Irish Fiscal Advisory Council

Fiscal Assessment Report

June 2024

A growing need for a strong domestic fiscal framework

Foreword

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

The Council's mandate is to:

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

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

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

The Council would like to acknowledge the kind help from staff at the Central Statistics Office (CSO), Trinity College Dublin, University of Limerick, and the Parliamentary Budget Office (PBO). The Council submits its Fiscal Assessment Reports to the Minister for Finance and within 10 days releases them publicly. This report was finalised on 31st May 2024.

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

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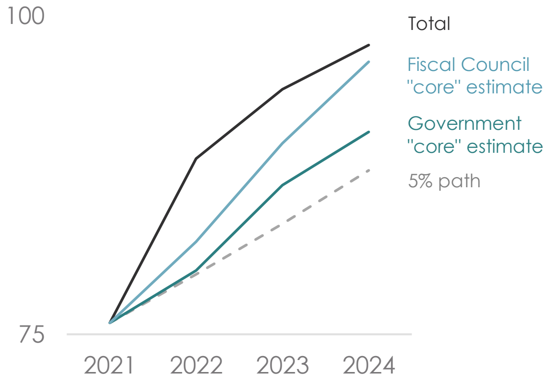
Summary assessment

The Irish economy remains strong, operating at or above potential. While economic growth has moderated somewhat, the jobs market remains very tight, with record high employment and historically low unemployment. Inflation is moderating, due to falling energy prices, but underlying inflation remains relatively high. The Council assesses the economy to be operating at or above capacity. There is a risk of the economy overheating.

Against this backdrop, pursuing loose budgetary policy would make overheating more likely to occur. Despite favourable economic conditions, the Government's underlying balance is projected to remain in deficit for the next 3 years. Excluding excess corporation tax receipts, a deficit of €2.7 billion (0.9% GNI*) is forecast for this year. This comes despite a strong economy, with record high employment and historically low unemployment. The question arises: if underlying surpluses are not being run now that the economy is strong, when would they be run?

Repeat breaches of National Spending Rule

€ billion, core net spending



The Government looks set to repeatedly breach the National Spending Rule. Net spending is set to increase by more than 5% this year and next year. Since the rule was introduced in 2021, the level of budgetary measures by 2024 is cumulatively €8.5 billion (9.7%) above what would be implied by a 5% path.

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

- Overruns in health spending are still not reflected in *SPU 2024* spending forecasts. Health spending overruns in 2023 were not incorporated into *Budget 2024* forecasts. This year, spending overruns are materialising earlier in the year than normal and are at a higher level than previously. Health spending overruns have been commonplace for over a decade.
- The Council welcomes spending on health related to Covid-19 and spending on humanitarian assistance for Ukrainian refugees being included in spending forecasts beyond this year. This contrasts with *Budget 2024*, when this spending was assumed to fall to zero in 2025. However, this spending is likely to be long-lasting. Hence, it should be included in core spending. The continued use of fiscal gimmickry—the use of creative accounting techniques to make a government's fiscal numbers adhere to fiscal rules or look more favourable than they are—is undesirable as it weakens transparency.

Government revenue is highly concentrated and hence could reverse suddenly. Risks around corporation tax are well known, with estimates suggesting 3 firms contributed 43% of corporation tax in 2022. Income tax is also heavily concentrated. A small number of employees pay a large share of income tax. These highly paid employees are likely to work in highly profitable sectors where large corporation tax payments are made. A downturn in these sectors would mean not just a reduction in corporation tax, but also income tax.

Therefore, the Council is of the view that current budgetary policy is not conducive to prudent economic and budgetary management. Given the favourable position of the economy, this is not a time for fiscal stimulus. Despite this, a large Budgetary package was introduced for this year. *SPU 2024* indicates another sizeable increase in net spending is planned for next year.

As is always the case, there are several seemingly compelling demands for public spending and tax cuts.

