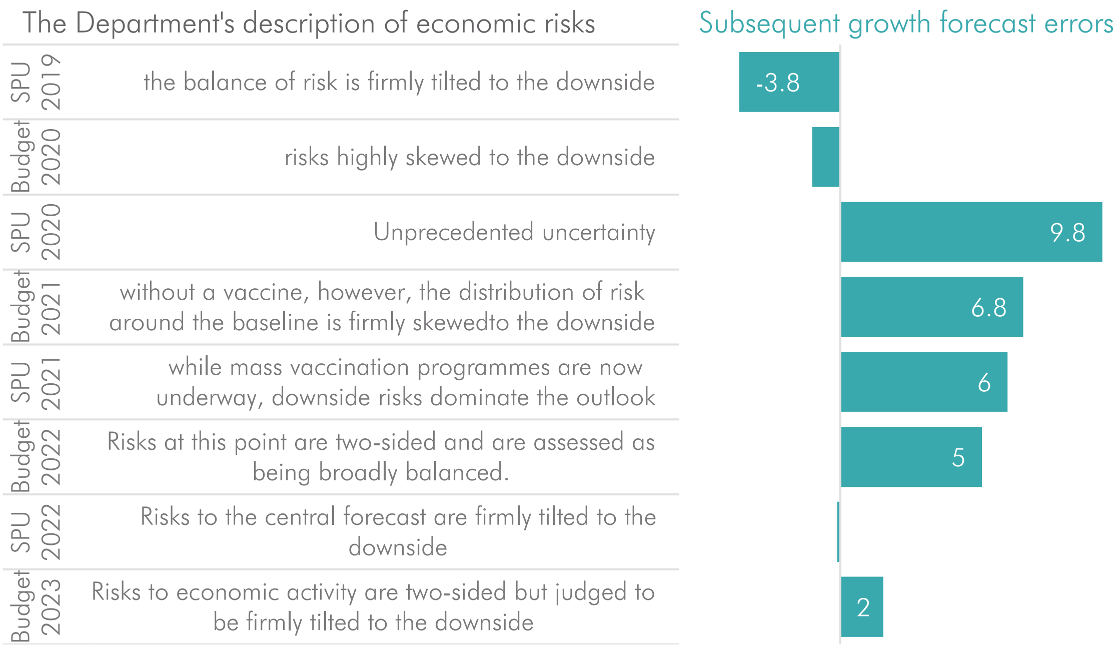
Numerous downside risks identified by the Department include weaker external demand, further energy/geopolitical shocks, higher inflation and interest rates, renewed Brexit disruption, loss of competitiveness, and sector-specific shocks. Just two upside risks were anticipated, including higher wages/investment paid for by multinationals, and higher domestic demand via an unwinding of excess savings.

The Council assesses that an additional downside risk is the potential for weaker foreign direct investment by multinationals, which could be adversely affected by higher interest rates. Further upside risks could include higher net inward migration, and higher investment among domestic sectors (other than projects paid for by multinational firms). Higher domestic investment could be driven by a faster increase in new dwelling completions, alongside larger multiplier effects due to a planned ramp-up in public investment levels.

In each Stability Programme Update and Budget, the Department tries to anticipate risks to the macroeconomic outlook. Its assessment in recent years has generally been that risks to the central projections are tilted to the downside, and some of the downside risks identified have come to pass. Despite this, the economy has recently performed more strongly than expected over the short term, across in-year and year-ahead forecasts (N°17). This is especially the case in the recovery from the slowdown associated with Covid-19 which turned out faster than feared at the height of the Pandemic.

Nº17
Despite many downside risks, growth has exceeded recent forecasts

%, average two-year-ahead real GNI* growth forecast error, annualised

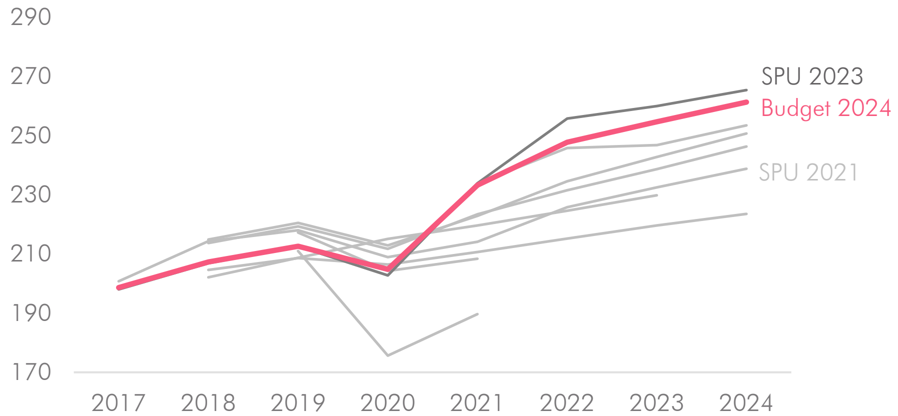


Note: Nominal GNI* adjusted for the GNP deflator is used until real GNI* forecasts begin in 2021. *Budget 2024* estimates of 2023 real GNI* are used to inform *SPU 2022* and *Budget 2023* errors.

As noted above, the performance of the economy in recent years has been stronger than expected by the Department (N°18). Some of this outperformance is explained by wages and corporation taxes paid by foreign-owned multinationals, together comprising 23% of GNI* in 2022, up from 20% in 2019. Higher corporation tax contributes to economic performance as only the after-tax profits of foreign firms flow out of the economy's national income.

Nº18
Real GNI* in 2024 is forecast to be 9% larger than in *SPU 2021*

€ billion, 2021 constant prices



Sources: Department of Finance, and Fiscal Council workings.
Note: All forecast levels reflected in the previous figure (N°17) are shown in this chart, and nominal GNI* adjusted for the GNP deflator is again used until real GNI* forecasts begin in 2021.

Real GNI* this year is expected to be considerably higher now compared to recent years. In 2024, the level of real GNI* is projected to be 9.4% higher than forecast in *SPU 2021*. This is a larger revision than the Council's latest Benchmark projection, which is 3.7% above the March 2021 forecast.

Comparing forecast errors with risk assessments is difficult and does not allow clear conclusions on the cause of differences. Better-than-feared outturns could signal that the forecasts were too pessimistic. They could equally mean that downside risks were realised but smaller in magnitude than anticipated, or that upside risks materialised.

Risk analysis often gravitates towards downside risks, but a full assessment of risks should include a range of upside considerations. Opportunity costs can arise when an economy performs considerably better than forecast. For example, in such a scenario, investment plans for both the government and private sector could prove insufficient, leading to higher costs and capacity constraints that could have been alleviated with more accurate macroeconomic projections.

1.2 Council's assessment of official medium-term economic forecasts 2025 to 2030

The *Budget 2024* medium-term forecasts are assessed below. In line with their short-term outlook, the Department forecasts growth in real GNI* of around 2% a year until 2030. These medium-term growth forecasts are assessed for the two main components of GNI*, namely modified domestic demand and the modified current account. The interaction of the current account with gross capital formation, and its implications for capacity constraints, is also assessed.

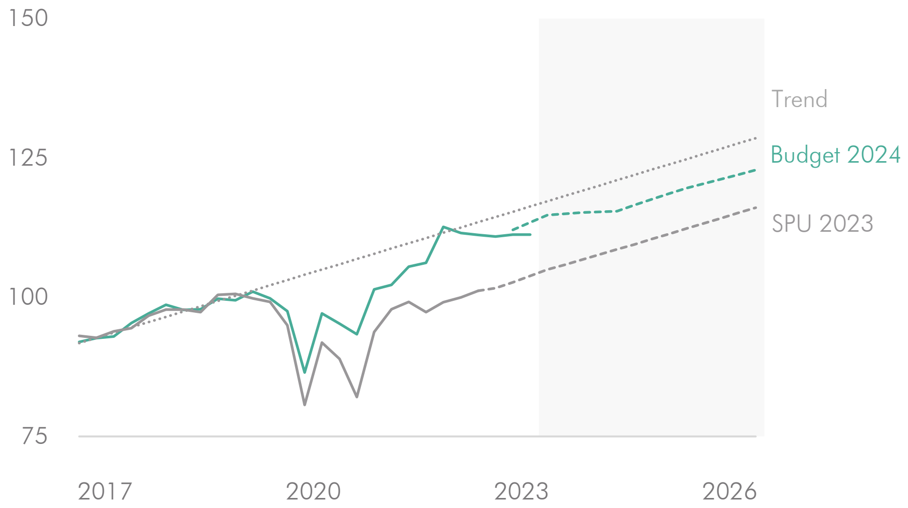
Budget 2024 forecasts domestic demand below trend levels

The Council assesses that national income has broadly recovered from the pandemic (N°3), though other indicators such as modified domestic demand remain weaker than their pre-pandemic trend (2014–2019). *Budget 2024* projects a continuation of this gap, which amounts to 4.5% in 2026 (N°19).

Lower modified investment is the main reason behind forecast weaker domestic demand over the medium term (see N°15). In line with the Department's medium-term expectations, it is possible that potential growth will be slower by 2026. This would imply that a shallower path for domestic demand and potential output would be consistent. Alternatively, if housing output increases significantly over the medium term, and if cost pressures continue to moderate, this could push real activity closer to its pre-pandemic trend.

Nº19 ***Budget 2024* forecasts domestic demand below trend levels**

€ billion, 2021 prices



Sources: CSO, Department of Finance, and Fiscal Council workings.

Slower GNI* growth is projected in *Budget 2024*

The Department of Finance forecasts GNI* based on a bottom-up framework out to 2026, while the forecasts for subsequent years are based on a production function approach.[13]

For the production function approach, an important assumption underpinning the Department's projection for economic growth is a sustained slowdown in employment growth over the medium term. Aligned to this assumption, as noted in the Council's discussion of the endorsement of the *Budget 2024* macroeconomic forecasts (Fiscal Council, 2023c), the Department assumes a fall in net inward migration. However, if higher net inward migration instead occurs, it could add to employment and economic growth.

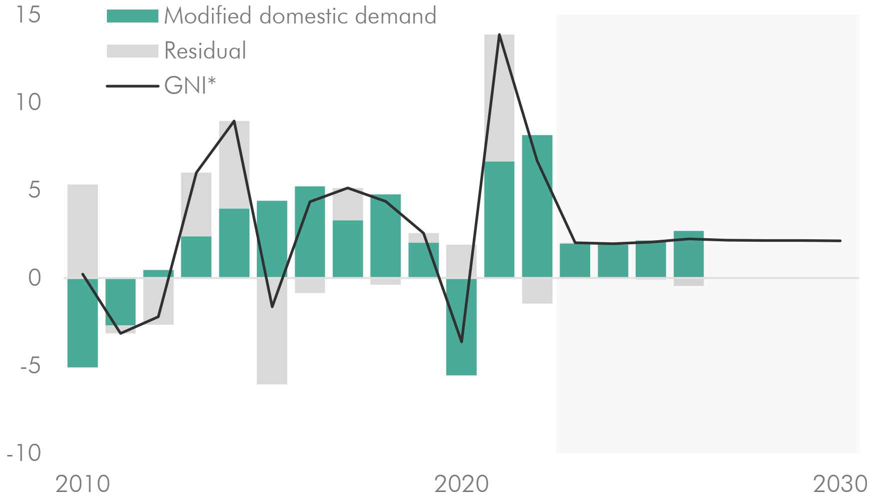
For the bottom-up framework, growth in modified (total) domestic demand is supplemented with expectations for a residual term, which mainly comprises the modified current account (CA*). To forecast CA*, many outsized categories of exports and imports are disregarded. This is because they are assumed to mainly represent multinationals' sales, and profits arising from these sales should not be reflected in GNI*, since the multinationals are owned abroad.

[13] The bottom-up estimation closely follows the approach of the Council (Box E in the May 2020 Fiscal Assessment Report), and the Department's methodology is detailed by Lennon and Power (2021). For the production-function approach, Hogan *et al.* (2023) recently described the Department's methodology, which is similar to the Council's in the *Long-term Sustainability Report*.

A shortcoming of the approach is that forecasts of the residual term tend to generate very little growth contributions.[14] However, in absolute terms, the residual term has been a considerably larger factor in recent history (N°20). This mainly reflects a strong domestic net exports performance, aside from multinationals' sales.

Nº20 **National income growth of 2% a year is forecast until 2030**

% change y/y and contributions



Sources: CSO, Department of Finance, and Fiscal Council workings.

The current account can also be viewed from the savings-less-investment perspective.[15] This framework indicates that high levels of savings generated across the domestic economy have not been subsequently invested. As discussed below, Ireland's capital stock appears to be low in various parts of the economy. In this context, low levels of domestic investment in recent years have likely contributed to capacity constraints.

Capacity constraints

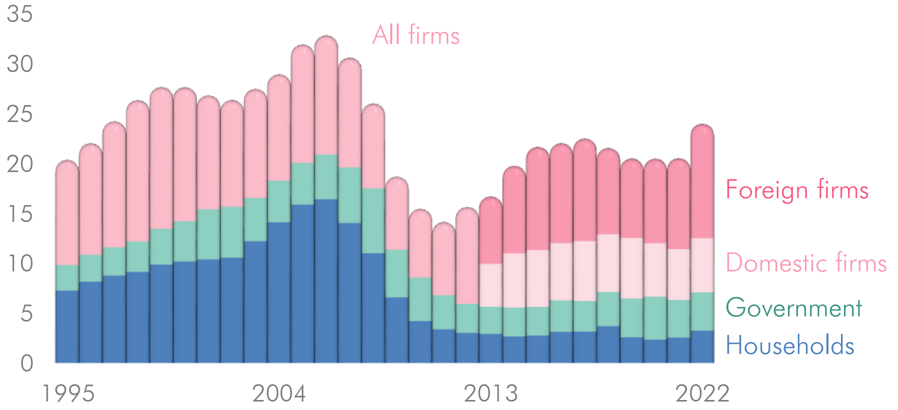
As a share of national income, gross capital formation in the Irish economy remains lower than levels seen in the early 2000s. The primary difference across institutional sectors is that households are investing considerably less now (N°21). This is largely a reflection of the low availability for household purchases of new dwellings. Other important factors include greater caution on the part of borrowers since the collapse of the property bubble in the late 2000s, and the Central Bank's macroprudential lending limits.

[14] The methodology forecasts the change in the residual term based on international forecasts of external demand for domestic exports, and an assumed import content of final demand in GNI* (modified total domestic demand plus domestic exports). With a large residual term reflecting a large modified current account surplus, forecast changes are typically minor by comparison, implying a small growth contribution to GNI*. However, the Department also uses judgement to estimate the current year's modified current account balance from a savings-less-investment perspective.

[15] For example, see the Box on the modified current account in Timoney (2023).

Nº21 **Investment has been increasingly paid for by foreign firms**

% of GNI*



Sources: CSO, Department of Finance, and Fiscal Council workings.

Investment levels by foreign-owned firms accounted for half of the growth in modified gross capital formation in 2022. Recent data indicate that the composition of modified investment has become increasingly driven by foreign multinationals, rather than domestic sectors. Whereas investment from domestic sectors has remained at around 12% of GNI* since 2019, investment by foreign sectors has increased by 3.5% of GNI* over the same period.

To an extent, this may reflect "crowding out" of domestic investment priorities, and it increases the risk that domestic firms stagnate. Of greater concern is the risk of "Dutch disease", as foreign multinationals increasingly fund demand in the domestic economy through consumption (wages), government spending (corporation tax), and direct investment. In turn, the wages paid by multinational firms put upward pressure on domestic firms to increase pay, and this could harm international competitiveness as well as domestic investment capacity.

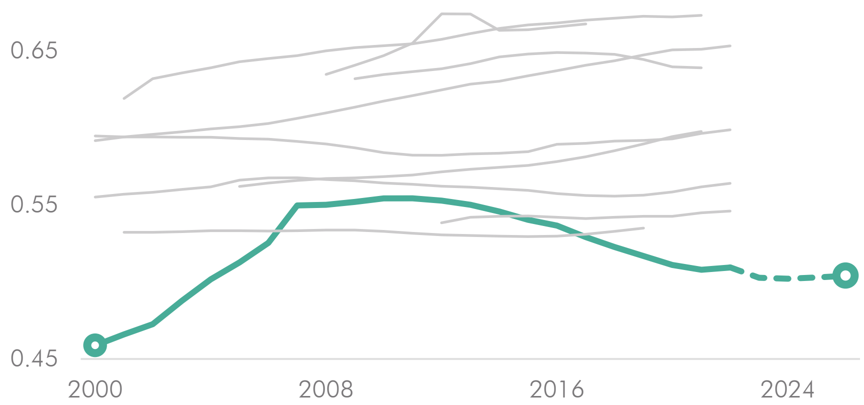
The low level of investment by households is also reflected in the relatively weak prospects for Ireland's housing stock. Housing stock per person aged 15 or over is low relative to other EU15 countries (N°22).[16]

[16] Since Ireland has a relatively young population, children up to the age of 14 are excluded from the population across countries in this comparison.

Nº22

Ireland's housing stock is low relative to other EU15 countries

Housing stock per person aged 15 years and over



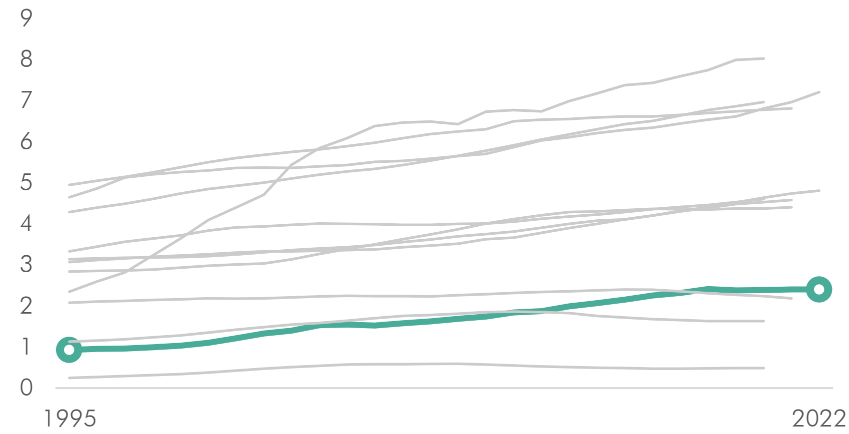
Sources: Eurostat, Statistik Austria, StatBel, Danmarks Statistik, Tilastokeskus Suomi, INSEE, DeStatis, European Central Bank, Centraal Bureau voor de Statistiek, Instituto National de Estatística, Moody's, Statistikmyndigheten, Office for National Statistics, Department of Finance, CSO and Fiscal Council workings.
Notes: For Ireland, Census data for 1991, 1996, 2002, 2006, 2011, 2016, and 2022 are used for the dwellings stock. The interim years are approximated using a capital accumulation equation based on ESB connections (1992–2010) and new dwelling completions (2011–2022) data, and an average annual implied depreciation rate of 0.31% for 1992–2022. The forecast shown is based on *Budget 2024* forecasts for new dwelling completions, population growth, and the same assumed annual depreciation rate of 0.31%.

By this measure, high levels of completions in the mid-2000s led to Ireland's housing stock briefly exceeding levels in the UK and the Netherlands. However, Ireland's housing stock has been in relative decline since 2010. If *Budget 2024* projections are achieved, this would only maintain the relatively low level of the housing stock until 2026. To achieve the sample average across countries (for the most recently available year), Ireland would need an additional 170,000 dwellings, equivalent to nearly six years of the level of completions achieved in 2022.

Elsewhere, Ireland's infrastructure in health is also low compared to other EU14 countries (EU15 but excluding the UK) when scaled by the number of adults in the population (N°23). The same applies to transport infrastructure (N°24) scaled by total population. For education infrastructure scaled by the population aged 5 to 22 (N°25), Ireland's capital stock is close to the median of the sample. Across the economy, for both public and private sectors, there is evidently scope for investment in infrastructure over the medium term, which could bring Ireland's capital stock more in line with similarly high-income EU14 countries.

Nº23 **Health infrastructure is low compared to EU14 countries**

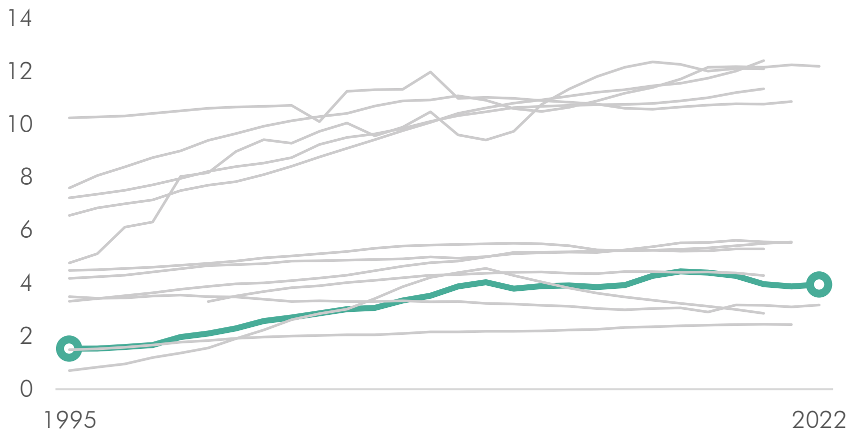
Health net capital stock (€ million, 2015 constant prices) per person aged 15 years and over



Sources: Eurostat, CSO and Fiscal Council workings.

