Irish Fiscal Advisory Council

Fiscal Assessment Report

June 2024

A growing need for a strong domestic fiscal framework

Key messages

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Irish Fiscal Advisory Council

- Irish economy is performing well and is operating at or above capacity.
- The Government is set to breach the National Spending Rule this year and next year.
- Our assessment of the breach is larger than that shown in SPU 2024.
- Government revenue is highly concentrated and could reverse suddenly.
- Therefore, the Council believes that current budgetary policy is not conducive to prudent economic and budgetary management.

Key messages

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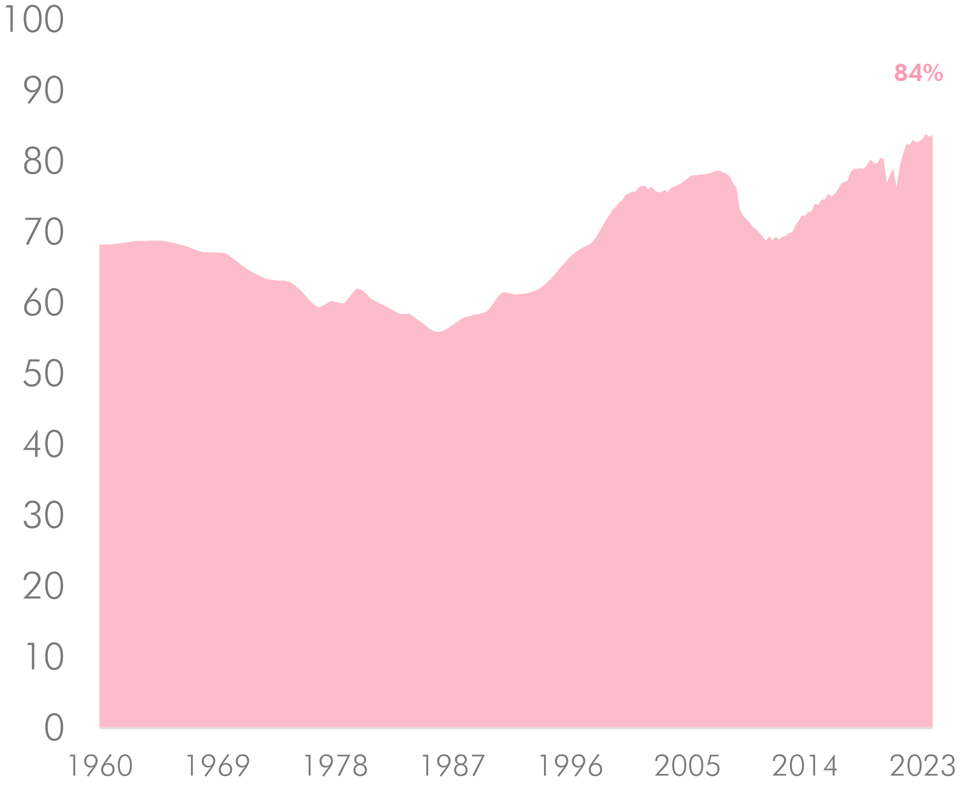
- As is always the case, there are several seemingly compelling demands for public spending and tax cuts.
- The Government's underlying balance (excluding 'excess' corporation tax receipts) is projected to remain in deficit out to 2026.
- The new EU fiscal rules bring a welcome medium-term focus to budgeting. But, the new EU fiscal rules will not be a good guide for Ireland's budgetary policy.
- Hence the domestic fiscal framework is key.
- The establishment of the Future Ireland Fund is welcome. But it should not be viewed as a substitute for complying with the National Spending Rule.