- The costs of maintaining existing levels of services exceeds current spending allocations. Our estimates suggest that the SPU forecasts of current spending increases are on average €0.7 billion lower than annual stand-still costs in 2025, 2026 and 2027. An ageing population means significant costs to maintain existing levels of service.

- Given some of the evident infrastructure shortfalls, it is tempting to increase public capital spending to address these. Given the strong position of the economy and the tight labour market, getting value for money on public investment could be challenging.

- In addition, addressing infrastructure deficits while the jobs market is tight will be challenging. Attracting construction workers to work on these projects looks to be more difficult than it was in the early 2000s.

However, choices must be made. Spending pressures are likely to be much stronger than SPU forecasts indicate. But this is not a time for the 'everything now' approach of tax cuts, increases in current spending and ramping up capital spending all at once. As the spending rule is defined in net terms, spending increases greater than 5% would call for sustainable revenue-raising measures. Not indexing the tax system would be one way of raising revenue for larger spending increases.

Against this background, committing to a credible fiscal framework is key. So far, the Government's commitment to the National Spending Rule has been weak, with repeated breaches and fiscal gimmickry used to hide the extent of the breaches.

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. This plan will limit the growth in net expenditure each year, beginning in 2025.

However, the new EU fiscal rules will not be a good guide for Ireland's budgetary policy. The new rules will continue to be assessed on a GDP basis and they will not account for excess corporation tax receipts.

Therefore, the health of Ireland's public finances will be overstated, meaning the new EU rules are unlikely to bind. A positive assessment from the European Commission based on EU rules is of little value given how inappropriate the rules are for Ireland.

Hence the need to strengthen the domestic fiscal framework. Tying medium-term net spending to a sustainable growth rate of the economy is desirable. An anchor for budgetary policy helps to guide Ireland away from boom-bust budgetary policies of the past.

Budgetary projections should be improved. Budgetary projections in *SPU 2024* only go three years ahead. Forecasts should be produced at least five years ahead to give a medium-term orientation to budgetary policy. The full impact of fiscal costs that are inevitable in the coming years should be factored in. *SPU 2024* projections do not incorporate the likely costs of climate change and Sláintecare. Budgetary forecasts should be focused on general government terms, which is the relevant fiscal aggregate at the EU level. Transparency needs to be enhanced, especially for non-Exchequer areas of spending.

The National Spending Rule should be further strengthened. The National Spending Rule should be widened to cover all general government, include adjustments for cyclical unemployment spending and appropriate escape clauses should be created. Placing the National Spending Rule on a legislative basis would strengthen the rule and make it more likely to be complied with.

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. The Council welcomes the establishment of the Future Ireland Fund. However, the Council believes the Government should be more ambitious and set aside all windfall corporation tax receipts into the savings funds. This would leave Ireland better placed to withstand the costs arising from an ageing population and climate change. Saving into such funds is a complement to, not a substitute for, complying with the National Spending Rule. Running a budgetary policy which is too loose when the economy is operating at or over full capacity is bad practice. This is the case regardless of what contributions are being made to savings funds.

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	✓	✓

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

Notes: Output gaps and potential output estimates, including those used for the structural balances, are based on the Department of Finance's preferred alternative estimates. xc = Exceptional circumstances apply for these years, meaning that a temporary deviation from the requirements of the fiscal rules is allowed. [1] These figures exclude one-offs. One-offs that the Council considers relevant are excluded to assess the underlying fiscal position. These include Covid-related expenditure and expenditure and revenue related to the EU funds for the Brexit Adjustment Reserve and the National Recovery and Resilience Plan. [2] This is based on the Council's own 'bottom-up' estimates of the structural primary balance. [3] From 2024, a maximum growth rate in nationally financed net primary expenditure replaces the Expenditure Benchmark. Unlike the Expenditure Benchmark it replaces, the new measure does not smooth out investment costs over a four-year period (Section 4). [4]A 'significant breach' is a breach greater than 0.5% of GNI* for the nationally financed net primary expenditure growth limit, or 0.5% of GDP for the structural balance rule. A 'breach' means that the limit for the corresponding rule is forecast to be exceeded, but by less than 0.5% of GNI* or 0.5% of GDP.

