Rialtas na hÉireann
Government of Ireland

Summer Economic Statement

JULY 2023

Prepared by Department of Finance and the
Department of Public Expenditure, NDP Delivery and Reform
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Summer Economic Statement

July 2023

Le ceannach díreach ó FOILSEACHÁIN RIALTAIS
52 FAICHE STIABHNA, BAILE ÁTHA CLIATH 2
(Teil: 046 9423100 nó Riomhphost: publications@opw.ie)
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Foreword

Notwithstanding a series of adverse shocks in recent years, the Irish economy is in a reasonably healthy position. The level of Modified Domestic Demand (MDD) is well above its pre-pandemic peak with little, if any, evidence of any 'scarring' to the economy from these shocks. It is especially notable that economic growth since the passing of the pandemic has been employment-rich – the level of employment now exceeds 2.6 million for the first time in our modern history.

Rather than any shortfall in demand, the binding constraint on growth at present is mainly on the supply-side of the economy. The latest data, for instance, show the unemployment rate was just 3.8 per cent in May, its lowest ever. The lack of sufficient housing supply is another bottleneck that is holding back economic growth, including by reducing labour mobility, both within the country and from abroad. Other important domestic capacity constraints include the energy infrastructure where, at times over the past year, demand has come very close to the capacity of the system to provide electricity.

The resilience of the economy in the face of the sequential pandemic and energy price shocks reflects, in part, the counter-cyclical budgetary measures put in place by Government. Supports to households and firms have helped to limit the economic fallout from these external developments. Encouragingly, the re-balancing of energy markets means that wholesale prices for oil and gas are now back at pre-war levels although, in the case of natural gas prices, there will be some lag before wholesale price reductions are passed on to retail prices.

Budget 2024 is, therefore, being framed against the backdrop of an economy that is operating at, or perhaps even beyond, its maximum sustainable level. Accordingly, in calibrating budgetary policy, Government must strike an appropriate balance between the need to provide additional public services and support living standards on the one hand and avoid adding to inflationary pressures on the other hand.

In addition, a key policy goal is the need to avoid building up permanent fiscal commitments on the basis of revenues that may prove transitory, which will help to ensure the sustainability of our approach to budget management to deliver improvements in public services. As has been well documented, corporate tax receipts have increased substantially over the past decade or so and are highly concentrated within a small sub-set of firms. Firm- or sector-specific shocks could put a major dent in these revenue streams. Moreover, international tax policy changes will impact on future receipts, though the timing remains unclear.

In recognition of this vulnerability, the Minister for Finance will bring forward proposals to Government to establish a long-term savings fund that will provide for *inter alia* long-term structural challenges, such as ageing and the climate transition, while also ensuring high levels of public investment can be maintained. The fund will be capitalised with part of the budgetary surpluses that are projected – under the baseline scenario – in the coming years. Details will be outlined in the autumn when the draft legislation is published.

In order to increase the pace of delivery of enhanced infrastructure, €2¼ billion of windfall receipts will be utilised to support additional infrastructure projects over the period 2024 to 2026. This is a critical element of delivering better, fit-for-purpose public services and supporting the climate transition.

Turning to the near-term outlook, the Government's spring economic projections – compiled by the Department of Finance – were published in April, with MDD growth of 2.1 per cent envisaged for this

year and 2.5 per cent for next year. These were calibrated on the assumption of a gradual improvement in household disposable income over the course of this year, as headline inflation eases. High-frequency data published in the meantime broadly confirm this assessment with, potentially, some upside to this year's projection. From a policy perspective, the data underline the need for a budgetary policy that does not further increase the mismatch between demand and supply in the economy.

Beyond the very near-term, risks to the outlook are firmly tilted to the downside. Growth is slowing in many of our key export markets, as the impact of significant monetary policy tightening in most regions weighs on demand. Irish exports will not be immune from weaker external demand, although headline exports may continue to benefit from the resilience of exports in some of the multinational-dominated sectors.

The Government's medium-term expenditure strategy was set out in its *Summer Economic Statement 2021.* It provided for annual increases in (net) public spending that are in line with estimates of the trend growth rate of the economy, taking into account an assumed inflation rate of 2 per cent. However, this framework must be responsive to the economic landscape. While inflation is easing, it is expected to remain above trend next year.

On this basis, Government is adjusting its fiscal parameters for *Budget 2024.* Core public spending will be increased by 6.1 per cent in 2024, bringing it to €91.2 billion. The overarching objective is to fund measures that protect the most vulnerable in our society and to finance further enhancements to our public services and infrastructure.

On the taxation side, a package of €1.1 billion is being provided for in *Budget 2024,* with Government prioritising measures that shield workers from higher taxation arising because of inflation.

In aggregate terms, this would mean an overall budgetary package of €6.4 billion for next year. This approach will balance the competing needs of delivering high-quality public services while minimising the impact of budgetary policy on inflation. In conjunction with the establishment of a long-term savings vehicle, this approach will also help to ensure that the public finances remain on a sustainable trajectory.

Finally, it is important that complacency is avoided. While the economy has been able to absorb major shocks in recent years, it is not bullet-proof. Major structural changes are underway in the wider global economy; the future could be very different from the past. It is imperative that we remain flexible and that we continue to adapt in order to respond to new challenges and opportunities.

Michael McGrath T.D.
Minister for Finance

Paschal Donohoe T.D.
Minister for Public Expenditure, NDP Delivery and Reform

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[1] The material set out in this document is based on data available to end-June. It was compiled by staff in the Departments of Finance and Public Expenditure, NDP Delivery and Reform, and every effort is made to ensure accuracy and completeness. When errors are discovered, corrections and revisions are incorporated into the digital edition available on the website of the Department of Finance. Any substantive change is detailed in the on-line version.

[2] In line with the Government's *Open Data Initiative,* the data underpinning charts in this document are available on the Department of Finance website.

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SUMMARY AND KEY MESSAGES

The macroeconomic backdrop is one in which the economy is operating at full employment

> Helped by Government support, the economy – at least at an aggregate level – has absorbed the severe supply-side shocks of recent years as well as could have been expected.

> Modified Domestic Demand is now well above its pre-pandemic peak and very close to the hypothetical level implied by the pre-pandemic trend; in other words, scarring has effectively been avoided.

> The recovery in the labour market has exceeded expectations; there are now over 2.6 million people employed and unemployment is now at its lowest rate ever.

> The rapid recovery means that lack of supply – of labour, housing, infrastructure, etc. – is the binding constraint on growth right now.

> Notwithstanding the strong economic position at present, risks to the outlook are tilted to the downside, most notably in relation to the external economic situation.

Inflation is past its peak though underlying inflationary pressures remain

> Headline inflation has passed it peak, and the re-balancing in global energy markets should support the downward trajectory for inflation over the remainder of the year.

> Underlying inflationary pressures – measured by non-energy prices for instance – have proven more persistent, indicative of the imbalance between demand and supply in the economy.

> This is also a feature of other advanced economies and is the main reason for the aggressive tightening of monetary policy over the past year.

The headline fiscal position masks underlying vulnerabilities

> Tax revenue growth has remained robust in the first half of the year, consistent with the strength of economic activity, including in the labour market.

> Overall receipts are now heavily dependent on the revenue streams of a small number of multinational firms headquartered in Ireland. Changes currently being negotiated at international level in relation to corporate tax policy have the potential to reduce this revenue stream.

> Excluding 'excess' corporate tax receipts means that a modest underlying deficit is in prospect for this year.

> Public debt in Ireland is already very high, with significant fiscal challenges now firmly on the horizon. Financing an ageing population, climate change mitigation, and the digital transition will all put pressure on the public finances in the years to come.

BUDGETARY STRATEGY: AN OVERVIEW

Government has responded to the cost of living challenge in a pro-active manner

- From a budgetary perspective, it is crucial that fiscal and monetary policy are pulling in the same direction.

- Government has provided significant resources, €12 billion in permanent and temporary measures, to cushion the impact of higher prices – much of these have been targeted to those most in need in order to limit the risk that budgetary policy becomes part of the inflation problem.

For next year, the Government is adapting its budgetary strategy

- In the *Summer Economic Statement 2021*, the Government adopted a medium-term budgetary strategy based on net public expenditure growth of 5 per cent per annum over 2023-2025.

- This was designed to ensure sustainable public expenditure growth, with annual increases in spending anchored to the economy's estimated trend growth, taking into account an assumed inflation rate of around 2 per cent.

- While inflation is easing, it is expected to remain above trend next year. On this basis, Government is adjusting its fiscal parameters for *Budget 2024*.

- For *Budget 2024*, an overall budgetary package of €6.4 billion is being made available.

To protect public services, core spending will increase by 6.1 per cent next year

- Government is providing for core spending of €91.2 billion next year. This ceiling will provide for an expenditure budgetary package of €5.2 billion, an increase of €1.0 billion relative to what was originally provided for.

- This additional quantum balances the need to deliver improvements in public services and continued investment in critical capital infrastructure as part of the NDP while ensuring that budgetary policy does not become part of the inflation problem.

- Additional capital expenditure of €2.25 billion, from windfall receipts, will be made available over the period 2024 to 2026 to boost delivery of critical infrastructure projects and to make a contribution to the existing Climate Action Fund for nature restoration and for other Government priorities.

- Government is also providing €4 billion in non-core expenditure for temporary measures. This expenditure will provide humanitarian supports for refugees arriving from Ukraine and more limited Covid-19 provision in respect of potential continued requirements.

The overall budgetary package also provides for taxation measures

- Government is also providing for an overall taxation package of €1.1 billion next year.

- A key priority of taxation policy in the forthcoming budget will be to avoid workers paying additional tax simply because they move through higher tax brackets due to wage growth.

- The revised budgetary parameters set out in the *Summer Economic Statement 2023* would be consistent with a general government surplus of €11.7 billion next year.

Table 1: Budgetary strategy, € billion (unless stated)

	2023	2024	2025	2026
Total budget package (1 = 2 + 3)	*6.9*	*6.4*	*5.7*	*5.9*
Budgetary decisions^ (2)	*2.7*	*3.2*	*3.2*	*3.2*
To be allocated^^ (3 = 4 + 5)	*4.3*	*3.1*	*2.5*	*2.7*
of which: expenditure measures (4)	*3.2*	*2.0*	*1.4*	*1.6*
of which: tax measures^^^ (5)	*1.1*	*1.1*	*1.1*	*1.1*
Voted spending				
Temporary	*5.2*	*4.0*	*0.4*	*0.2*
Windfall capital investment		*0.25*	*0.75*	*1.25*
Permanent ('core')	*85.9*	*91.2*	*95.7*	*100.5*
Growth in core spending	*5.9*	*5.2*	*4.6*	*4.8*
Growth in core spending, per cent	*7.4*	*6.1*	*5.0*	*5.0*
Memo				
*General Government Balance^^^^*	*10.0*	*11.7*	*16.3*	*18.5*

Note: Rounding can affect totals
^ Existing Level of Service in respect of demographics, NDP and public sector pay commitments.
^^ To be announced on Budget day.
^^^ Technical assumption for 2025 and 2026.
^^^^ SPU 2023 GGB after taking into account the SES 2023 fiscal parameters. A full suite of fiscal forecasts will be published alongside *Budget 2024*.
Source: Departments of Finance and Public Expenditure, NDP Delivery and Reform.

Table 2: Expenditure strategy, € billion (unless stated)

	2023	2024	2025	2026
Expenditure ceiling	*91.1*	*95.5*	*96.9*	*102.0*
: core spending	*85.9*	*91.2*	*95.7*	*100.5*
: non-core spending	*5.2*	*4.0*	*0.4*	*0.2*
: windfall capital investment		*0.25*	*0.75*	*1.25*
Memo				
Growth in core spending	*5.9*	*5.2*	*4.6*	*4.8*
Growth in core spending, per cent	*7.4*	*6.1*	*5.0*	*5.0*

Note: technical assumptions for 2025 and 2026.
Source: Departments of Finance and Public Expenditure, NDP Delivery and Reform.

Chapter 1
Economic Strategy

1.1 Background

Incoming data show that economic activity increased by 2.7 per cent in the first quarter of this year. This means that Modified Domestic Demand (MDD) is now 8.6 per cent higher than its pre-pandemic peak. At an aggregate level, the economy has absorbed the energy price shock as well as could reasonably be expected though, of course, the aggregate hides a multitude of differences.

The re-balancing in global energy markets means that headline inflation has peaked and is now on a downward trajectory. In common with elsewhere, underlying inflation – that is excluding volatile components such as energy prices – has proven more persistent. This has necessitated aggressive monetary policy tightening in most advanced economies and, in some regions, this triggered isolated bouts of financial distress. The rapid response of regulators helped limit contagion, including in the UK, where last autumn's fiscal mis-adventure serves as a reminder of the importance of prudent, evidence-based budgetary policies.

Perhaps the most notable feature of the economy at present is the employment-intensity of the post-pandemic recovery, with over 2.6 million now in employment (11½ per cent higher than immediately before the pandemic). The unemployment rate is now at its lowest ever; while undoubtedly a positive development, the exceptionally low rate does signal that the demand for labour may well be in excess of supply, potentially triggering 'second-round' effects on inflation.

The external economic environment is increasingly fragile, especially in light of the fact that the bulk of the impact of monetary tightening is still in the pipeline. Perhaps the most significant risk relates to the inflation trajectory in advanced economies – if price inflation remains 'sticky', additional policy measures may be needed in order to dampen demand. Finally, geopolitical tensions remain high and evidence is mounting of an increasingly polarised global economy.

All-in-all, therefore, notwithstanding the stronger-than-expected performance in the first half of the year, downside risks continue to dominate.

1.2 Economic Strategy

It is against this highly uncertain macroeconomic backdrop that *Budget 2024* is being prepared. Beyond short-term, cyclical developments, it is also clear that major structural change is underway in the global economy. The *National Economic Dialogue* took place in mid-June; its theme was "*The Irish Economy in 2030 – ensuring a sustainable future for all*".

An overview paper, prepared for the Dialogue and re-produced in this document (**annex 1**), highlighted the "4Ds" that will have a major bearing on the evolution of Irish living standards in the years to come: demographics (an ageing population), digitalisation (especially the opportunities and challenges associated with artificial intelligence), decarbonisation (the transition to net zero by 2050), and de-globalisation (the threat posed to the economy from a 'localisation' of economic activity).

Responding to these and other challenges will be a key focus of Government in the years ahead. Government continues to work to enhance Ireland's economic resilience and lay the groundwork for

future improvements in living standards. As part of the *Programme for Government*[3] commitments, progress in living standards is also being measured across a range of economic, environmental and social indicators, and this approach continues to be integrated into the budgetary process (**annex 3**).

Boosting housing supply

Results from *Census 2022*[4] show the population reached 5.15 million people in April of last year, an increase of 8 per cent since the previous census, and the highest since 1851. Data suggest a further increase in the year since then.

While undoubtedly a positive development, the rapid expansion of the population has created challenges, most notably in the provision of housing. The Government's policy response – set out in *Housing for All*[5] – is a suite of measures designed to boost average housing supply to 33,000 units per annum over the remainder of the decade. Leading indicators – new start data for instance – point to a rebound in housing output and Government will continue to work to further enhance supply in the months and years ahead.