Nº24 **Transport infrastructure is low compared to EU14 countries**

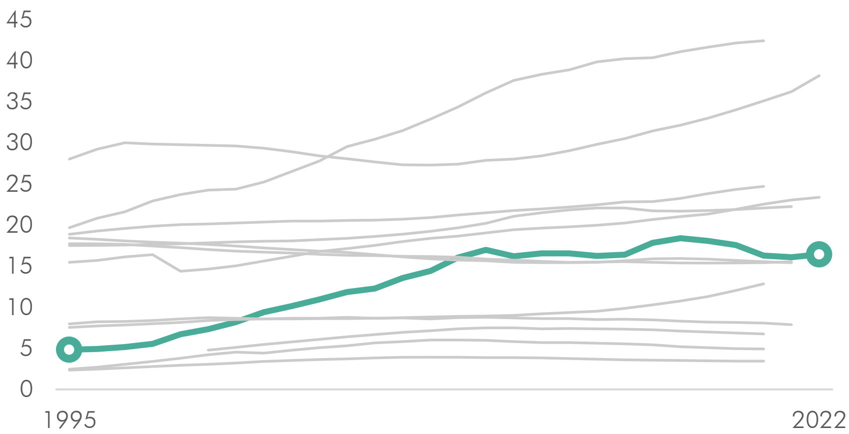
Transport net capital stock (€ million, 2015 constant prices) per person



Sources: Eurostat, CSO and Fiscal Council workings.

Nº25 **Education infrastructure is middling compared to EU14 countries**

Education net capital stock (€ million, 2015 constant prices) per person aged 5 to 22



Sources: Eurostat, CSO and Fiscal Council workings.

Budgetary Assessment

Spending forecasts are inadequate and opaque

2 Budgetary Assessment

Spending forecasts are inadequate and opaque

Numerous shortcomings with Budget 2024 projections

The basis for *Budget 2024* spending forecasts is unrealistic and the projections going forward lack credibility. The spending estimates omit large amounts of known spending this year. Overruns in health spending have been building through the year and were well known before budget day.

By ignoring the overruns in 2023, the Budget 2024 projections are also likely to underestimate health spending in 2024. Furthermore, while some unallocated spending is provided for, the costs of the new public sector pay deal are unclear and may exceed unallocated amounts, pushing spending higher again.

Transparency is lacking

In addition, transparency around the measures introduced in Budget 2024 was particularly poor. Overall, the separation of spending into core and non-core elements has become unhelpful. The definitions of core and non-core spending have become extremely blurred. A better approach would be to focus on general government spending, net of tax measures. The National Spending Rule should also focus on general government spending net of tax measures.

Spending overruns being ignored, and poor transparency around how spending is classified, signals a weakening of Ireland's fiscal framework.

Given some of the shortcomings of Budget 2024 projections, an alternative set of projections are presented. These alternative projections imply that both general government revenue and spending would be higher than Budget 2024 forecasts suggest. Alternative estimates suggest that by 2026 spending could be €8.6 billion higher than Budget projections, with revenue €3.4 billion higher. The general government balance would be €5.2 billion weaker.

Forecast horizon too short to plan for major challenges

The Government's budgetary forecasts underpinning Budget 2024 run only as far as 2026. This is too a short time-horizon for the Council to provide a comprehensive assessment of the Government's tax and spending plans over the medium term. It runs contrary to previous commitments made by the Government to plan further ahead. More generally, it demonstrates weak medium-term budgeting and further underscores the need to strengthen the fiscal framework.

A major concern is that the forecast horizon ends right before some of the major budgetary challenges facing Ireland begin to bite. The costs associated with an ageing population and the transition to a lower carbon economy will begin to build quickly as this decade closes.

2.1 Budgetary forecasts for 2023

In this section, the Council assesses the budgetary forecasts published in *Budget 2024*. Given that the fiscal forecasts in Budget 2024 are deemed to be inadequate, an alternative set of forecasts are also presented.

Overruns not baked in for 2023

Budget 2024 forecasts for 2023 look to be inadequate, with the basis for the forecasts being unrealistic. White Paper estimates of spending—which feed into budget forecasts—were derived based on aggregate within-year expenditure. These take into account developments throughout the year. Yet this approach is top-down and is not built-up based on an analysis of the likely expenditure at departmental level. By not carrying out an analysis at departmental level it is difficult for the Council to assess how realistic the forecast for 2023 is, and to assess the adequacy of the provisions for spending into 2024 given potential overruns in 2023. The approach to forecasting within-year expenditure for the White Paper, and by extension at Budget time, needs to include a granular assessment of within-year spending at departmental level. This would also aid planning for subsequent years.

Spending for 2023 looks set to be higher than *Budget 2024* forecasts imply. Spending has been revised up for 2023 to take account of the cost-of-living measures announced on Budget Day (many of which come into effect in 2023) and the Christmas Bonus. However, spending forecasts do not account sufficiently for the overruns in spending which are apparent in the Department of Health and the Department of Children. These overruns were building throughout the year and were apparent well before budget day.

The overruns in health appear—in part—to be due to increased demand arising from demographics (Section 2.44). As a result, overruns in health spending should result in higher core spending in 2023 and this higher spending would be likely to recur into 2024. Since Budget 2024, a supplementary estimate of €960 million has been approved by Government for the Department of Health. However, the HSE's overspend in 2023 is likely to be higher than this, with the HSE likely to use cash reserves and accruals to fund spending this year.

Cost-of-living spending measures announced in *Budget 2024* cost €1.7 billion in 2023. This is in addition to what *Budget 2024* describes as non-core spending of €5.2 billion. Overall, there is spending of at least €6.9 billion in addition to core spending for 2023.

On the revenue side, forecasts for taxes and PRSI for this year are largely unchanged from *SPU*, while general government revenue has been revised up (€1,460 million).

Excluding windfall corporation tax receipts, a deficit is forecast in 2023 (€2.0 billion). In headline terms a surplus of €8.8 billion is forecast (Nº26).

Nº26

Budget 2024 fiscal forecasts

€ billions

	2022	2023	2024	2025	2026
General Government Revenue	116.1	124.9	129.6	136.0	141.0
Income Tax	30.7	33.0	34.3	36.4	38.4
VAT	18.6	20.4	21.8	23.2	24.4
Corporation Tax	22.6	23.6	24.5	25.8	25.6
of which excess	10.7	10.8	11.1	11.7	10.8
PRSI	14.0	15.7	16.9	18.2	19.5
Excise	5.4	5.7	6.2	6.7	7.0
Stamp Duties	1.8	1.8	1.8	1.7	1.8
Other GG Revenue	22.8	24.8	24.1	24.2	24.3
General Government Expenditure	107.6	116.1	121.3	121.8	126.3
Social payments	37.2	39.0	40.6	41.0	41.6
Compensation of employees	28.8	30.3	31.5	32.1	33.3
Intermediate consumption	17.9	19.5	19.8	18.6	19.4
Capital expenditure	10.1	11.6	12.8	14.4	15.9
Interest expenditure	3.3	3.4	3.5	3.5	3.7
Subsidies	3.3	3.2	3.1	3.2	3.3
Other	7.1	9.1	10.0	8.9	9.2
Primary expenditure	104.2	112.8	117.8	118.3	122.6
Current Primary expenditure	94.1	101.1	105.0	103.9	106.7
General Government Balance excl. windfall corporation tax	-2.2	-2.0	-2.7	2.5	3.8
General Government Balance	8.5	8.8	8.4	14.2	14.6

Sources: CSO; Budget 2024, and Fiscal Council workings.
Notes: Estimates of windfall corporation tax receipts are the Department of Finance’s estimates published in Budget 2024. Estimates of revenue and expenditure one-offs are those judged by the Council.

2.2 Another large budget package

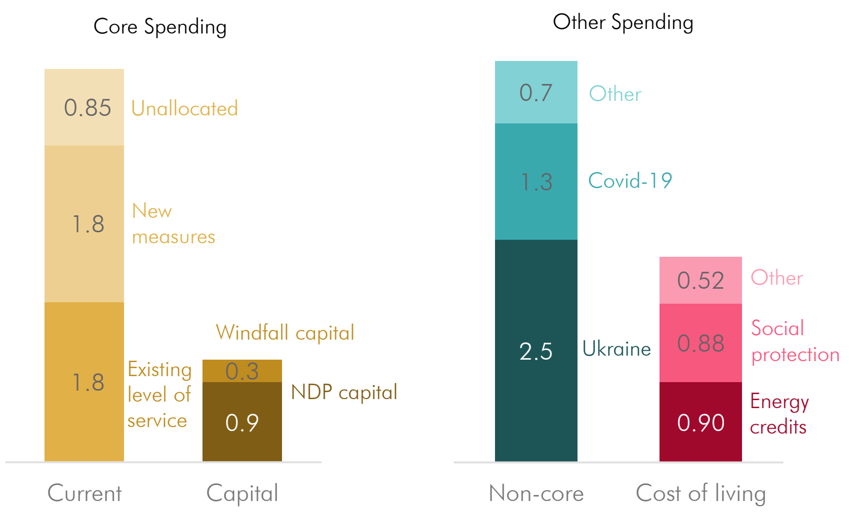
Budget 2024 included a net package of over €12 billion. This was made up of a spending package of €12.4 billion, with a net tax package of €0.1 billion spread out over 2024 and the remaining part of 2023 (N°27).

Budget 2024 included a core spending package of €5.6 billion, made up of €4.4 billion current expenditure increases and €1.1 billion capital expenditure increases (N°27).

Of the current expenditure, the Department of Public Expenditure estimates that approximately €1.8 billion is required to maintain the existing level of service, while a further €1.8 billion has been allocated for new measures.[17] A remaining €0.85 billion has been left unallocated, which is likely to fund further new measures, including any new public sector pay deal but may also be used to fund potential overruns.

Nº27 **Spending package of €12.4 billion**

€ billion



Sources: Budget 2024, and Fiscal Council workings.

Outside of core spending, there was a package of €6.8 billion spending measures announced. This consisted of €2.5 billion in support of Ukrainian humanitarian aid, €1.3 billion for Covid-19 related expenditure, €2.3 billion cost of living expenditure measures, and €0.7 billion related to expenditure funded by EU programmes.

[17] This €1.8 billion allocated to maintain the existing level of service does not appear sufficient to fully maintain the existing levels of service—absent any significant efficiency gains. See Section 2.3 below for further details.

Box C: What does "core" and "non-core" mean?

A recent feature of Irish budgets is that parts of the overall budget package have been labelled "core" and "non-core". This box revisits the principles behind what can be considered temporary and permanent measures in this context.

When was the idea introduced?

Core spending was first introduced in 2020. This was primarily to remove Brexit-related costs from total expenditure. This spending was not expected to be structurally but was instead exceptional spending which would continue over several years.

The idea of non-core spending was then extended in the 2021 *Summer Economic Statement* to include Covid-related spending. At the same time, the National Spending Rule was introduced, with the rule itself anchored on core spending.

The concept of non-core spending has since grown to cover more items. The Government has added supports for Ukrainian refugees and cost-of-living measures to this classification. Rather than being a temporary feature, it has become a recurring part of recent budgeting.

The Department's approach to forecasting non-core expenditure is to assume a base cost of zero each year, irrespective of whether measures are likely to continue or not. This is an inadequate approach as it can give the impression of really large surpluses available that could be spent in later years, when in reality there is spending that is likely to take place but is not incorporated in the forecasts. This is part of the reason why recent figures for cumulative surpluses were revised downwards (N°46).

How the Council assesses core and non-core spending

The Council prefers to stick to two guiding principles when assessing whether something is permanent or a one-off, which is one possible categorisation into non-core or temporary measures:

Principle 1: One-offs do not recur

A simple guiding principle as to whether something is a one-off or permanent budgetary measure is that one-off measures are not repeated. As a general rule of thumb, something present for more than two years is clearly not a one-off item.

Principle 2: Permanent unless proven otherwise

If a policy measure increases the deficit, it should be assumed to be permanent. This presumption gives policymakers the right incentive to fully recognise the permanent impacts of their budgetary decisions. It also emphasises that one-off measures are an exceptional part of budgeting and should only be recognised in cases where it is unambiguous that they are temporary in nature.

This assessment should be independent of how the measure is announced. This means it does not matter whether a policymaker describes the measure as temporary or permanent. What matters is whether it is inherently temporary or permanent in nature. Another consideration here is that, while they may include specific end dates initially, many budgetary measures can end up being extended indefinitely.

Other useful guidelines

There are a few other useful guidelines to consider.

First, it is not worth considering small measures worth less than 0.1% GNI*. These are more likely to constitute normal volatility of the public finances and ignoring these small measures generally avoids excessive complexity in monitoring.

Second, volatile parts of spending or revenue should not be considered one-off in nature. This is relevant where some volatility is part of the normal course of developments in the public finances.

Third, cyclical parts of spending or revenue should not be considered once-off. Their impact should be corrected for through adjustments for the cycle. In this sense, one-offs should not be used as a means of smoothing out time series.

Is capital spending one-off?

In general, the Council does not consider capital spending to be a one-off item. 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 one-off if they are to keep pace with population growth. Even if some capital projects are completed, annual spending on public investment is likely to continue as other projects take their place. For these reasons, the Council tends to presume that capital spending is part of permanent spending unless there are clear reasons to suggest otherwise.

2024 spending

Looking at Figure N°27, we can see that €2.5 billion of spending has been allocated for humanitarian assistance for Ukrainian refugees and €1.3 billion for Covid. Both of these spending items are assessed as part of core spending by the Council. As a result, reclassifying these spending items would increase core spending by €3.8 billion in 2024.

Transparency is lacking

The fiscal numbers provided in budgetary documents have become increasingly complex in recent years. It has become more difficult to analyse expenditure outturns and projections, given the various categories of spending being used. Before 2020, total expenditure would be the focus, with an indication that some expenditure items may be one-off.

In Budget 2024, a variety of expenditure headings were used, including core, non-core, windfall capital investment and one-off (cost of living measures). Even where information is provided, some of the classifications seem unusual (see Box D on fiscal gimmickry). This added complexity makes the budgetary forecasts and outturns more difficult to analyse and less transparent.

In addition, the focus of much of the budgetary documentation is on Exchequer spending.[18] This means that almost 20% of government spending is omitted. The focus should be on general government spending and revenue, as these are the most comprehensive measures. With the Rule focusing mainly on Exchequer spending, general government spending could be growing faster than the pace set out in the National Spending Rule.[19]

Alarmingly, *Budget 2024* continues a pattern in which no assessment of core spending is provided that adjusts for tax measures. This is key to assessing compliance with the National Spending Rule, which is a net spending rule—spending net of tax changes. In addition, the Department makes no reference to the original ceilings first set out in *Budget 2022*. This too is bad for transparency.

[18] This includes spending by the Social Insurance Fund and the National Training Fund.

[19] For example, if Exchequer spending was growing by 5% and non-Exchequer spending was growing by 10%, that would mean general government spending growing by about 6%.

Some of the shortcomings of the National Spending Rule have been highlighted previously by the Council (2021). These include the Rule focusing on "core" spending rather than general government spending. The Council also called for the National Spending Rule to be put on a statutory footing.

Overall, the separation of spending into core and non-core elements has become unhelpful. Measures that appear to be permanent are being counted as non-core and the definitions have become extremely blurred (Box D). A better approach would be to focus on general government spending, net of tax measures. The National Spending Rule should also focus on general government spending net of tax measures.

There may be times where unusual circumstances would warrant spending above what the Rule would allow. Occasional deviations from the Rule may be justifiable on these grounds. It should be up to the government of the day to explain why this is the case. Even in these instances, the focus should remain on overall net general government spending, rather than various dubious definitions of what is included in core spending.

On the revenue side, the Tax Policy Changes document, which outlines all the revenue policy changes has in the past incorporated the impacts of PRSI changes on revenue.[20] However, on this occasion, the announced increase in PRSI rates is completely absent from the document and the only reference to this change is in Minister Donohoe's speech.

Box D: Fiscal gimmickry strikes back

Fiscal gimmicks are the use of creative accounting techniques to make a government's fiscal numbers adhere to fiscal rules or look more favourable than they are. As fiscal rules become more binding, the use of fiscal gimmicks tends to increase (Alt *et al.*, 2014; Koen and van den Noord, 2005; von Hagen and Wolff, 2006). The use of creative accounting techniques also tends to increase before elections (Reischmann, 2016).

Ireland is no exception, and with the introduction of a National Spending rule, we have seen a rise in fiscal gimmicks used by the Government. This box looks at some key examples in *Budget 2024* but this is by no means an exhaustive list.

Windfall capital investment

The 2023 *Summer Economic Statement* included for the first time a line item for spending labelled "Windfall capital investment". This is additional capital spending that is to occur contingent on windfall corporation tax receipts remaining at elevated levels.

This spending was not classified as core or non-core expenditure. As a result, it was not included in the Government's calculations for the National Spending Rule. This was despite this spending being a permanent—and increasing—feature for the entirety of the Government's forecast horizon.

[20] See https://www.gov.ie/en/publication/de3d4-budget-2024-taxation-measures/.

By treating this capital spending in that manner, the Government presented figures that suggested a smaller breach of the National Spending Rule than would otherwise be the case.

Despite the windfall capital investment being earmarked for "projects that are ready for development" (Department of Finance, 2023a), this funding was not allocated to any specific department on budget day.

Non-core spending

The concept of non-core spending was introduced in response to the Covid-19 pandemic and Brexit to separate out "crisis management measures to address the challenges posed by Covid-19 and Brexit, while preserving and maintaining existing levels of service within core expenditure programmes" (Pre-Budget Expenditure Update 2020). Since then, the scope of non-core measures has been broadened to include spending on Ukrainian refugees and, at times, cost of living measures.[21] The Government sets its National Spending Rule on the basis of core spending. As a result, all measures that are classified as non-core are excluded, whether they are likely to recur or not.

While there may be a case for some measures to be treated in this fashion for a period of time, there is no case for doing this indefinitely and there is a risk that this classification is abused to make the Government's fiscal numbers look more favourable.

Non-core spending – Covid 19 spending

The Expenditure Report states that "[Non-core Covid-19 spending] has been increased by €0.5 billion for Budget 2024 to fund the post pandemic **escalation of health sector costs, including increased activity and demand across acute hospitals**". These areas of spending mentioned are permanent and not likely to recede in value. In other words, health spending is structurally higher. The Government included this spending as part of non-core, and therefore falling out of what they consider part of the National Spending Rule.

For 2024, €150 million non-core Covid-19 spending is allocated to the Department of Transport. This is to fund the continuation of the 20% public transport fare reduction, the Young Adult Card reduction and the 90-minute fare into 2024. It is unclear how the continuation of these measures is related to the Covid-19 pandemic and not related to other strategic government objectives.

Once again, classifying this spending in this manner, limits the amount by which the Government breaches the National Spending Rule, and shows the Government plans in a more favourable light.

Non-core spending – Ukrainian refugee spending

Outside of spending directly related to Ukrainian refugees, but incorporated under the heading for Ukrainian spending, some €180 million is allocated to meet spending on the International Protection Accommodation Service. This is spending to meet the needs of additional non-Ukrainian refugees who are classified outside of the EU Temporary Protection Directive. It is unclear why this additional spending on non-Ukrainian refugees should be included as Ukrainian refugee spending and classified as non-core, given that the majority of these refugees are seeking protection for reasons unrelated to the war in Ukraine.[22] While the increase occurred over the same time period as the war in Ukraine, the increase appears structural and should be treated in the same fashion as other structural expenditures.

[21] Cost-of-living spending has fallen under non-core allocations at certain times, while at other times it is classified separately to core, and non-core spending.

[22] Since January 2022, the number of non-Ukrainian refugees seeking protection in Ireland has increased almost three-fold. The nationalities that have seen the largest increases are Georgian, Algerian, Nigerian, Somalian, Afghan, and Zimbabwean, in that order.

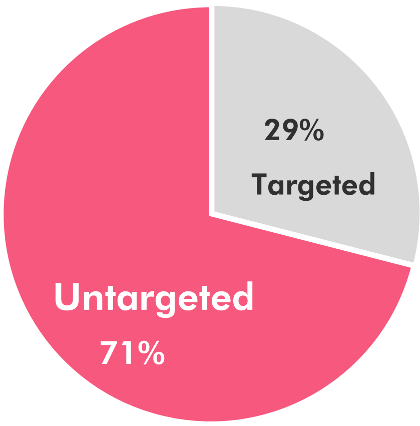
2.3 Cost-of-living measures are largely untargeted

Overall, €2.9 billion of cost-of-living measures were announced in *Budget 2024*. When one considers all taxation and spending measures, only 29% of the cost is on targeted measures (N°28). Unsurprisingly, universal measures such as the electricity credits and child benefit double payments are more costly than more targeted measures which have a lower number of recipients.

The untargeted nature of these supports continues a pattern. Cost-of-living measures have been used since early 2022. In each case, the package of measures has been largely untargeted.[23]

Nº28 **Cost-of-living measures are highly untargeted**

% of total cost-of-living measures



Sources: Budget 2024; and Fiscal Council workings.
Notes: All tax and spending cost of living measures introduced in Budget 2024 are considered. Subjective judgements are made as to whether each measure is targeted or not. When in doubt, measures are classified as targeted.

The Exchequer cost of the measures is spread over two years (N°29). In some cases, the benefits to citizens may occur in 2024, but the cost to the Exchequer occurs in 2023. For example, two of the three energy credits will be received by households in 2024, but the Exchequer cost of all three occurs in 2023.

[23] The package of measures introduced in *Budget 2023* was the most targeted, accounting for 33%.