Macro Assessment

Capacity constraints and productivity are key

1 Macro Assessment

Capacity constraints and productivity are key

The Council is required to assess the official forecasts produced by the Department of Finance for *SPU 2024*. The Council recently published its endorsement note (Fiscal Council, 2024), which details many of the key issues that arose during the endorsement process.

This Section outlines the Council's thinking on some of the key macroeconomic issues, as well as highlighting SPU forecasts in these areas.

The Irish economy continues to perform well. The labour market is characterised by record high employment and record low unemployment, while economic activity continues to grow. This is despite a challenging external environment; inflation is moderating due to falling energy prices, but underlying inflation remains high; interest rates are higher now than they have been for over a decade; and global demand appears to be relatively weak.

Over the medium term, *SPU 2024* forecasts growth to moderate, with the economy transitioning to a lower medium-term growth rate. Productivity growth in the medium term could be inhibited by infrastructure deficits in the Irish economy.

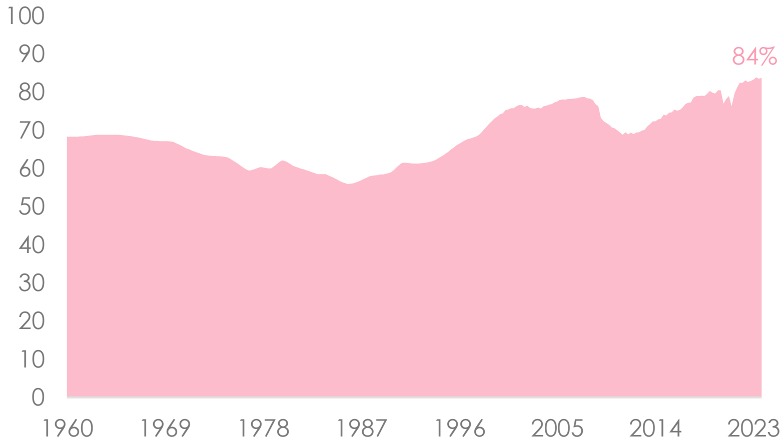
The labour market is tight

The Irish labour market remains exceptionally tight. This is clear from the record high share of prime age population at work (N°1).

N°1

Employment at record highs

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



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

Employment growth has been strong in recent years. The strong demand for workers has been satisfied through two channels: rising labour force participation and inward migration.

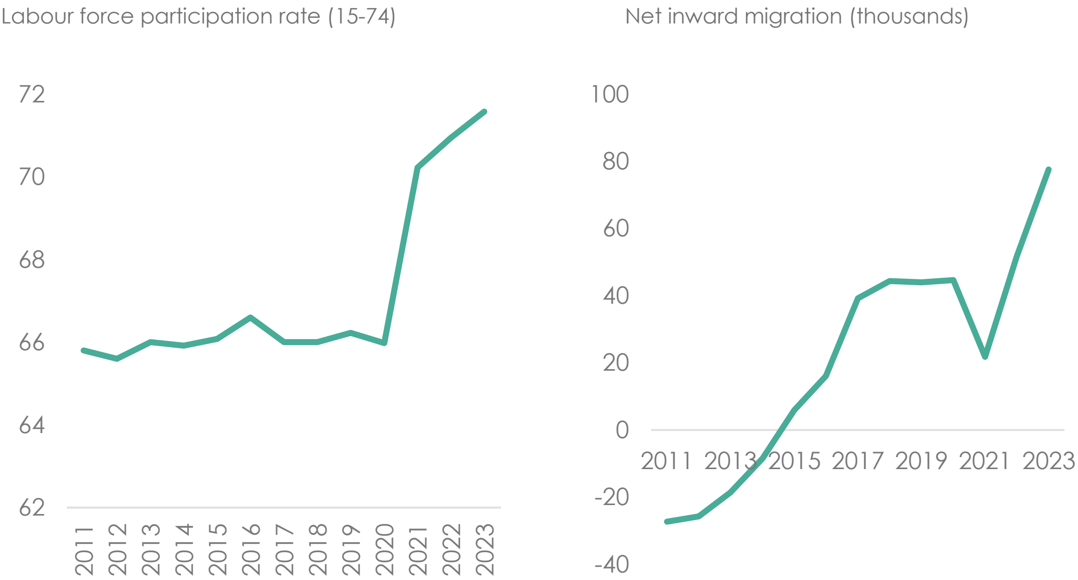
The labour force participation rate has increased substantially since the Covid-19 pandemic, and has remained high in the subsequent years (N°2).[1] However, it seems unlikely that there will be further significant increases in the participation rate over the coming years, due to an ageing population and participation rates already being at high levels.