Decarbonising the economy

Achieving 'net zero' by 2050 is a key objective for Government and, as an interim target, legislation that requires a halving of CO_2 and other greenhouse gas (GHG) emissions by 2030, relative to 2018, has been enacted.[6] Current estimates suggest this will require around a 7½ per cent annual reduction in GHG emissions over the remainder of the decade.

Latest published data from the EPA in June 2023, however, show that total GHG emissions were around 1 per cent lower in 2021 compared to 2018 (based on inventory data), highlighting the scale of the challenge involved.[7]

Building more resilient public finances

The headline budgetary position masks considerable vulnerabilities – the State's revenue stream is highly concentrated among a very small number of multinational corporations and a relatively small number of workers (25 per cent of workers account for c. 85 per cent of income tax payments). In addition, an ageing population means that demographically-sensitive components of public expenditure (healthcare, pensions, long-term care) are set to increase substantially: by the end of this decade, public expenditure will be €7-8 billion higher, per annum, simply to maintain existing levels of service.

To help address these challenges, the Minister for Finance will bring proposals to Government to establish a long-term saving vehicle, which will be capitalised *inter alia* by revenue windfalls. Importantly, this will complement – rather than substitute – other reforms that will be needed to sustainably finance an ageing population (the Government has indicated that changes in social security rates will be needed at some stage in the future).

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[3] Available at: https://www.gov.ie/en/publication/7e05d-programme-for-government-our-shared-future/
[4] Available at: https://www.cso.ie/en/releasesandpublications/ep/p-cpsr/censusofpopulation2022-summaryresults/keyfindings/
[5] Available at: https://www.gov.ie/en/publication/ef5ec-housing-for-all-a-new-housing-plan-for-ireland/
[6] Climate Action and Low Carbon Development Act.
[7] Available at: https://www.epa.ie/our-services/monitoring--assessment/climate-change/ghg/key-messages/

1.3 Summary

To summarise, it is clear that the economy is now operating at full capacity, having rebounded strongly following a series of negative supply-side shocks. Nevertheless, downside risks have increased since the Department's spring projections, most notably on the external front.

On the domestic front, budgetary policy must be calibrated to avoid generating second-round effects on inflation while, at the same time, supporting continued improvements in the provision of public services and supporting those households least equipped to absorb higher price levels. Against this backdrop, *Budget 2024* will provide for an overall tax and spending package of €6.4 billion.

Chapter 2
Economic Outlook

2.1 Summary

Over the last year or so, the Irish economy has weathered three inter-related shocks – global uncertainty, multi-decade high inflation rates and the aggressive monetary policy response – remarkably well. With wholesale energy prices subsequently reverting towards historic norms, headline inflation has, as expected, eased considerably. However, non-energy inflation remains elevated and more persistent than expected. At the same time, unemployment is at an all-time low, wages are rising and labour shortages are evident in many sectors, particularly construction, pointing to mounting capacity constraints across the economy.

Economic growth surprised on the upside in the first quarter, relative to the Department's spring forecasts, with consumer and investment spending (including housing) both up strongly. Looking ahead, the outlook has not materially changed since the spring forecasts, with the pace of growth expected to continue to pick up throughout the year in line with a continued easing in headline inflation. However, risks remain elevated, with the global economy still in a low-growth, highly-uncertain environment. Domestically, there is a mounting risk of binding capacity constraints and domestically-produced price pressures, with implications for competitiveness and Ireland's inward investment proposition.

Beyond the short-term, the economy is facing into a period of slower growth, brought on partly by a combination of structural forces affecting all advanced economies, namely the "4Ds" of demographic change, decarbonisation, digitialisation and de-globalisation. While some of these forces, such as demographic change and de-globalisation, will act as headwinds to growth, decarbonisation and digitalisation present opportunities as well as challenges.

2.2 Recent Developments

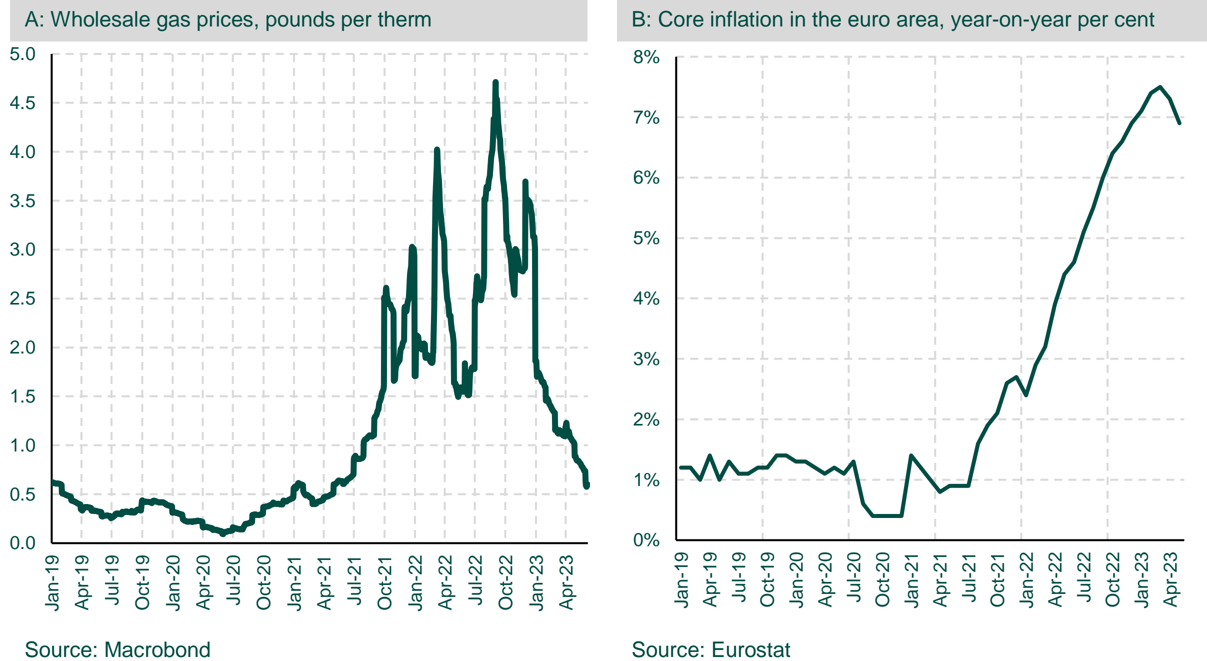
International economic developments

Following three years of successive economic shocks (a global health pandemic followed by an energy crisis brought about by war, both of which contributed to multi-decade high inflation rates), the global economy is now adjusting to an aggressive and rapid change in the stance of monetary policy. That said, with energy prices reverting to pre-war levels and the correction of earlier supply chain bottlenecks, headline inflation in Ireland's main export markets appears to have peaked. Non-energy price inflation, however, has remained relatively high in many regions, weighing on disposable income and dampening growth.

Following large price spikes last year, oil and natural gas on wholesale markets have returned towards historical norms. In June, natural gas prices in the UK and Continental Europe were trading at mid-2021 levels (**figure 1a**). As a result, there has been a significant easing in energy prices over the first half of the year in the euro area, with headline inflation falling markedly as a result. However, core inflation is proving somewhat stickier (**figure 1b**), with some evidence of rising profit margins as well as pressures from exceptionally tight labour markets.[8]

[8] See OECD Economic Outlook, available at:
https://www.oecd.org/economic-outlook/june-2023/

Figure 1: Price developments

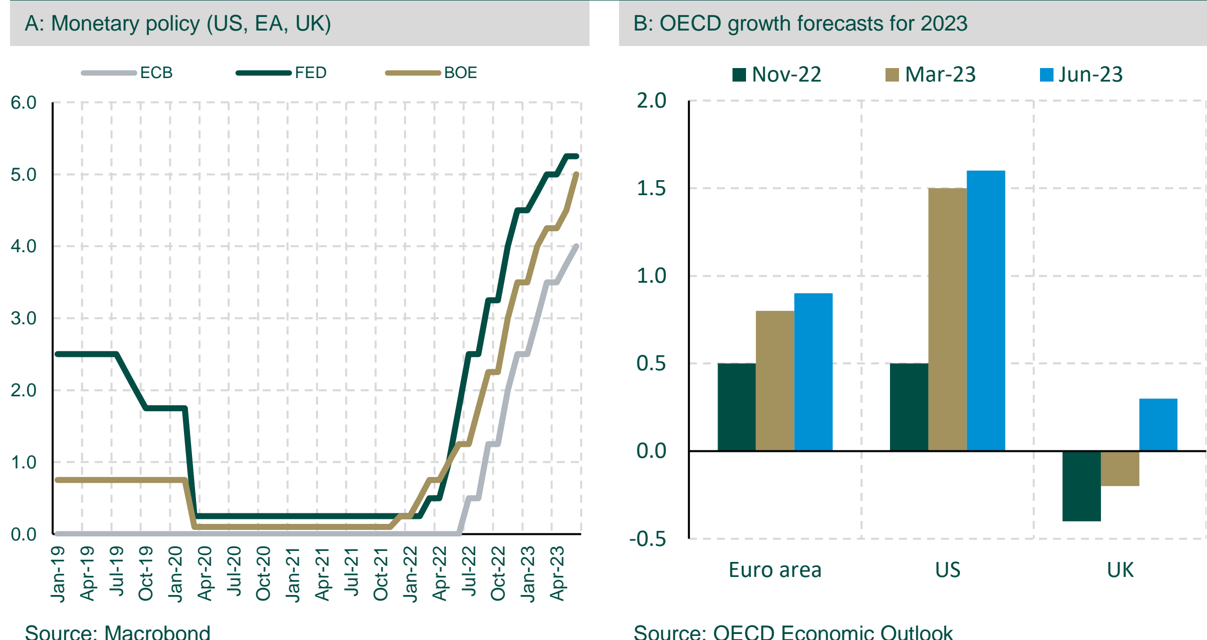


Source: Macrobond

Source: Eurostat

The impact of higher interest rates is increasingly being felt (**figure 2a**) though, given lags in the transmission to the 'real' economy, the full effects may not materialise until next year. Property markets have begun to cool in many economies, with housing investment declining in all the large OECD economies in the second half of 2022.[9] Meanwhile pockets of stress have appeared in some financial market segments as investors reassess risks and return, with credit conditions tightening.

Figure 2: Monetary policy developments and growth outlook for trading partners



Source: Macrobond

Source: OECD Economic Outlook

In its summer economic assessment, the OECD is projecting global GDP growth of 2.7 per cent in 2023, the lowest annual rate since the global financial crisis (apart from the exception of the pandemic-hit year of 2020), with a very modest improvement next year. A disproportionate share of growth is

[9] See OECD Economic Outlook, available at:
https://www.oecd.org/economic-outlook/june-2023/

expected to come from China and emerging markets and the outlook amongst Ireland's main trading partners is particularly weak, with growth of 0.9 per cent, 1.6 per cent and 0.3 per cent projected this year in the euro area, the US and the UK, respectively (**figure 2b**).

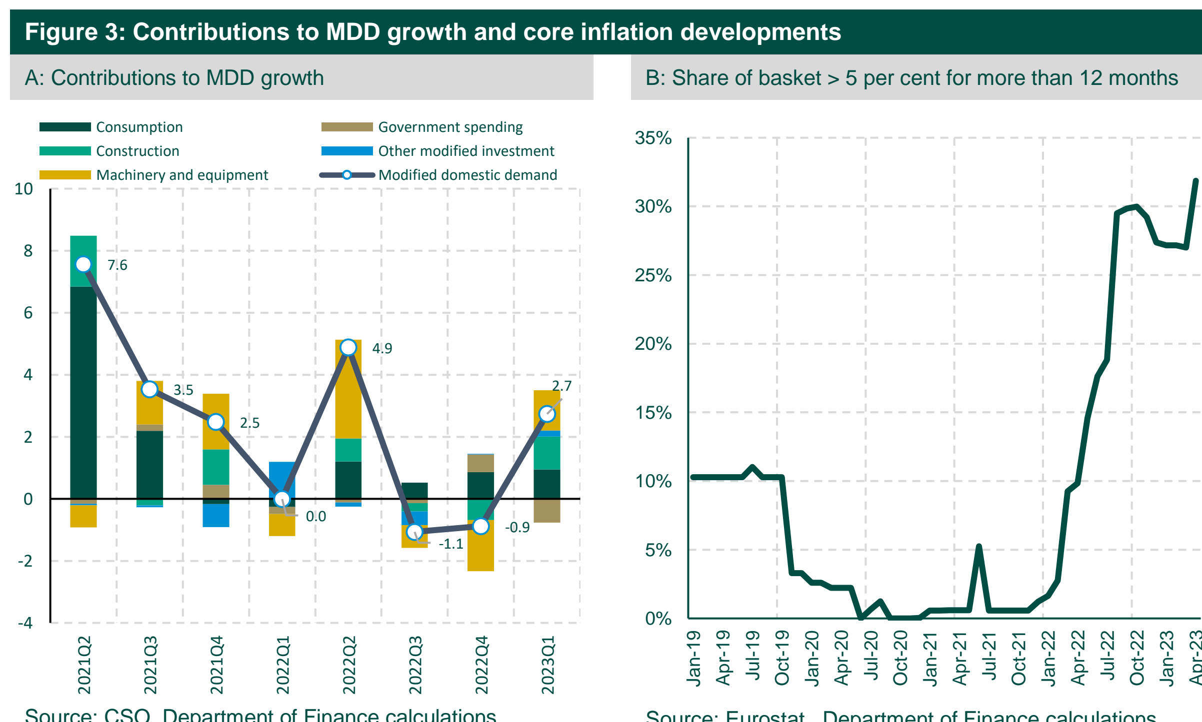
Significant uncertainty about global economic prospects remain, with risks heavily tilted to the downside. The persistence of core inflation means that the impact of monetary policy tightening on economic growth could be more negative than expected, particularly if tighter financial conditions were to trigger further stress in the financial system and undermine financial stability. The uncertain course of the war in Ukraine could lead to further disruptions in global energy and other commodity markets (including food). In summary, although energy prices and inflation are on a downward path, the overall outlook remains muted, with downside risks to the fore.

Domestic economic developments

Official data confirm a broad expansion in the domestic economy since the start of the year, with Modified Domestic Demand (MDD) up 2.7 per cent in the first quarter. This was supported by stronger than expected growth in consumer spending as well as expansions in construction activity and investment in plant and machinery by the private sector, in particular by multinational firms (**figure 3a**). This tallies with data on the labour market, where the unemployment rate has fallen to a record low.

Having peaked at just over 9½ per cent last summer, headline inflation has fallen by nearly 5 percentage points, reaching 4.8 per cent in June. The bulk of this decline has come in the last six months, with headline inflation still at 9 per cent as recently as November. That said, core inflation is proving to be more persistent than expected and was above headline inflation in May for the first time since the start of this inflation cycle. Perhaps more tellingly, over one-quarter of products in the core inflation basket have recorded an inflation rate in excess of 5 per cent for more than a year (**figure 3b**).

Figure 3: Contributions to MDD growth and core inflation developments



Source: CSO, Department of Finance calculations

Source: Eurostat, Department of Finance calculations

Expansions in the labour market and targeted cost of living policy supports have led to a general improvement in sentiment and a fall in uncertainty. As a result, consumer spending grew by 1.7 per cent in the first quarter. Following several years of impairment, a general improvement in global supply

chains gave way to strong growth in car purchases by households,[10] with spending on other goods and services also growing in the first quarter.

