N°55 Funds are a big step, but much more progress is needed

Recommended action	*SPU 2024* assessment	Council calling for action since	Progress
Clarify how Reserve Funds will work	Comprehensively addressed	Jun-16	
Provide transparent costings of major policies	Climate action costs still not factored in	Dec-20	-1
Forecast five years ahead	Fiscal forecast horizon only three years ahead	Nov-17	
Make spending plans realistic	Spending projections for later years are a little more realistic, but health spending overruns still not incorporated	Jun-16	+1
Strengthen fiscal framework	National Spending Rule severely undermined, but savings funds introduced	Nov-17	
Show how rules will be complied with	Repeated breaches planned and gimmickry still being used	Dec-20	
Show how taxes will be adjusted if needed	No information on this. Tax and Welfare Commission recommendations dismissed	Dec-20	
Make non-Exchequer forecasts more transparent	No improvement in transparency	Nov-19	
Improve general government forecasting methodology	No improvements evident	Jun-23	
Overall assessment: Some progress			

Box D: Reinforcing the National Spending Rule

Ireland's public finances are unlikely to be guided by EU fiscal rules in future (see Section 4). The Government seems less committed to the spirit of the National Spending Rule. Official plans show repeated breaches, and fiscal gimmicks are being used to hide their extent. The rule can help guide the public finances through challenges such as the climate transition and the rapid ageing of Ireland's population. It can also help ensure that the Government is able to support the economy through future downturns rather than raising taxes and cutting spending, as it did during the austerity period. To ensure this, the rule needs to be reinforced and adhered to.

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

- Review the 5% assumption for steady state nominal growth every five years. Box E explores if 5% growth in net spending is appropriate with current macroeconomic projections. At present, the rule sets a 5% limit that implicitly reflects real trend growth of 3% and a medium-term inflation rate of about 2%. While inflation is higher at present, trend growth rates are projected to moderate. Projections in *SPU 2024* for real GNI* are below 2.5% for every year out to 2030.
- Protect public investment with a minimum steady state target set as a % of GNI*. This could help avoid sudden cuts, while improving long-term planning.
- Introduce an appropriate escape clause. Not every situation will be anticipated by the design of the National Spending Rule. Escape clauses, if appropriately designed, can be a helpful way of dealing with exceptional circumstances.

- Expand the rule's coverage to a general government basis. This wider measure of government activity is a more relevant basis for assessing fiscal policy. The current focus on the Exchequer ignores about one-fifth of spending.
- Allow for cyclical savings and costs related to unemployment supports. Unemployment supports are a key area of expenditure that vary with the economic cycle. In good times, they can make the public finances look stronger than they would otherwise be, while in bad times they can make the public finances look weaker. This can be adjusted for by considering the welfare expenditure that would be associated with more normal rates of unemployment of, say, 5% for example.
- Put the National Spending Rule in legislation. International evidence suggests that there tends to be higher compliance with expenditure rules when these are enshrined in law (Cordes, Kinda, and Muthoora, 2015).

Box E: What rate should the National Spending Rule be set at?

The National Spending Rule has been in place since 2021. It is a net spending rule: it applies to core spending net of tax policy changes.[44]

The idea is to have the growth rate of spending (net of tax policy changes) linked to the sustainable growth rate of the economy. The National Spending rule was set at a growth rate of 5%. The rationale for this was that the medium-term real growth rate of the economy was 3%, with inflation expected to be 2%.

In periods where inflation is high, the National Spending Rule should be more difficult to comply with. This is not a problem with but a feature of the National Spending Rule. The idea is to avoid procyclicality — doing too much in an already tight economy, hence adding to price pressures. By contrast, the rule is more generous in times when price pressures are low. That is, it still allows growth consistent with an implicit 2% inflation assumption when price pressures are lower than that.

The Council has previously suggested that, as part of the National Spending Rule, there should be periodic reviews of the sustainable growth rate of the economy. Since the Irish economy may be heading for a more mature growth phase (see Section 1), now might be an appropriate time to review the sustainable growth rate of the economy.

After strong growth in recent years, *SPU 2024* forecasts a moderation in growth. Real growth in GNI* is forecast to average 2.2% over 2024-2030. In every year of the forecast, real GNI* growth is forecast to be below 2.5% (N°56).

In addition, the Department's models of potential output growth also point to lower potential output growth. The midpoint of the Department's estimates are also shown (N°56) and are always below 3% growth.

[44] When the National Spending Rule was first introduced in 2021, core spending excluded Brexit-related costs and Covid-related expenditure. The rationale given was that temporary spending of this nature should be excluded from spending considered for the National Spending Rule. While there is merit to excluding some spending that may be temporary in nature, the Council believes that this approach has been applied too liberally in recent years.