№29 Budget 2024 cost of living measures

€ millions

	2023	2024	Total	Targeted	Untargeted
Expenditure measures					
Energy credits	900		900		✓
Double social welfare payments		342	342	✓	
Child benefit	179		179		✓
Fuel allowance	123		123	✓	
Living alone allowance	47		47	✓	
Carers, blind pension	138		138	✓	
Qualified children payment	37		37	✓	
Working family payment	18		18	✓	
Education measures	250		250		✓
Foster care	2		2	✓	
Extended youth travel card	20		20	✓	
Business supports		250	250		✓
Total	1,714	592	2,306	727 (32%)	1,579 (68%)
Taxation measures					
Mineral oil tax	49	122	171		✓
VAT on electricity and gas		315	315		✓
Mortgage interest relief		125	125	✓	
Total	49	562	611	125 (20%)	486 (80%)
Total tax and expenditure measures	1,763	1,154	2917	852 (29%)	2,065 (71%)

Sources: Budget 2024, and Fiscal Council workings.
Notes: Judgements are made as to whether each measure is targeted or not. When in doubt, measures are classified as targeted. There is limited detail available on the nature of the business supports. Previous business support schemes such as the Temporary Business Energy Support Scheme (TBESS) had limited take up, hence had a much lower cost than anticipated. All three energy credits are listed in 2023 as the Exchequer pays the cost of all three in 2023. Similarly, the extended youth travel card cost is recorded in 2023. On a general government basis, the cost of the extended youth travel card and two of the three energy credits (€600 million) will be part of 2024 expenditure.

2.4 The costs of maintaining existing services

The costs of standing still over the medium-term

To gauge the cost of current policy decisions into the future, the Council estimates the costs of maintaining the existing level of services, or "Stand-Still" costs. These Stand-Still estimates factor in the expected costs of demographic changes, the costs of maintaining welfare rates and public sector pay relative to forecast wage growth, and the cost of other inflationary pressures. This approach assumes that there are no efficiency gains in the provision of public services. To assess the potential medium-term Stand-Still costs, the Covid-19 and Ukrainian spending are included in the baseline costs for 2024.

This section takes the policies for 2024 as given. Yet there are some caveats mentioned below around insufficient provision for maintaining existing services into 2024 which mean the level of spending may be higher still.

Nº30 **Stand-Still costs will be substantial over the medium term**

€ billion, gross voted expenditure

	2024	2025	2026	2027	2028	2029	2030
Official allocations	82.8	82.3	86.3	n.a.	n.a.	n.a.	n.a.
Fiscal Council Stand-Still estimates							
Stand-Still costs	82.8	87.9	92.9	97.4	102.1	106.5	111.1
Stand-Still pressures		5.1	5.1	4.5	4.7	4.4	4.6
of which:							
Demographics		1.7	1.7	1.6	1.9	1.7	1.7
Prices		3.3	3.4	2.8	2.9	2.7	2.9
by area:							
Health		1.6	1.6	1.6	1.6	1.6	1.7
Pensions		1.5	1.5	1.5	1.7	1.5	1.6
Social welfare		0.5	0.5	0.5	0.5	0.4	0.4
Education		0.5	0.4	0.3	0.4	0.3	0.3
Other		0.9	0.9	0.6	0.6	0.6	0.6

Sources: Fiscal Council workings.
Notes: Covid-19 and Ukrainian refugee spending is incorporated in the base for Stand-Still estimates. Official allocations include Covid-19 and Ukrainian refugee spending for 2024. The official allocations have no provision for Ukrainian refugee spending or Covid-19 for 2025 and 2026. National Recovery and Resilience Plan and Brexit Adjustment Reserve funded expenditure are excluded. Pensions includes the state pension contributory, public sector pension, widow(er)s' and surviving civil partners' pension contributory, and state pension non-contributory. Social welfare includes the Social Insurance Fund and excludes pensions. Education includes the National Training Fund and Higher Education. Get the data.

For 2025-2026, the increase in Stand-Still costs average €5.1 billion per year, with the demographic's component accounting for €1.7 billion of this (N°30). Looking further ahead, as price pressures are expected to recede, the increase in

Stand-Still costs fall to an annual average of €4.6 billion between 2027 and 2030.

However, these estimates show the costs of maintaining existing policies. There are additional spending pressures, such as meeting Ireland's climate targets, which are not adequately factored into current policies. Casey and Carroll (2023) estimate the impact of transitioning to a low carbon economy on government revenue and expenditure. Between 2027 and 2030, revenues could decline by about 0.9% of GNI* and spending could rise by 0.8%.

Funding is insufficient to maintain services in 2024

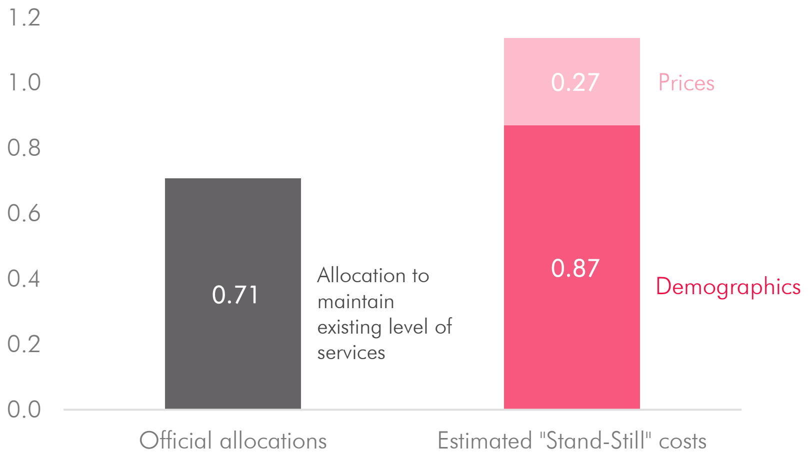
Estimates from the Council's Stand-Still approach suggest that certain provisions by the Department of Public Expenditure to maintain the existing level of services into 2024 may be too low given expenditure and service levels in 2023.

In *Budget 2024* the Department of Health was allocated €0.7 billion in 2024 to maintain the existing level of service relative to a 2023 figure that does not incorporate any overruns. Up until end-November, current spending in the Department of Health is €1,079 million (5.9%) higher than forecast.

Figure (N°31) also shows the Council's Stand-Still estimates for Health in 2024, excluding any impact of 2023 overruns, and any impact of a potential public sector pay deal. The impact of demographics on the health budget means that €0.8 billion would be required, while increasing prices would add an additional €0.3 billion to standstill costs.

Nº31 **Health allocation insufficient to cover 2024 "Stand-Still" costs**

€ billion, 2024 health expenditure



Sources: Department of Finance; and Fiscal Council workings.
Notes: The Fiscal Council Stand-Still figure does not incorporate the impact of any overrun in the Health vote for 2023 and its knock on impact into 2024. It also does not include the potential costs of any new public sector pay deal. Were public sector pay per head to rise in line with economy-wide forecasts for 2024, this would add an additional €0.33 billion to Stand-Still costs for 2024. Get the data.

Clearly, the €0.7 billion allocated to maintain the existing level of service falls short of the Council's estimated €1.1 billion. However, inexplicably, the allocated amount of non-core Covid-19 related health expenditure in 2024 is set to increase by €0.3 billion relative to 2023.[24] As outlined in Box D, this may be a case of incorporating what should be core permanent health expenditure in non-core to present a flattering picture of the public finances. Were this funding used to maintain the existing levels of service, there would still be a shortfall of €0.1 billion relative to "Stand-Still" costs.

Were a public sector pay deal agreed that would see the average pay per head rise by 5%, this would see an additional €0.3 billion added to the cost of standing still.[25] There remains an unallocated €0.85 billion of core gross voted current expenditure, potentially available to meet the costs of a public sector pay deal. Spending on pay in Health accounts for 38% of total Exchequer pay, meaning on a proportional basis, €0.3 billion of the unallocated €0.85 billion could be available for Health to meet the costs of a public sector pay deal.

The analysis above does not factor in any potential overrun in the Department of Health in 2023. The overruns in 2023 are likely to lead to a higher baseline level of expenditure in 2024. Given this higher level, the "Stand-Still" costs will be higher still than those shown in N°31.

Looking further ahead, the costs of maintaining existing levels of service in health will rise substantially over the coming decade as more of the population moves into older age groups and as people live longer (Box E).

[24] This is inexplicable given the impact of the Covid-19 pandemic was receding over the course of 2022 and 2023 and is expected to recede further in 2024. Despite this, *Budget 2024* sees Covid-19-related health expenditure increases in 2024 relative to 2023.

[25] The Department forecast that economy-wide average pay per head is to grow by 5% in 2024.

Box E: Are health pressures predictable?

Outside of emergency situations, the increase in demand for health services is largely predictable based on changing demographics. This box looks at the increase in demand for health services from key demographics relative to the increase in population in those key demographics.

Both the Secretary General of the Department of Health and the CEO of the HSE have argued that the HSE has been facing "unprecedented demand". While some of the recent demand may be related to pent-up demand arising from lower-than-normal demand for non-Covid activities during the pandemic years, much of the demand has been predictable.[26]

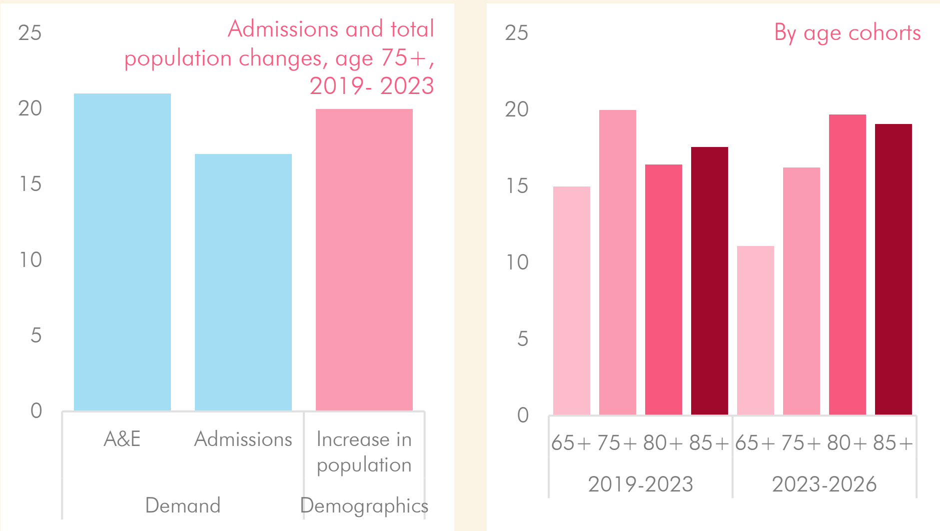
As an illustration of this "unprecedented demand", the Secretary General outlined that "emergency department attendances by those aged over 75 are up 21% in the last four years, while admissions from emergency departments of patients over 75 are up by over 15%". The Secretary General went on to say that "The demographic figures are surprising in terms of the impact of the number of people over 75 and the number over 80. The amount of healthcare they are consuming is a surprise in Ireland and across the developed world."

The demand for services from those aged over 75 typically follows changes in the population of those over the age of 75. Over the last four years (2019-2023), the population aged over 75 grew by 20% (N°32). As a result, the increase in demand for services by those aged over 75 that the HSE is currently experiencing is in line with the increase in the population over the age of 75.

N°32

Increase in demand has been largely predictable

% change in population



Sources: Fiscal Council workings.
Notes: Figures for 2023-2026 show projections based on the Fiscal Council's demographics model. Get the data.

The increase in demand over the last four years has been predictable based on demographics. Likewise, the increase in demand expected over the next four years is also predictable. Figure N°32.B shows demographic projections using the Council's demographics model. The population over the age of 75 will grow by approximately 16% between April 2023 and April 2026, while the population over the age of 80 will grow by approximately 20%.

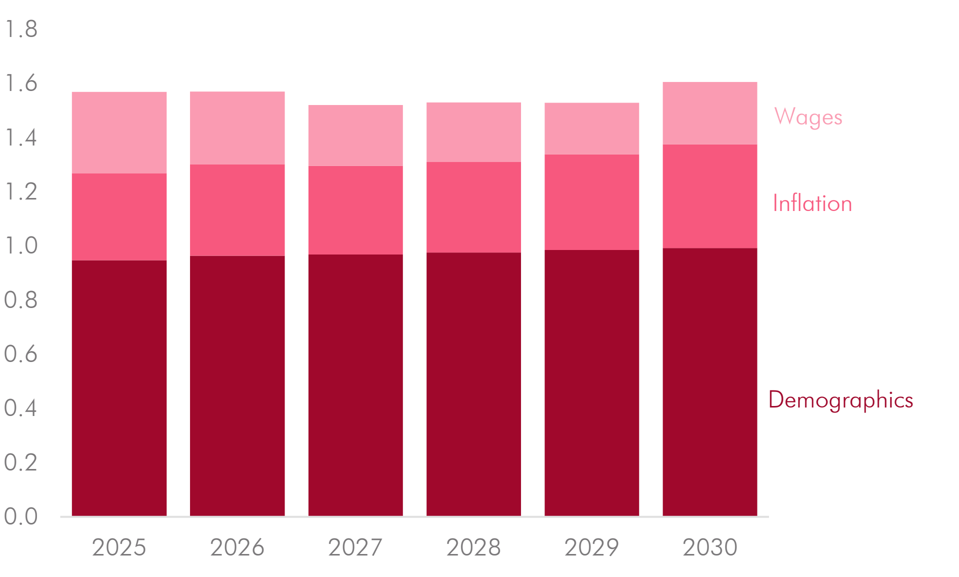
Looking even further ahead, by 2030, the number of people over the age of 75 will increase by 66% relative to 2019. This will see a corresponding increase in demand for health services from these demographics. Based on existing service levels, over the period 2025-

[26] See testimony before the Joint Committee on Health, debate – Wednesday, 27 Sep 2023: https://www.oireachtas.ie/en/debates/debate/joint_committee_on_health/2023-09-27/2/.

2030, demographic costs will add approximately €1 billion per annum to health spending (N°33).

Nº33 **Health stand-still costs set to average €1.6 billion per annum**

€ billion



Sources: Fiscal Council workings.

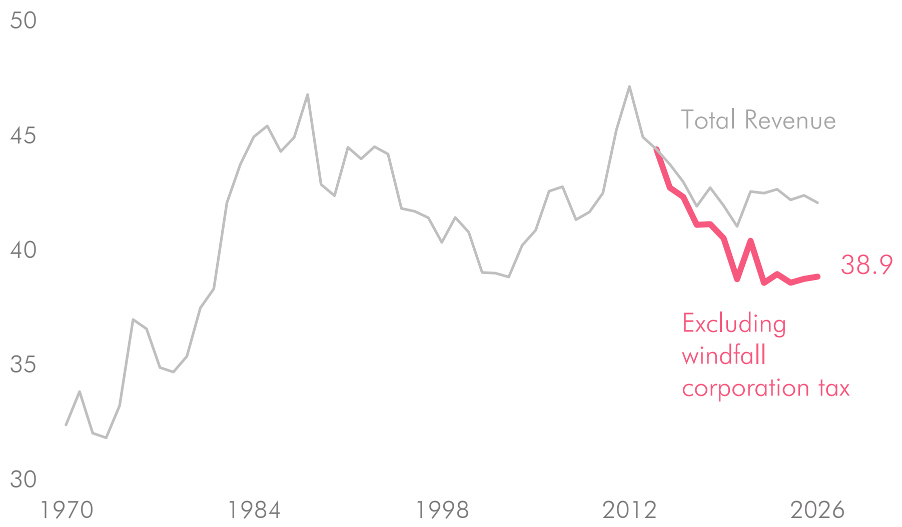
2.5 Tax revenue projections

Budget 2024 projections imply that general government revenue (excluding windfall corporation tax) is forecast to remain at a historically low level as a share of national income (N°34).

Nº34

Revenue to remain low as a share of national income

General government revenue as a share of GNI*



Sources: CSO; Budget 2024, and Fiscal Council workings.
Notes: Fiscal Council estimates of windfall corporation tax are used for 2015-2021. Budget 2024 estimates are used for 2022-2026. Prior to 1995, current and capital receipts (excluding borrowing) are used to extend the general government series back (from the historical *Annual National Accounts*, 1970-1995).

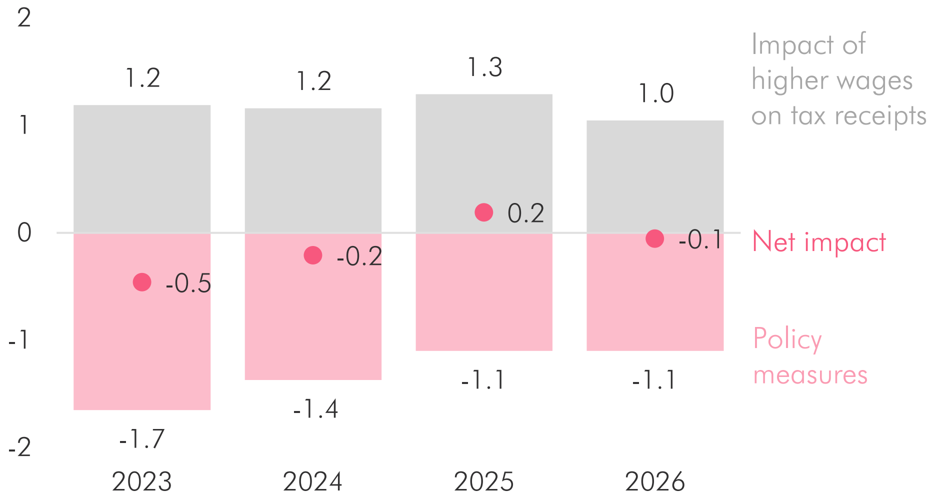
Income tax cuts exceed indexation costs

Income tax cuts in 2023 and 2024 appear to exceed what would be required for full indexation of the tax system. For 2025 and 2026, budget projections assume an income tax package of €1.1 billion. This is close to the cost of fully indexing the income tax system (N°35).

Indexing the income tax system is often considered as a neutral policy. However, not fully indexing the income tax system is a potential avenue to raise revenue in an economy operating at capacity in order to stem overheating risks.

Nº35 **Income tax cuts more than offset inflation**

€ billions



Sources: Budget 2024, Revenue ready reckoner and Fiscal Council calculations.

Notes: A net impact below zero indicates assumed policy changes are greater than the assumed yield from not indexing income tax bands and credits. As a result, income tax revenue would be lower than if full indexation of the income tax system were assumed. Budget 2024 estimates of the cost of indexation for the years 2023-2025 are used. For 2026, the Revenue Commissioners' post-Budget 2024 "ready reckoner" is used. This is combined with Budget 2024 forecasts of hourly wage growth.

Here we assess the official main revenue forecasts contained in Budget 2024. For the major Exchequer tax headings, the forecasts can be broken into various factors. These include growth of the macroeconomic driver, policy changes and other factors such as judgement or one-offs. Supporting information Section S.1 shows this in more detail.

For income tax and excise duties, significant negative judgement has been incorporated into *Budget 2024* forecasts. Significant negative judgement has also been applied to corporation tax (in addition to the negative assumed impact of Base Erosion and Profit Shifting (BEPS) reforms in 2026).

The negative judgement applied to income tax is to "keep the effective tax rate broadly stable". However, N°36 shows that Budget 2024 projections imply a slight fall for income tax as a share of compensation of employees. Income tax would be €1 billion higher than forecast for 2026 if it remained at its 2023 share of compensation of employees.

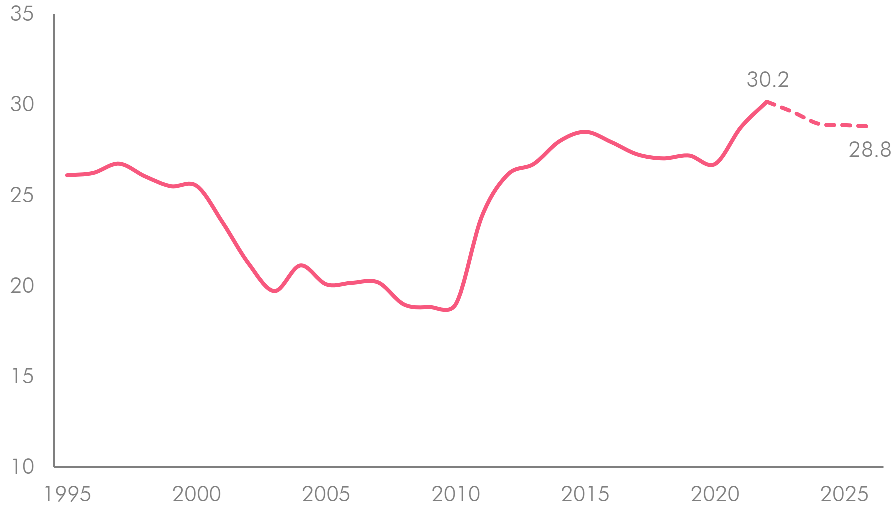
Negative judgement of €350 million is applied to excise for 2024, with this effect carrying into later years, to reflect "weaker trends in recent months".

General government social contributions are mainly made up of PRSI contributions. However, other social contributions are still a significant amount of revenue (€5.8 billion in 2022). Budget 2024 forecasts of other social contributions look conservative for 2023, with this effect carrying into following years.

Given many of the judgements made seem conservative, an alternative set of revenue forecasts are presented in Section 2.6.

Nº36 **Effective income tax rate forecast to fall**

Income tax as a percentage of compensation of employees



Sources: CSO; Budget 2024, and Fiscal Council workings.