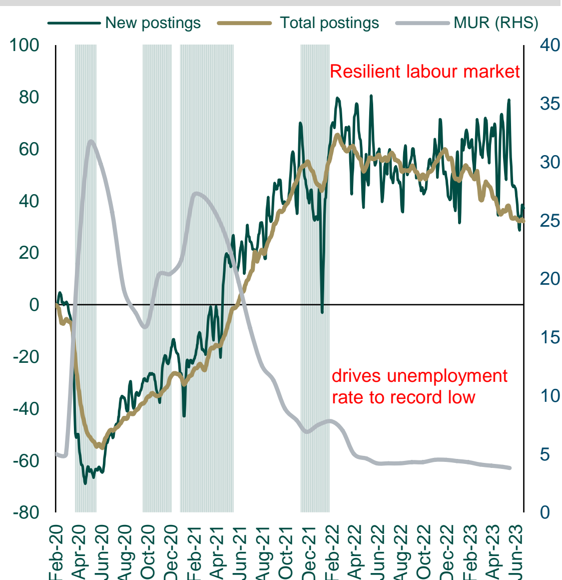
On the investment side, the first quarter was particularly strong. Following a post-pandemic rebound in building activity last year, momentum continued into this year with all sub-sectors (residential, commercial and civil engineering) recording growth on the quarter. On the housing side, just over 6,700 units came on stream in the first quarter, up by almost one-fifth on the same period last year. Meanwhile the private sector continued to invest in plant and equipment, up 16 per cent on the previous quarter, led by multinational investment in new facilities. This category of investment was just shy of €20 billion over the last four quarters, a record level. In time, these investments will give rise to new activity and value-added in the economy (most likely through additional exports).

The current position of the economy is probably most visible in the labour market where the unemployment rate stood at 3.8 per cent in May (**figure 4a**), an all-time low. In the first quarter, the level of employment exceeded 2.6 million for the first time, an increase of more than a quarter of a million on its pre-pandemic level. Moreover, the employment rate - the share of the working age population in employment – stands at 73½ per cent, also a record high.

Employment growth has been broad-based, with the notable exception of construction where employment has actually fallen for two consecutive quarters despite strong demand; this is largely a reflection of labour shortages in the sector. Notably, despite high profile announcements relating to lay-offs by certain firms, employment in the ICT sector increased in the first quarter to a new record high.

Figure 4: Labour market developments

A: Unemployment rate at record low



Note: MUR = Monthly unemployment rate.
Source: Indeed job postings, CSO.

B: Participation rates (PR) 15+

Source: CSO

Perhaps the most remarkable aspect of the labour market expansion since the pandemic is that virtually all of it arose from increases in the labour force, with the level of unemployment relatively unchanged. The growth in the labour force was driven by both cyclical and structural factors, with notable increases in migration (with increases in the working age population) and participation (a greater share of the population engaged in the labour market). The participation effect is particularly notable, with the overall

[10] According to CSO Vehicle Licensing Data, in the first five months of the year, the number of private cars licensed for the first time rose 13 per cent year-on-year.

participation rate up 2½ percentage points relative to its pre-pandemic rate (**figure 4b**), the highest since late 2008. This was largely driven by an increase in female participation, up 3.2 percentage points to 59.6 per cent, an all-time high, supported in part by more flexible working arrangements such as remote hybrid working (**box 1**).

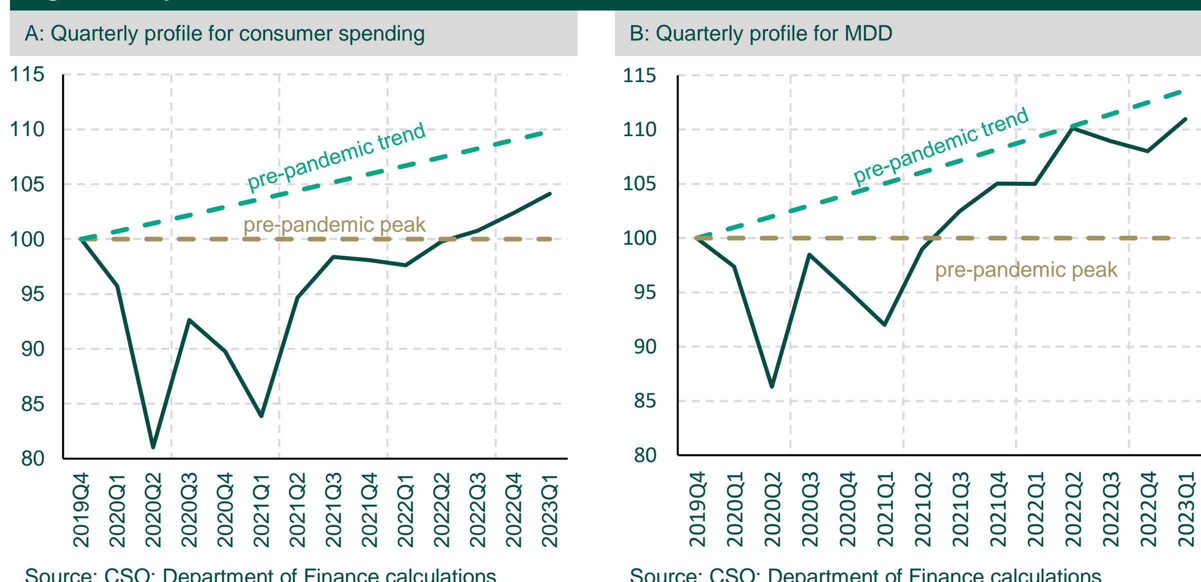
In line with the generally uncertain global economic environment, exports eased in the first quarter, down 2 per cent on a headline basis, in large part due to a significant quarterly decline in 'contract manufacturing' (a globalisation-related distortion). Underlying goods exports were also down on the quarter, led by an expected post-pandemic easing in pharmaceutical exports. Positive, yet subdued growth in services offset some of this decline. Looking ahead, the ramp-up in capital investment in manufacturing facilities over the last year or so bodes well for future export growth.

2.3 Economic Outlook: 2023

The pathway for the domestic economy this year, as set out in the Department's spring forecasts, is conditioned on a dual tailwind of a sustained fall in both inflation and uncertainty (boosting real incomes, real margins and confidence) dominating the headwind of higher financing costs from monetary policy tightening. The net result is expected to be an improvement in consumer spending and underlying investment (i.e. excluding large-scale multinational corporation-related investments in plant and equipment). The first quarter results confirm this outlook, though this remains conditioned on no further spikes in energy prices or widespread financial market disruption arising from monetary policy tightening.

In terms of consumer spending, the profile set out in the spring forecasts was for a relatively modest first quarter followed by an acceleration from the second quarter onwards arising from a significant weakening in the inflationary grip on the economy (**figure 5a**). While inflation has generally followed the expected path (in broad terms), the better-than-expected out-turn for consumer spending in the first quarter - supported by consistent improvements in sentiment, labour market conditions and real incomes - may mean that there is some upside to the projection for this year. Meanwhile the improvement in domestic, and to a lesser extent global, economic conditions, and an easing in uncertainty are expected to impact positively on private investment, with aggregate investment further supported by record levels of public capital.

Figure 5: Key short-term economic trends



Box 1: Remote working practices and labour force attachment

The sudden and unprecedented restriction of economic activity arising from the Covid-19 pandemic turned the labour market on its head. Employment fell rapidly, with hours worked down by 22 per cent (17½ million hours) year-on-year in the second quarter of 2020.

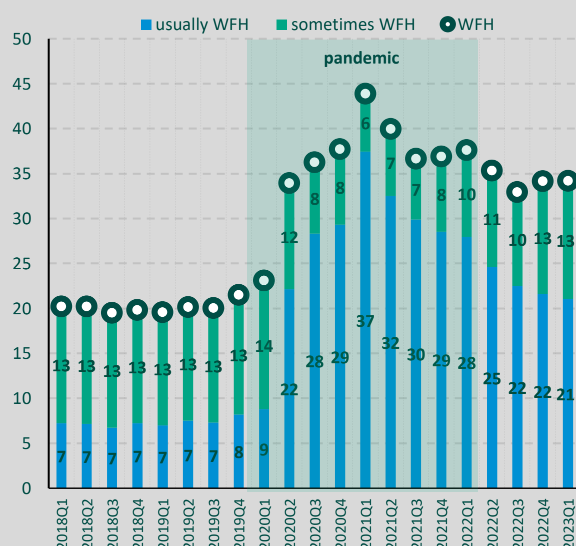
In advanced economies, employers responded by moving – where possible – to remote working arrangements. This was evident in Ireland, where those 'usually' working from home moved from an 8 per cent share pre-pandemic to a peak of 37 per cent in the first quarter of 2022. The latest data show that the share remains well above the pre-pandemic level, and is 21 per cent at present (**figure 6a**).

The shift toward remote working was particularly strong in Ireland relative to other European economies. Although those 'usually' working remotely increased across the EU (+5 pp), the change in the share between 2019 and 2022 was strongest in Ireland (+18 pp), Sweden (+12 pp), and Belgium (+10 pp); and weakest in economies such as Portugal (+1.2 pp) and Greece (+0.6 pp).

These differences are possibly explained by differences in digital-intensity, with changes in remote working strongest in economies where workers were more likely to work in digital occupations and thus more likely to be resilient to the conditions associated with the shock from Covid-19.

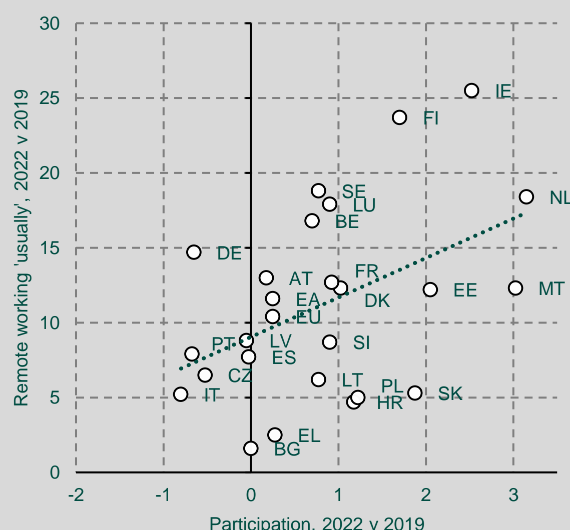
Figure 6: Remote working

A: Remote working 'usually', pp change 2022 v 2019



Note: WFH = work from home.
Source: Eurostat, Department of Finance.

B: Participation gains associated with remote working



Source: Eurostat, CSO, Department of Finance.

The rise in the incidence of remote working can also explain, in part, the increase in participation that has persisted beyond the pandemic. Indeed, larger participation gains have accrued to economies with a greater share of persons working remotely (**figure 6b**).

The association between home-working and increased participation likely reflects demand shifting towards digital sectors and platforms as well as the opportunities afforded to second earners (particularly females) and other marginally attached workers through more flexible working arrangements.

Overall, the rise of remote working, in tandem with Government policies designed to maintain the link between employers and employees, helped to ensure the resilience of the labour market during the pandemic.

Moreover, it is also worth noting that the change in labour force participation has largely persisted in Ireland and some other economies.

As cyclical factors ease, it is likely that the flexibility afforded by remote working could see labour force participation remain structurally higher. This is a significantly positive development as it would reflect a permanent increase in opportunities for older and marginally attached workers to participate.

A full set of macroeconomic projections will be published as part of the Department's autumn forecasts alongside *Budget 2024*. At this point, MDD is expected to grow by at least the 2.1 per cent rate projected in the spring, with potentially some upside to this projection. The generally positive economic conditions, underpinned by strong (at least in aggregate terms) household balance sheets and a robust labour market, are expected to continue into next year, resulting in MDD growth of 2.5 per cent as set out in the Department's spring projections.

Beyond the very near-term, the balance of risks is firmly titled to the downside with the same forces shaping the global risk assessment, namely the fallout from monetary tightening and the war in Ukraine, equally affecting the Irish economy (the Irish economy tends to be highly 'elastic' or sensitive to world output shocks). However, a mounting concern relates to capacity constraints and overheating risks domestically.

2.4 Economic Outlook: the medium-term

The outlook for the economy over the medium-term will depend on the availability of capital and labour and the efficiency with which these are combined to produce output. In this context, with core inflation proving to be persistent, a more sustained increase in whole economy input costs could do lasting damage to potential output. Mounting labour shortages in certain sectors, particularly construction, represent a particular risk for increasing wage pressures. Against this backdrop, there is a real risk that a wage-price spiral emerges. This would damage Ireland's cost competitiveness and hamper the economy's ability to compete in the global marketplace.

Beyond the short-term, economic activity is assumed to evolve in line with the economy's supply capacity, which is assumed to moderate over the medium-term, *inter alia* due to an ageing population. Given the demographic factors at work, with a higher share of older workers in the labour force, the participation rate is also expected to decline over the coming years leading to a declining contribution to the productive capacity of the economy from the labour market. As a result, capital and productivity will become increasingly important. Overall GNI* (a de-globalised version of GDP) is expected to grow at an average rate of 2¼ percentage points over the second half of this decade, compared with 2½ per cent on average over the previous decade.[11] A partial offset to these demographic changes is the higher educational attainment of younger workers (**box 2**).

Demographic challenges are not the only structural headwinds facing the economy in the medium-term. Indeed, demographic change is one of four longer-term trends (one of the "4Ds" along with digitisation, decarbonisation and de-globalisation (**annex 1**), some of which have accelerated as a result of the pandemic, that will have a profound impact on the Irish (and global) economy in the years ahead.[12] Navigating these potentially de-stabilising transformations will be crucial for Ireland's continued economic advancement. To boost resilience, there is clearly a premium on up-skilling and re-skilling. Enhancing the stock of physical infrastructure, including green infrastructure, will also help smooth the transition. Greater flexibility and adaptability of firms and workers are also part of the solution.

The annual budgetary cycle cannot be divorced from these longer-term structural trends. From a public finances perspective, counter-cyclical budgetary policies, alongside measures that boost the quality of public spending and the efficiency of the taxation system, can play a key role in helping to absorb the tectonic shifts underway.

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[11] For a detailed discussion on medium-term prospects, including scenarios, see Hogan and Rehill (2023) forthcoming

[12] See *Setting the scene: The Irish Economy in 2030 – enabling a sustainable future for all*, Department of Finance, June 2023, available at:
https://www.gov.ie/pdf/?file=https://assets.gov.ie/260158/50762603-827c-4269-a5cf-995edaa651dd.pdf#page=null

Box 2: The demographic composition of educational attainment in Ireland

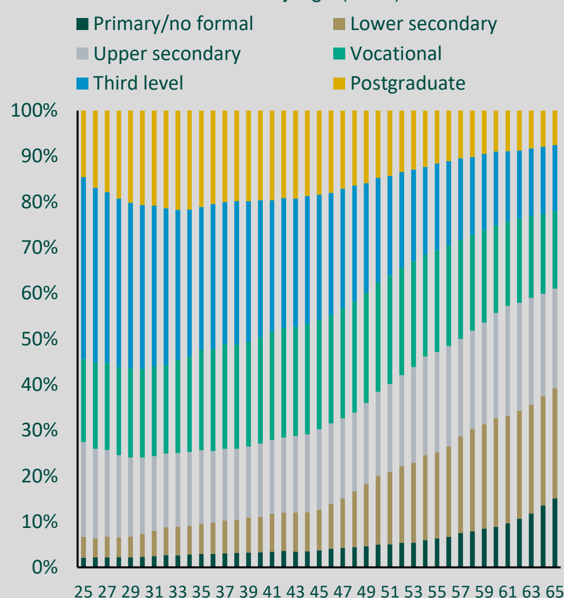
Newly released Census data reveal a striking pattern in educational attainment within the State. As shown below (**figure 7a**), the level of education is correlated with age, with younger individuals being significantly more likely to hold a third-level or postgraduate degree (a function of the introduction of free second level education in the late-1960s).