Economic outlook

The labour market is tight

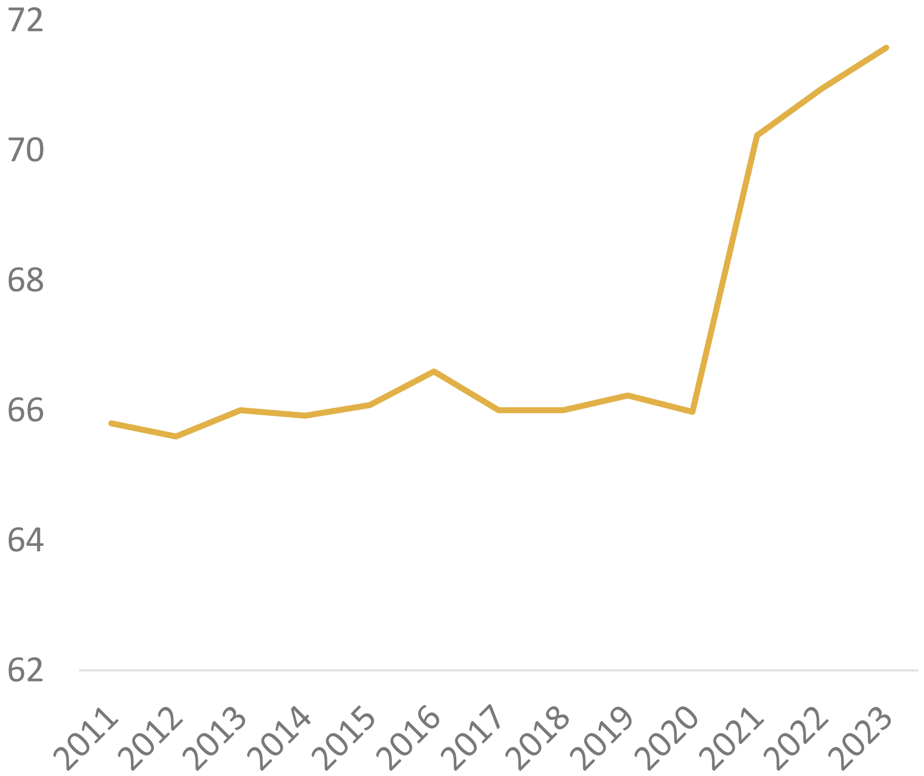
Employment at record highs

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



Participation remains high

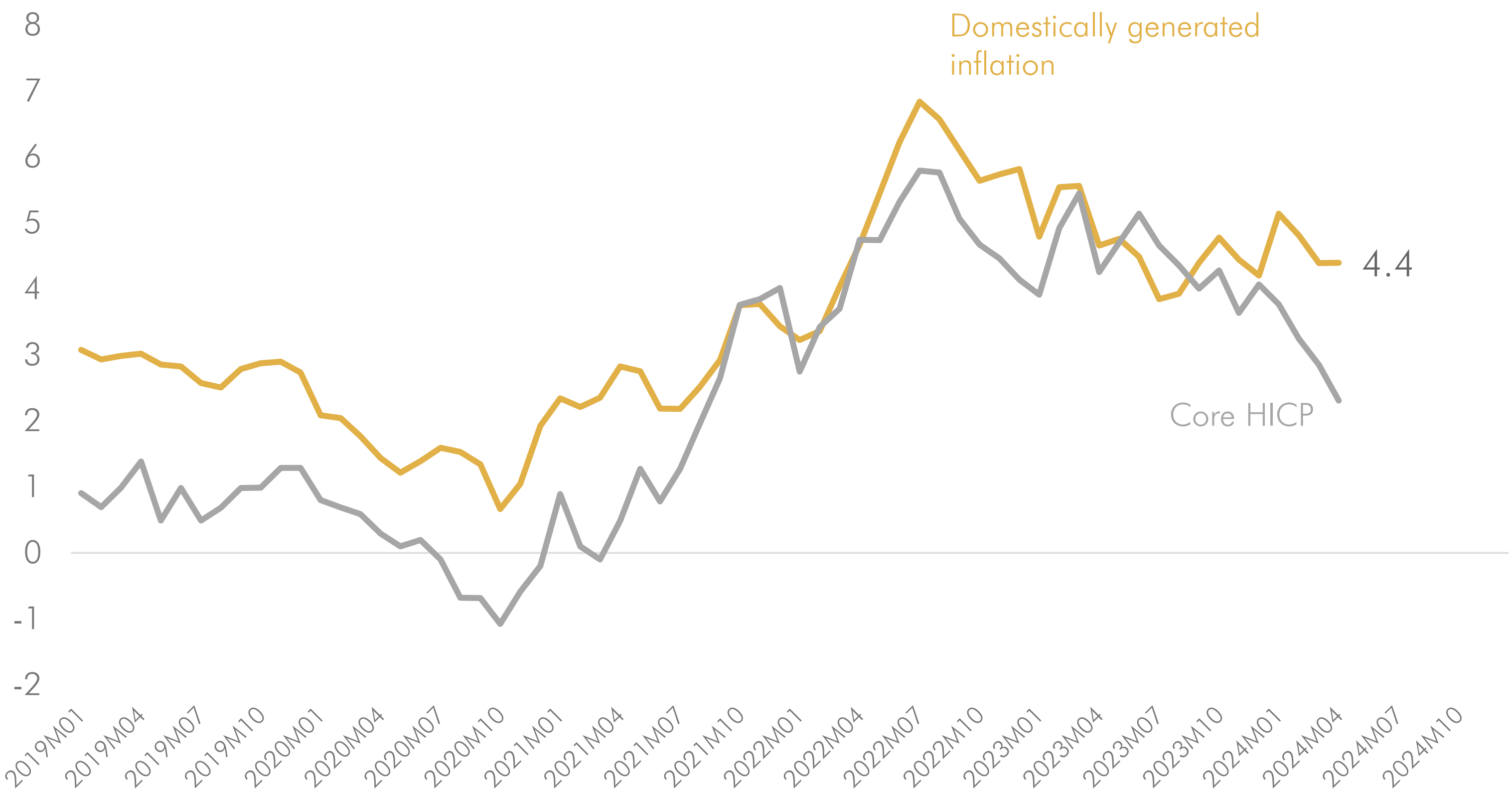
Labour force participation rate (15-74)



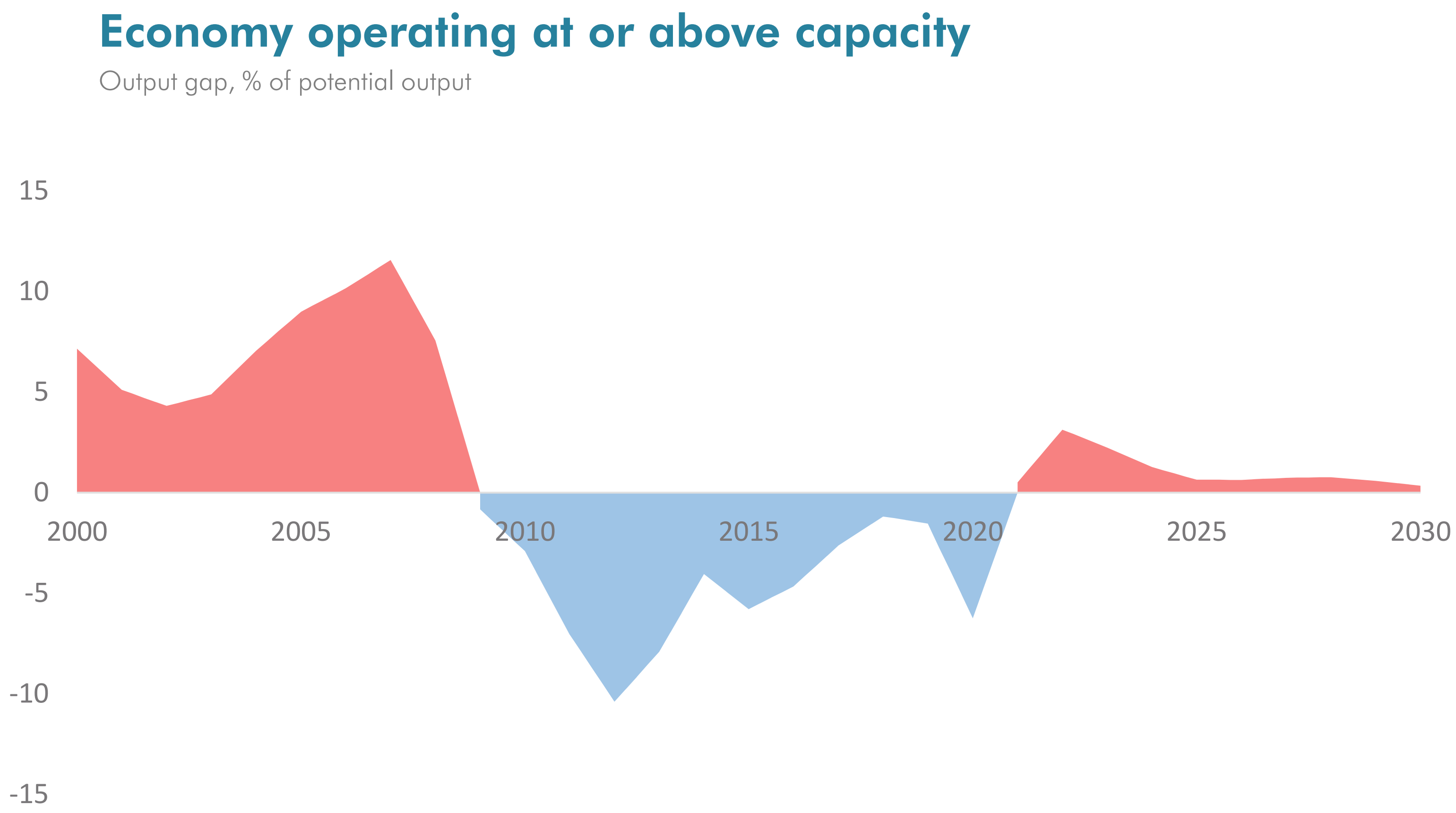
Inflation falling due to energy prices… but domestic inflation remains high