2.6 Alternative projections of the public finances

Given that several parts of Budget 2024 fiscal projections are substandard, this section presents an alternative set of projections of the public finances. The lack of quarterly general government revenue and spending outturns and profiles makes this a difficult task.[27] Nonetheless, the exercise highlights that both revenue and expenditure are likely to be underestimated out to 2026.

Revenue could be stronger than Budget 2024 forecasts

Table N°37 shows a possible alternative projection of general government revenue out to 2026. This is done by examining both Exchequer revenue and non-Exchequer revenue which forms general government revenue. The areas where the alternative projection differs from Budget 2024 forecasts are shown in N°37.

Income tax is higher in the alternative scenario so that it remains at its 2023 share of compensation of employees thereafter. Other taxes on income and wealth are also revised up for 2025 and 2026 so that their growth is more in line with GNI*.

Excise receipts are also higher than Budget 2024 forecasts from 2024 onward. This reverses the negative judgement applied in Budget 2024 forecasts. Tax revenue of local government is also revised up slightly.

For social contributions, non-PRSI receipts are revised up for 2023 and 2024. This is done so that non-PRSI social contributions grow in line with GNI*.[28]

Corporation tax forecasts are not adjusted from the Budget 2024 levels. This is because any increase or decrease in receipts relative to *Budget 2024* forecasts is likely to be due to changes in "excess" corporation tax receipts. As a result, this would not impact on the general government balance excluding excess corporation tax, which is the most important measure to focus on.

Finally, "other general government revenue" is revised up for 2025 and 2026. This is done so that this category settles at its 2022 share of national income, which is a historical low. Budget 2024 projects a further fall.

[27] While the quarterly Government Finance Statistics produced by the CSO are helpful, they come with a significant lag and only cover historical outturns. Quarterly profiles of general government revenue and spending should be produced as part of budgetary documentation.
[28] Non-PRSI social contributions are made up of government employees' contributions and employers' imputed contributions (see Fiscal Council, 2023A). Forecasts for 2025 and 2026 are not revised, as Budget 2024 forecasts look to be at an appropriate level.

Overall, the alternative scenario shows stronger revenue out to 2026. By 2026, general government revenue is €3.4 billion higher than Budget 2024 projections.

This alternative forecast also implies revenue to be a larger share of GNI*. The increase is mainly seen in 2025. This is mostly driven by income tax and social contributions. These revenue headings rise as a share of national income because the labour share of income is forecast to increase in 2025 (see Fiscal Council, 2023c).

Nº37 **Alternative general government revenue forecasts**

€ billions

	2023	2024	2025	2026
Alternative general government revenue	125.4	131.1	138.7	144.3
Budget 2024 general government revenue	124.9	129.6	136.0	141.0
Differences:				
Current taxes on income, wealth		0.6	1.1	1.3
Of which: income tax		0.6	0.9	1.0
Of which: other			0.2	0.3
Social contributions (non-PRSI)	0.5	0.4	0.0	0.0
Taxes on production and imports	0.1	0.4	0.4	0.5
Of which: excise		0.4	0.4	0.4
Of which: local government taxes	0.1	0.1	0.1	0.1
Other general govt revenue			1.1	1.6
Total differences	0.5	1.4	2.7	3.4
Alternative Revenue (% GNI*)	42.8	42.7	43.2	43.1
Budget 2024 Revenue (% GNI*)	42.7	42.2	42.4	42.1

Sources: Budget 2024, and Fiscal Council workings.
Notes: Revenue headings which are not different from Budget 2024 projections are not shown. These include corporation tax, VAT and PRSI.

Spending is likely to be stronger than Budget 2024 forecasts

As shown in Section 2.4, Budget 2024 spending projections for 2025 and 2026 are short of what is required to maintain existing service levels and the real value of social protection payments. The Stand-Still exercise takes Budget 2024 levels of spending for 2024 as given and grows spending forward using that as a base. As a result, this assumes that spending on humanitarian assistance for refugees and spending labelled as Covid-related will continue over the medium term.

However, spending is likely to be higher than Budget 2024 projections for 2023 and 2024. As a result, the level of spending in 2025 and 2026 needs to be adjusted upwards by more than just the additional stand still costs.

As highlighted earlier, health spending is going to be higher than *Budget 2024* forecasts for this year, with costs likely to recur next year. For this alternative projection, we assume a €1.4 billion overrun in health spending this year.[29] In addition, as shown in Section 2.4 (Nº31), the costs of standing still in health next year would be at least €0.1 billion higher than has been allocated. As a result, the upward revision to spending on health grows to €1.5 billion in 2024.

The Christmas Bonus has not been budgeted for beyond this year. The cost this year was €330 million. This cost assumed for future is grown in line with inflation. Costs associated with the Government's planned autoenrollment pension scheme have also not been incorporated into spending projections. These are also included in the alternative spending projections.

General government gross fixed capital formation will increase sharply when the National Children's Hospital is completed. This has not been recognised in Budget 2024 forecasts. The latest data suggestions a completion in the fourth quarter of 2024 with a cost of around €2.3 billion. As a result, in the alternative forecasts an additional investment of €2 billion is added in 2024.[30]

In the alternative forecasts, spending remains relatively flat as a share of national. This is in contrast to *Budget 2024* projections, which show spending falling as a share of national income throughout the forecast horizon.

Nº38 **Alternative general government spending forecasts**

€ billions

	2023	2024	2025	2026
Alternative general government expenditure	117.5	123.2	129.3	134.9
Budget 2024 general government expenditure	116.1	121.3	121.8	126.3
Differences:				
Health	1.4	1.5	1.5	1.5
Christmas Bonus		0.3	0.4	0.4
Autoenrollment pension scheme		0.1	0.1	0.1
Additional standstill costs			5.5	6.6
Investment		2.0		
Total differences	1.4	3.9	7.5	8.6
Alternative spending (% GNI*)	40.1	40.7	40.3	40.3
Budget 2024 spending (% GNI*)	39.7	39.5	38.0	37.7

Sources: Budget 2024, and Fiscal Council workings.
Notes: Spending headings which are not different from Budget 2024 projections are not shown. Additional standstill costs refer to the additional spending required to maintain existing service levels, above the spending forecast in Budget 2024.

[29] A supplementary estimate of €960 million has been approved for the Department of Health. However, the HSE is likely to require additional funds this year. This is likely to occur via the HSE using cash reserves and accruals. This would still imply additional general government spending in 2023 over and above the €960 million extra Exchequer funding.
[30] *Budget 2024* forecasts incorporate the cash costs of the project, hence only €2 billion of the €2.3 billion is added to Budget forecasts in the alternative scenario.

Bringing together the alternative forecasts of revenue and expenditure, this leads to an alternative forecast for the general government balance. In the alternative forecasts, the general government balance is weaker throughout the forecast horizon. When excess corporation tax receipts are excluded, a deficit is forecast out to 2026 (Table N°39). This contrasts to *Budget 2024* projections, which show an underlying surplus in 2025 and 2026.

Nº39 **Alternative general government balance forecasts**

€ billions

	2023	2024	2025	2026
General government balance (excluding excess corporation tax)				
Budget 2024	-2.0	-2.7	2.5	3.8
Alternative forecast	-2.9	-5.2	-2.3	-1.4
Budget 2024 (% GNI*)	-0.7	-0.9	0.8	1.1
Alternative forecast (% GNI*)	-1.0	-1.7	-0.7	-0.4
General government balance				
Budget 2024	8.8	8.4	14.2	14.6
Alternative forecast	7.9	5.9	9.4	9.4
Budget 2024 (% GNI*)	3.0	2.7	4.4	4.4
Alternative forecast (% GNI*)	2.7	1.9	2.9	2.8

Sources: Budget 2024, and Fiscal Council workings.

2.7 Corporation tax

Corporation tax receipts for 2023 look likely to meet the forecast in *Budget 2024*.[31] This is despite reduced payments from the pharmaceutical sector, where some companies are experiencing lower profits—primarily driven by lower sales of Covid-19 vaccines and anti-viral therapies.

Corporation tax receipts are still at elevated levels (N°40). Firms in the pharmaceutical sector firms are still generating significant profits and are expected to develop new revenue streams in future.

Nº40 **Corporation tax receipts are still at elevated levels**

€ billion, 12-month rolling sum

Sources: Department of Finance; and Fiscal Council workings. Get the data.

The Council has repeatedly advised against making permanent spending commitments based on excess corporation tax receipts. Any fall in excess corporation tax receipts should not be a cause for alarm. A well-planned budget should not be impacted by changes (up or down) in excess corporation tax. If a fall in excess corporation tax receipts causes fiscal plans to change, that reflects a lack of appropriate planning and budgeting. Sticking to the National Spending Rule would help insulate the Government from risks around corporation tax receipts.

Budget 2024 forecasts of corporation tax assume a €2 billion negative impact of the OECD's Base Erosion and Profit Shifting (BEPS) Pillar I and Pillar II reforms. This impact is now anticipated in 2026.[32] This €2 billion estimate is unchanged since January 2020. Since then, corporation tax receipts have grown significantly.

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[31] Receipts for October, which were only known after the Budget was published, were €1 billion lower than for October 2022. This was offset by November receipts, which were €1.3 billion higher than November 2022.

[32] *SPU 2023* had assumed a €2 billion impact in 2025.

€2 billion was 18.4% of 2019 corporation tax receipts but is 8.5% of the forecast 2023 receipts.

In addition, there is likely to be some additional revenue from the new 15% minimum effective tax rate for large firms. This is likely to be fully implemented before the Pillar I reforms. Box F explores the potential impact of the new 15% minimum effective tax rate. *Budget 2024* does not incorporate any assumed yield from this policy change.

Box F: What is happening to Ireland's corporation taxes?

Ireland's corporation tax receipts remain at historically high levels. In November, they increased by 27% year on year, reversing some of the weakness in previous months.

Corporation tax revenues had shown year-on-year declines in August, September, and October. There are a number of reasons why receipts might have fallen during these months. Part of this relates to timing issues and how corporate groups organise payments within their calendar year. There is also some evidence that profits in the pharmaceutical sector are moderating as vaccine demand declines. We will explore these issues in a forthcoming Analytical Note (Cronin, 2023b). Yet there are also several reasons why corporation tax receipts may rise further over the medium term.

Regardless of recent or forthcoming developments, Ireland's corporation tax receipts remain incredibly concentrated and inherently very risky. The Government is right to treat much of these receipts as windfall in nature. The National Spending Rule and the Future Ireland Fund can help guard against the risks of using risky receipts to fund permanent budgetary measures. Sticking to the National Spending Rule would help ensure that month-to-month developments in corporation tax receipts, which are largely outside of Ireland's control, do not jeopardise the sustainability of the public finances.

Profits in some firms in key sectors remain elevated

Ireland's corporation tax revenues are dominated by highly profitable ICT and pharmaceutical firms. Global revenues and profits of the leading ICT firms remain far in excess of their 2019 levels, although the exceptional rates of growth they experienced during the pandemic have moderated. In addition, while some pharmaceutical companies have seen revenues take a significant hit from falling Covid-related demand, the growth outlook for non-Covid products remains strong. Moreover, the pharmaceutical sector could yet benefit from the technological advances made in response to the pandemic.

The exhaustion of capital allowances could boost receipts in future

Another potential upside to short-term corporation tax receipts could come from the unwinding of large capital allowances by key multinational firms, provided that their company structures and profits do not change significantly. Of course, were these corporate structures to be altered, the risks could be in the opposite direction.

The move to a 15% minimum effective corporation tax rate could raise receipts

Ireland's rate of corporation tax for large corporate groups is set to increase. The Government has introduced draft legislation which seeks to implement the OECD's Pillar II reforms as adopted in the EU's Minimum Tax Directive. The reforms will see a minimum effective corporation tax rate of 15% applied to those corporate groups whose annual global revenues have exceeded €750 million in at least two of the previous four years.

The new rules represent a major change to Ireland's corporation tax regime. In effect, large corporate groups will continue to pay corporation tax at the same tax rates as at present, before then making a top-up payment to bring them up to the 15% effective rate.[33] The reforms will come into force for accounting periods beginning on or after 31 December

[33] There are two rates of corporation tax in Ireland: 12.5% for trading income and 25% for non-trading income (such as rental income) and income from an excepted trade.

2023. The first top-up tax return must be filed no later than 18 months after the end of the first accounting period.[34] In other words, the first filing deadline will be 30 June 2026. Therefore, the public finances will only begin to benefit from the additional top-up tax revenues from 2026.

The Department of Finance has yet to publish estimates of the expected yield arising from the new 15% rate. We use publicly available data to estimate the additional yield that would have arisen in 2021 had the top-up tax come into effect that year (N°41).[35] Over 1,600 large corporate groups are likely to affected, mostly foreign-owned multinationals (Department of Finance, 2023b).

N°41 **The top-up tax could increase receipts by some €2 billion**

€ billion

	2021
Taxable income	135.6
less adjustment to taxable income	-19.1
Net qualifying income	116.4
less carve-out for eligible payroll costs*	-4.0
less carve-out for eligible tangible assets*	-17.6
Excess profit	94.9
multiply by top-up tax rate (%)	× 2.4%
Top-up tax revenue	2.2
Actual corporation tax revenues in 2021	15.3
Top-up tax revenue as a share of total corporation tax revenues (%)	14.7

Sources: McCarthy (2023), CSO, Department of Finance, Fiscal Council workings. Get the data.
*Note: A substance-based income exclusion provides that a percentage of both the eligible payroll costs and the carrying value of eligible tangible assets are excluded from the top-up tax. The percentage of payroll costs to be excluded starts at 10%. The percentage of the carrying value of tangible assets to be excluded starts at 8%. These are the rates applied in the table above. However, both percentages gradually decline each year over a transition period of ten years, such that both rates are 5% in 2033.

Our central estimate is that the top-up tax would have yielded an additional €2.2 billion in corporation tax revenue in 2021 (N°41). This equates to a 14.7% increase in the corporation tax take that year. Based on several other scenarios, we consider this estimate might plausibly vary between a range of €1 billion and €3½ billion.

The estimates we produce here require a number of careful assessments to arrive at net qualifying income so as to determine the relevant tax base on which the new effective tax rate will apply. For 2021, the top-up tax rate we estimate is 3% based on the difference between the actual effective tax rate and the minimum 15% effective rate. We also estimate "substance-based income exclusions" that allow deductions for 10% of eligible payroll costs and 8% of the carrying value of eligible tangible assets based on CSO and Revenue data. The forthcoming Analytical Note provides full details on how these are derived (Cronin, 2023b)

Corporation tax receipts are now even more concentrated

Ireland's corporation tax revenues are very highly concentrated among a small number of large, foreign-owned multinationals. What's more, it appears that this level of concentration is increasing. We estimate that just three corporate groups accounted for 43% of all corporation tax receipts in 2022 (N°42). These same

[34] After the first year, the top-up tax return must be filed no later than 15 months after the end of the relevant accounting period.

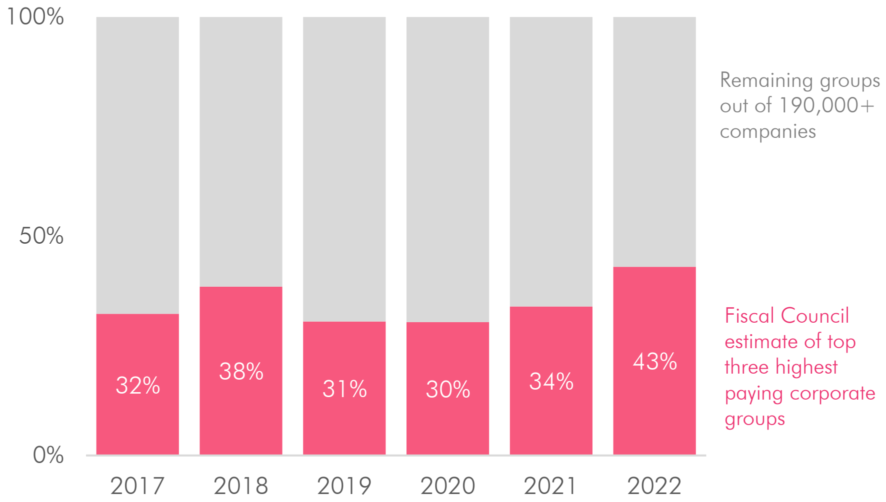
[35] 2021 is the most recent year for which data on taxable income and average effective tax rates is available.

three groups accounted for around one-third of all corporation tax revenues between 2017 and 2021 (Cronin, 2023a).

Nº42

Corporation tax receipts becoming more concentrated

% total corporation tax receipts



Sources: Company financial statements, Cronin (2023a), and Fiscal Council workings.
Notes: See Cronin (2023a) for further detail on the approaches used to estimate each group's corporation tax payments. 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.

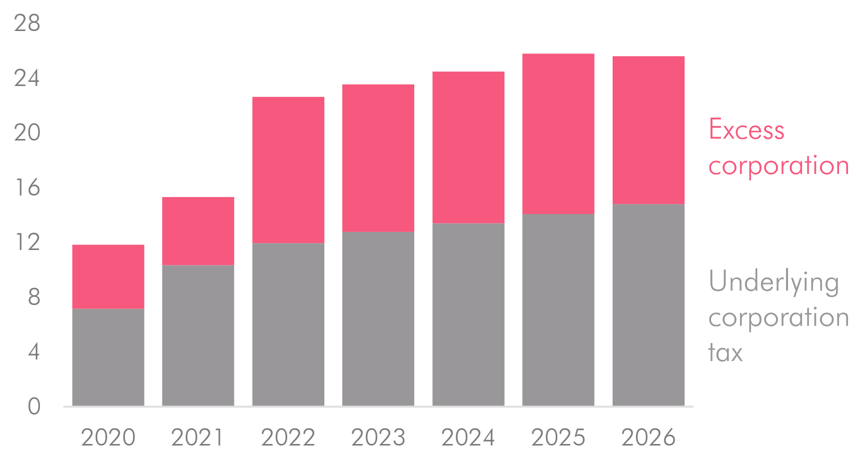
One can split forecasts of corporation tax into forecasts of "windfall" corporation tax receipts and underlying corporation tax receipts. For underlying receipts, Budget 2024 forecasts show them growing in line with GNI*.

By contrast, "windfall" corporation tax is forecast to remain largely flat over the coming years, with the assumed negative impact of BEPS international tax reforms reducing forecast receipts for 2026.

Nº43

Excess corporation tax receipts projected to remain at €11 billion

€ billions



Sources: Budget 2024, and Fiscal Council workings.
Notes: Estimates of excess corporation tax for 2020 -2022 are Fiscal Council estimates. Estimates for 2023-2026 are taken from Budget 2024.

2.8 Capital spending

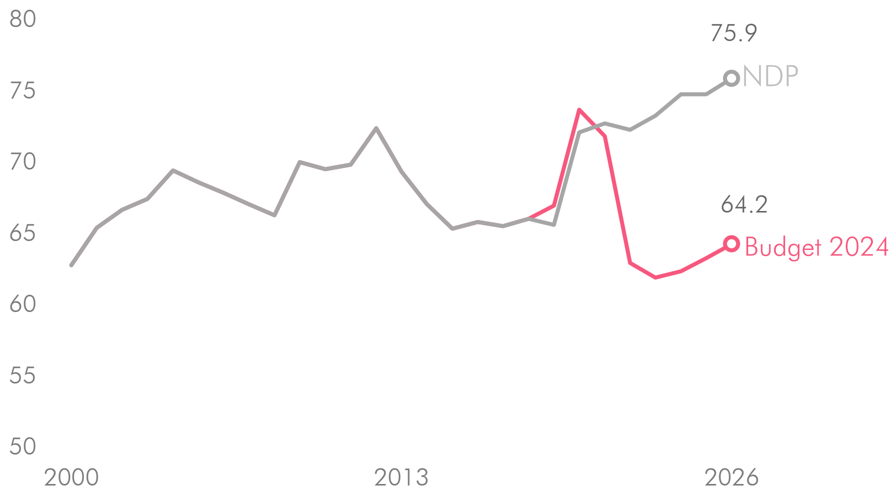
Recent strong growth in nominal GNI* has not been matched by the public capital investment. As a result, the public capital stock has fallen as a share of national income (Figure N°44). Using the latest outturns, we can see that there was a large fall in the public capital stock as a share of national income in 2022. While the nominal public capital stock did grow in 2022 (2%), this was well below the growth of nominal GNI* (17%).

Budget 2024 projections suggest a slight increase in the public capital stock as a share of national income but staying well below levels seen in recent years. If one looks back to when the National Development Plan (NDP) was announced, the public capital stock was projected to reach a much higher share of national income (Conroy, Casey and Jordan-Doak, 2021).

In nominal terms, the latest estimates and forecasts of the capital stock are slightly higher than that projected in Conroy, Casey and Jordan-Doak (2021). It is the higher nominal level of national income that has since led to a big downward shift as a share of national income.

N°44 **Inflation has eroded the estimated increase in public capital**

Government non-financial assets, % GNI*



Sources: Budget 2024, NDP and Conroy, Casey and Jordan-Doak (2021).
Notes: For the Budget 2024 line, the latest outturns for Government Non-financial assets and GNI* are used. Thereafter Budget 2024 forecasts of general government fixed capital formation are used. The depreciation rate assumed is the average over the years 2000-2022 (3.3%). Similarly, Other changes in non-financial assets are assumed to be their historical share of the capital stock (2.3%). The NDP line shows how the capital stock was expected to evolve after the NDP was announced. This line corresponds to the analysis conducted by Conroy, Casey and Jordan-Doak (2021).

Government investment is forecast to rise over the coming years. Over 2024 to 2026, government investment is forecast to increase by over €1 billion per annum. About €0.5 billion of annual spending increases would be required to maintain its share of national income (N°45).