This relationship already appears to have begun to alter the educational structure of the workforce, as older workers have retired and been replaced with better-educated younger workers. CSO Labour Force Survey data, for instance, reveal that between 2009 and 2022 the percentage of those aged between 25 and 64 with at least a third-level degree increased from just over one-third (36 per cent) to more than half (53 per cent) of that population group. This increase has been driven mainly by a steady increase in the level of education of those entering the labour force over time. As set out below (**figure 7a**), the proportion of 25-30 year olds with a third-level or postgraduate degree has expanded by 16 percentage points over the last decade. There is also no indication that this rate of increase has plateaued, with the number of students enrolled in third-level education continuing to trend upwards year-on-year according to the Higher Education Agency (HEA).**^**

Given the well-established relationship between human capital investment and growth,**^^** this development bodes well for the Irish economy. This is especially true given that demographic changes are likely to decrease the ratio of workers-to-dependents in the decades to come. The analysis suggests that the economic challenges posed by this change may be partially ameliorated by the fact that those who remain in the labour force are likely to be more productive.

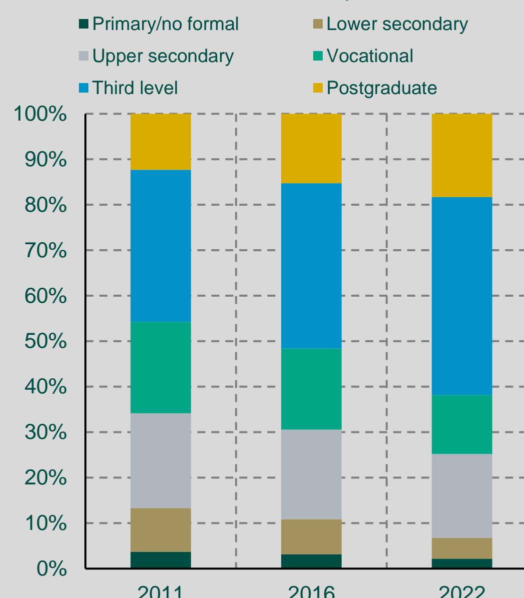
Figure 7: Educational attainment in Ireland

A: Educational achievement by age (2022)



Source: CSO Census Data

B: Educational breakdown of 25-30 year olds



Source: CSO Census Data

However, the decline in the number of young people choosing to pursue apprenticeships or vocational training is potentially problematic, with the proportion of 25-30 year olds with a vocational qualification having decreased from 20 to 13 per cent (**figure 7b**) over the last decade. A lack of skilled workers in the construction sector has repeatedly been cited as a capacity constraint in the building of housing,**^^^** and these results suggest that current apprenticeship and training schemes are not attracting sufficient people to meet the demand for vocational skills in the labour market. This issue is particularly salient given the current shortage of construction workers, in what is a particularly tight labour market.**^^^^**

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^ Higher Education Agency. (2022). *Higher Education – Key Facts and Figures 2021/2022*. HEA.
^^ Solow, R. M. (1956). *A Contribution to the Theory of Economic Growth*. The Quarterly Journal of Economics, 65-94; Lucas, R. E. (1988). *On the mechanics of economic development*. Journal of Monetary Economics, 3-42.
^^^ Irish Fiscal Advisory Council. (2023). *Fiscal Assessment Report June 2023: Managing Corporation Tax Inflows and Capacity Constraints*.
^^^^ Conefrey, T., & McIndoe-Calder, T. (2018). *Where are Ireland's Construction Workers?* Quarterly Bulletin: Central Bank of Ireland.

Chapter 3
Budgetary Strategy

3.1 Summary

The Government's medium-term framework was set out in the *Summer Economic Statement 2021*. This framework set 'net' core expenditure growth of 5 per cent annually over 2023-2025. This was designed to meet four key objectives:

> maintaining the public finances on a sustainable trajectory;
> minimising the possibility of transient revenues being used to finance permanent commitments;
> continuing to invest in the productive capacity of the economy; and
> avoiding pro-cyclical budgetary policies.

Given the energy price shock, the framework was adapted last year, with the *Budget 2023* parameters adjusted to take account of the higher inflationary environment. Overall, Government has now made available €12 billion (almost 4½ per cent of national income) in direct fiscal support through temporary and permanent measures to help address increases in the cost of living (**figure 8a**). The overarching objective has been to balance the need to mitigate the impact of higher inflation while, at the same time, to avoid adding to inflation. This has been achieved by focusing, in part, on temporary, timely and targeted fiscal measures to cushion the fallout from higher prices.

For *Budget 2024*, an overall budgetary package of €6.4 billion is being made available.

This overall budget package will be composed of a spending allocation amounting to €5.2 billion in 2024. 'Core' expenditure will grow by 6.1 per cent in 2024. This adjustment to the Government's expenditure framework takes into account the fact that inflation is expected to be above trend next year. An overall taxation package amounting to €1.1 billion will be provided, once again focusing on the need to adjust income tax bands and credits so that workers are not 'dragged' into higher levels of taxation by virtue of wage inflation ('fiscal drag').

In addition, €2¼ billion of 'windfall' corporate tax receipts will be made available over the period 2024 to 2026 to fund 'windfall capital investment'. This form of capital investment will be contingent on 'windfall' receipts remaining at elevated levels.

The revised budgetary parameters set out in the *Summer Economic Statement 2023* would be consistent with a General Government surplus of €11.7 billion next year.

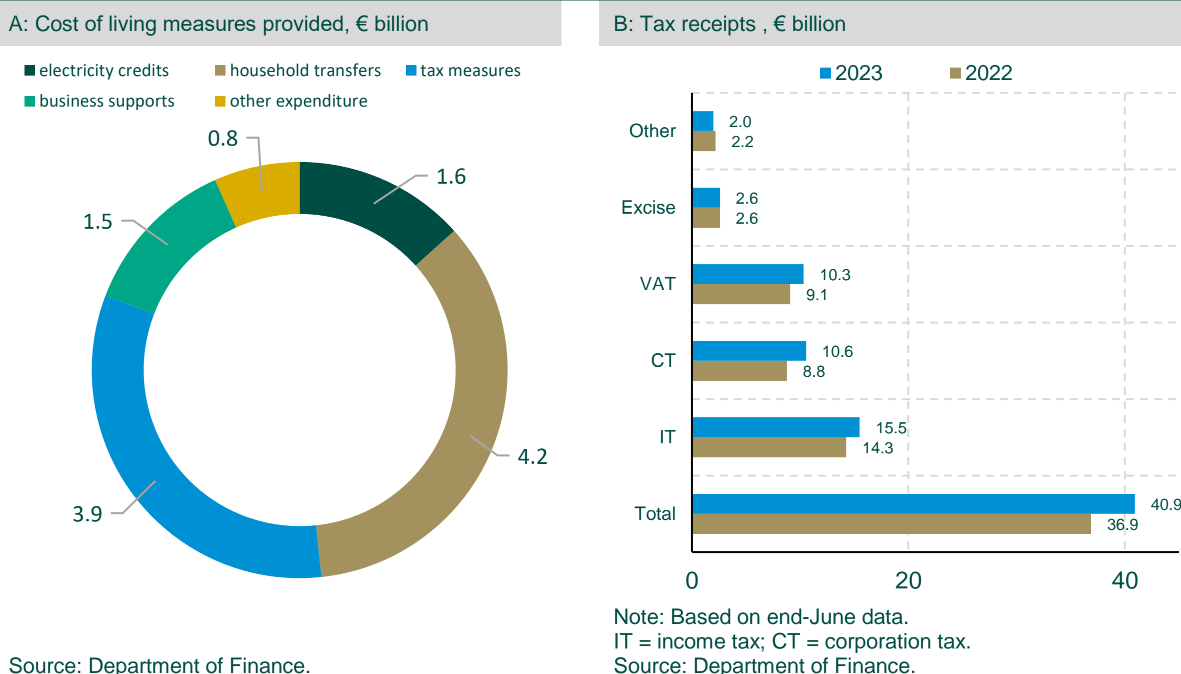
3.2 Fiscal Developments in 2023: an update

At end-June, taxation receipts were up by €4.0 billion (almost 11 per cent) on an annual basis, driven by solid growth in income tax, corporate tax and VAT receipts (**figure 8b**). The strong performance reflects the resilience of the domestic economy, as well as continued increases in profitability in the multinational sector. However, tax revenue growth is expected to decelerate in the second half of this year as nominal consumer spending slows on foot of an easing in inflation and, in particular, due to an expected slowdown in growth in corporation tax receipts.

In the spring, tax revenue was projected at €88.9 billion for this year, up almost 7 per cent on an annual basis and, as of end-June, receipts are broadly in line with this projection.

Total gross voted expenditure in the first half of this year amounted to €41.9 billion, an increase of €3.4 billion (8.7 per cent) in year-on-year terms. This trend is driven by the significant investment in public services outlined in Budget 2023 and the ramping up of investment in infrastructure under the *National Development Plan*. It also reflects the non-core supports that have been put in place in the first half of 2023. These include supports to welcome and accommodate those arriving in Ireland from Ukraine and the Spring/Summer Cost of Living social welfare payments.

Figure 8: The cost of living and H1 tax receipts



Source: Department of Finance.

Note: Based on end-June data.
IT = income tax; CT = corporation tax.
Source: Department of Finance.

3.3 Budgetary Strategy: key factors

While the headline figures have improved significantly in recent years, the underlying fiscal position, i.e. excluding estimates of 'windfall' corporate tax receipts, is still in deficit this year. This underscores the need for a credible fiscal strategy to address the key challenges facing the Irish economy. Over the short-term, these challenges are primarily macroeconomic in nature while, over the medium to long-term, measures will be needed to ensure fiscal sustainability.

Short-term challenges

Avoid overheating the economy

In an elevated inflationary environment, where the economy is operating at or beyond full employment, fiscal policy must be calibrated so as to avoid adding to inflationary pressures. Excess, or poorly targeted, interventions could potentially backfire, with fiscal policy itself becoming part of the problem. This could result in fiscal and monetary policies working at cross–purposes.

At an aggregate level, an overly expansionary fiscal stance is not appropriate at the current juncture. More specifically, Government policy will continue to focus on fiscal measures to cushion – rather than fully absorb – the fallout from higher prices. At the same time, there is a need to continue to improve the provision of public services, including adding to the public capital stock.

Medium- to long-term challenges

Challenge 1: Medium- to longer-term fiscal challenges – the "4Ds"

Beyond short-term cyclical considerations, there is an abundance of evidence to suggest that longer-term structural changes are underway that will have a profound impact on the Irish economy. In designing an appropriate budgetary strategy, the Government must take into account the impact of structural changes to the economy that will place enormous pressure on the public finances over the medium to long-term, in particular adverse demographics, possible de-globalisation, the need to decarbonise economic activity and the acceleration in digitalisation.[13]

Current demographic trends mean that age-related expenditure will be around €7-8 billion higher by the end of this decade simply to maintain existing levels of service.

Unprecedented events of recent years – the UK's exit from the European Union, the global pandemic and the war in Ukraine – have also highlighted Ireland's status as a small open economy heavily exposed to changes in the global economic environment. The fragility of global supply chains has also become increasingly apparent, while heightened geopolitical tensions or a shift towards protectionism internationally could jeopardise Ireland's economic progress.

Over the longer-term, the gradual reshaping of the economy towards carbon neutrality, and the digital transition – trends that have been accelerated by the pandemic and the effects of the war in Ukraine – will necessitate increased public investment, posing further challenges to fiscal sustainability.

The considerable headline budgetary surpluses in prospect over the next few years (at least under the Department's baseline scenario) means that Government can act to address these looming fiscal challenges but, crucially, the window of opportunity is rapidly closing.

While these "4Ds" are certainly challenges, they are also opportunities, though these are contingent upon policy decisions being made today. If the transition is managed correctly, a greener, digital economy will bring economic benefits, generating innovation, increased productivity and highly-skilled, highly-paid employment.

Challenge 2: High debt and rising borrowing costs

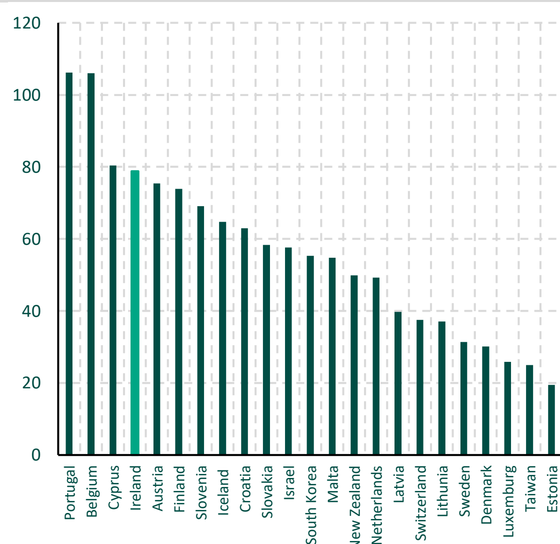
While the debt ratio has declined in recent years, the level of public debt still remains elevated at €225 billion last year. This means that Ireland remains one of the most indebted small open economies in the world (**figure 9a**). In addition, the normalisation of monetary policy in response to multi-decade high inflation means that marginal borrowing costs for the Government have increased considerably and are likely to continue to rise over the coming period (**figure 9b**).

A stock of public debt on this scale can be managed, but only if the appropriate policy stance is in place. The best way to absorb this level of debt and insulate the public finances from the higher cost of re-financing is to ensure that Ireland's debt ratio is not out-of-sync with other small open economies. This will require a consistent reduction in the debt-income ratio over the medium-term. Building fiscal buffers in this way will enable Government to respond forcefully when necessary through counter-cyclical budgetary policy as it successfully did during the pandemic.