Domestic inflation remains elevated

% change year on year



Economy operating at or above capacity

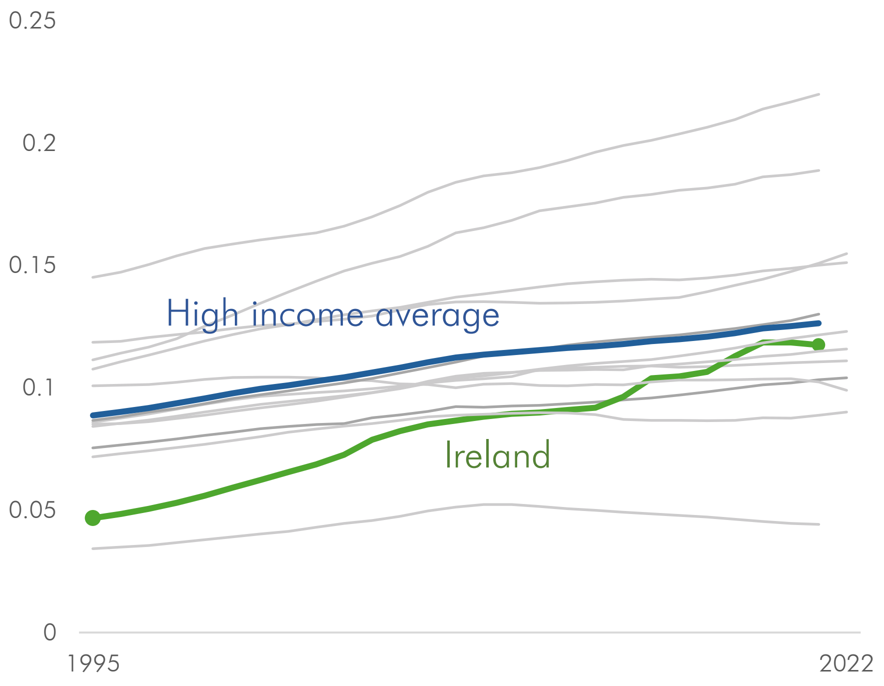


- Positive output gap (red) indicates an economy operating above potential
- Signals fiscal policy should not add to demand

Infrastructure becoming stretched

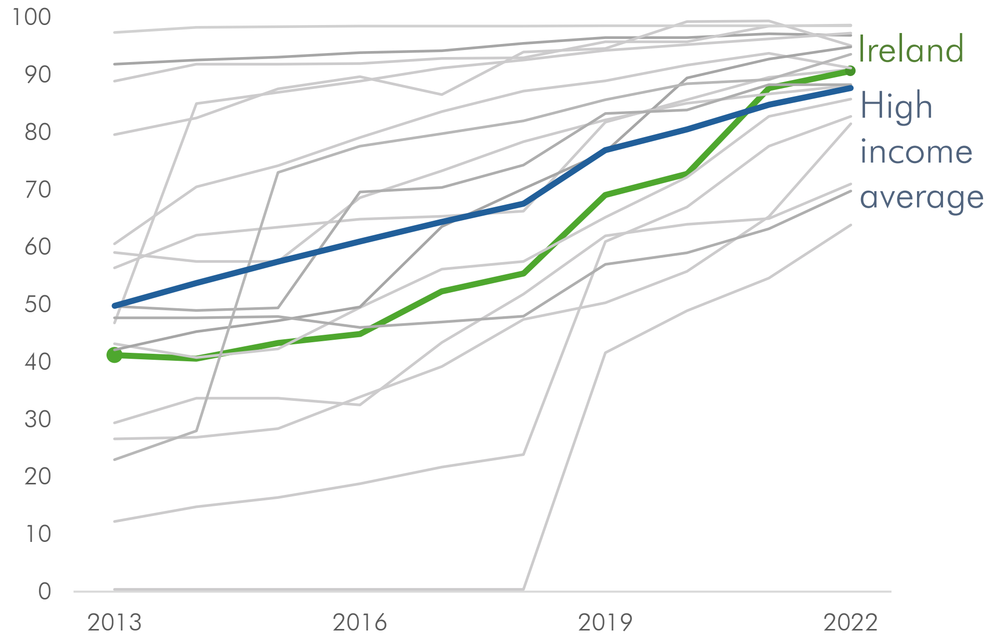
Capital stock below high income average countries

real capital stock per capita (€ million)



Mid table high speed broadband coverage

% of population with access to high-speed broadband



Budgetary outlook

Underlying balance to remain in deficit

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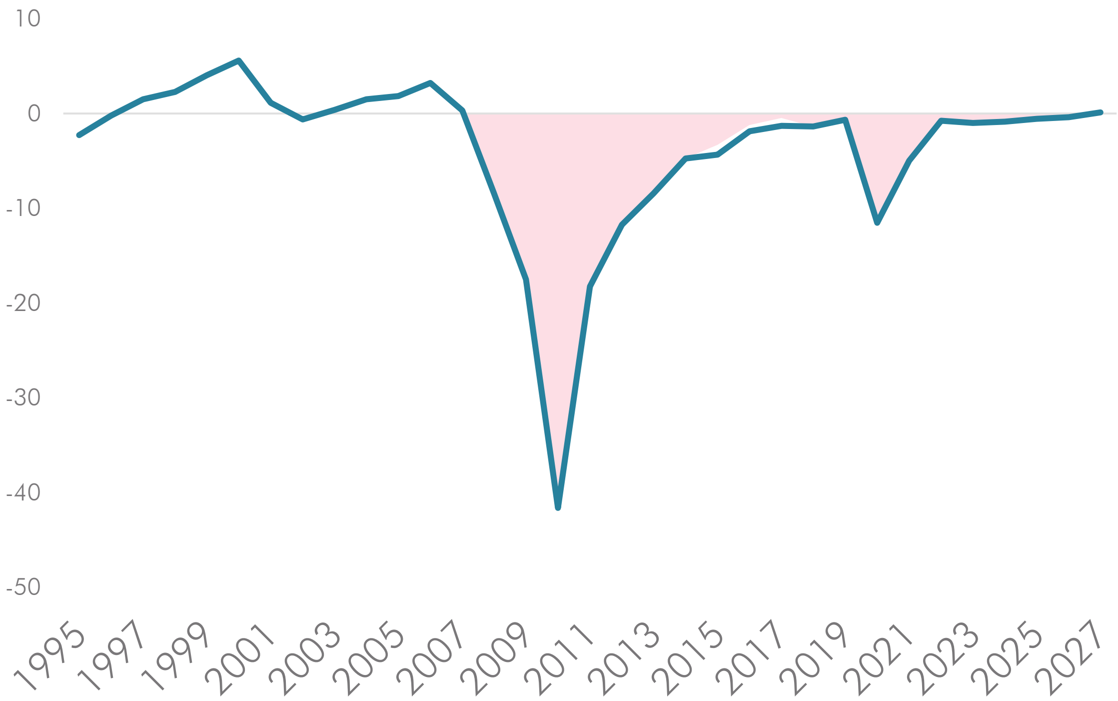
Government balance excluding excess corporation tax