If spending increases of €1 billion per year were achieved, it would lead to government investment increasing as a share of national income. By 2026, investment is forecast to reach 4.3% of GNI*.

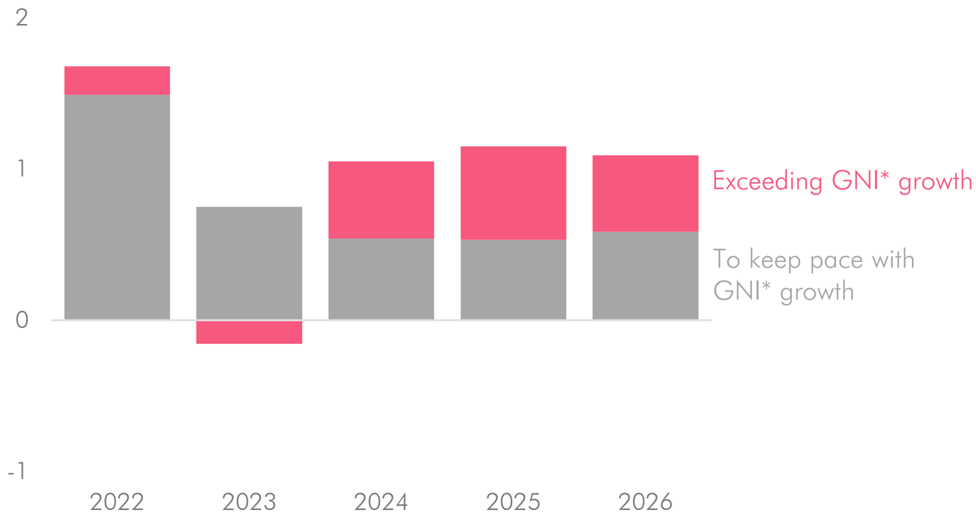
Government investment has struggled to reach targets

If capacity constraints were to persist, it may continue to be challenging to increase investment at the pace planned. Gross voted capital expenditure has been revised down by €600 million for this year relative to *SPU 2023*.

Gross voted capital spending the Department of Housing is **€385** million (15.2%) lower than expected for the year to end November.[36] This is a continuation of a pattern of underspends in housing capital expenditure in recent years (Fiscal Council, 2023a).

Nº45 **Capital spending is outpacing national income growth**

€ billions increases



Sources: *Budget 2024*.
Notes: CSO outturns and *Budget 2024* forecasts of general government gross domestic fixed capital formation are used. Grey bars show the amount of capital spending growth that would be required in that year to maintain the same share of national income. Additional spending growth shows any growth in capital spending above that amount, which would lead to an increasing share of national income. In 2023, capital spending fell as a share of national income, hence the "exceeding GNI* growth bar is negative.

[36] Almost all the unspent funding carried over into 2023 has now been spent in the Department of Housing, Local Government and Heritage.

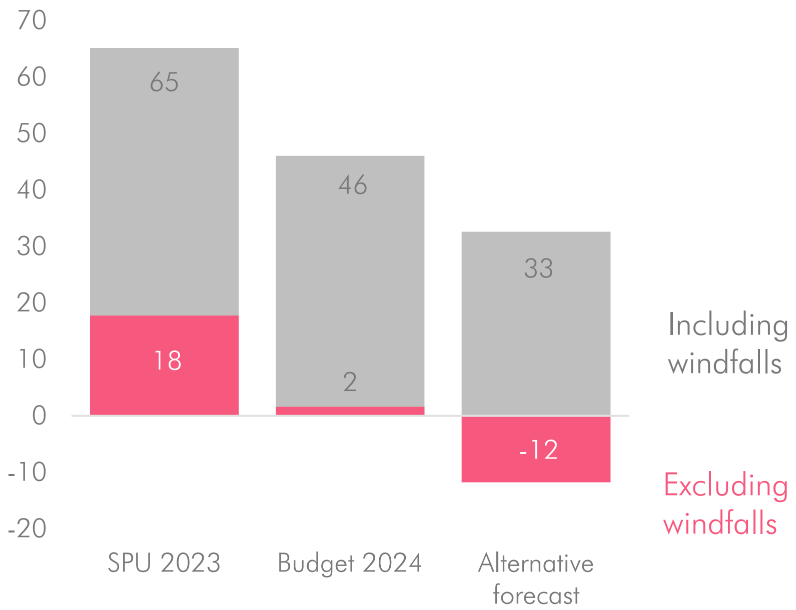
2.9 Medium-term forecasts are absent

The fiscal forecasts in Budget 2024 only go as far as 2026. This means that many of the major fiscal challenges Ireland faces are not captured by this forecast horizon.

In *SPU 2023*, headline surpluses were shown out to 2026. For the years 2023-2026, these cumulative headline surpluses were €65 billion. If one excluded windfall corporation tax receipts, these surpluses fell to €18 billion. As noted in Fiscal Council (2023a), several spending items were excluded from *SPU 2023* projections.

Nº46 **Predicted surpluses rely heavily on windfalls**

€ billion cumulative surpluses, 2023-2026



Sources: SPU 2023, Budget 2024 and fiscal council workings
Notes: Budget 2024 estimates of windfall corporation tax receipts are used.

Budget 2024 forecasts now show smaller surpluses over this period. This is due to expenditure being revised up for every year over 2023 to 2026. Headline cumulative surpluses for 2023 to 2026 are now projected to be €46 billion. When windfall corporation tax receipts are excluded, this falls to €2 billion.

However, spending and revenue are likely to be higher than Budget 2024 forecasts. Section 2.6 shows alternative forecasts of the public finances. The alternative forecasts suggest cumulative deficits (excluding excess corporation tax) of €12 billion over this period.

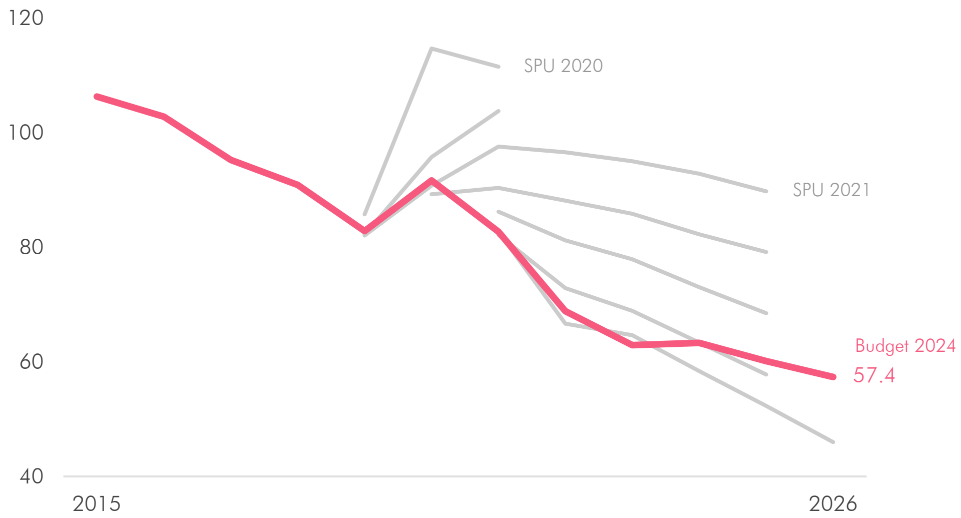
Debt trajectory to continue downward

Since 2015, Ireland's net debt-to-GNI* ratio has seen a remarkable fall. By the end of 2023, the debt ratio is forecast to be 63% of GNI*, a fall of more than 43 percentage points since 2015 (N°47).

The net debt ratio is expected to fall by a further 6 percentage points by 2026, reaching 57% of GNI*. This latest forecast was revised up slightly since *SPU 2023* as some cash assets are now being transferred to two new investment funds (see Boxes H and I).

Nº47 **Debt continues its downward trajectory**

% of GNI*, net debt



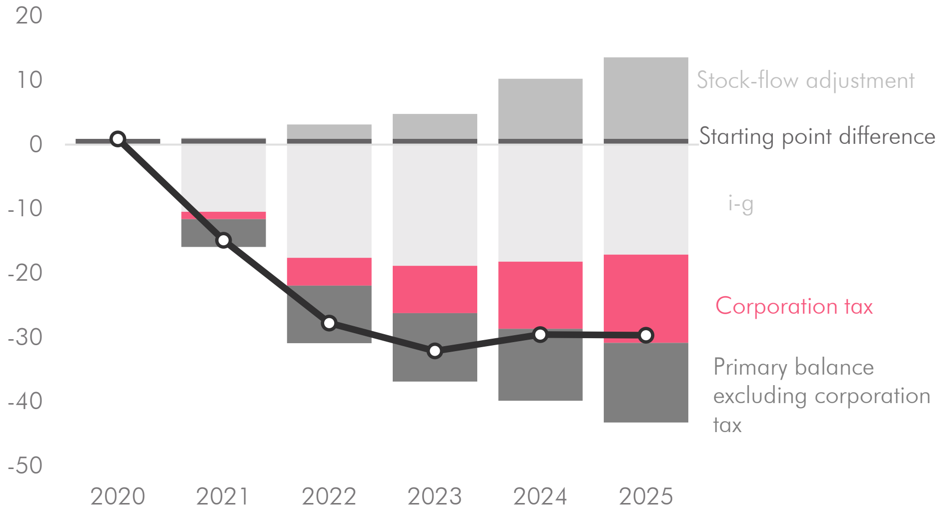
Sources: CSO and Department of Finance.

The net debt ratio by 2025 is now forecast to be 30 percentage points lower than was forecast in *SPU 2021* (N°48). Higher than forecast nominal growth relative to interest rates accounts for 17 percentage points of this downward revision. Given the relatively unchanged forecasts for interest rates (N°49), this can largely be attributed to higher nominal growth.

Stronger corporation tax receipts account for almost 14 percentage points of the downward revision, while a better primary balance excluding corporation tax contributes a further 12 percentage points reduction. This was offset by a positive increase from the stock-flow adjustment of 13 percentage points by 2025.

N°48 **Higher growth and corporation tax receipts help lower debt**

Percentage point difference in net debt ratio, *Budget 2024 – SPU 2021*

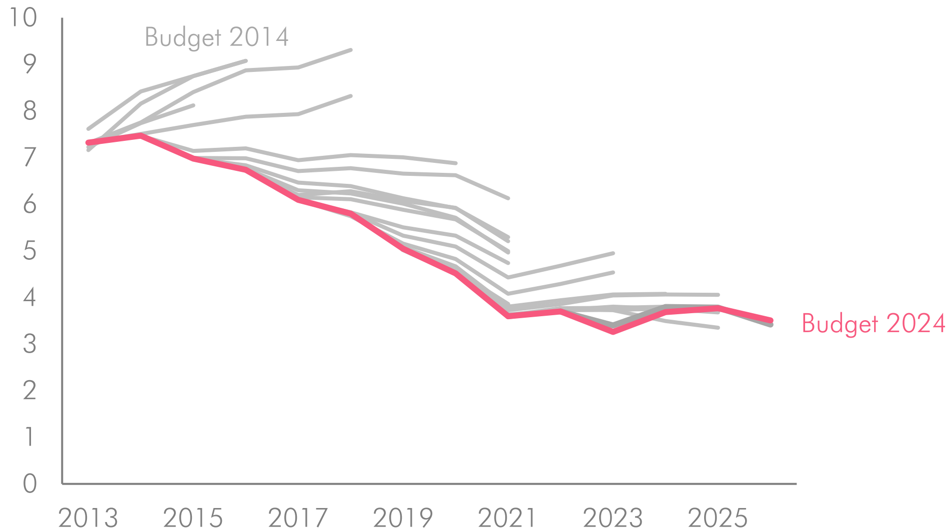


Sources: Department of Finance; and Fiscal Council workings.
Notes: Figures show the contributions to the lower net-debt ratio forecasts between *Budget 2024* and *SPU 2021*. The stock-flow adjustment is net of changes in liquid assets. i-g is the nominal interest rate growth differential. Get the data.

While interest rates have risen in recent months, the Exchequer interest rate bill is expected to remain low in the coming years (N°49). Exchequer interest is expected to average €3.7 billion per year over the period 2024-2026, half of what was paid in 2014.

N°49 **Interest payments are expected to remain low**

€ billion, Exchequer interest



Sources: Department of Finance. Get the data.

2.10 Fiscal risks

Section 2.6 shows alternative forecasts of the public finances. These forecasts show that both spending and revenue are likely to be higher than Budget 2024 projections. This points to obvious risks to the Budget 2024 fiscal forecasts.

There are risks of further expenditure on redress schemes. A redress scheme for owners of apartment s built between 1991 and 2013 with defective concrete blocks seems possible. Early estimates of the potential costs suggest over €2 billion could be spent on this scheme.

With the increased frequency of extreme weather events, significant spending on emergency relief schemes could become more frequent and costly.

A risk to *Budget 2024* fiscal forecasts is that further policy changes could result in additional spending. For example, cost-of-living support measures could be extended despite inflationary pressures receding.

Given the short forecast horizon in Budget 2024, many of the medium-term challenges to the public finances do not arise within that forecast horizon. These include ageing costs and the costs of transitioning to a low carbon economy. As a result, Budget 2024 forecasts do not incorporate these costs.

On the revenue side, there are potential upside risks. The increased rate (15%) of corporation tax on large multinationals could yield significant revenue. No yield from this rate change has been incorporated into *Budget 2024* forecasts.

There could be further one-off revenue windfalls. While there has been a recent update on the Apple tax case, a final decision and possible settlement could still be some time away. In addition, there may be one-off windfalls relating to ongoing data protection enforcement action by the Data Protection Commission. Several substantial fines have been announced, but are being challenged in the courts.

Fiscal Stance

A time for restraint

3 FISCAL STANCE

A time for restraint

In this section, the Council assesses how prudent the Government's overall fiscal stance is. Its assessment is informed by (1) a broad economic assessment that considers how to appropriately manage the economic cycle as well as the sustainability of the public finances; and (2) an assessment of compliance with domestic and EU fiscal rules.

3.1 Where are we in the cycle?

In general, budgetary policy should seek to support the economy in bad times and provide less support in good times. This approach can help avoid amplifying the economic cycle. It means less risk of adding to price pressures in good times and a greater ability to offset rising unemployment in bad times.

Assessing where the economy is in terms of "good" or "bad" times is obviously difficult. To do this, the Council assesses a broad range of indicators. It uses a range of models of the "output gap" — the difference between actual economic activity and its potential. It pays close attention to measures of domestic economic activity. And it assesses a broad array of macroeconomic imbalances.

This is clearly not a time to amplify the economic cycle

In 2023, the Irish economy appears to have broadly recovered from the pandemic and withstood the effects of the war in Ukraine (see Chapter 1). In fact, the jobs market is tighter than it has ever been — only once in seven decades has unemployment been at this low an annual rate. Price pressures stemming from the domestic economy are high. Inward migration flows have been strong even when Ukrainian refugees are excluded. Historically, these pressures have tended to suggest that the economy is performing above normal levels of activity.

Indeed, every model used by the Council to assess how the economy is performing relative to its potential are signalling some degree of overheating. In some cases, this is estimated to be as high as it was in the mid-2000s prior to the financial crisis.

There are some indicators such as levels of outstanding debt and the current account surplus that allay some of the concerns about overheating. However, the strength of the jobs market, broad economic activity and inflation pressures provide sufficient concern to warrant some restraint in fiscal policy.

While there are clear pressures to improve Ireland's public services and infrastructure, the lessons from the 2000s are clear. Doing everything now will add to price pressures in the economy, will mean worse value for money for public projects than if they were done at another time, and risks exacerbating capacity constraints.

3.2 How sustainable are the public finances?

When assessing the appropriate stance for the Government to take, the Council also assesses how sustainable the public finances are. This is not straightforward.

Typically, best practice involves assessing a broad variety of factors.

1) Most likely path — First, we tend to assess the most likely path for the public finances. This involves assessing current debt levels and the expected path for economic growth, tax revenues, government spending, interest costs and funding requirements.

2) Risks — Second, the Council considers important risk factors, such as how sustainable the tax base is, spending pressures that might not be factored in, and the potential for sudden changes in the economic outlook.

3) Framework — Third, the Council assesses how appropriate the overall budgetary framework is. That is, whether there are reasonable anchors guiding budget decisions, such as a functioning spending rule, or savings funds that might be used to alleviate future pressures.

The path for budgetary measures has drifted up

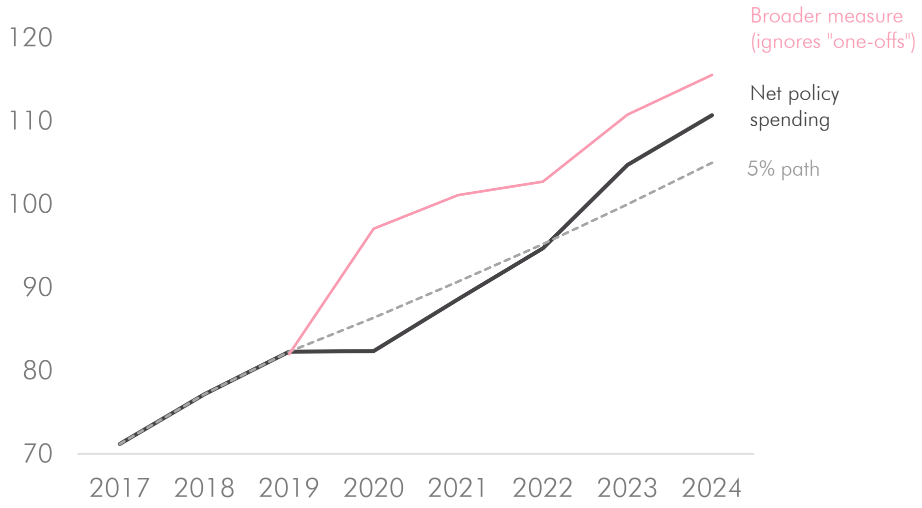
When assessing the fiscal stance, the Council tries to take a long-run view. One way to do this is to examine the cumulative effects of tax and spending changes over time.

A useful measure in this sense is "net policy spending". This measure bears some similarities to the "core spending" measure underpinning the National Spending Rule, but there are a couple of key differences. First, it is defined on a general government basis and so captures more than the approximately four-fifths of government spending represented by the Exchequer. Second, it excludes the estimated savings or costs of cyclically high or low unemployment rates. Like the National Spending Rule, it treats tax-raising measures as offsetting net spending increases and tax cuts as adding to net spending increases.

The decisions set out in Budget 2024 see net policy spending drifting above a sustainable path for net policy spending (N°50). The difference between a hypothetical 5% path from 2019, before the pandemic, and the projected outturn for 2024 is €5.7 billion (+5.4%). This equates to 1.9% of GNI*, a little over half the size of one of the typical austerity budgets run between 2009 and 2014 (3.6% of GNI*).

Nº50 **Net policy spending has drifted above a sustainable path**

€ 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.

Net spending may have drifted by more. The Council's assessment of "Net Policy Spending" assumes that most of the cost-of-living measures are truly once off in nature (N°50). This includes the energy credits, reduced student fees, and double welfare payments. The "non-core" spending on health related to Covid (€1.3 billion) and Ukrainian supports (€2.5 billion) is also assumed to be once-off here.

There are reasons to suggest that health "Covid" spending and Ukrainian supports will continue. A likely health overrun in 2023 was left out of Budget 2024 but could raise spending further. The additional health allocation for 2024 was also described as insufficient by the head of the Health Service Executive and the Health Minister.[37] Analysis in Section 2.4 suggests that even with the non-core

[37] Irish Times 17 Oct 2023 "No plans to reopen health service budget allocations, says Donohoe".

Covid allocation included, the health allocation falls marginally short of Stand-Still costs by €0.1 billion.

Taking the Ukrainian supports and Covid spending as essentially permanent would suggest much higher spending. If one were to cut through all the temporary classifications included in Budget 2024, the path for spending would look far different. Ignoring one offs, a broader measure of net policy spending would suggest net spending for 2024 is likely to be €10.5 billion above a hypothetical 5% path since 2019.

The true picture is likely to be somewhere in between. That is, not all of the Ukrainian supports may be needed in future years as more individuals leave emergency accommodation. Many of the cost-of-living supports should be unwound as inflation eases.

Transparency has been exceptionally poor

The transparency around budgetary measures classified as temporary has been exceptionally poor. Many of the measures labelled as "non-core" or one-off look likely to persist beyond 2024. Some of the cost-of-living measures introduced, such as mortgage interest relief, also look unlikely to reverse. This includes the Ukrainian supports and Covid spending in health. Worse still, a new category of capital spending labelled "windfall capital investment" is just additional capital spending and yet was treated as outside of both "core" and "non-core" spending.

These deliberate attempts to game fiscal assessments are deeply concerning. Gimmicks like this tend to crop up when governments want to make budgetary figures look more favourable than they really are (Box D). The National Spending Rule's focus on core spending is also likely to have prompted this. The Council will continue to monitor and highlight these attempts in future.