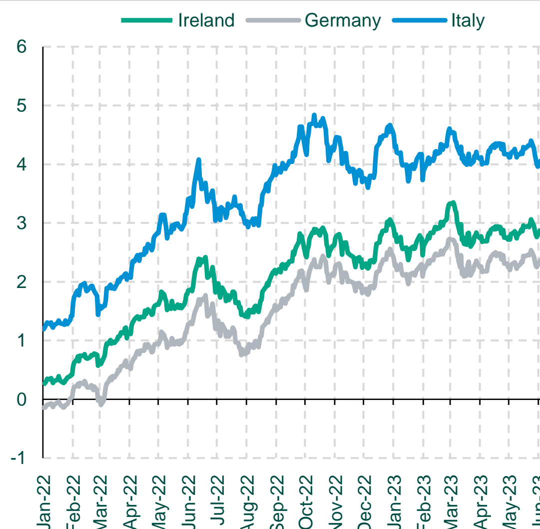
[13] See *Setting the scene: The Irish Economy in 2030 – enabling a sustainable future for all*, Department of Finance, June 2023, available at:
https://www.gov.ie/pdf/?file=https://assets.gov.ie/260158/50762603-827c-4269-a5cf-995edaa651dd.pdf#page=null

Figure 9: Public debt developments

A: Debt-to-GDP ratio in small open economies, 2023



B: Interest cost on 10-year government bond, per cent



Note: IE debt ratio as a share of GNI*
Source: European Commission, IMF, DoF.

Note: as per end-June.
Source: Macrobond.

Challenge 3: Exposure to corporation tax

Government must also be conscious of the possibility of a decline in corporation tax receipts over the coming years. There are two separate risks in this regard:

The first risk relates to the impact of the OECD international tax agreement. A first estimate of the potential cost of implementation of this agreement was published in 2020, with corporation tax receipts tentatively assumed to decline by €2 billion (approximately 20 per cent of corporation tax revenue at that time). Corporation tax receipts have doubled since the pandemic; accordingly, the proportional cost of implementing the agreement is expected to rise, though not *pro rata* as there are many moving parts to the negotiations. Material uncertainty remains in relation to the final design of the rules across both pillars and estimates of the revenue-at-risk will be revised once there is further clarity on the final design and implementation of the rules globally.

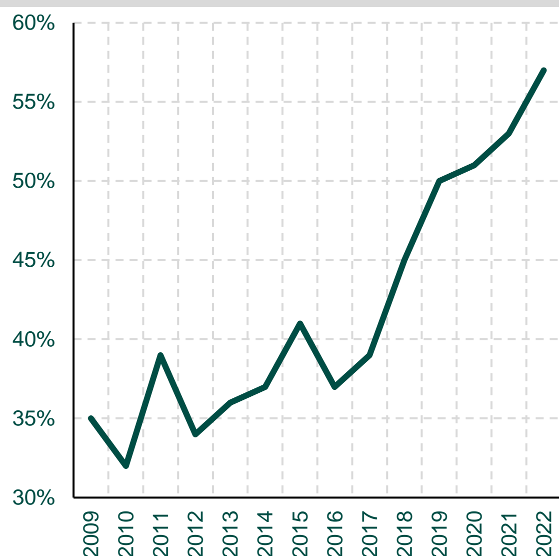
The second risk relates to concentration. Corporation tax receipts last year stood at €22½ billion, a five-fold increase on their level a decade ago, and now account for over a quarter of overall tax receipts. As the corporation tax yield has increased, the source of receipts has narrowed; last year, just ten firms accounted for almost three-fifths of all corporate tax revenue (**figure 10a)**, with research suggesting that as few as three large payers account for approximately one-third of total corporate tax revenue.[14]

The Department estimates that 'windfall' corporation tax receipts – that is the amount that cannot be explained by underlying drivers and, therefore, may be more vulnerable to a shock – amount to almost €12 billion or approximately half of the corporate tax-take this year. If these potentially unsustainable receipts are excluded, the fiscal accounts would be in deficit this year (**figure 10b**). As a result, if these receipts are allowed to fund permanent expenditure commitments, a shock to the multinational sector could have severe implications for the public finances.

[14] See *Understanding Ireland's Top Corporation Taxpayers*, Irish Fiscal Advisory Council, June 2023, available at: https://www.fiscalcouncil.ie/understanding-irelands-top-corporation-taxpayers/

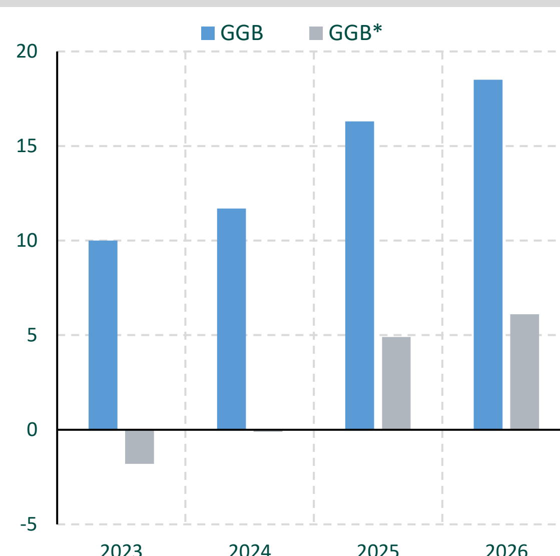
Figure 10: Corporation tax and the public finances

A: Corporation tax paid by top 10, per cent of total



Note: Data on net receipts basis.
Source: Revenue Commissioners.

B: Underlying general government balance, € billions



Note: GGB* excludes estimates of windfall corporation tax.
Source: Department of Finance.

For these reasons, it is essential to use the current elevated level of corporation tax receipts to rebuild fiscal buffers over the coming years. Government has acted to mitigate this vulnerability; over the last 12 months, €6 billion in 'windfall' receipts has been transferred to the *National Reserve Fund* to rebuild fiscal buffers.

In May, the Department of Finance[15] outlined a range of options for the establishment of a long-term savings fund to help to address *inter alia* future age-related expenditure costs. This proposal differs from the *National Reserve Fund* currently in place in that the proposed fund would prioritise the return on investment whereas the *National Reserve Fund* is a short-term vehicle focussed on maximising liquidity, to be used to fund an emergency fiscal response in the event of a major unforeseen shock to the economy.

Investing 'windfall' corporation tax in a longer-term savings vehicle would enable Government to address two structural challenges simultaneously. First, by committing excess receipts to such a fund, transient revenues would not be used to fund current expenditure. This would prevent a repeat of the policy mistakes made in the build-up to the financial crisis a decade ago. Second, today's windfalls can be used to meet long-term structural challenges, such as demographics and climate change (**annex 1**). However, it should be noted that even if such a policy tool is put in place that age-related expenditure will nonetheless pose a significant fiscal challenge without structural reforms to the pensions system.

The Minister for Finance will bring forward proposals to establish such a fund to Government shortly, with details to be published with draft legislation in the autumn.

3.4 Budgetary Strategy

In order to take account of the still elevated, although gradually easing, inflationary environment and broader challenges facing the public finances, *Budget 2024* will be based on a total package of €6.4

[15] See *Future proofing the public finances*, Department of Finance, May 2023, available at:
https://www.gov.ie/en/publication/8a0a8-future-proofing-the-public-finances-the-next-steps/

billon. This is composed of a core expenditure package of €5.2 billion, and a net tax package of €1.1 billion.

This package, along with the additional non-core and windfall capital investment, would be consistent with a General Government surplus of €11.7 billion next year.

Given significant capacity constraints in housing, healthcare and other key public infrastructure, as well as an economy clearly at ‘full employment’, any spending beyond this would risk unnecessarily adding to inflationary pressures and overheating the economy.

Over the medium-term (2025-2026), inflation is projected to return to 2 per cent per annum. On that basis, Government will revert to the strategy set out in the *Summer Economic Statement 2021*. Specifically, net core public expenditure will be allowed to grow at a rate of 5 per cent per annum over the years 2025-2026; broadly in line with the estimated trend growth rate of the economy.

Chapter 4
Public Expenditure Strategy

4.1 Overview

Developments over the past number of years have required a responsive approach to the management of public expenditure.

The *Summer Economic Statement 2022* set out a public expenditure strategy to respond to growing inflation, supply chain issues and an emerging humanitarian crisis in Ukraine. It was developed following the rollout of a post-*Budget 2022* package of temporary supports to help households and businesses with the initial spike in energy prices. Recognising the likely persistence of these challenges, the *Summer Economic Statement 2022* included an increase in core expenditure for 2022 and 2023. This was reflected in *Budget 2023* where an increase in core expenditure of €5.8 billion was provided alongside a package of temporary expenditure supports to households, businesses and public and community services. In addition, significant non-core expenditure of €5.2 billion was made available to mitigate the impact of external challenges, including Covid-19, Brexit and the war in Ukraine.

This two-pronged policy approach enabled Government to respond as inflation reached an annual headline rate of 8.1 per cent for 2022 (and a forecast rate of 4.9 per cent for 2023).

Building on the supports in the Budget, another package of temporary measures was delivered this spring to further protect the most vulnerable. Between 2022 and 2023 the Government provided €12 billion in measures to tackle the cost of living crisis.

In recognition of the persistence of higher prices, another adjustment to the anchor is required in 2024 (**section 4.4**). This will see core spending growth of some €5.2 billion in 2024 or 6.1 per cent (€1.0 billion over the *Stability Programme Update, April 2023* (SPU)). The strategy also plans for a measured return to the 5 per cent core expenditure growth anchor from 2025 onwards given the expected easing of inflation to the average inflation rate of 2 per cent which the medium-term expenditure strategy originally accounted for. This will mean €95.7 billion expenditure in 2025 rising to €100.5 billion in 2026. This represents a significant level of expenditure on public services and investment in society, and will smooth the impact of price pressures currently being experienced by households, individuals and businesses across the economy.

4.2 Sustainable Public Expenditure and Medium-Term Expenditure Strategy

The *Summer Economic Statement 2021* set out a framework for public expenditure called the Medium-Term Expenditure Strategy (MTES). The purpose of this framework is to ensure a sustainable path for permanent public expenditure. There are two types of permanent expenditure; core current and core capital expenditure. Core current spending covers the 'day-to-day' activities of Departments, providing services and supports. Core capital spending funds the building or maintenance of infrastructure and/or physical assets of the public service.

The objectives of the MTES are to ensure that:

- the level of core expenditure growth is sustainable long-term; and,
- investment in expenditure protects and delivers improvements in public services.

The strategy anchors core expenditure growth to the trend growth rate of the economy, taking into account an assumed inflation rate of 2 per cent. On this basis, core expenditure growth was set at 5 per cent.

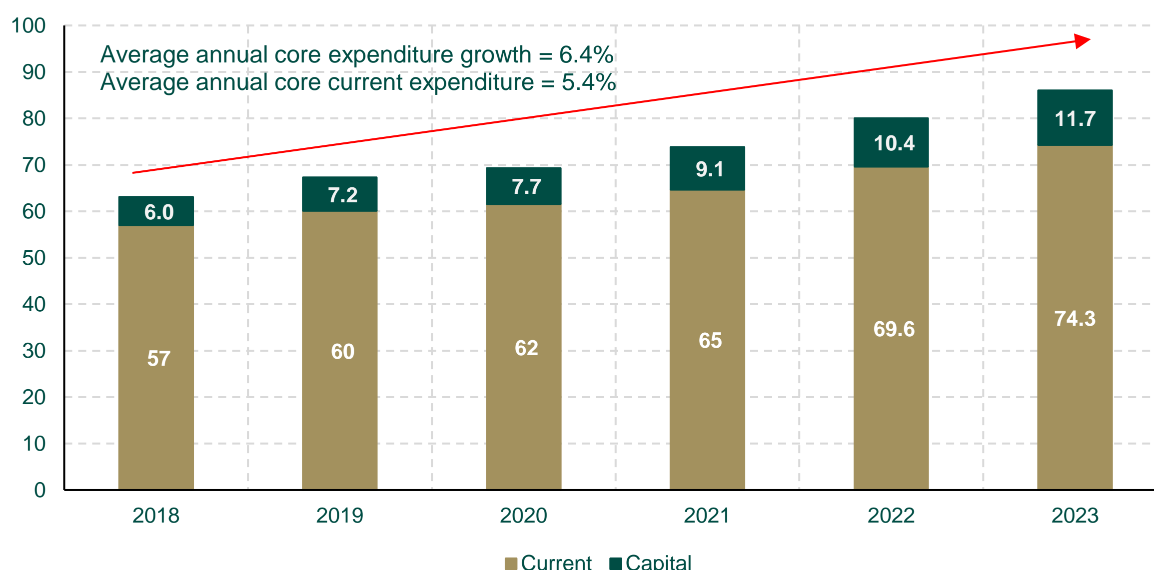
Expenditure developments

The trajectory of core public expenditure has varied in recent years. A number of trends (**figure 11**) include:

> significant increases in capital investment as set out in the National Development Plan;
> current expenditure growth of c. 5 per cent in the period before the onset of the Covid-19 pandemic;
> slowdown in expenditure growth in 2020 and 2021 due to reduced activity as a result of pandemic-related lockdowns; and
> an element of acceleration in current expenditure growth in 2022 and 2023 due to catch-up from the previous two years and the impact of an elevated inflationary environment.

Figure 11: Average annual core expenditure growth

A: Average annual core expenditure growth, € billions, 2018 - 2023



Source: Department of Public Expenditure, NDP Delivery and Reform

This level of expenditure has delivered significant outputs and outcomes to accommodate our growing and changing population. This increased funding has provided for enhanced social protection supports and recruitment of additional public sector staff to deliver critical services, expanded frontline service provision and reduced access costs of certain services. It is also facilitating the rollout of key Government strategies in relation to housing, healthcare, childcare and climate change. Further detail is set out in the recently published *Public Service Performance Report.*[16]

[16] Available at: https://www.gov.ie/en/collection/61d3f-public-service-performance-reports/

Since 2020 there has been a number of externally driven developments requiring an expenditure response by Government. These include Brexit, the Covid-19 pandemic and the war in Ukraine. In order to respond to these challenges and to protect investment in core expenditure, a two-pronged approach to budgetary policy has been adopted. A category of expenditure called "non-core" expenditure has been utilised alongside investment in "core" expenditure as part of the MTES. Over the period 2020 to 2023 additional non-core expenditure of €42.9 billion has been utilised. Further information is set out later (**section 4.5**).

Continued impact of inflation

Since late 2021/early 2022 inflation has increased above the trend rate of 2 per cent for the second consecutive year (**chapter 2**). Elevated inflation poses a risk to the value of public services and the purchasing power of lower-income households. Fiscal policy must remain responsive by seeking to strike a balance between taking action to support the value of public services while not adding to inflationary pressures.

The Government has adopted a dual approach to investment in public services and supporting households and businesses during this period of increasing prices. This approach utilises both permanent increases in public expenditure alongside temporary supports. The *Summer Economic Statement 2022* increased the core expenditure growth rate for 2022 and 2023 which facilitated additional investment in core public service provision.

In terms of households and businesses, the fiscal response, over the period 2022 and 2023, including tax and expenditure has totalled €12 billion. This included permanent measures such as enhanced social protection payments, income tax package and reductions in childcare costs. A series of packages of temporary measures have also been implemented including four household energy credits, additional social protection payments and rollout of the Temporary Business Energy Support Scheme (TBESS). The measures introduced sought to strike a balance between targeted supports to those struggling most in society while avoiding actions that would fuel inflationary pressures. The combination of temporary and permanent measures as a delivery mechanism helped ensure that expenditure remained on a sustainable trajectory.

Although inflation is forecast to subside considerably in 2024 and beyond, prices are likely to be above the trend rate for a period of three years. Therefore, the Government's approach, as outlined in *Summer Economic Statement 2022*, will smooth the impact of inflation to support households and businesses while also protecting the public finances. A further adjustment will also be required in 2024. Inflation is forecast to return to the trend rate of 2 per cent in 2025, providing a smooth path back to the anchor set out in the medium-term expenditure strategy.