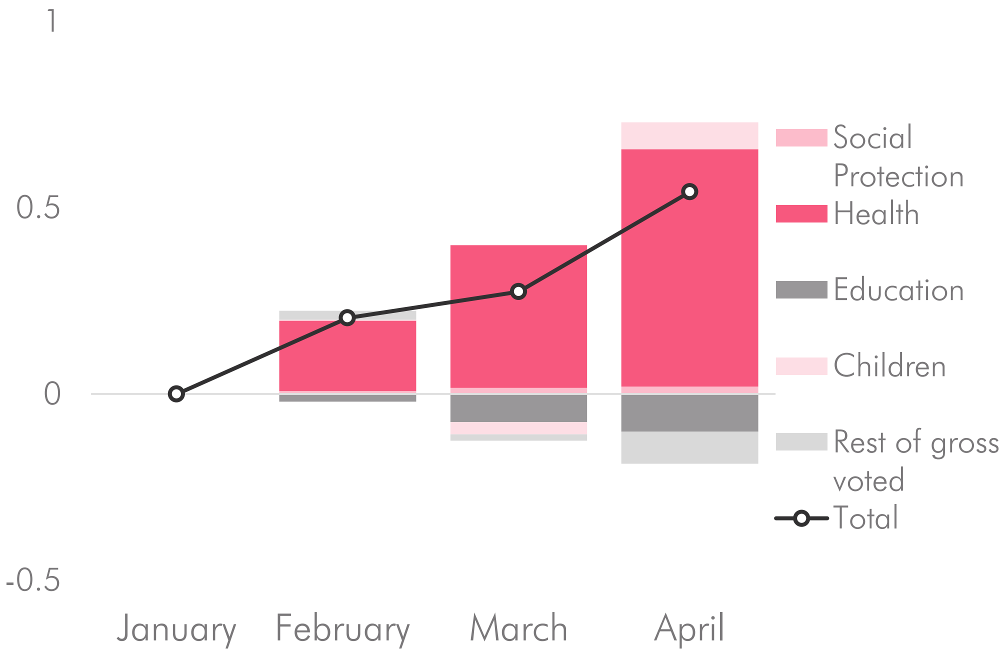
% GNI*



- The SPU forecasts an underlying general government deficit of 0.9% of GNI* in 2024 (excluding windfall corporation tax receipts).
- Balance remains in deficit in 2025 and 2026.

The fiscal projections in the SPU have several methodological issues

Spending overruns already building
€ billion, spending relative to Budget 2024 forecasts



- Health spending overruns not incorporated.
- The forecast horizon for budgetary forecasts only three years ahead. Multi annual budgeting demands a longer horizon.
- Major challenges not shown, climate change and an ageing population.
- General government forecasting poor, focus remains on exchequer and cash basis.

Health spending overruns are accelerating

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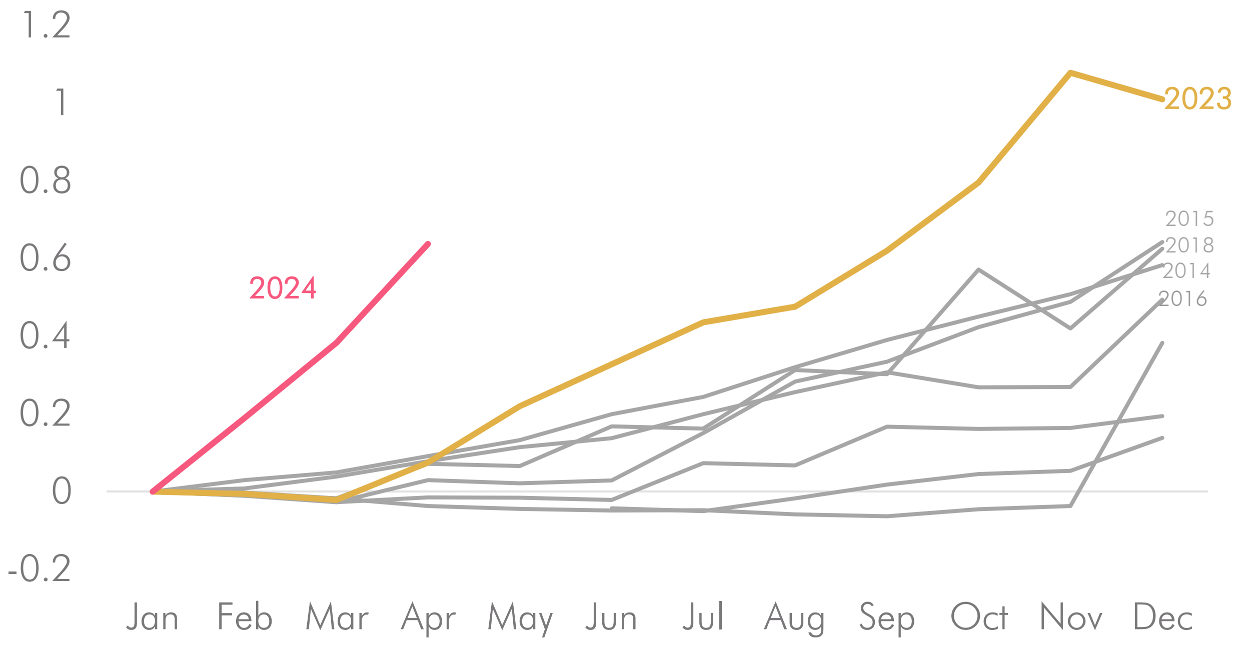
Spending overruns are larger and happening earlier

€ billion, Health spending overruns 2014-2024



- Health spending overrun of around €1.6 billion looks likely

Making the fiscal projections as realistic as possible aids assessment of the fiscal position

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- SPU forecasts spending forecasts include €4.5 billion mainly reflecting Covid-19 health and humanitarian assistance for refugees.
- The Council welcomes this. This approach is more realistic than Budget 2024, where this spending was assumed to drop to zero.
- However, this spending is likely to be long-lasting. Hence, it should be included in core spending. Covid-19 health spending and Humanitarian assistance for refugees still presented as non-core in SPU 2024.
- The continued use of fiscal gimmickry is undesirable as it weakens transparency.