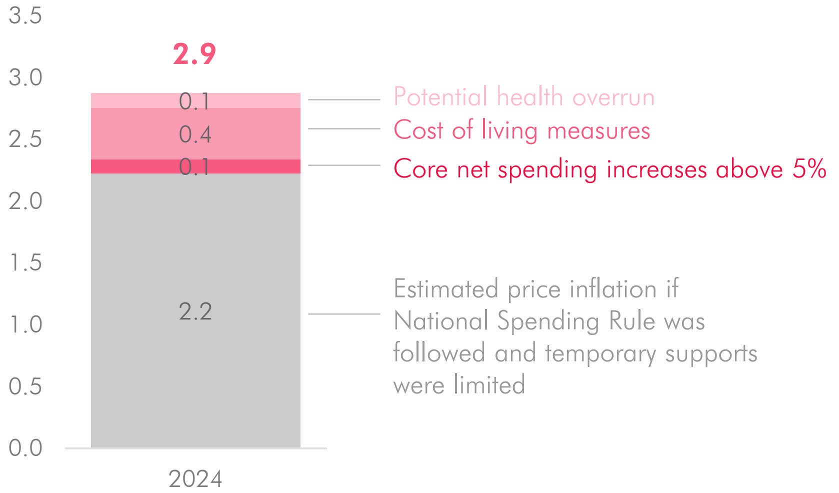
The budget package is likely to have fuelled inflation

The decision to push net core spending beyond the 5% limit set by the National Spending Rule is likely to have added to price pressures in the economy. Taken together we estimate a boost to the rate of inflation of about 0.7 percentage points in 2024.

The budget package could impact inflation across several channels. Using the Maq model, we estimate that the 5.8% core net spending increase (Chapter 4) is likely to have boosted inflation by 0.1 percentage points in 2024 relative to a situation in which the spending rule was adhered to (N°51). This is likely to persist for inflation rates in the next few years. In addition, the package of cost-of-living measures is estimated to have added a further 0.4 percentage points to inflation in 2024. This could unwind if the supports are removed in 2025. Finally, we estimate that a potential health overrun of €1 billion could add a further 0.1 percentage points to inflation in the short term.

Nº51 **Fuel to the fire**

% estimated impact on consumer price inflation (HICP) in 2024 due to Budget package



Sources: Fiscal Council workings using the Maq model.
Notes: Estimates are produced by comparing a scenario with a 5% core net spending increase and no cost-of-living package relative to the baseline Budget 2024 forecasts.

There is considerable uncertainty around these estimates. New evidence presented in this report suggests that the tax cuts introduced in Budget 2024 alone could fuel price pressures by more than is estimated here (Box A).

A risk is that these pressures persist into the future. Expectations are vital in terms of how inflationary pressures evolve. By keeping inflation higher, this could lead to a longer-lasting high rate of price increases. By cutting taxes and raising spending at a faster pace, the Government is also acting against efforts by the European Central Bank to dampen price pressures.

Plans are very short

The extent to which the Council can assess how sustainable the Government's plans are on this basis is limited by the short forecast horizon. The Government should extend its fiscal forecasts. This would allow the Council to better assess medium-term sustainability. It would also help deliver more credible plans to tackle medium-term challenges such as climate and ageing.

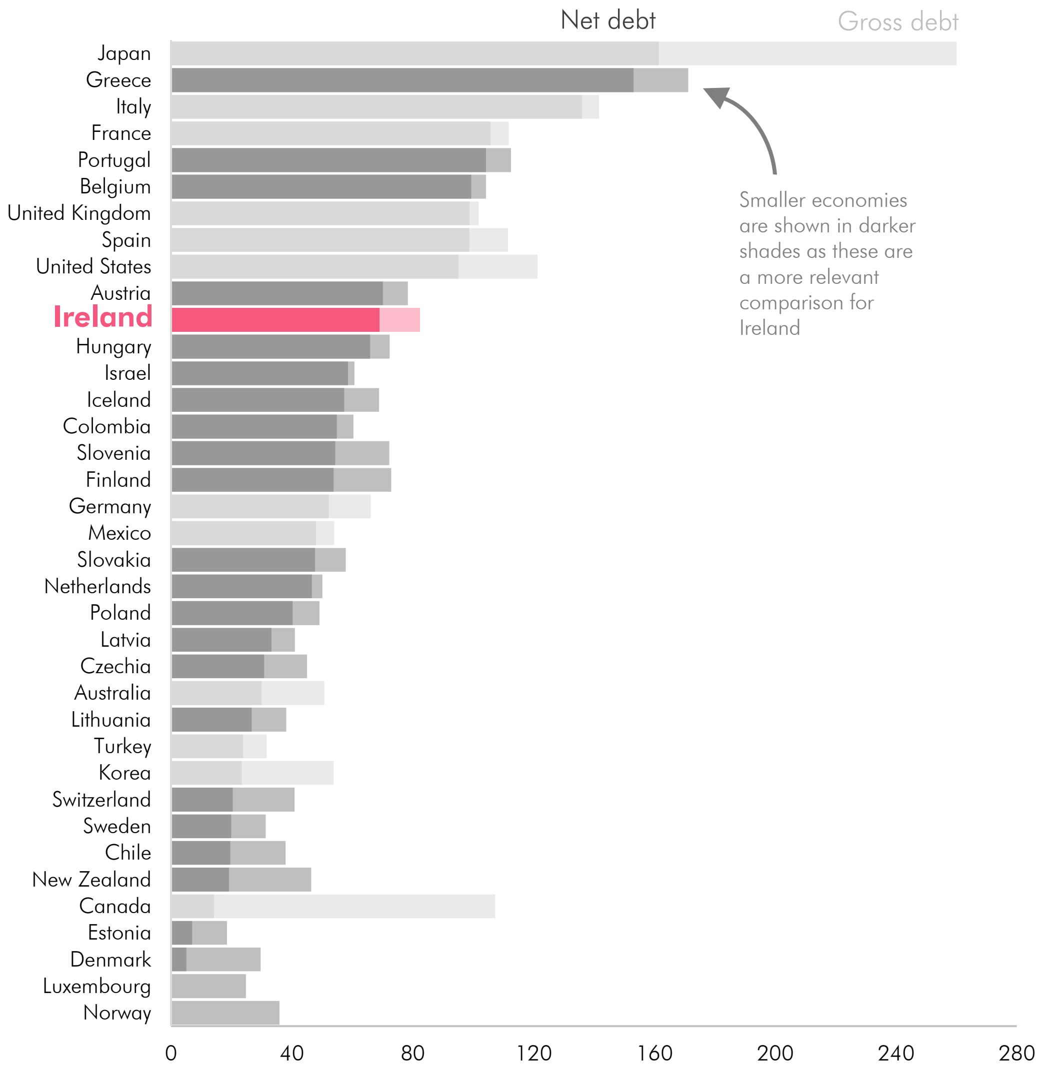
While the Government previously committed to a five-year-ahead forecast horizon, it has since backslid on this commitment. This is particularly concerning now, given that the pressures associated with the climate transition and ageing-related costs are expected to ramp up significantly towards the end of the decade.

Debt ratio has fallen but remains high for a small economy

Ireland's debt ratio is no longer one of the highest in the OECD. Taking the net debt ratio — which takes account of liquid assets held by the State — Ireland sits as eleventh highest in the OECD at the end of 2022 (N°52).

N°52 **High debt for small economy, but no longer among OECD's highest**

% GDP (% GNI* for Ireland)



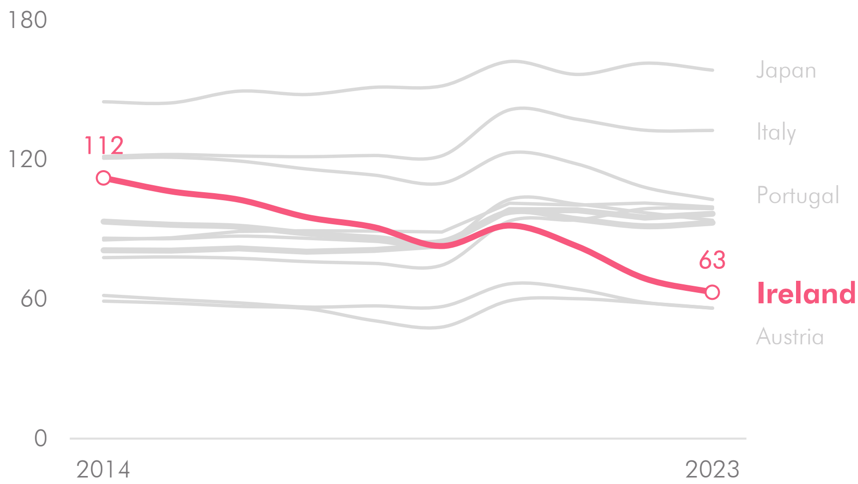
Sources: Eurostat, CSO, IMF, and Fiscal Council workings. Get the data.
Notes: Small OECD countries are a better comparator for Ireland. We define big as above a certain level of nominal GDP in US dollars, which leaves US, UK, Japan, Italy, France, Spain, Germany, Australia, Canada, Mexico, Turkey, and Korea as the "large" economies. Net debt is general government gross debt excluding assets held by the State in the form of currency and deposits, debt securities, plus loan assets. The 60% ceiling for government debt set out in the Stability and Growth Pact is set in gross rather than net terms. Net debt does not include the State's bank investments.

Ireland's net debt ratio is high for a small open economy. It is the fifth highest in the OECD when focusing solely on smaller economies. Smaller economies tend to have more volatile growth and a greater exposure to economic shocks (Furceri and Karras, 2007 and 2008). In particular, they cannot rely on a large domestic market to help offset economic turbulence coming from elsewhere. The implication is that they carry a greater vulnerability to downturns and to sudden changes in debt sustainability.

Ireland has been able to reduce its net debt ratio relatively quickly. This is despite numerous challenges, including the pandemic and the war in Ukraine. Indeed, since 2014, the reduction in the net debt ratio has been almost 50 percentage points (N°53). This steady reduction is unlike experiences in any of the other high debt countries in the OECD. With the exception of Portugal, others have seen their debt ratios remain broadly at the same rate and in some cases increase.

Nº53 **Ireland has been able to reduce its high debt quickly**

% GDP (% GNI* for Ireland), net debt



Sources: Eurostat, CSO, IMF, and Fiscal Council workings. Get the data.

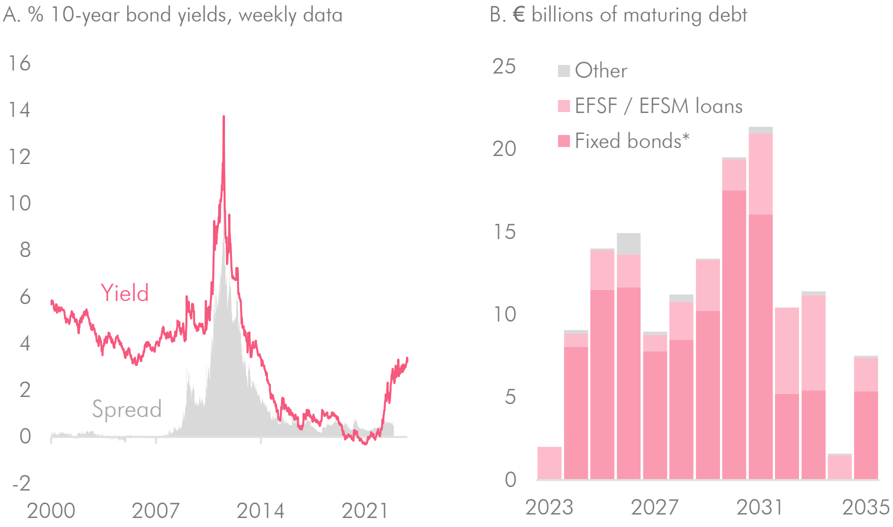
Financing conditions are relatively favourable

While interest rates have risen substantially, Ireland's funding outlook remains favourable.

Interest costs are manageable. Yields on Ireland's 10-year bonds have risen to about 3.4%, which is high but still below the pre-financial crisis rates that prevailed during the 2000s (N°54). Almost 98% of debt outstanding is at fixed interest rates meaning that changes in interest rates have little bearing on the existing stock of debt and interest costs attached to it. The effective interest rate is projected to remain around 1.6% out to 2026. Of course, if interest rates remained high much further out, this would gradually add to annual interest costs.

There are also large buffers available to the State. Cash and liquid assets remain high at €28 billion as of end-October 2023. These are sufficient to cover maturing debt out to the end of 2025 even if no Exchequer surpluses were run.[38] As it stands, the Department projects annual average Exchequer surpluses of about €2.7 billion between 2024 and 2026. This reduces the need to draw on existing cash buffers.

Nº54 **Funding is broadly favourable despite higher interest rates**



Sources: Macrobond; NTMA; and Fiscal Council workings.

The debt path is sustainable in the near term

Debt sustainability is complex and depends on the interactions between many variables. A useful way to assess debt sustainability is through "stochastic debt sustainability analysis". This is a way of modelling multiple debt paths with different probabilities attached to each path, while recognising the typical relationship between variables.[39] Using this approach, we can assess the risks of a continuously rising debt ratio — one that could prompt sudden losses in creditworthiness, rising borrowing costs, and a need for sudden and painful tax increases and spending cuts.

Over the near term, the debt ratio appears set to continue falling. Using official forecasts, the probability of the net debt ratio remaining at or climbing above its current level by the end of the forecast horizon is estimated to be less than 5%.[40]

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[38] The cash balance includes the National Reserve Fund. As its funds are transferred over to the Future Ireland Fund and the Infrastructure, Climate and Nature Fund, the cash balances will reduce correspondingly.

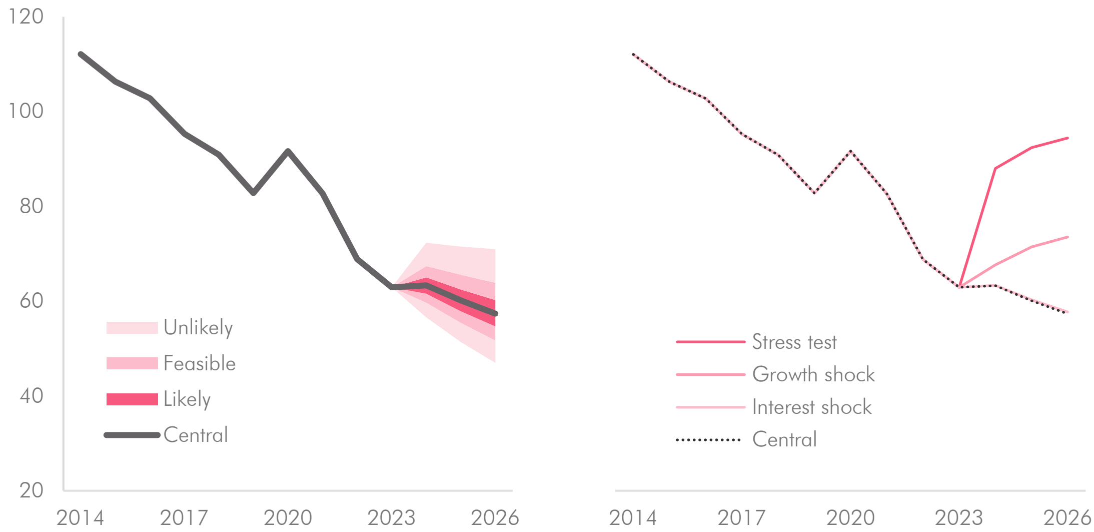
[39] See Blanchard, Leandro and Zettelmeyer (2021) for a clear discussion and Casey and Purdue (2021) for an application to Ireland.

[40] The work by Blanchard, Leandro and Zettelmeyer (2021) proposes a 5% threshold as a useful fiscal standard for gauging debt sustainability. Of course, maintaining a probability less than 5% does not necessarily imply that debt is "sustainable" in practice. What it implies is that some form of adjustment to the Government's fiscal plans is unlikely to be needed to achieve a high probability of debt sustainability.

The Government's fiscal plans also appear reasonably robust to a series of conservative "stress tests" (N°55).

Nº55 **Debt sustainability looks reasonably assured in the near term**

% GNI*, net debt ratio



Sources: Department of Finance, CSO, NTMA data on debt securities, and Fiscal Council workings.
Notes: The fan chart on the left shows the probability of different paths for the net debt ratio. The "Likely" range covers the 30% confidence interval, "Feasible" the rest of the 60% interval, and "Unlikely" the rest of the 90% interval. The chart on the right shows risk scenarios. The "Growth shock" assumes real GNI* growth rates 3.6 percentage points weaker than the central scenario in each of two years (equivalent to one standard deviation on growth rates over 1996 to 2019 excluding the financial crisis and leaving output about 7% below the central scenario). The "Interest shock" assumes marginal interest rates are 2 percentage points higher for the full period. The "Stress test" combines the growth and interest shocks with an assumed realisation of 25% contingent liabilities suddenly in one year. Get the data.

Unexpected corporation tax receipts have helped

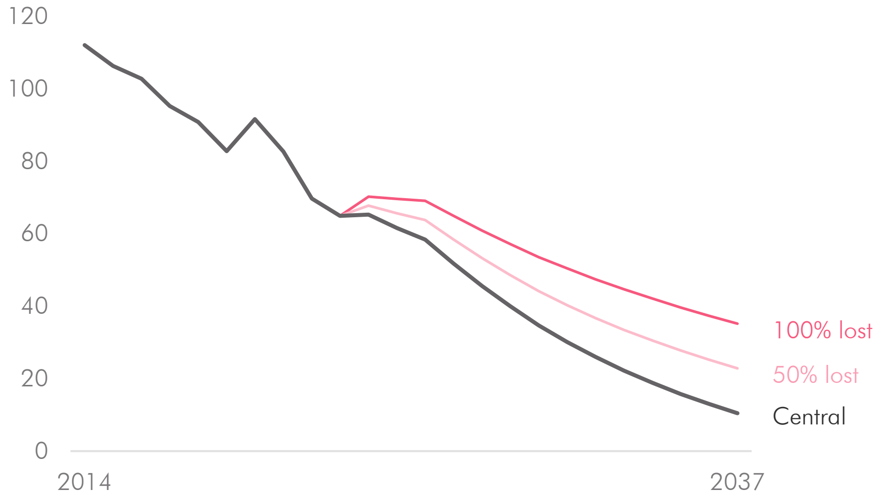
The net debt ratio has been brought down with the help of stronger-than-expected nominal growth and exceptional corporation tax receipts. Of the 30-percentage point greater-than-expected reduction in the net debt ratio between 2021 and 2025, 14 percentage points were due to outperforming corporation tax receipts (N°48 and Section 2.9).

Whether or not these factors will continue to drive down the debt ratio quite so fast is hard to say. It depends on growth remaining robust and the excess corporation tax receipts remaining high. A loss of corporation tax windfalls alone would probably slow debt reduction. However, if governments stuck broadly to the National Spending Rule in future years, it would not necessarily put debt on an unsustainable path (N°56).

This highlights how the corporation tax windfalls are not essential to ensuring a steady downward path for the debt ratio. What matters is that growth continues relatively undisturbed and that Government decisions around spending increases and tax cuts remain broadly in line with the National Spending Rule. In this context, the decision to reduce the reliance on windfalls by allocating some of these to the two new savings funds is welcome.

Nº56 **Losing corporation tax windfalls would slow debt reduction**

% GNI*, net debt ratio



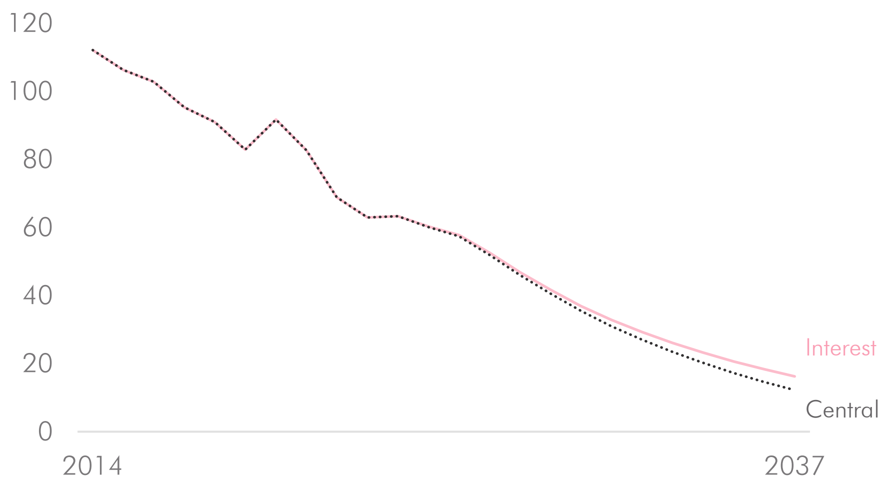
Sources: Department of Finance, CSO, NTMA data on debt securities, and Fiscal Council workings.
Notes: The central scenario is extended in line with Casey and Cronin (2023) except for windfall corporation tax receipts being assumed to remain in place for the extended central scenario. The scenarios assume that either 50% or 100% of the average €11.2 billion of windfall corporation tax receipts projected for 2024 to 2026 are permanently lost.

A rise in interest rates would take a long time to impact

One risk worth considering is a sustained increase in interest rates. If the State were to face higher borrowing costs over a sustained period, this could raise the debt path, but not substantially (N°57).

Nº57 **Higher interest rates would feed in slowly**

% GNI*, net debt ratio



Sources: Department of Finance, CSO, NTMA data on debt securities, and Fiscal Council workings.
Notes: The central scenario is extended in line with Casey and Cronin (2023). The Interest shock scenario assumes marginal interest rates are 2 percentage points higher for the full period.

There are major costs ahead not factored into plans

The official forecasts paint an encouraging picture for the public finances. However, there are several important factors not included in these projections. As well as the short-term spending pressures such as health overruns and the likelihood of ongoing supports for Ukrainian refugees being needed, Ireland faces two major challenges in the coming years and decades.

Ireland needs to face up to the budgetary impacts of the climate transition and its rapidly ageing population.