Inward migration has also added significantly to the labour force in recent years (N°2). While some of this inward migration involves refugees, much of the migration appears to be for more standard economic reasons, with workers being attracted by well-paid employment.[2]

[1] This may have been aided by more flexibility in remote-working arrangements.

[2] Box A explores where additional construction workers could come from, given plans to increase housing completions.

N°2 Labour force growth driven by participation and migration



Sources: CSO and Fiscal Council workings.
Notes: The labour force participation rate is adjusted for the impact of the pandemic unemployment payment in the years 2020-2022. [Get the data.]

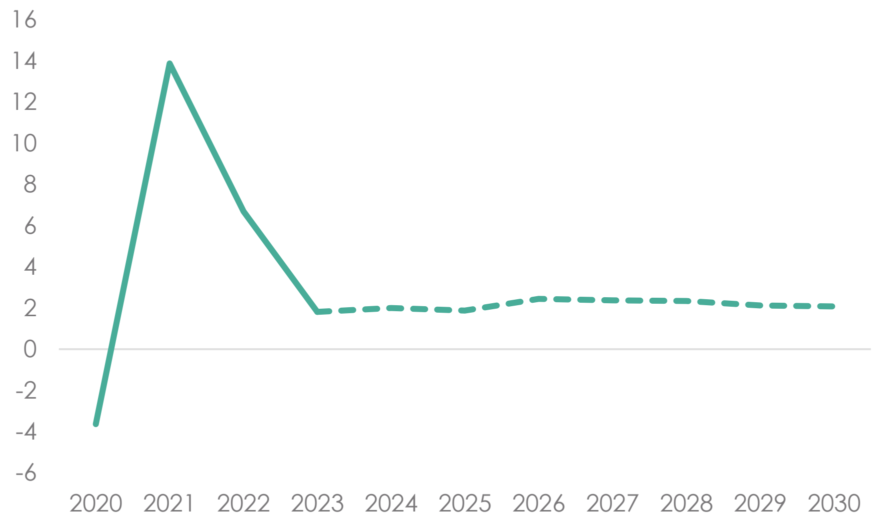
Over the medium term, *SPU 2024* forecasts the labour market to remain tight. Employment is forecast to continue to grow, albeit at a more moderate pace (1% on average over 2026-2030). Forecast labour force growth is mainly driven by continued net inward migration. The unemployment rate is forecast to be largely flat over the medium term, at just below 5%.

Growth is expected to moderate in the coming years

Economic activity continues to grow, despite headwinds from inflation, high interest rates and a mixed picture from the external environment. Early estimates suggest that real GNI* grew by around 2–3% last year, slower than previous years. *SPU 2024* forecasts growth of 2% this year, with similar growth rates for the rest of the forecast horizon (N°3).