4.3 Budget 2024 and National Development Plan (NDP) / Capital Ceilings

Capital expenditure has been prioritised in recent years, with expenditure increasing from €3.7 billion in 2015 to almost €12 billion in 2023.

The National Development Plan (NDP), published in October 2021, provides a detailed and positive vision for Ireland over the next decade, with total investment of €165 million over the period 2021 to 2023. The NDP will support economic, social, environmental and cultural development across all parts of the country under Project Ireland 2040.

In line with the NDP, Budget 2024 will provide an additional €0.9 billion to bring total available capital expenditure to just over €12.8 billion. This will continue the progress and delivery of infrastructure

investment across all sectors of the economy made in recent years. The growth in baseline allocations from 2022 to 2026 is set out in **table 3**.

Table 3: National Development Plan allocations, € billion (unless stated)

	2022	2023	2024	2025	2026
Allocations	11.1	11.9	12.8	13.6	14.2
- Increase, € billion	1.3	0.7	0.9	0.8	0.6
- Percentage increase	13.6	6.7	8.2	6.1	4.4

Source: Department of Public Expenditure, NDP Delivery and Reform.

Investment in infrastructure is a critical component in supporting Ireland's growth and in delivering better, fit-for-purpose public services. In order to progress additional projects, a further allocation of €2.25 billion from windfall receipts will be made available over the period 2024 to 2026. This will facilitate the progression of important projects in key sectors such as Education and Health and enable more rapid development of key *Programme for Government* commitments, particularly the delivery of actions to fulfil our climate action plan commitments. Recognising the capacity constraints in the economy, it is intended that the additional funding will be targeted at projects that are ready for development.

Table 4: National Development Plan and Additional Capital, € billion (unless stated)

	2023	2024	2025	2026
NDP allocations	11.86	12.82	13.60	14.20
Additional capital from windfall receipts	-	0.25	0.75	1.25
Total available capital	11.86	13.07	14.35	15.45
Per cent of GNI (based on SPU 2023)*	4.2	4.4	4.6	4.7
Year-on-year growth	0.74	1.21	1.28	1.10
Year-on-year growth (per cent)	6.7	10.2	9.8	7.7

Source: Departments of Finance and Public Expenditure, NDP Delivery and Reform.

An independent mid-term review of investment priorities and capacity of the NDP is currently ongoing by the ESRI, and is focusing on the capacity to deliver Government priorities, to utilise sectoral capital allocations and to estimate the impact of the NDP on key economic indicators such as domestic demand, employment, wages and inflation. The analysis will inform the allocation of capital expenditure ceilings over the remaining period of the NDP.

4.4 Budget 2024 Core Expenditure

The approach for 2024 is to increase the total core expenditure by €5.2 billion or 6.1 per cent. This will result in total available core resources of €91.2 billion (**table 5**). This figure reflects the smoothing of current expenditure in an ongoing elevated inflationary environment alongside continued investment in capital. The indicative ceilings for 2025 and 2026 are based on a return to trend rates of inflation.

Table 5: Medium-term core expenditure trajectory, € billion (unless stated)

	2023	2024	2025	2026
Total core expenditure	85.9	91.2	95.7	100.5
- year-on-year increase	5.9	5.2	4.6	4.8
- year-on-year increase, per cent	7.4	6.1	5.0	5.0

Source: Department of Public Expenditure, NDP Delivery and Reform.

The total core expenditure ceiling for 2024 of €91.2 billion will facilitate a budget that:

- provides an increased level of investment in the NDP;
- accommodates new measures in line with Government priorities; and
- caters for increased demand in existing service delivery.

Core current spending is to increase by 5.8 per cent on the 2023 allocation or c. €78.6 billion. Core capital spending will increase by 8 per cent or €0.9 billion in line with the NDP.

As with each year, a significant portion of this increase will provide for greater investment in our existing public services and policies through the Existing Levels of Service (ELS) allocations. ELS funding provides for areas such as carryover costs of the previous year's budget decisions; increased costs of providing existing services to a growing population as well as the changing profile of our population; and public service pay commitments under existing central pay deals such as the extension to Building Momentum.

Under the approach adopted as part of the MTES, some 3 per cent of the core current expenditure base is set aside as an indicative amount each year to meet ELS costs. The division of the available resources under the ELS provision will be examined as part of the Estimates process.

Box 3: Adjustment to the medium-term expenditure strategy

The growth rate of overall core expenditure is being lifted for 2024 to take account of short-term price pressures expected to persist into early 2024. The adjustment will increase core current spending by 5.8 per cent and core capital by 8 per cent in line with the agreed NDP ceilings. This amounts to an increase in core spending of €5.2 billion in total (6.1 per cent), consisting of €0.9 billion for core capital and €4.3 billion for core current expenditure.

This will facilitate an additional €1.0 billion of core expenditure over the amount of €4.3 billion expenditure growth set out in the SPU in April 2023. This continues the Government strategy, as outlined in *Summer Economic Statement 2022*, of helping to mitigate the impact of inflation, and supporting households, individuals and businesses while seeking to avoid adding to inflationary pressures.

Table 6: Core expenditure ceilings – capital and current, € billion (unless stated)

	2023	2024
Total core expenditure, € billion	85.9	91.2
of which:		
- core current expenditure	74.3	78.6
- core capital expenditure	11.7	12.6
Total core expenditure, percentage growth	7.4%	6.1%
- core current expenditure growth, year-on-year	6.8%	5.8%
- core capital expenditure growth, year-on-year	12.5%	8.0%

Source: Department of Public Expenditure, NDP Delivery and Reform.

Looking towards the medium-term, inflation is forecast to return to 2 per cent from 2025 out to 2030. This will facilitate a return to the 5 per cent anchor in expenditure growth as envisaged in the MTES, leading to core expenditure reaching €95.7 billion in 2025 and €100.5 billion in 2026 (**table 5**). Taken alongside the use of non-core funding as the dual strategy adopted in the previous *Summer Economic Statement*, the adjustment provides for a responsive and credible budgetary response.

4.5 Non-Core Expenditure Response

Since *Budget 2020*, when there was a substantial risk of a disorderly Brexit, the dual policy response of core expenditure growth alongside the supplementary use of temporary 'non-core' measures for external pressures has been adopted. Non-core expenditure relates to temporary external challenges requiring additional resources, outside the day-to-day expenditure of Departments. Such funding has proved a key expenditure policy response to external factors, from Brexit to Covid-19 and now the Ukraine humanitarian crisis.

As non-core expenditure relates to temporary challenges – for which the duration of impact is not known – future requirements will be considered as part of the whole of year budgetary process in relevant years.

Table 7: Non-core expenditure, € billion (unless stated)

	2023	2024	2025	2026
Total non-core expenditure	5.2	4.0	0.4^^	0.2^^
of which:				
- Covid-19 expenditure	1.5	0.75		
- Ukraine Humanitarian Contingency	2.0	2.5	TBA	TBA
*- Other^*	1.7	0.75		

Note: ^ includes TBESS, Brexit Adjustment Reserve, NRRP
^^ Covid and NRRP only.
Future requirements for non-core items such as Ukraine are unknown at this juncture and are considered as part of annual estimates process.
Source: Department of Public Expenditure, NDP Delivery and Reform.

A non-core expenditure provision of €4 billion is being made as part of the expenditure strategy for 2024. This includes a provision of €2.5 billion for the wide range of Ukraine humanitarian supports and €0.75 billion for Covid-related spending. While €4 billion remains a substantial figure, it is worth noting that in 2020 this provision was €16½ billion and year-on-year the requirement for this funding has been lower and lower (falling by 23 per cent or €1.2 billion from 2023 to 2024).

Responding to the humanitarian crisis as a result of the war in Ukraine is a key challenge for Government. In 2023, €2 billion has been provided for the provision of accommodation, health, education and welfare supports for those refugees arriving in Ireland. Following consideration of arrivals trends, service usage rates, demographics and expenditure incurred, a contingency provision of €2.5 billion is being made available for 2024. The latest available information will be reviewed in the context of *Budget 2024* preparations and inform funding allocations.

A declining amount of Covid-19 expenditure is being provided in 2024 to support those sectors with the remaining impacts of the pandemic on services. Looking beyond 2024, the exceptional Covid-19 supports are being unwound progressively and on a phased basis.

Other non-core expenditure of €0.75 billion is being provided in 2024 for other temporary expenditure including that relating to the Brexit Adjustment Reserve, the National Recovery and Resilience Plan (NRRP) and RePowerEU.

Annexes

Annex 1
The Irish economy in 2030 – enabling a sustainable future for all[17]

The theme of this year's *National Economic Dialogue* is "*The economy in 2030 – enabling a sustainable future for all*". The objective is to shift the focus of economic discussion towards more medium-term issues and, in doing so, gain a shared understanding of the longer-term factors that will shape economic trends and drive living standards in the future.

Beyond short-term cyclical considerations, there is an abundance of evidence to suggest that longer-term structural changes are underway, and these will have a profound impact on the Irish economy.[18] While several 'slow-moving' trends have been in motion for some time, the global public health pandemic and war on European soil appear to have accelerated some of these structural economic shifts.

The annual budgetary cycle cannot be divorced from these longer-term trends, which look set to transform the Irish economy in the years ahead. Against this backdrop, the purpose of this paper is to provide an overview of the key economic forces that will shape the global and Irish economies over the remainder of this decade and beyond.

A useful framework to think about these transformative trends is the "4Ds" – demographics, decarbonisation, digitisation and de-globalisation. From an economic standpoint, each of these is summarised below.[19]

Medium-term outlook for the economy

Before proceeding, it is useful to briefly review the medium-term outlook for the economy. To facilitate this, the Department of Finance set out medium-range economic projections, covering the period 2023-2030, in the Government's *Stability Programme, April 2023 Update*.[20]

Helped by large-scale Government intervention, the Irish economy has weathered the pandemic and energy price shocks reasonably well. The unemployment rate is now at a historical low and consistent with (and maybe even beyond) any reasonable definition of 'full employment'. Supply, rather than demand, is the binding constraint at present, with capacity constraints most notable in housing, healthcare and other key public infrastructure. While housing supply has recently picked up somewhat, with completions in the last year reaching their highest level since 2008, the accumulated imbalance between supply and demand poses challenges for labour mobility and competitiveness.[21]

The forecasts envisage a moderation in the pace of economic growth (as measured by modified gross national income, GNI*) from the second half of this decade, as demographic headwinds become increasingly binding and productivity growth reaches natural limits (**figure A1a**). On a cumulative basis, the projections imply national income per capita in 2030 being around 12½ per cent higher than at present (**figure A1b**).

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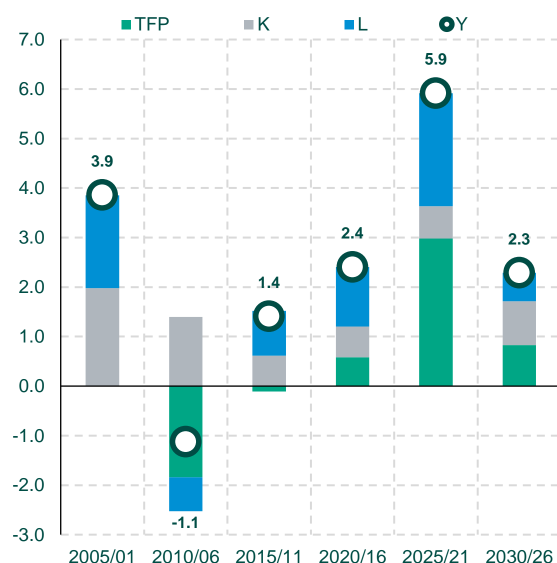
[17] This short note was originally published as a scene-setter for the *National Economic Dialogue* in June.
[18] Many of these changes will also impact on society, well-being and other areas; the focus of the Dialogue is the economy.
[19] This paper does not purport to be a definitive account of these trends; instead, the objective is to provide an overview of the key changes that are in train. Some of the issues (e.g. demographic trends) are explored in more detail in various Department of Finance publications.
[20] See *Stability Programme, April 2023 Update*, Department of Finance. Available at: https://www.gov.ie/en/publication/e4f3a-stability-programme-update-2023/
[21] See 'risk matrix' in *Stability Programme, April 2023 Update* (op. cit.)

Employment growth is set to moderate, simply because the supply of available labour will expand more slowly than in the past. Unemployment is projected to remain at around its 'natural' rate of around 4½ per cent on average over the period – though short-term, cyclical factors (unforeseeable at this stage) will undoubtedly result in some fluctuation around this rate over the period.

The projections are calibrated on the assumption that the era of exceptionally low inflation (less than 1 per cent) that characterised the 2010-2020 period has ended. Instead, annual price changes are assumed to revert to 2 per cent, in line with the definition of price stability in the euro area.

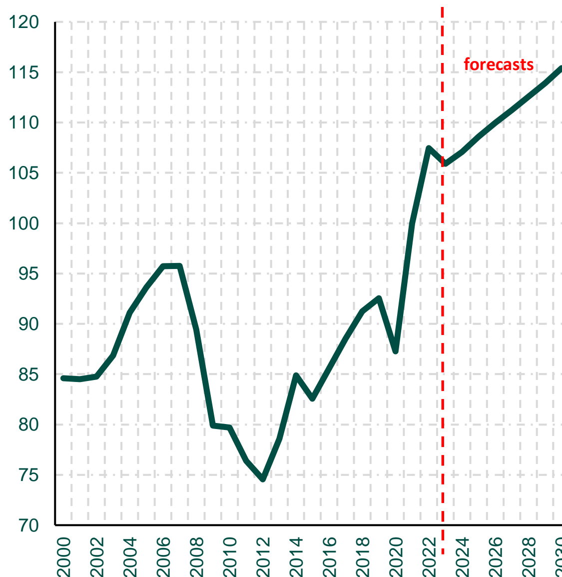
Figure A1: Ireland's medium-term growth and population projections

A: Annual average growth rate and contributions, per cent



Note: Y = GNI*; K= contribution of capital; L= contribution of labour; TFP = contribution of total factor productivity.
2005/01 = average between 2001 and 2005
Source: Department of Finance.

B: GNI* per capita, 2021 = 100



Note: Data updated since NED publication date
Source: Department of Finance.

Structural trend #1: Demographic change

In common with other advanced countries, population ageing (the origins of which are the long-term decline in fertility rates and increases in life expectancy) is a key factor that will shape economic trends in Ireland in the years ahead. Put simply, the population aged 65+ is projected to grow significantly faster than the working age population (those aged 20-64),[22] so that the number of older people exiting the labour force will exceed the number of young people entering.

While demographic change is a slow-moving variable, the budgetary impact is becoming increasingly visible, with pension and healthcare provision the most demographically-sensitive components of public expenditure. By the end of this decade, age-related expenditure will be €7-8 billion higher per annum relative to the position at the beginning of the decade.