Fiscal gimmickry

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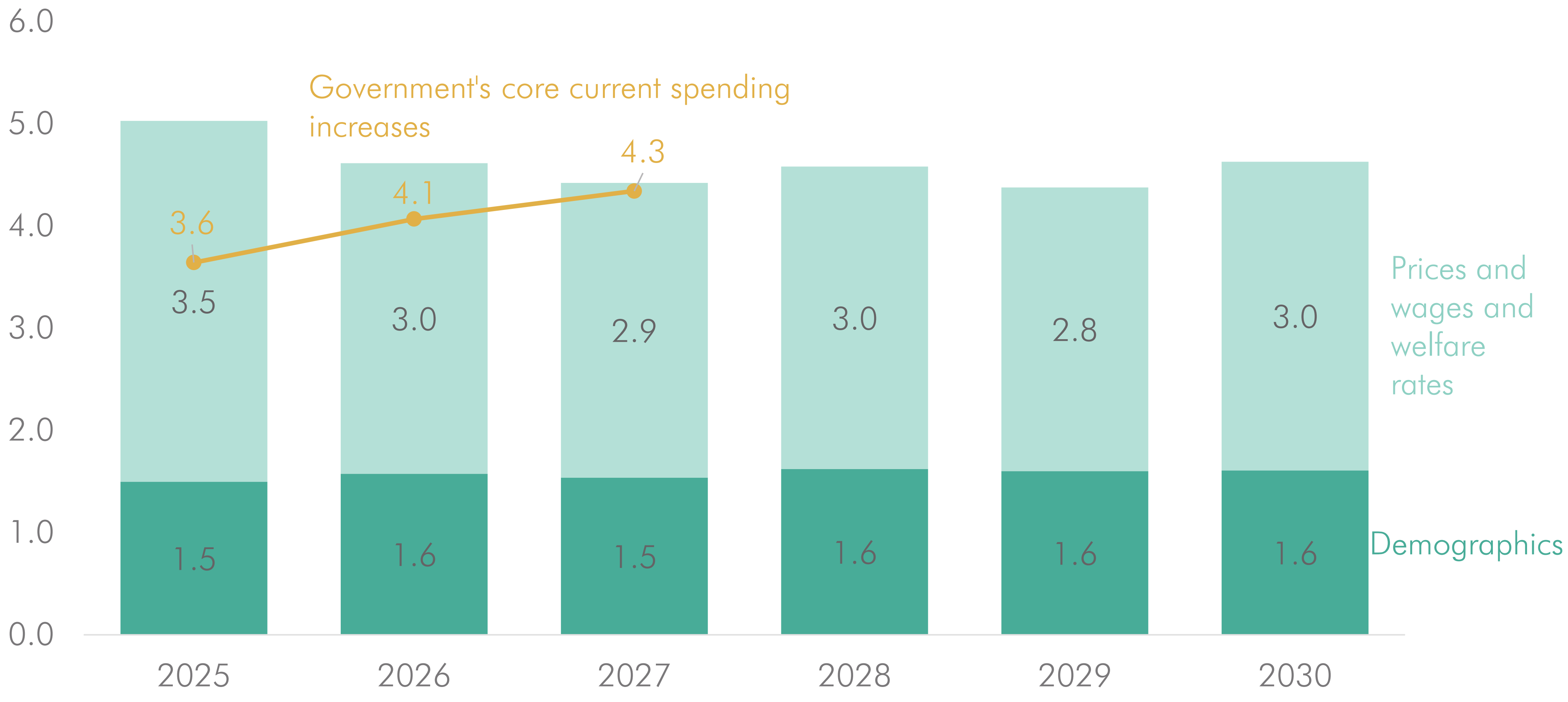
- Fiscal gimmickry refers to the use of accounting techniques to make a government's fiscal numbers adhere to fiscal rules or look more favourable than they are.
- A technical term, there are around 2,000 articles written on the topic (Google Scholar)