The rapidly ageing population

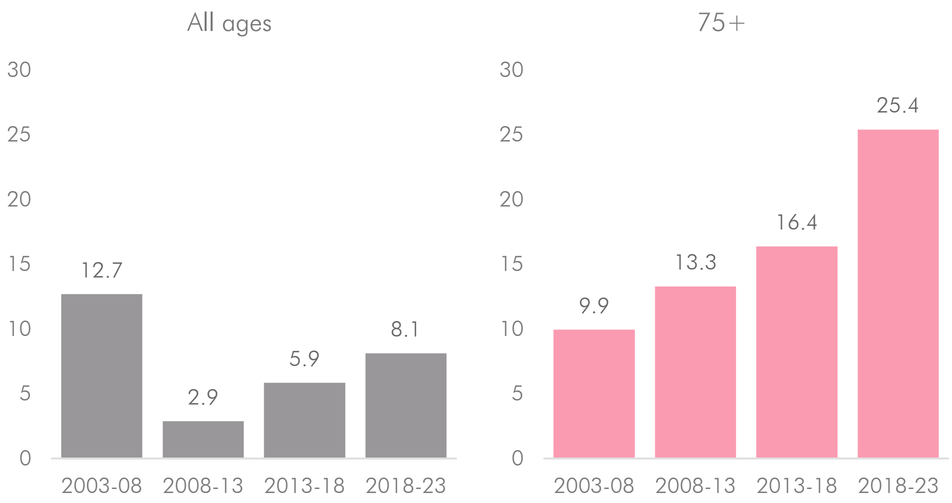
The most substantial challenge facing the Government over the medium term is Ireland's rapidly ageing population.

Ireland faces a sharp increase in pensioners relative to workers in the coming years. Those in retirement are also expected to have a longer life expectancy. These two factors will put substantial pressure on the public finances. It will mean higher expenditure, including for pensions and healthcare spending. It will also contribute to a slowdown in economic growth and tax revenues.

Some of this rapid ageing has already been evident. While the total population grew by 8.1% between 2018 and 2023, the over 75 age cohort grew by 25.4% — more than three times faster. This pattern of faster growth in the older age cohorts that typically put more pressure on health and long-term care services, for example, has been evident for some time (N°58).

N°58 **Older age cohorts have been growing quickly**

% growth rates between periods shown (example: from 2003 to 2008)

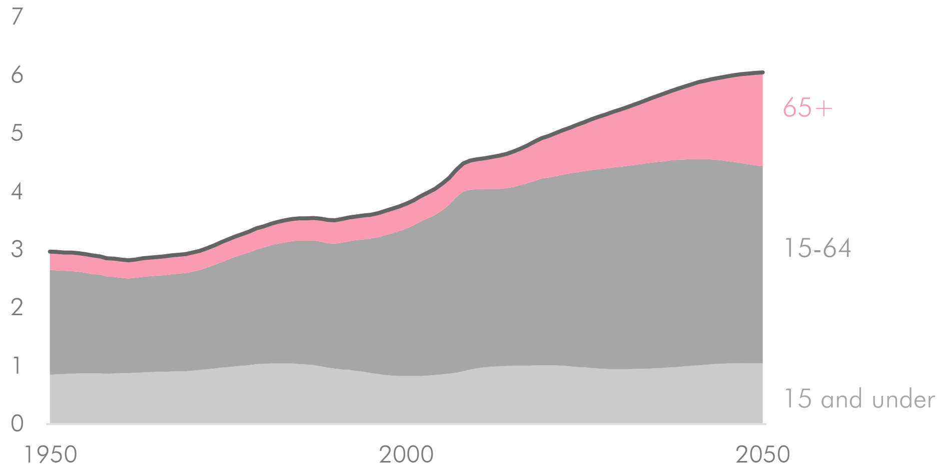


Source: CSO population estimates.

This pattern is expected to continue. As a result, older age cohorts will expand sharply in the coming years and decades to make up a greater share of the overall population (N°59).

Nº59 **Older age cohorts will continue to expand sharply**

Population in millions



Source: Fiscal Council (2020), Long-term Sustainability Report.

The ageing of Ireland's population is expected to add as much as 7 to 9.5% of GNI* to Ireland's expenditure by 2050 relative to 2019 (Fiscal Council, 2020). In today's terms, this equates to an additional annual outlay of about €20 to 28 billion.

This has big implications for planning around the State's pensions, healthcare and long-term care commitments. Both the Pensions Commission and the Tax and Welfare Commission were clear that the funding requirements were substantial and that revenue-raising measures would likely be needed.

In this respect, the Government's recent decision to approve a series of small multi-year increases in social contributions (PRSI) rates are welcome. They should go some way towards addressing the funding gap related to pensions expenditure. However, the increases are smaller than was envisaged in the Pension Commission's proposals. They imply a 1.4 percentage point increase in employee and employer's rates between 2023 and 2030. This is broadly in line with the Commission's proposals for a 1.2 percentage point increase assuming no increase in the pension age. Yet the envisaged increase in the employers' PRSI rate of just 0.7 percentage points over this period is substantially less than the 6 percentage point increase proposed by the Commission.

The climate transition

There are three key avenues through which the public finances will be affected by the climate transition.

First, there will be direct impacts related to the green transition. Tax revenues will reduce as people shift away from fossil fuels and spending on supports to encourage the transition will most likely be needed. Recent work by the Council (Casey and Carroll, 2023) estimates that as much as 0.9% of GNI* (€2.5 billion in today's terms) of annual revenues could need replacing by the end of the decade, rising to 1.6% of GNI* (€4.4 billion) by the 2040s. On the spending side, costs of between 0.6 and 1.1% of GNI* (€1.6 to 3.0 billion in today's terms) per annum over the years 2026 to 2030 may be required to encourage the adjustments needed. These could then average between 0.4 and 0.7% of GNI* (€1.1 to 1.9 billion) from 2031 to 2050.

Second, there will be costs if Ireland misses its targets. Ireland is legally bound to achieve carbon neutrality by 2050 and to stay within three sequential carbon budgets between 2021 and 2035. Estimates by Walker *et al.* (2023) put the potential costs of non-compliance at about €0.35 billion annually up to 2030, when costs rise to €0.7 billion (0.2% of GNI*).

Third, there are likely to be costs associated with damage caused by extreme weather events and improving defences. Ireland has seen an increase in major weather events over time. Increased rainfall and rising temperatures carry risks of more regular flooding and wildfires. When these events occur, the costs associated with them could be in the region of 0.2% of GNI* (about €0.5 billion in today's money). Limiting these risks could require further adaptation costs beyond the €0.1 billion per annum allocated for flood defences in the National Development Plan.

While the costs involved in the climate transition are substantial, they can be managed and planned for. Box G takes a look at what the expenditure supports might mean for public debt assuming that revenues are replaced.

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

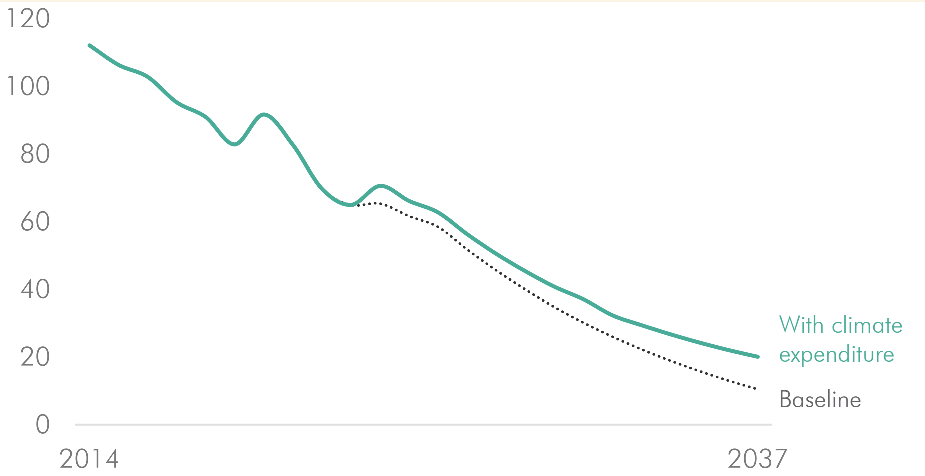
A point worth stressing is that the reductions in revenues related to the climate transition could be replaced without changing the average effective tax burden. As in, these are revenues that are already being collected today. In a sense, these could simply be replaced without adding to tax rates on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

Nº60 **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.

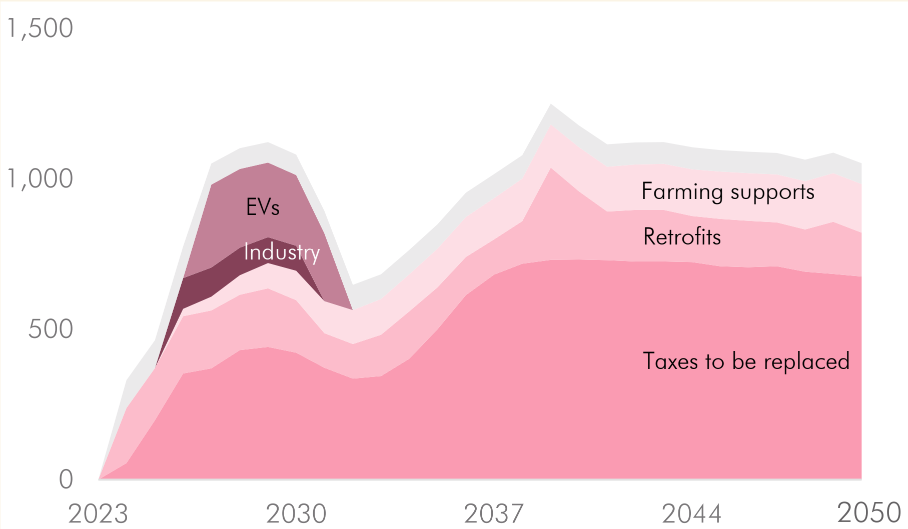
One useful way to think of climate challenges is through the lens of its potential impacts on individuals.

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.

Ireland needs a serious fiscal framework

If Ireland is to face up to the costs not yet factored into official plans and other risks, it needs a serious fiscal framework. While the Council has been calling for improvements that would help for a considerable time now, progress remains modest (N°62).

Several key aspects of Ireland's budgetary framework are weaker than they should be.

The recent undermining of the National Spending Rule is a notable weak point. This has manifested itself in terms of plans to repeatedly breach the rule, while using fiscal gimmickry and unrealistic spending forecasts to mask these breaches. This, coupled with the lack of any alternative rules that will credibly guide fiscal policy (the EU fiscal rules are unlikely to act as a constraint), means that Ireland's fiscal policy lacks strong direction. Without this, it is at the discretion of the government of the day. This leaves the public finances at risk of giving way to unsustainable decisions from budget to budget.

Nº62 **Funds are a big step, but much more progress is needed**

Recommended action	Budget 2024 assessment	Council calling for action since	Progress
Forecast five years ahead	Fiscal forecast horizon continues to shrink	Nov-17	-1
Strengthen fiscal framework	National Spending Rule severely undermined, but savings funds introduced	Nov-17	-2
Make spending plans realistic	Spending projections less realistic again	Jun-16	-1
Provide transparent costings of major policies	Climate action costs still not factored in	Dec-20	
Clarify how Reserve Funds will work	Comprehensively addressed	Jun-16	+1
Show how rules will be complied with	Limited information and gimmickry used	Dec-20	-1
Show how taxes will be adjusted if needed	No information on this. Tax and Welfare Commission recommendations dismissed	Dec-20	
Make non-Exchequer forecasts more transparent	No improvement in transparency	Nov-19	

Overall assessment: Some progress

Ireland's budgetary planning should also be substantially improved. The forecast horizon for budgetary projections remains short at just three years ahead. The end point, 2026, comes at a crucial time. Many of the large-scale challenges facing Ireland in terms of climate transition and ageing pressures will begin to ramp up towards the end of the 2020s. It is a missed opportunity to plan for these challenges. The Department of Finance has developed macroeconomic forecasts with a longer horizon. These could easily be adapted to facilitate longer-term revenue projections. However, the sticking point is expenditure. The latest spending forecasts are not realistic for 2023, let alone for future years. They are far from what is needed to adequately plan for the future.

Finally, transparency is weak. This is relevant in terms of the lack of information on how the National Spending Rule is being adhered to. It is also important in terms of the lack of information on non-Exchequer areas of spending. This includes, for example, spending on housing by approved housing bodies. The Government should also be more upfront about how it would increase taxes if needs be, particularly given the heightened expenditure pressures that lie ahead. In this respect, the Government's apparent dismissal of recommendations by the Tax and Welfare Commission is unhelpful.

The National Spending Rule is key

Reinforcing the National Spending Rule would be a major step to ensure the public finances are managed sustainably. It could form a central part of Ireland's fiscal framework, bringing it in line with international best practice (Casey and Cronin, 2023).

Ireland's public finances are unlikely to be guided by EU fiscal rules in future. The Government is also clearly less committed to the spirit of the National Spending Rule. Official plans show repeated breaches, and gimmicks are being used to hide the extent of these. The rule can help guide the public finances through challenges such as the climate transition and the rapid ageing of Ireland's population. It can also help ensure that the Government is able to support the economy through future downturns rather than raising taxes and cutting spending, as it did during the austerity period. To ensure this, the rule needs to be reinforced and adhered to.

One of the reasons the Government cites for breaching the rule is that inflation is high. Yet this is how the rule should work. The idea is to avoid procyclicality — doing too much in an already tight economy, hence adding to price pressures. By contrast, the rule is more generous in times when price pressures are low. That is, it still allows growth consistent with an implicit 2% inflation assumption when price pressures are lower than that.

The National Spending Rule could be reinforced along several dimensions. As explored in Casey and Cronin (2023), the Government could:

- Review the 5% assumption for steady state nominal growth figure every five years. At present, the rule sets a 5% limit that implicitly reflects real trend growth of 3% and a medium-term inflation rate of about 2%. While inflation is higher at present, trend growth rates are projected to moderate. Projections for real GNI* converge closer to 2% over the medium term.

- Protect public investment with a minimum steady state target set as a % GNI*. This could help avoid sudden cuts, while improving long-term planning.
- Introduce an appropriate escape clause. Not every situation will be anticipated by the design of the National Spending Rule. Escape clauses, if appropriately designed, can be a helpful way of dealing with exceptional circumstances.
- Link the spending rule to the debt ratio. Maintaining spending in line with trend growth in the economy and revenues should help avoid unsustainable deficits building and steadily reduce Ireland's debt ratio. However, a smarter design would allow more scope for expansion in circumstances where debt ratios are favourable, or less scope when the debt path is unsustainable.
- Expand the Rule's coverage to general government. This wider measure of government activity is a more relevant basis for assessing fiscal policy. The current focus on the Exchequer ignores about one-fifth of spending.
- Allow for cyclical savings and costs related to unemployment. Unemployment costs are a key area of expenditure that varies with the cycle. In good times, they can make the public finances look stronger than they would otherwise be, while in bad times they can make the public finances look weaker. This can be adjusted for by considering the welfare expenditure that would be associated with more normal rates of unemployment of, say, 5% for example.

The Future Ireland Fund strengthens Ireland's framework

As part of Budget 2024, Ireland announced the details of two new savings funds. The funds are designed to set aside some of the windfall corporation tax receipts Ireland expects to collect in the coming years.

Both funds will help to ringfence the excess corporation tax receipts Ireland expects to collect. This is an appropriate use of tax receipts that are exceptionally concentrated and subject to risks of sudden reversals.

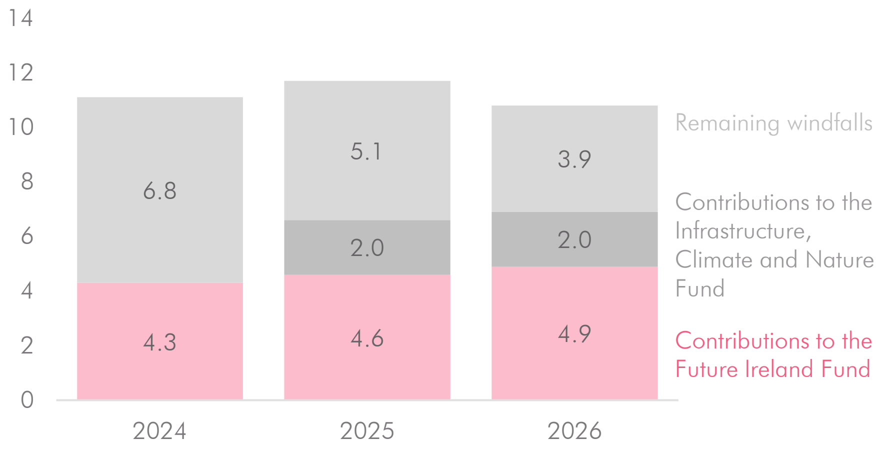
The Council welcomes the development of the Future Ireland Fund in particular. This puts the excess receipts to good use. The Fund will invest them and generate returns that can be used to offset future costs such as ageing. As Box H shows, the Fund could build to a substantial size. Assuming the Fund continued contributions beyond 2035, it could cover more than half of the increase in ageing costs vs 2023 in 2041 and a quarter by 2050. The range is again large, with a 90% probability that roughly 10% to 50% of additional costs could be covered by 2050.

The second fund, the Infrastructure, Climate and Nature Fund will also help ringfence corporation tax receipts (Box I). However, this could have been achieved with the Future Ireland Fund and the need for a countercyclical tool is less clearcut provided Ireland sticks to the National Spending Rule and debt remains on a broadly sustainable path.[42]

The Government already has two necessary tools to plan for sustainable increases in capital spending. First, the National Development Plan provides a means of planning capital projects over a ten-year horizon. Second, the National Spending Rule helps ensure government spending does not exceed typical growth rates for the economy and government revenues. Sticking to the rule helps limit excessive spending increases or tax cuts that might warrant undesirable cuts to capital spending in future if the public finances suddenly needed to adjust course. A better approach would be to build on these existing tools.

Nº63 **Some windfalls are left outside the new savings funds**

€ billions



While the savings funds set aside some corporation tax windfalls, the Council had hoped that more of these would have been saved. As it stands, some 40% of the windfalls are left unsaved — €5 billion in 2025 and almost €4 billion in 2026 (N°63). These may ultimately be used for debt reduction or for building cash buffers elsewhere. However, by leaving them outside of the Fund, there is a risk that the remaining windfalls are used for larger-than-planned budget packages that push budgetary measures further beyond what is deemed sustainable.

[42] See Box A of Fiscal Council (2023b).

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.

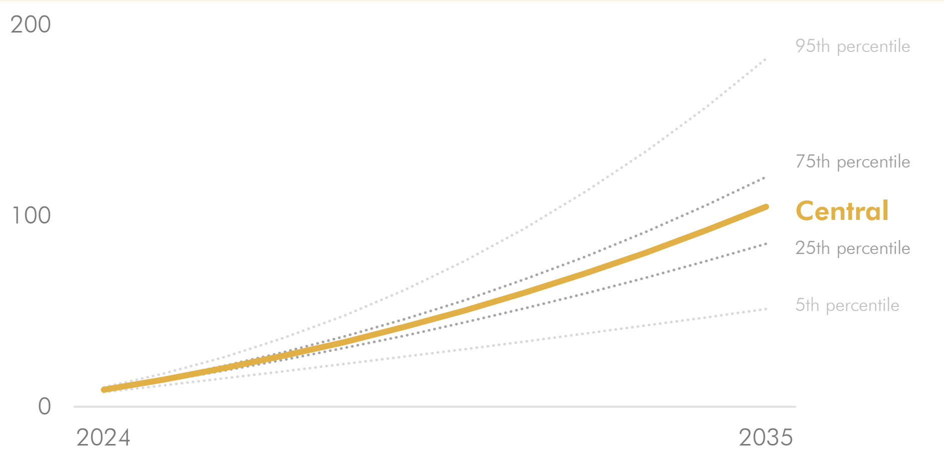
How might the Fund evolve?

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

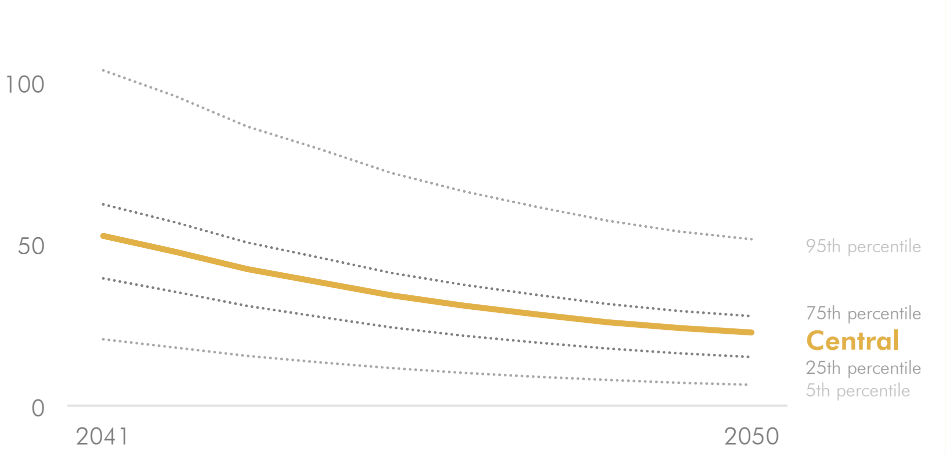
[45] Specifically, we treat nominal GDP growth as a random walk and develop 10 million simulations of the Fund's reserves drawing randomly from a distribution of the historical returns of similar pension funds (Norway, Japan, Australia). The sample used for GDP growth rates is 1990 to 2023.