Beyond this decade, demographic change is set to accelerate: the so-called 'population pyramid' in 2050 will be very different to that of today (**figure A2a**). These dynamics are also evident in the evolution of the dependency ratio, i.e. the number of dependents for every person of working age (**figure A2b**). At present, there are currently 4 persons of working age for each retiree; this is set to fall

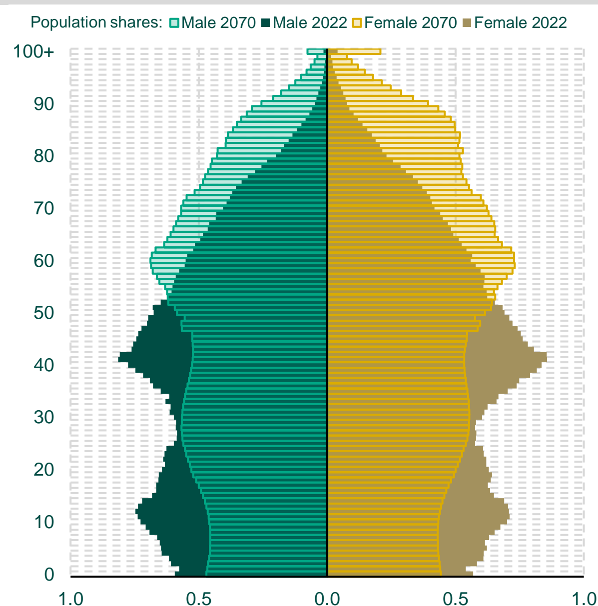
[22] See *Population ageing and the public finances in Ireland*, Department of Finance, 2021, available at: https://www.gov.ie/en/publication/6ba73-population-ageing-and-the-public-finances-in-ireland/

to 3 in the mid-part of the next decade and to 2 by around 2050. In practical terms, this means that each person of working age is supporting a larger number of retirees.

These trends are fiscally unsustainable without structural reforms. The optimum response to limit fiscal costs associated with population ageing is to gradually increase the retirement age in line with improvements in life expectancy. However, following consideration of the *Commission on Pensions Report*,[23] the Government decided to maintain the State pension age at 66 years and, instead, to introduce a new flexible system whereby workers will have the choice to remain in employment until the age of 70 in return for a higher State pension. The Government has also decided that social insurance contributions will be raised at some point in order to partly offset the cost.

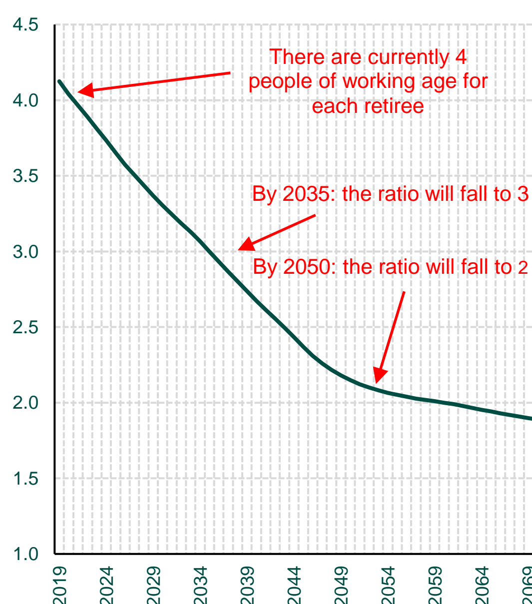
Figure A2: The Irish population is ageing

A: Ireland's demographic profile is changing



Source: Eurostat, Department of Finance.

B: Fewer working age people for each retiree



Source: Eurostat, Department of Finance.

In addition, the Minister for Finance will bring proposals to Government to establish a long-term savings vehicle to partly (though not fully) fund the budgetary costs of an ageing population. This will be capitalised *inter alia* with 'excess' corporation tax receipts.[24]

Structural trend #2: Decarbonisation

Scientific evidence is conclusive: higher levels of CO_2 and other heat-trapping greenhouse gases (GHG) in the atmosphere have triggered a warming planet, rising sea levels and increasingly frequent extreme weather and climate events. At a global level, decades of procrastination and 'stop-start' policy responses mean that the window of opportunity to limit the economic, natural environment and social fall-out is closing rapidly; to put it another way, the risk of a tipping-point involving irreversible damage is increasingly high.

[23] *Report of the Commission on Pensions*, available at: https://www.gov.ie/en/publication/6cb6d-report-of-the-commission-on-pensions/
[24] See *Future proofing the public finances*, Department of Finance, May 2023, available at: https://www.gov.ie/en/publication/8a0a8-future-proofing-the-public-finances-the-next-steps/

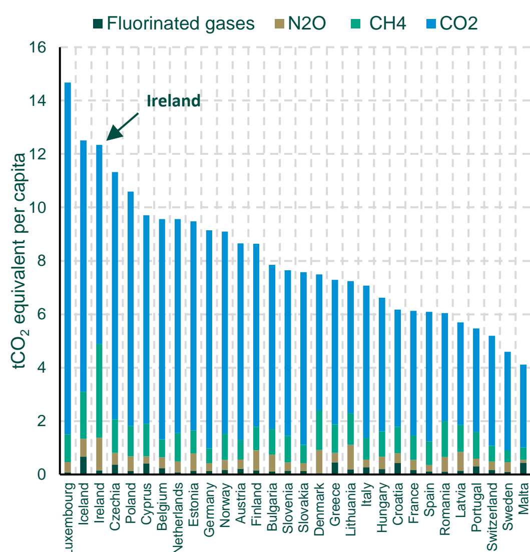
Decarbonising economic activity is a key part of the global policy response. The European *Green Deal* commits the EU Member States to cut GHG emissions and become climate-neutral by 2050. Ireland's national emissions reduction target is to reach 'net zero' across all sectors of the economy by 2050, with a reduction of 51 per cent by 2030 (relative to 2018); this equates to an average annual reduction of 7 per cent.[25]

In practical terms, Ireland will need to accelerate emission reductions across all sectors of the economy, including by altering its energy mix in order to reduce dependence of the fossil fuels that release CO_2 into the atmosphere, by transforming its electricity system, and by moving to more sustainable land use and agricultural practices. In facilitating the transition to carbon-neutrality, the Government inevitably faces important trade-offs, including the need to ensure an energy supply that is cheap, reliable and clean (fossil fuels are relatively cheap[26] and reliable but 'dirty'; renewables are clean and cheap but less reliable).

Although Ireland reduced its emissions by just under 1 per cent between 2018 and 2021, it remains off-track in terms of meeting its 51 per cent emissions reduction target by 2030 (**figure A3a**). Recent published research by the Department of Finance also highlights economic activity still remains correlated (or connected) with GHG emissions in Ireland.[27]

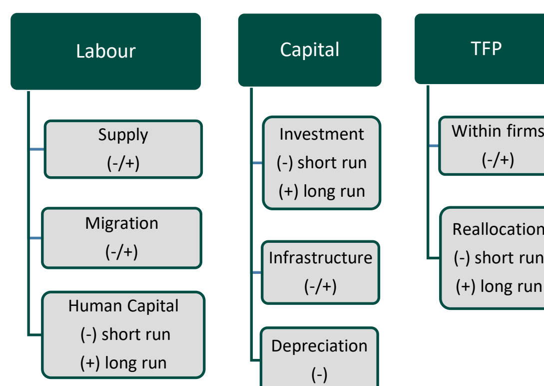
Figure A3: Macroeconomic impacts of climate change

A: Ireland's GHG emissions per capita, 2021



Source: Environmental Protection Agency.

B: Transmission channels and macroeconomic impacts



Source: Department of Finance.

From a purely economic perspective, the transition to (net) carbon-neutrality presents both opportunities as well as challenges, with both positive and negative effects (**figure A3b**). The Government's objective is to maximise the opportunities while minimising the challenges. From a practical point of view, the key policy objective will be to expand the green economy at a faster pace than the brown economy

[25] As outlined in CAP 2023. Available at:
https://assets.gov.ie/243377/92dce3ee-f19e-4645-b58a-9ece0287e41b.pdf
[26] Notwithstanding the temporary blip in fossil fuel prices caused by the war in Ukraine.
[27] See *A Conscious Decoupling: the relationship between economic activity and greenhouse gas emissions in Ireland*, Economic Insights, Department of Finance, Spring 2023. Available at:
https://www.gov.ie/en/publication/2c8b4-economic-insights-spring-2023/

shrinks, *inter alia* by ensuring the transferability of skills across these sectors in order to limit frictional unemployment during the transition.

To put it another way, the shift to greener technologies over the medium- and longer-term will have implications for production and consumption and, hence, for the allocation of resources (workers and firms within the economy). This will involve smoothing the transition of labour and capital from brown to green activities – through upskilling and re-skilling of workers while, simultaneously, facilitating the entry of 'green' firms and supporting restructuring of activities in traditionally 'brown' firms to become more environmentally sustainable. In some instances, this may result in the exit of 'brown' firms which would need to be done in as orderly a manner as possible.

From a public finance perspective, the transition will also affect the State's revenue stream, for instance through a reduction in excise duty receipts. In addition, there will be a need to finance public investment in green capital. The cost of inaction would, however, be substantial.

Structural trend #3: Digitalisation

One of the key tenets of economics is that technology is a key driver of economic growth. Throughout history, technological innovations – the invention of the spinning wheel, the steam engine, the automobile, the personal computer, the internet – and their rollout have transformed the production process. By allowing workers perform fairly routine tasks with greater efficiency, technological advances over time have boosted productivity and raised living standards across the globe.

Advances in digital are, perhaps, the latest transformative technology, (and sometimes referred to as the 'fourth industrial revolution' (**table A1**)), with these digital technologies re-shaping the nature of work. During the Covid-19 pandemic, for instance, the rapid rollout of digital technologies helped to boost the resilience of economies and societies across the globe, by facilitating *inter alia* remote working, on-line education, payment and e-commerce services.[28] With the passing of the pandemic, many of these changes remain *in situ* with, for example, hybrid working (**figure A4a**) also helping contribute to climate goals by reducing commuting journeys.

Table A1: The fourth industrial revolution?

	Starting point	Main features	Drivers
Industrial revolution 1.0	1800s	Mechanisation [ag / industry]	Water, steam
Industrial revolution 2.0	1870s	Mass production	Electricity
Industrial revolution 3.0	1980s	Technological advancement	Digital, electronic
Industrial revolution 4.0	2000s	AI / robotics / automation	Computer power

Source: Department of Finance illustration.

A multitude of new technologies – automation, robots, artificial intelligence, nanotechnology, quantum computing and algorithmic (machine) learning – are rapidly being rolled out; as these processes are incorporated into the workplace, there are genuine questions as to whether they are a *complement* for labour (i.e. boost productivity) or a *substitute* for labour (i.e. boost unemployment).

What makes the current innovation wave stand out is the potential for automation to perform non-routine, and even cognitive, tasks. In previous waves, the mechanisation of routine tasks freed up

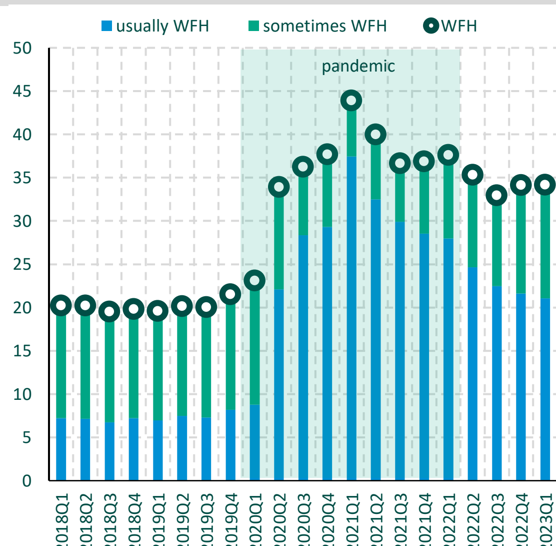
[28] See *We got locked down, but did we get back up again? High-frequency indicators post-Covid*, Economic Insights, Department of Finance, Summer 2022. Available at:
https://www.gov.ie/en/publication/d699e-economic-insights-summer-2022/

workers to move into higher value-added employment that required greater cognitive skills (or, to put it crudely, machines replaced hands not heads). In the current wave, rapid advances in computing power mean that newer, cutting-edge technologies are now moving into the cognitive domain (or, again crudely, machines replacing heads).

Historical evidence does not support the idea that automation will trigger mass unemployment. Instead, technological advances are likely to render some jobs as redundant while, simultaneously, creating new jobs. However, the impact may not be entirely benign – there will likely be both winners and losers.

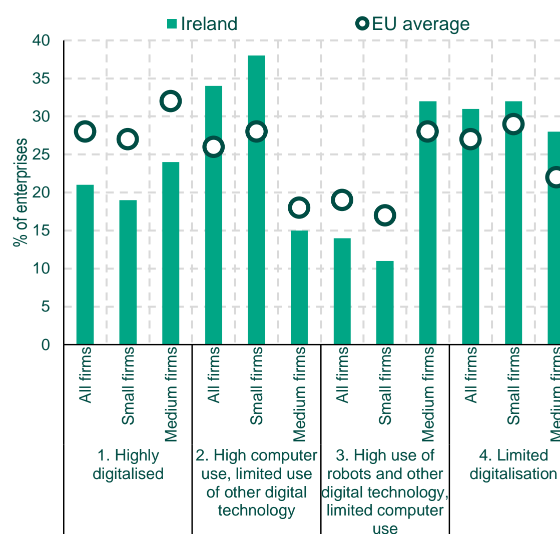
Figure A4: Digitalisation

A: Remote working, share of workforce, per cent



Note: WFH = work from home.
Source: CSO Labour Force Survey.

B: Digitalisation among Irish SMEs compared to EU avg.



Note: Small firms have 10-49 employees & medium firms have 50-249 employees. Data for large firms (250+ employees) have been suppressed, given the limited sample size for Ireland.
Source: Eurofound/Cedefop, 2019; European Company Survey 2019.

Policy has a key role in this regard, harnessing the benefits of these technological advances and minimising their potential adverse impacts. Labour market institutions, for instance, must be able to anticipate future skill needs and match them with the current skills base. In addition, given the disruptive nature of these technologies, a 'race to the bottom' must be avoided, suggesting a role for global guardrails (e.g. common principles regarding transparency and accountability). In summary, policy must ensure that these technologies remain a force for good.

Despite the rapid acceleration in digitalisation over recent decades, productivity growth is beginning to slow at the aggregate level across EU countries. The main driver of this slowdown is the increasing divergence between productivity and digitalisation driven by the cost of financing investments in intangible assets – especially for smaller firms. In an Irish context, the difference in digitalisation between Ireland and the EU average is most pronounced for small firms, while Ireland also remains well-below the EU average for all "highly digitalised" firms (**figure A4b**). These growing disparities in access to technology and intangibles have resulted in widening productivity gaps between small and large firms, as well as rising cross-firm dispersion in average wages and adjustment costs. The strong position of the information technology sector in Ireland suggests that the country could be well-positioned to benefit from increased digitalisation. The extent of concentration of this sector in a

relatively small number of very large firms also brings considerable exposure that idiosyncratic shifts in market structure and decisions by individual firms bring negative macroeconomic and fiscal effects.

Structural trend #4: De-globalisation

After rapid expansion from the mid-1980s onwards, global trade as a share of output has essentially moved sideways since the global financial crisis in the late-2000s (**figure A5a**). This has led to some suggestions that 'peak globalisation' has passed and that global economic integration may be reversing. While this trend is not universally accepted, it is certainly true that the pandemic exposed vulnerabilities in transnational business models involving elongated, and complex, global supply chains.