Stand still costs will be large in the years to come

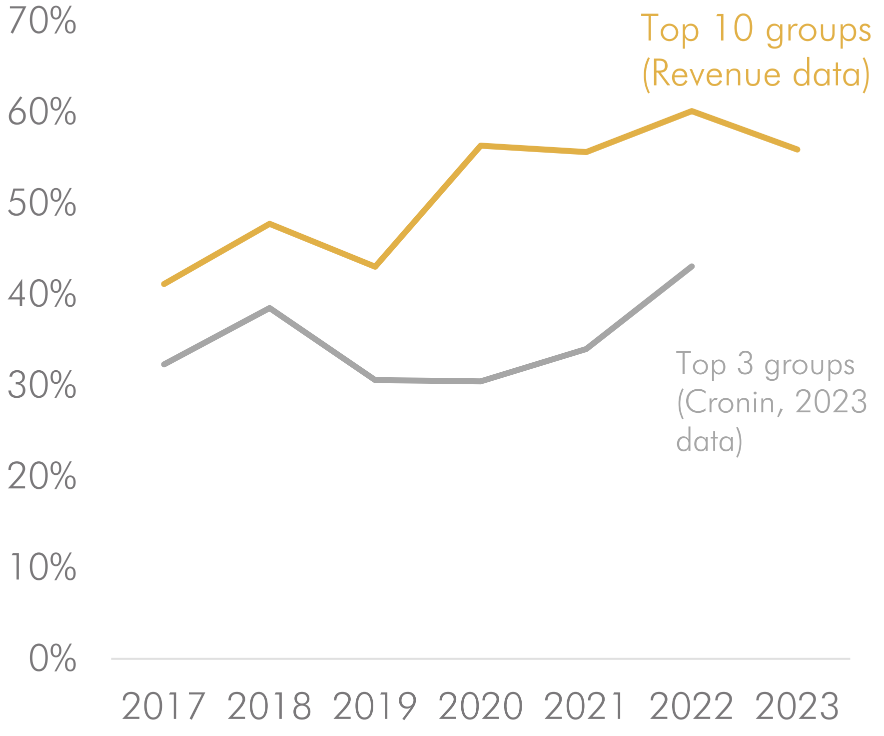
€ billion



Corporation tax and income tax are highly concentrated

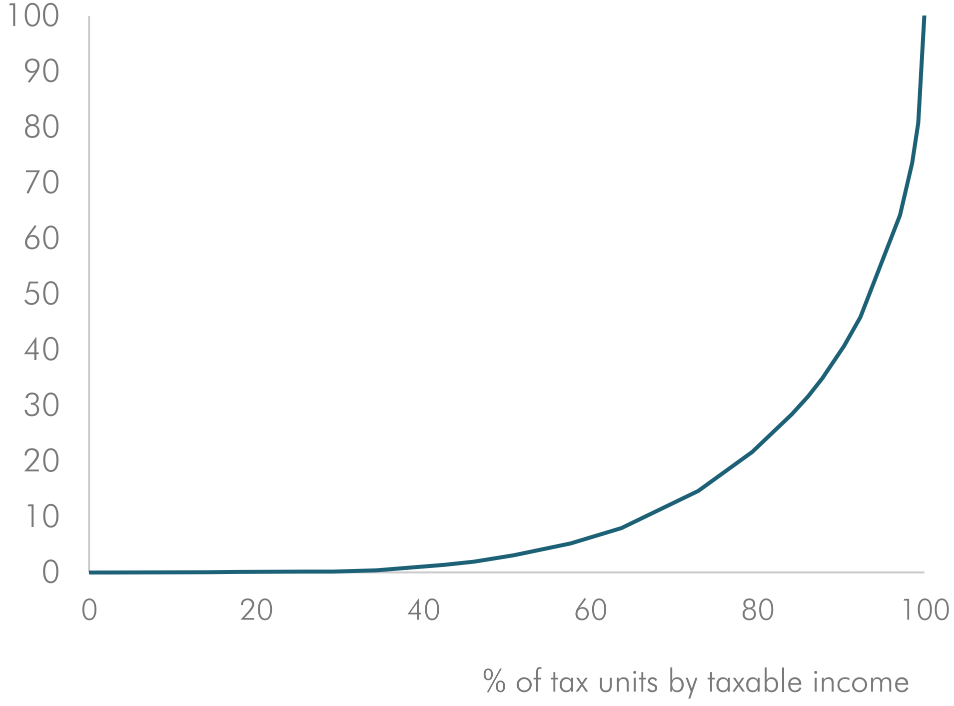
Corporation tax receipts have become more concentrated

% of corporation tax



Income tax is concentrated among highest earners

% of income tax paid



Shocks to key sectors could reduce corporation tax and income tax.

Public investment plans less ambitious

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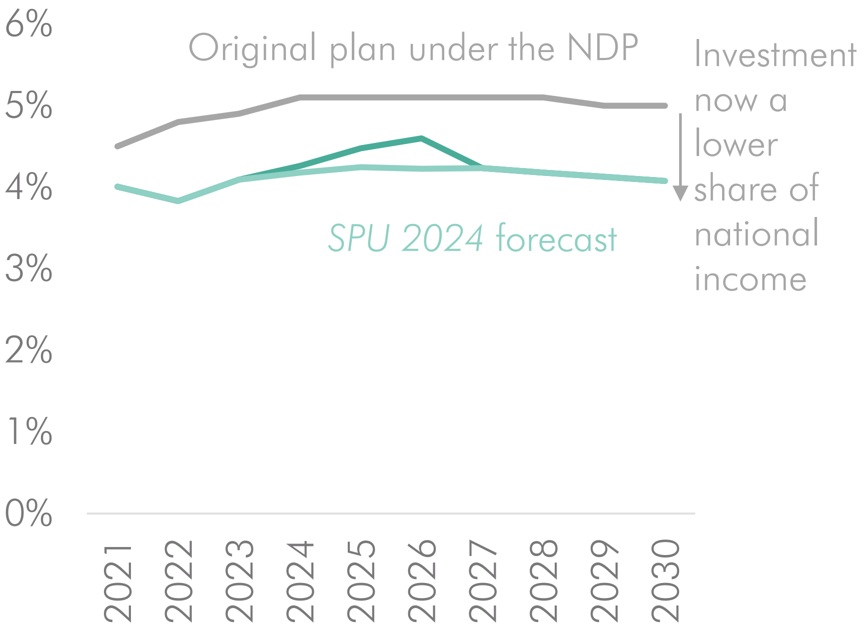
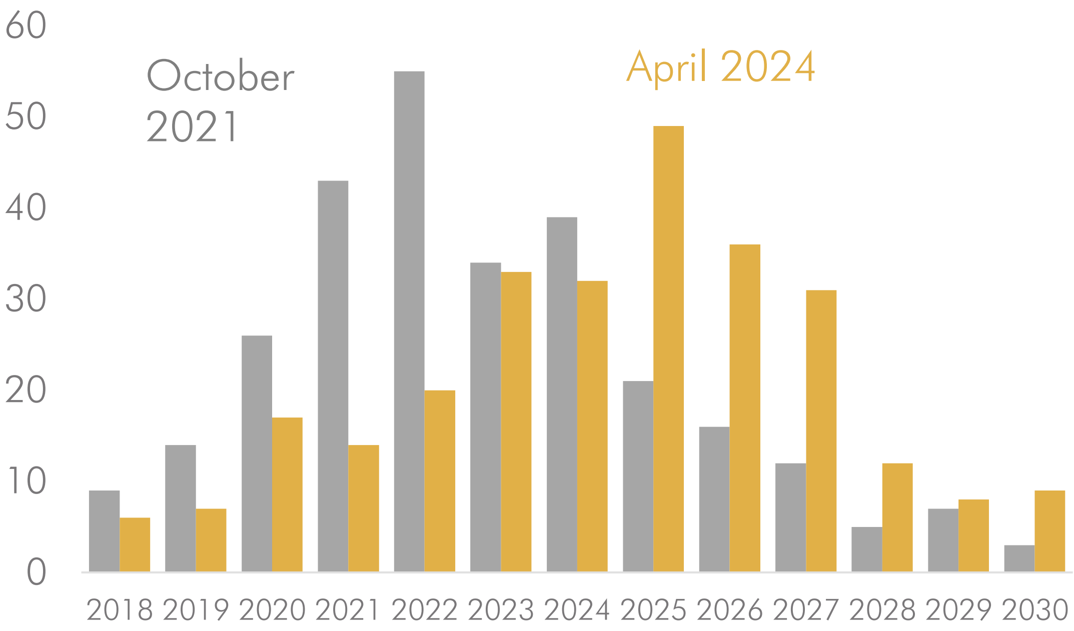
Capital spending a smaller share of GNI* than previously planned