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.

Box I: The Infrastructure, Climate and Nature Fund

Ireland's second new fund is the Infrastructure, Climate and Nature Fund. This Fund is the smaller of the two new funds outlined at the time of the Budget. It is intended to help avoid the need to cut capital spending in future downturns. More generally, its dual purpose is stated as to provide for countercyclical investment in the economy and to help achieve climate and nature goals.

The Fund is intended to provide support when

1) there is a significant deterioration in the public finances; and

2) there are projects that can help achieve Ireland's climate and nature goals.

Key features of the Infrastructure, Climate and Nature Fund[46]

Initial transfer and annual contributions

- An initial €2 billion will be transferred to the Fund from the dissolved Reserve Fund
- Yearly contributions of €2 billion will be made to the Fund from 2025 to 2030
- A €14 billion cap will apply in terms of contributions by 2030
- This cap equates to 5% of GNI*, the current annual target for capital expenditure
- Additional contributions can be made on Dáil resolution once the cap is not exceeded
- Contributions have to be made unless there is a specific Dáil resolution to halt or amend these or if a significant deterioration in the public finances is judged to exist
- In 2030, a decision will be made about future contributions

Drawdowns

- The Minister will evaluate whether a significant deterioration in the public finances has occurred such that resources will be drawn down in the following year
- Drawdowns to the Exchequer can occur in 2026 to 2030 following government approval and a Dáil resolution
- No more than one-quarter of the Fund's value can be paid out in a given year
- There are two criteria for drawdowns
- In a situation where the economic criteria are used to draw down amounts, all new climate and nature projects will be suspended and no further payments can be made except for those already underway
- For the climate criteria, drawdowns would only be allowed for projects reducing greenhouse gas emissions, improving water quality or meeting wildlife targets
- For climate criteria, no more than 22.5% of the Fund's value can be paid out and no more than €3.15 billion by 2030
- No commitments can be entered into which will provide for expenditure on the Fund post 2030

Investment strategy

- The NTMA will determine the investment strategy
- Investments will be on a commercial basis in or outside the State
- Investments should allow a timely drawdown
- 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
- Investment are to be "responsible" in line with Environmental, Social and Governance (ESG) considerations

The Fund will help ringfence risky corporation tax receipts

In advance of the Fund being created, the Council assessed that it would be useful to ringfence excess corporation tax receipts, though its broader merits were less clearcut.[47] This is still the Council's broad assessment. A countercyclical fiscal policy is of course desirable, but it is not clear that the Fund is necessary to achieve this, with the National Spending Rule being a more critical tool in this regard.

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[46] Based on the General Scheme of the Bill, which is subject to ongoing development.

[47] See Box A of Fiscal Council (2023b).

Fiscal Rules

Exceptional circumstances set to end

4 Fiscal Rules

Exceptional circumstances set to end

In this section, the Council assesses whether the budgetary forecasts published in *Budget 2024* comply with Ireland's Domestic Budgetary Rule, as set out in the Fiscal Responsibility Act 2012 (FRA), and the EU fiscal rules, as set out in the Stability and Growth Pact (SGP). In addition, the Council assesses compliance with the National Spending Rule. However, this rule lacks a statutory footing.

The "exceptional circumstances" and general escape clauses of the domestic and EU fiscal rules were activated at the onset of Covid-19 in 2020. They have remained in effect into 2023, allowing Ireland to temporarily depart from the requirements under both the domestic and EU fiscal rules during this time.[48]

However, the Council assesses that "exceptional circumstances" will no longer apply as of 2024. Furthermore, the European Commission (2023a) has confirmed that the general escape clause will be deactivated at the end of 2023.[49] It noted that the European economy has recovered beyond its pre-pandemic level and navigated the acute phase of the energy price shock caused by Russia's invasion of Ukraine. However, uncertainty remains high.

The Council has a mandate to monitor and assess compliance with the Domestic Budgetary Rule on at least an annual basis. Legal compliance with the fiscal rules continues to be assessed against GDP. However, GDP-based measures do not give an accurate picture of Ireland's fiscal position.

The Council has previously assessed broad compliance with the Domestic Budgetary Rule (N°66).[50]

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[48] For an overview of these dispensations, see Box K from the *May 2020 Fiscal Assessment Report*.

[49] The Commission's Fiscal policy guidance for 2024 discusses the ending of the general escape clause in more detail.

[50] Ireland's Domestic Budgetary Rule was set requires that the general government budgetary position be in balance or in surplus, or on an appropriate path to meet this condition. In practice, the Budgetary Rule is deemed to be achieved if the structural balance meets a specified structural balance target, the so-called medium-term objective (MTO), or is on an appropriate path towards it. Compliance is assessed using the Council's principles-based approach to the Domestic Budgetary Rule. For further information see Table 8 in the supporting information section.

Nº66

Exceptional circumstances in place since 2020

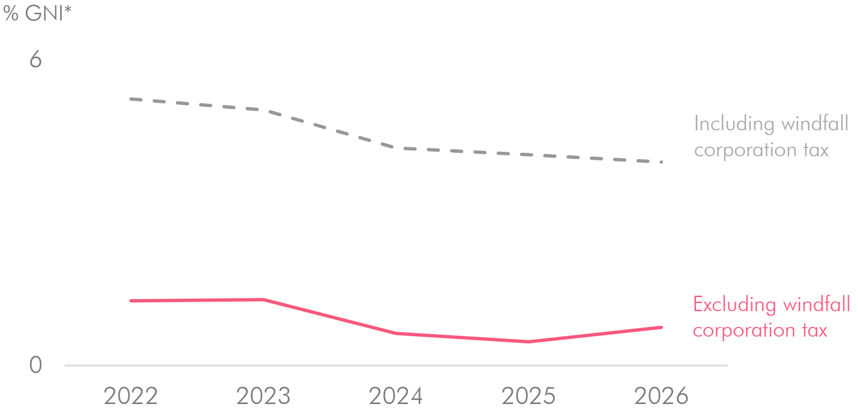
	2017	2018	2019	2020-2023
Expenditure Benchmark	Breach	Significant breach	Compliant	Exceptional Circumstances
Structural Balance Rule	Compliant	Compliant	Compliant	
Overall Assessment	Compliant	Compliant	Compliant	

Source: Fiscal Council workings.
Notes: The structural balance rule requires that the structural balance be above the medium-term budgetary objective (MTO) (set at minus 0.5% of GDP for 2016–2019) or moving towards the MTO at an adequate pace. The Expenditure Benchmark requires that the net government expenditure be below the average medium-term potential growth rate of the economy. Significant deviation means that the limit for the corresponding rule was exceeded by more than 0.5% of GNI* for the Expenditure Benchmark, or 0.5% of GDP for the structural balance rule. A "breach" means that the limit for the corresponding rule was exceeded by less than 0.5% of GNI* or 0.5% of GDP. From 2024, the Expenditure Benchmark will be replaced by a maximum growth rate of net primary expenditure (Box J).

The structural balance is projected to be in surplus in 2023 and in subsequent years. However, windfall corporation tax revenues continue to flatter Ireland's budgetary position. But even when these excess revenues are excluded, the structural balance is expected to remain in surplus for the remainder of the forecast horizon. Figure Nº67 shows these surpluses as a share of GNI*, a more appropriate measure for the Irish economy.

Nº67

Structural balance in surplus with or without windfalls



Sources: Department of Finance and Fiscal Council workings. Get the data.
Note: The structural balance is measured on a top-down basis using the Council's estimates of one-off items together with the Department of Finance's alternative estimates for the output gap, its GNI* forecasts, and its estimates of windfall corporation tax receipts.

Ireland's debt-to-GDP ratio is projected to stand at 41.4% by year-end 2023 and decline each year for the remainder of the forecast horizon. In 2026, the debt-to-GDP ratio is expected to be 33.3%.[51] These forecasts are well below the 60% limit imposed by the Stability and Growth Pact.

Therefore, Ireland would be on track to comply with domestic and EU fiscal rules, assuming these rules are reinstated in their current form in 2024. However, in

[51] The Council advocates using GNI* as a more appropriate benchmark for assessing Ireland's fiscal position. Ireland's debt-to-GNI* ratio is forecast to be 79% at the end of 2023 and fall to 65% by the end of 2026.

April, the Commission tabled legislative proposals to reform the EU's fiscal framework from 2024. At the time of writing, no agreement has yet been reached on these potential reforms. Discussions remain ongoing at an EU level, with a view to coming to an agreement on the reforms by year-end 2023 (Box J).

Supporting Information Section S.5 provides a full overview of compliance with the fiscal rules based on the Council's principles-based approach.

Ireland's medium-term expenditure framework

Ireland's Medium-term Expenditure Framework was established in 2013 as part of an extensive package of budgetary reform measures. Its purpose is to encourage Governments to plan further ahead than they had previously tended to do. Rather than concentrate solely on the next year, the framework seeks to adopt a more forward-looking approach, with a strong emphasis on realistic medium-term planning.

The framework legally requires the Government to set ceilings for how much each department will spend annually over the next three years. However, for the fourth year in a row, the Government failed to publish these spending ceilings on Budget Day. Instead, it seems likely that they will again be released in December. The repeated failure to fix these expenditure ceilings as part of the budgetary process implies that they are set, not with a view to imposing credible spending controls, but as a separate box-ticking exercise to meet legal requirements.

Furthermore, the medium-term estimates produced by the Department of Public Expenditure and Reform for individual department ceilings have tended to be highly unrealistic in recent years. In many areas, including health, they ignore demographic, price, and wage pressures and assume essentially constant levels of current spending in nominal terms. The Department leave large unallocated amounts that are then allocated where needed at a later stage. This approach to applying the ceilings undermines their credibility and is a backwards step in terms of transparency and the overall functioning of the fiscal framework.

The National Spending Rule

The National Spending Rule aims to limit core spending growth to 5% each year, in line with the estimated trend growth rate of the Irish economy.[52] The rule seeks to anchor core expenditure growth over the medium term.

The rule is not legally binding; it does not have a statutory footing. However, the Council considers it useful to assess the rule given its importance as a tool to help

[52] This trend growth rate is the sum of the Department of Finance's preferred estimates for medium-term potential output growth of 3% and steady-state price inflation of 2%. Sticking to the 5% path implies a broadly sustainable pace of expenditure growth, given revenues typically grow at this rate.

ensure the public finances are managed sustainably. Its importance is magnified by the fact that the EU rules are likely to prove less binding for Ireland in future, since GDP remains their main metric of reference (Casey and Cronin, 2023).

The Council assesses compliance with the rule on a net basis. That is, a rise in core net spending is offset by tax-raising measures but is added to by tax cuts.[53] This approach is in line with the Government's description of the rule (Department of Finance, *SPU 2023*, p. 30).

Budget 2024 continues a pattern in which the Department's forecasts lack transparency. Once again, no assessment of core spending is provided that adjusts for tax measures. In addition, the Department makes no reference to the original ceilings for core spending first set out in *Budget 2022*. This is bad for transparency and further highlights the need to strengthen the fiscal framework.

In *SPU 2023*, the Government revised up its ceiling for 2023, taking spending to a level beyond what would be implied by a 5% growth path. This decision was made to allow spending to adapt to high levels of inflation. *Budget 2024* goes further again and takes core net spending to an even higher level in 2023.

Nº68 **Government plans breach the 5% limit in 2024 and 2025**

€ billions

	2021	2022	2023	2024	2025	2026
Core net spending assessment (% year-on-year growth)						
5% limit		5.0	5.0	5.0	5.0	5.0
Budget 2024		5.4	7.0	5.8	5.1	4.9
Cumulative assessment						
5% path	75.9	79.7	83.7	87.9	92.2	96.9
Budget 2024	75.9	80.0	85.7	90.7	95.4	100.2
What goes into the Budget 2024 cumulative assessment?						
Total spending		88.8	93.4	96.6	96.9	102.0
less one-offs *		8.8	7.2	5.1	0.4	0.2
Core spending		80.0	86.2	91.5	96.5	101.8
less revenue measures (net)		0.0	0.5	0.3	0.3	0.5
Core net spending		80.0	85.7	90.7	95.4	100.2

Sources: Department of Finance and Fiscal Council workings.
*One-offs for this assessment assume all Covid-19 expenditure, Ukrainian supports, cost of living measures, and other expenditure, such as EU-funded spending for the Brexit Adjustment Reserve and the National Recovery and Resilience Plan are one off, as well as other provisions such as the Temporary Business Energy Support Scheme (TBESS).
Notes: Core net spending refers to core spending, 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 Fiscal Council.

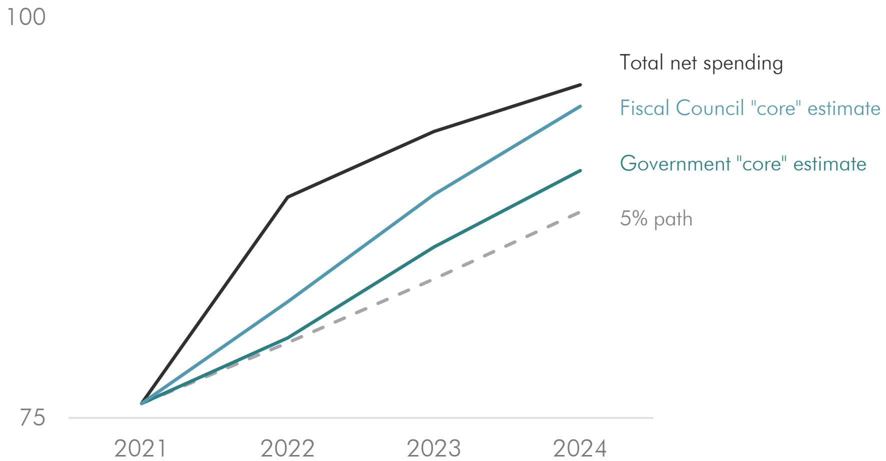
[53] These include the expected yields that would be raised from not indexing the income tax system.

The Government now intends to breach the National Spending Rule in 2024 and 2025 (N°68). Compared to *SPU 2023*, additional capital spending, labelled "windfall capital investment" has been introduced.[54] In addition, current spending plans were revised up, as were cuts to income tax. The pace of the core net spending increase is currently projected at 5.8% for 2024 and 5.1% for 2025. Core net spending is expected to grow 4.9% in 2026, within the 5% limit.

Cumulatively, the breaches of the National Spending Rule are substantial. The Government's estimate for core net spending is €2.6 billion above what a 5% path would imply in 2024 (N°69).

Nº69 **Different estimates for net spending exceed the 5% path**

€ billions



Sources: Department of Finance and Fiscal Council workings. Get the data.
Notes: The 5% path takes the total spending allocated for 2021 and grows it by 5% each year. The Government "core" estimate includes all core spending, adjusted for the net impact of new tax measures. The Fiscal Council "core" estimate begins with the Government "core" estimate but also factors in additional spending measures. These include the portion of Covid spending likely to be permanent, all spending related to supporting Ukrainian refugees, and windfall capital investment. "Total net spending" equals gross voted expenditure, adjusted for the net impact of new tax measures. Estimates of the net impact of new revenue measures are those judged relevant by the Fiscal Council.

However, there are a large number of measures which the Government classifies as temporary. Adding all these on would take total net spending to a far higher level. Total net spending includes all expenditure treated as "core" by the Government, as well as all expenditures related to Covid-19, Ukrainian supports, windfall capital investment and cost of living measures. Total net spending is forecast to reach €95.8 billion in 2024, €7.9 billion above a hypothetical 5% path from 2021.

Ultimately, the truth probably lies somewhere in between. The Council's own assessment of core net spending begins with the Government's estimate for core

[54] The Council treats the additional capital spending termed "windfall capital investment" as core spending. This is because this extra spending is included in the Department's spending forecasts each year from 2024 to 2026, and it rises over time. See Box D on fiscal gimmickry for more details.

expenditure. It then adds on all spending related to supporting Ukrainian refugees and the share of Covid-related spending likely to continue indefinitely.[55] It also includes windfall capital investment (N°70). This Council estimate for net spending is €6.6 billion (7.5%) above what a 5% path would imply in 2024.

Nº70

Walk to total net spending

€ billions

	2022	2023	2024
Government "core" estimate	80.0	85.7	90.4
add potentially permanent Covid spending *	1.3	1.3	1.3
add Ukrainian supports	1.0	2.0	2.5
add windfall capital investment			0.3
Fiscal Council "core" estimate	82.3	88.9	94.5
add temporary Covid spending	3.2	0.2	
add other **	3.3	3.7	1.3
Total net spending	88.8	92.9	95.8

Sources: Department of Finance, Fiscal Council workings.
*Some amount of Covid-19 related expenditure is likely to become permanent or "core" spending. *Budget 2024* allocates €1.3 billion for Covid-related expenditure for 2024. The Fiscal Council "core" estimate considers this to be permanent spending and, therefore, treats it as "core" in 2024. The Council's estimate also retrospectively treats €1.3 billion of the Covid-related spending in 2022 and 2023 as "core" too, given it has transpired to be long-lasting. **Other here includes all expenditures related to the cost of living measures, as well as EU-funded spending for the Brexit Adjustment Reserve and the National Recovery and Resilience Plan, and other provisions such as the Temporary Business Energy Support Scheme (TBESS).

The latest developments towards EU fiscal rules reform

In April, the European Commission (2023b) published a package of legislative proposals to reform the EU fiscal rules. Box J provides an update on how talks among Member States are progressing.

Pending an agreement on the reforms, the existing rules will be reinstated, albeit with some new features. A maximum growth rate in nationally financed net primary spending will now form the operational part of the rules.

Regardless of the outcome of the discussions, Ireland appears set to face less scrutiny under the new rules. In particular, the new rules look set to be underpinned by GDP-based measures, where distortions help to achieve compliance. A more appropriate assessment on a GNI* basis and reflecting excess corporation tax would signal greater risks (Casey and Cronin, 2023). The Council assesses that the National Spending Rule should be further developed as a "first line of defence" to ensure sound management of the economy and public finances at home.

[55] *Budget 2024* allocates €1.3 billion for non-core Covid-related expenditure in 2024. The Fiscal Council "core" estimate regards this as permanent. Moreover, the Council estimate also treats €1.3 billion of the Covid-related spending in 2022 and 2023 as core too, given it has transpired to be long-lasting.

Box J: The latest developments towards EU fiscal rules reform

In April 2023, the Commission (2023b) tabled legislative proposals to reform the EU fiscal rules. These build on the Commission's initial set of ideas from November last year (European Commission, 2022). They reflect discussions since then among EU Member States. We have previously discussed the outline of the new reforms in detail.[56] Here, we take a look at the latest state of play.

Agreement progressing but hangs on "safeguards"

At the time of writing, Member States have yet to reach an agreement on the Commission's proposed reforms. Most of the discussions have centred on what are labelled "numerical safeguards". Some Member States are seeking minimum requirements for debt and deficit adjustments that would apply regardless of a country's debt risks. They argue that medium-term country-specific fiscal plans could lack sufficient ambition and give countries too much fiscal leeway. However, other Member States regard the addition of these numerical requirements on top of the risk-based assessment as being too onerous. They argue these requirements would undermine a key tenet of the reforms, which is to tailor a country's fiscal adjustment path to its debt risks.

Member States are continuing to explore a potential compromise. It is hoped that an agreement will be reached by both the European Council and the European Parliament by year-end 2023, given parliamentary elections will take place in June 2024. Such an agreement would allow the new rules to come into effect in early 2024.

In the meantime, the rules will apply a mix of old and new elements

Pending an agreement on the reforms, the current rules still apply. The general escape clause will be deactivated at the end of 2023. As a result, the Commission has set country-specific recommendations for fiscal policies as part of its guidance for 2024.

The Commission's current guidance includes elements of both the new and old fiscal frameworks. For example, the structural balance rule remains in place for now. It sets a minimum annual requirement for the structural balance — the budget balance adjusted for the cycle and one-offs. Such a rule would be eliminated under the new proposals.

However, some parts of the latest proposals are incorporated in the guidance for 2024. The guidance focuses on a maximum growth rate for nationally financed net primary expenditure.[57] This spending limit is broadly consistent with the relevant Member State achieving its required improvement in the structural balance in 2024. In addition, these spending ceilings take account of a country's medium-term debt sustainability challenges.

Ireland will face little scrutiny under the EU fiscal rules in 2024

Some Member States, such as Ireland, are expected to achieve their medium-term objective in 2023.[58] Therefore, there is no guidance on a fiscal adjustment, although the Commission will continue to note the growth in nationally financed net primary expenditure.

All other Member States are expected to ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024. This would cap net spending increases at a slower rate than might otherwise be considered sustainable.[59]

[56] Box F of the *June 2023 Fiscal Assessment Report* explored these proposals in greater detail.

[57] Nationally financed net primary expenditure is defined as general government expenditure excluding interest, one-offs, EU-funded spending, and temporary spending on unemployment related to the cycle. It adjusts for the net impact of tax measures; tax-raising measures would allow for larger spending increases, whereas tax cuts would reduce the scope for spending increases. Unlike the Expenditure Benchmark it replaces under the current guidance, it does not smooth out investment costs over a four-year period.

[58] In its assessment of *SPU 2023*, the Commission forecast Ireland's structural deficit to be -0.1% of GDP in 2023 (European Commission, 2023c). Ireland's medium-term objective is set as a structural deficit of no more than -0.5% of GDP for 2023. Consequently, Ireland is expected to comply with the structural balance rule in 2023, given its structural balance is expected to be greater than the medium-term objective.

[59] In this instance, sustainable means in line with usual — or "potential" — economic growth, and, by extension, revenue growth.

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