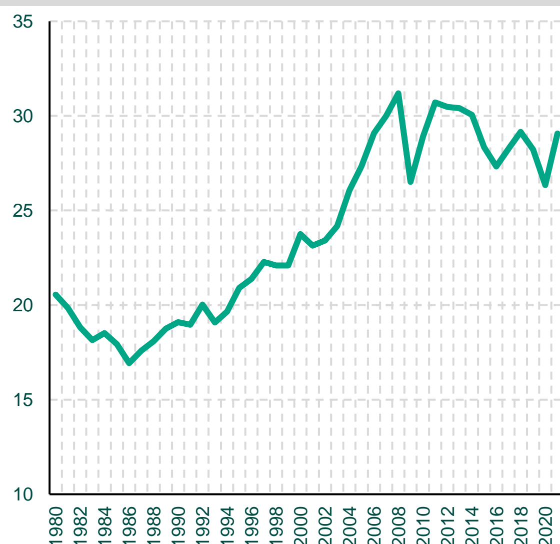
Furthermore, the passing of the pandemic was immediately followed by the Russian invasion of Ukraine, which further exposed 'choke points' in supply chains, with both Russian and Ukraine being important commodity exporters (initially, choke points threatened mass starvation in low-income countries dependent on grain imports from Ukraine). Geopolitical tensions elsewhere are also relevant in the analysis of supply chains: the vast majority of high-specification semi-conductors, for example, are produced in Taiwan and any supply disruption could have major implications for the global production of electrical goods.

In summary, there is a very real risk that the global economy could increasingly fracture along geopolitical lines, with countries aligning different strategic poles. From a purely economic perspective, such a multi-polar world would reverse many of the gains from globalisation, including lower prices, higher productivity and access to a wider variety of goods and services.

Re-shaping supply chains in order to build resilience and boost economic security is likely to be a feature of the post-pandemic global economy. Risk-reduction strategies in this context could include a re-shoring of production ('localisation'), 'friend-shoring', or diversification, with the first of these potentially reducing globalisation further while the latter two may see the same levels or increased trade but with patterns shifting across countries.

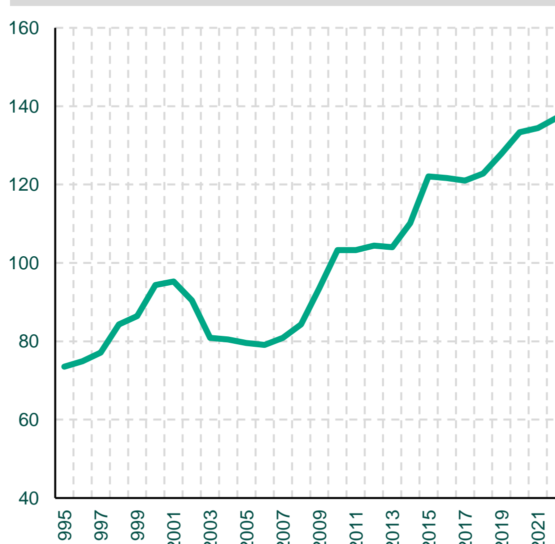
Figure A5: De-globalisation

A: World trade as a percentage of world GDP



Source: World Bank.

B: Exports as share of GDP in Ireland



Source: CSO.

Ireland is a highly globalised economy (**figure A5b**), and a key part of global supply chains in many sectors. The globally connected nature of Ireland's trade, technological and financial relationships means that while Ireland is a beneficiary of global growth, it is always vulnerable to external shocks, including sector-specific shocks.

Finally, a global de-coupling could also lift the lid on many of the forces that kept inflation low in recent decades; this would involve *inter alia* higher borrowing costs into the future.

Conclusion

Long-standing structural changes are now coming to the fore, and there can be no room for complacency. Despite remarkable resilience in the face of unprecedented shocks in recent years, neither the economy nor the public finances are bullet-proof. Powerful forces are reshaping the world economy, and past success is no guarantee for future success.

While structural changes tend to be slow-moving, the global public health pandemic and war in Europe have added an additional impulse.

Navigating these potentially de-stabilising transformations will be crucial for Ireland's continued economic advancement. To boost resilience, there is clearly a premium on up-skilling and re-skilling. Enhancing the stock of physical infrastructure, including green infrastructure, will also help smooth the transition. Greater flexibility and adaptability are also part of the solution.

From a public finances perspective, counter-cyclical budgetary policies, alongside measures that boost the quality of public spending and the efficiency of the taxation system, can play a key role in helping to absorb the tectonic shifts underway.

Annex 2
Monitoring imbalances in the Irish economy

An important lesson from the euro area sovereign and banking crises is that macroeconomic imbalances within the single currency area can trigger contagion effects and, hence, pose a threat to overall economic and financial stability of the euro area as a whole. In Ireland, serious economic and financial imbalances were allowed to accumulate in the early- to mid-2000s, with serious consequences for the domestic and wider euro area economies.

This historical experience illustrates the importance of monitoring, identifying and addressing potential emerging imbalances in the economy before these become problematic.

As part of the revised economic architecture put in place after the Global Financial Crisis, the European Commission (the 'Commission') monitors key macroeconomic developments in all Member States, with a view to identifying emerging imbalances. Each year, the Commission identifies Member States who may be at risk of, or who are experiencing, macroeconomic imbalances, conducting country-specific 'In Depth Reviews' alongside policy-relevant recommendations to mitigate identified imbalances.

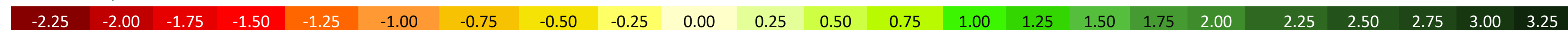
The Macroeconomic Imbalance Procedure (MIP) scoreboard is a tool used by the Commission to identify the presence of potential imbalances. Each year, the Department complements the Commission's annual assessment with a 'heat-map' analysis (**table A2**). This type of analysis is part of the overall macroeconomic assessment toolkit and is not, and should not, be applied in a mechanistic manner; deviations from a threshold are not always a negative development while, symmetrically, a reading within the threshold is not necessarily always a benign development.

Looking ahead, persistent inflation and an uncertain geopolitical environment could trigger the build-up of new macro-imbalances. In this context, resilience and adaptability will be key, and it will be important to closely monitor the evolving situation.

Table A2: Heat-map of macroeconomic indicators, 2005-2022

Indicator	LR avg	Threshold*	06	07	08	09	10	11	12	13	14	15	16	17	18	19	20	21	22
Current account balance, % GDP	-1.0%	-4/6%																	
Alternative: CA % GNI**	1.4%	-4/6%																	
NIIP, % GDP	-115.6%	-35%																	
*Alternative: Underlying NIIP, % GNI**	-58.7%	-35%																	
REER, 1-year % change	0.0%	±5% (EA)																	
Export market share - % of world exports	1.4%	-6%																	
ULC, nominal 1-year % change	0.1%	9% (EA)																	
House price index, 1-year % change	2.0%	6%																	
Private sector credit flow, % GDP	7.5%	14%																	
Private sector debt, % GDP	195.0%	133%																	
Alternative: Household debt (% GNI)*	81.3%																		
Government debt, % GDP	60.7%	60%																	
*Alternative: Government debt, % GNI**	67.0%	60%																	
Unemployment rate, %	9.0%	10%																	
Financial sector liabilities, 1-year % change	11.0%	16.5%																	

Colour key



Source: Department of Finance calculations based on Eurostat, CSO, Central Bank data.
How to read: Darker colours suggest imbalances (whether dark red or dark green, with green imbalances generally less harmful), while light yellow shading represents values broadly in line with the long-run average for each indicator. Grey areas indicate data gaps.
Note: the indicators for unit labour costs, private sector credit and debt, household debt, government debt, unemployment and financial sector liabilities have been inverted such that red represents a value above the long-run average, and vice versa. The three additional employment indicators in the MIP scoreboard are not shown here. GNI* and CA* values in 2021 are Department of Finance estimates and subject to revision with the official release of the 2021 NIE results by the CSO. NIIP = net international investment position; REER = real effective exchange rate; ULC = unit labour cost
*Threshold refers to the MIP threshold set out in the European Commission's procedure.

Annex 3
Ireland's well-being framework

It is well established that macroeconomic data, such as GDP, employment, etc., do not fully capture the quality of life in a country. Reflecting this, the literature around 'well-being' has expanded significantly in recent years. This new economic literature suggests the objective is to provide a more comprehensive measure of quality of life rather than focusing solely on the narrower, purely economic indicators.

The *Programme for Government*[29] recognised this trend, and a Well-being Framework for Ireland has been developed by the Department of the Taoiseach, in partnership with the Departments of Finance and Public Expenditure, NDP Delivery and Reform, and in consultation with a wide range of stakeholders. It intends to systematically consider progress in quality of life outcomes in Ireland across economic, environmental and social issues simultaneously, rather than in isolation.

Analysis, published in June 2023, of the latest available data for the 35 indicators showed that Ireland's performance is positive across ten of the eleven well-being framework dimensions with only one dimension, environment, climate and biodiversity, showing a negative performance (measured by trend over approximately five years and international comparisons). Of the thirty-five indicators, eight show negative performance. These are; school-aged children who report being happy with their life overall; research and development personnel; pollution, crime or other environmental problems; water body quality; greenhouse gas emissions; waste generated; long working hours in main job; and persons who experienced discrimination in the last two years.

The introduction of a comparable metric for equality across indicators allows for the assessment of each dimension for equality outcomes. An examination of this data shows that several groups experience inequality across a high proportion of indicators. These are: women; single-parent households; people living alone; immigrants/non-Irish; unemployed people; households with lower incomes; households in rented accommodation; and people with long-term illness or disability. Note that the groups featured here are based on research, relevance and data availability. There may be other groups that experience inequality that the available data do not show.

Of the eleven dimensions, two show particularly large average differences between groups. These are housing and the built environment; and income and wealth. Dimensions that showed small differences between groups include civic engagement, trust and cultural expression; and subjective well-being.

Environment, climate and biodiversity is the only one dimension that has an overall negative performance of the sustainability indicators. Fourteen of the thirty-five indicators have been identified as particularly important for sustainable well-being,[30] with an overall negative performance reported for four of these indicators. These are research and development personnel; water body quality; greenhouse gas emissions; and waste generated. A snapshot of performance is set out below (**figure A6)**, and more detail on the Framework, including the full report and methodology, is available on the Well-being Portal.[31]

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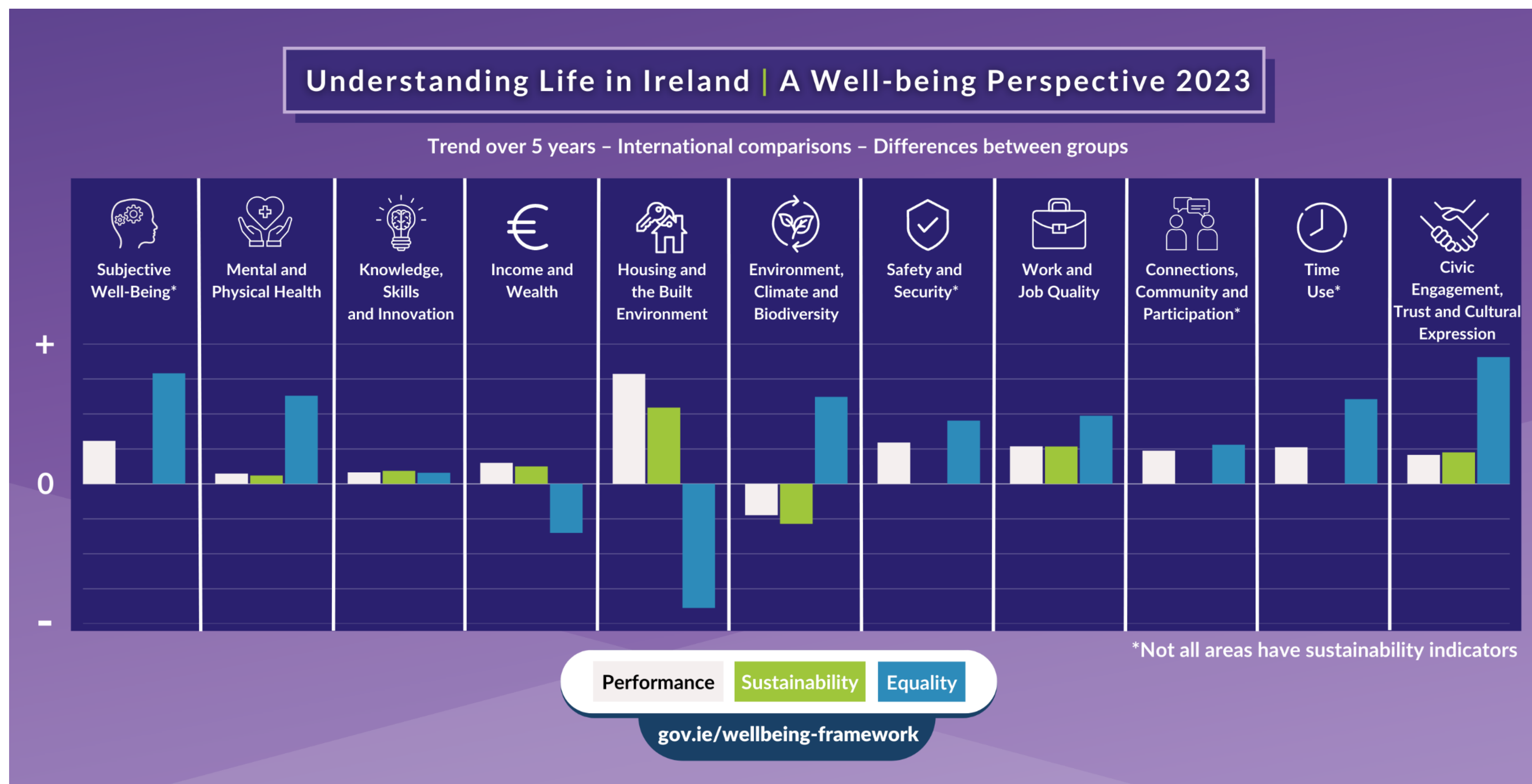
[29] Available at: https://www.gov.ie/en/publication/7e05d-programme-for-government-our-shared-future/
[30] As defined in the Department of Finance: Department of Finance (2022), *Sustainability in the Irish Well-being Framework: A Review*, which also identified the fourteen indicators. Available from: https://www.gov.ie/en/publication/3da98-sustainability-in-the-irish-well-being-framework-a-review/
[31] Available at: https://www.gov.ie/wellbeing-framework

Figure A6: Understanding life in Ireland: a well-being perspective 2023



Source: Department of the Taoiseach, *Understanding Life in Ireland: The Well-being Framework* 2023

Rialtas na hÉireann
Government of Ireland

Tithe an Rialtas. Sráid Mhuirfean Uacht,
Baile Átha Cliath 2, D02 R583, Éire
Government Buildings, Upper Merrion
Street, Dublin 2, D02 R583, Ireland

T:+353 1 676 7571
@IRLDeptFinance
@IRLDeptPER
www.gov.ie/finance
www.gov.ie/per