% GNI*



Delays in delivery of NDP projects

Number of projects by estimated (or actual) completion date

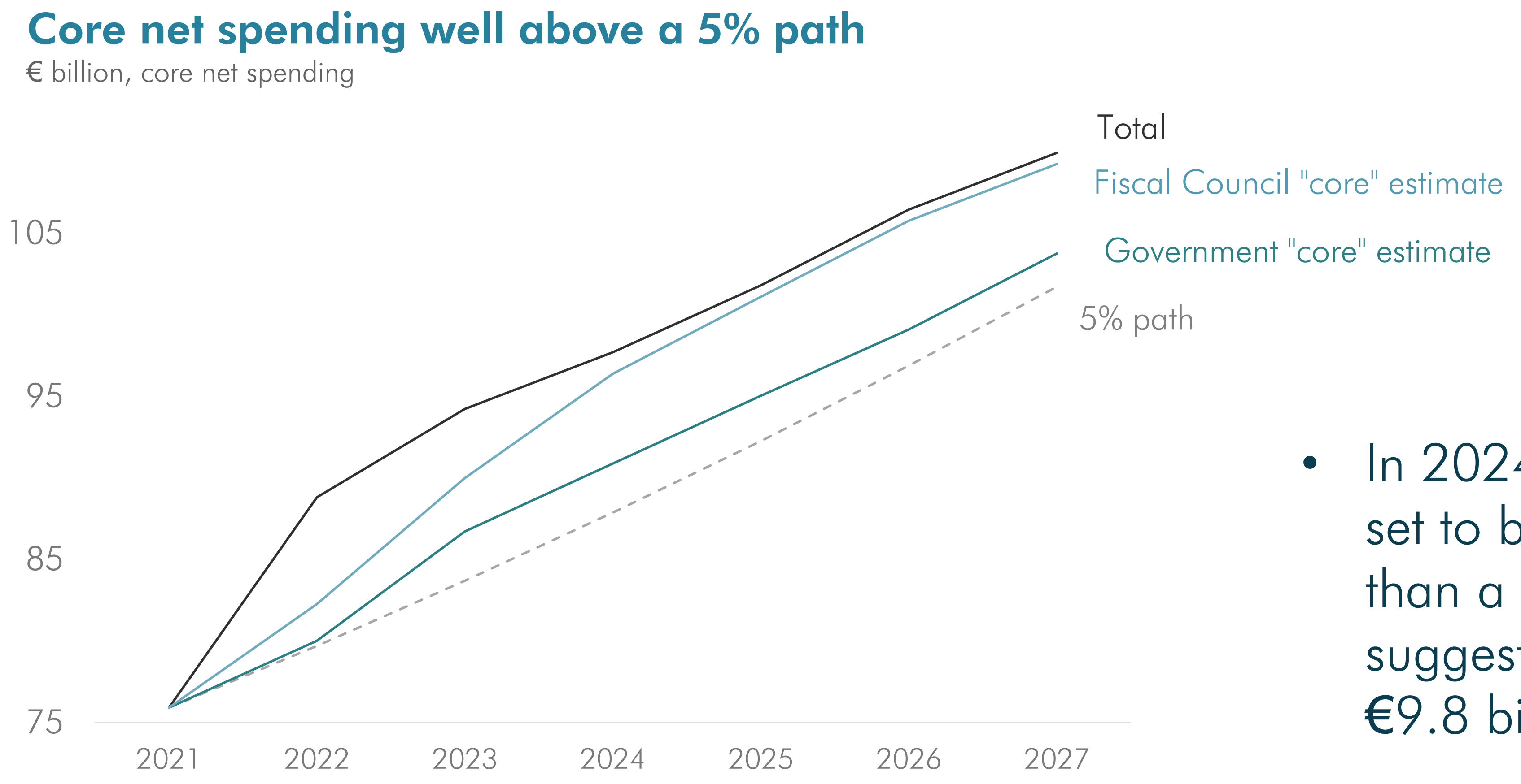


Fiscal stance and framework

The National Spending Rule is helpful as a “first line” of defence

- New EU fiscal rules, set in GDP terms, are unlikely to guide fiscal policy.
- The National Spending Rule is the best guide for fiscal policy.
- It is a **net** spending rule – raising taxes allows for additional spending
- The rule should be strengthened by placing it in legislation. This would make it more likely to be adhered to.

Different estimates of net spending all point to breaking the National Spending Rule



- In 2024, core net spending is set to be €8.5 billion higher than a 5% path would suggest. (Total measure = €9.8 billion)

Different estimates of net spending all point to breaking the National Spending Rule

Growth rates	2023	2024	2025	2026	2027
5% limit	5.0	5.0	5.0	5.0	5.0
Excluding health overruns	8.4	5.1	5.1	4.7	3.3
Including health overruns	8.4	6.7	5.1	4.7	3.4

- In both cases we include windfall capital investment and spending we deem to be permanent in nature (Covid-19 health, humanitarian assistance to refugees).
- Health overruns refers to a likely overrun of €1.6 billion in 2024 which then grows by 5% thereafter.

Breaching the National Spending Rule means…

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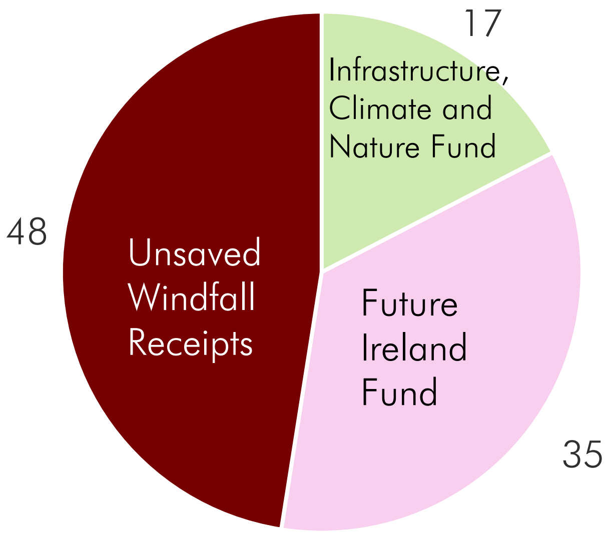
- Budgetary policy is adding to demand when the economy is already operating at full capacity.
- Adding to price pressures and risk of economy overheating.
- Doing "everything now" will make capacity constraints worse.
- Spending increases can be done but should be offset by revenue raising measures.
- Signalling weak commitment to Irelands Fiscal framework
- Not conducive to prudent economic and budgetary management

The two new funds are welcome

Just over half of windfalls being saved

2025, % of windfall corporation tax



- Saving into the two new funds can help manage windfall revenues.
- This can also offset the cost of climate change and an ageing population.
- These costs are inevitable.
- Government could be more ambitious with contributions to funds.

What should Irelands fiscal framework look like

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- National Spending Rule in legislation (more likely to be adhered to)
- National Spending Rule to cover general government, adjust for cyclical unemployment.
- Forecast a minimum of five years ahead
- Provide transparent costings for climate action and Sláintecare.

Key messages

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Irish economy is performing well and is operating at or above capacity. The jobs market remains tight and underlying inflation remains high. Loose budgetary policy could overheat the economy and add to inflation.

The Government is set to breach the National spending Rule this year and next year. Net spending is set to increase by more than 5% this year and next year. The National Spending Rule is a net rule, so additional spending could be offset by revenue raising measures.

Our assessment of the breach is larger than that shown in SPU 2024. This is because we account for likely health spending overruns and fiscal gimmickry.

Government revenue is highly concentrated and could reverse suddenly. Income tax and corporation tax are both highly concentrated. A downturn in a small number of sectors could impact on both.

Therefore, the Council believes that current budgetary policy is not conducive to prudent economic and budgetary management. Given the position of the economy, this is not a time for budget giveaways.

Key messages

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As is always the case, there are several seemingly compelling demands for public spending and tax cuts. Choices need to be made. Doing 'everything now' could overheat the economy and would add to inflation. There are significant costs to just maintain existing service levels.

The Government's underlying balance (excluding 'excess' corporation tax receipts) is projected to remain in deficit out to 2026. This would mean 19 consecutive years in deficit.

The new EU fiscal rules bring a welcome medium-term focus to budgeting. Under the new rules, the government will submit a medium-term (5 year) plan.

But, the new EU fiscal rules will not be a good guide for Ireland's budgetary policy. A continued focus on GDP and not excluding windfall corporation tax mean the rules are unlikely to bind for Ireland.

Hence the domestic fiscal framework is key. An anchor for budgetary policy helps to guide Ireland away from boom-bust budgetary policies of the past.

The National Spending Rule should be further strengthened.

The establishment of the Future Ireland Fund is welcome. But it should not be viewed as a substitute for complying with the National Spending Rule.

Background charts

Summary Table of *SPU 2024* Economic and Budgetary Projections

% GNI* unless stated

Summary Table of *SPU 2024* Economic and Budgetary Projections

% GNI* unless otherwise stated

	2023	2024	2025	2026	2027
Macro forecasts					
Real GNI* growth (%)	1.8	2.0	1.9	2.4	2.4
Nominal GNI* growth (%)	6.4	5.4	4.6	4.9	4.8
Nominal GNI* (€bn)	291	306	320	336	352
HICP growth (%)	5.2	2.1	2.1	2.0	2.0
Output gap (% of potential)	2.2	1.3	0.6	0.6	0.7
Potential output growth (%)	2.3	2.7	2.3	2.2	2.2
Budgetary forecasts					
Balance excl. excess corporation tax	-1.0	-0.9	-0.6	-0.4	0.1
Balance	2.9	2.8	3.0	2.6	3.0
Balance (€ billion)	8.3	8.5	9.7	8.7	10.7
Balance excl. one-offs [1]	4.7	4.0	3.0	2.6	3.0
Balance excl. one-offs [1] (€ billion)	13.8	12.3	9.7	8.7	10.7
Revenue excl. one-offs [1]	42.9	42.8	42.8	42.2	42.2
Expenditure excl. one-offs [1]	38.2	38.7	39.8	39.6	39.2
Primary balance excl.one-offs [1]	5.9	5.1	4.1	3.6	4.2
Revenue growth excl. one-offs [1] (%)	7.0	5.0	4.8	3.3	4.8
Primary expenditure growth excl. one-offs [1] (%)	11.1	7.2	7.8	4.3	3.3
Gross debt ratio (% GNI*)	75.9	72.1	69.7	67.4	66.0
Net debt ratio (% GNI*)	62.2	58.7	56.5	53.8	50.7
Gross debt (€ billion)	220.7	220.8	223.2	226.4	232.4
Cash & liquid assets (€ billion)	40.0	41.1	42.2	45.8	53.9
Net debt (€ billion)	180.7	179.7	181.0	180.6	178.5
Fiscal stance					
Structural primary balance[2]	0.5	0.4	-0.2	-0.2	0.7
- change (p.p.)	-1.5	-0.1	-0.6	0.0	0.9
Net policy spending growth (%)	11.8	6.7	7.4	3.7	3.0
Change in net debt ratio (p.p.)	-6.7	-3.5	-2.2	-2.7	-3.0
Fiscal rules					
National Spending Rule	Breach	Breach	Breach	✓	✓
Nationally financed net primary expenditure growth limit [3]	xc	Breach	Sig. breach[4]	✓	✓
Structural Balance Rule	xc	✓	Breach	✓	✓
Overall Assessment	xc	✓	Breach	✓	✓

Stand-still costs over the medium-term

€ billion

	2024	2025	2026	2027	2028	2029	2030
Government's core current increases		3.6	4.1	4.3			
Stand-still costs	1.4	5.0	4.6	4.4	4.6	4.4	4.6
Of which							
Demographics		1.5	1.6	1.5	1.6	1.6	1.6
Prices (and wages)		3.5	3.0	2.9	3.0	2.8	3.0
Increases by key area (increases in €bn)							
Education		0.6	0.4	0.3	0.4	0.3	0.3
Health	1.4	1.7	1.5	1.6	1.6	1.6	1.7
State pensions		1.2	1.2	1.2	1.3	1.2	1.3
Public sector pensions		0.2	0.3	0.2	0.3	0.2	0.3
Social welfare (excl. pensions incl. SIF)		0.5	0.5	0.4	0.4	0.4	0.4
Other spending		0.8	0.6	0.6	0.6	0.6	0.6
Increases due to demographics by key area (€bn)							
Education		0.0	0.0	-0.1	0.0	0.0	0.0
Health		0.8	0.9	0.9	0.9	0.9	0.9
State pensions		0.5	0.5	0.5	0.5	0.6	0.6
Public sector pensions		0.1	0.1	0.1	0.1	0.1	0.1
Social welfare (excl. pensions)		0.1	0.1	0.1	0.1	0.1	0.1
Increases due to prices by key area (€bn)							
Education wages		0.6	0.4	0.3	0.4	0.3	0.3
Education prices		0.1	0.1	0.1	0.1	0.1	0.1
Health wages		0.6	0.4	0.4	0.4	0.3	0.4
Health prices		0.3	0.3	0.3	0.3	0.3	0.4
State pension		0.8	0.7	0.7	0.7	0.7	0.7
Public sector pension		0.2	0.2	0.1	0.2	0.1	0.2
Social welfare (excl. pensions)		0.3	0.4	0.4	0.4	0.3	0.4
Other wages		0.4	0.3	0.3	0.3	0.3	0.3
Other prices		0.3	0.3	0.3	0.3	0.3	0.3