Nº3 Growth to moderate in the coming years

Real GNI* growth

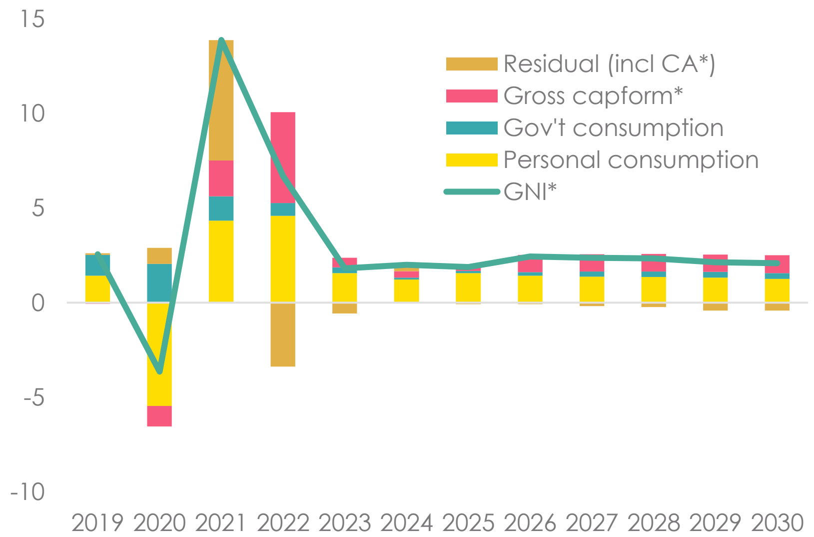


Sources: CSO, Department of Finance (*SPU 2024* forecasts). Get the data.

SPU forecasts of growth of real GNI* are driven by domestic components, particularly personal consumption (N°4). Net trade is forecast to make no significant contribution to growth in 2024 and 2025. This may reflect a more mature phase in the Irish economy as competitiveness declines somewhat.

Nº4 Growth to be driven by consumption

Contributions to GNI* growth



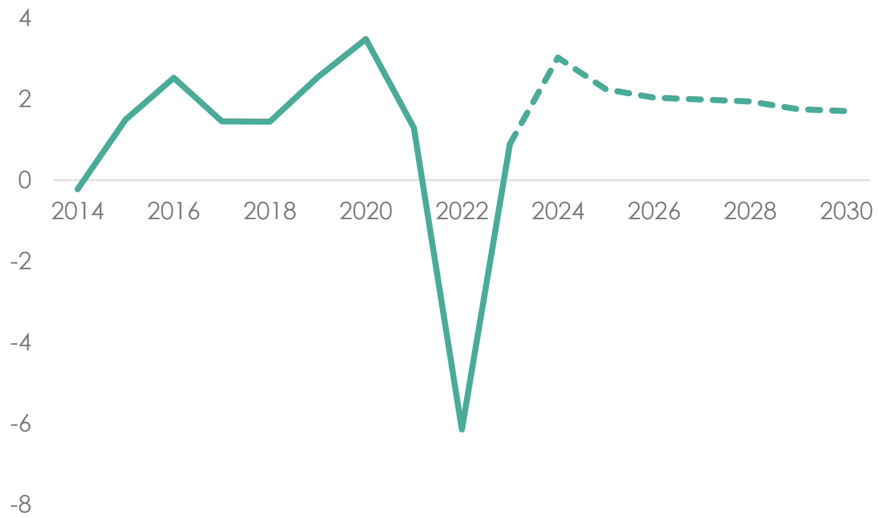
Source: *SPU 2024*. Get the data.

Real wage growth forecast to outpace productivity

Real wages are now recovering, having been reduced by the sharp increase in inflation in 2022. Modest real pay growth was recorded in 2023. A significant increase is forecast for this year in *SPU 2024*. This would still leave real wages below their 2021 level (N°5).

N°5 Real wages to recover

Real hourly wages, percentage growth



Sources: CSO, Department of Finance.
Notes: Nominal hourly wages are deflated by HICP. Get the data.

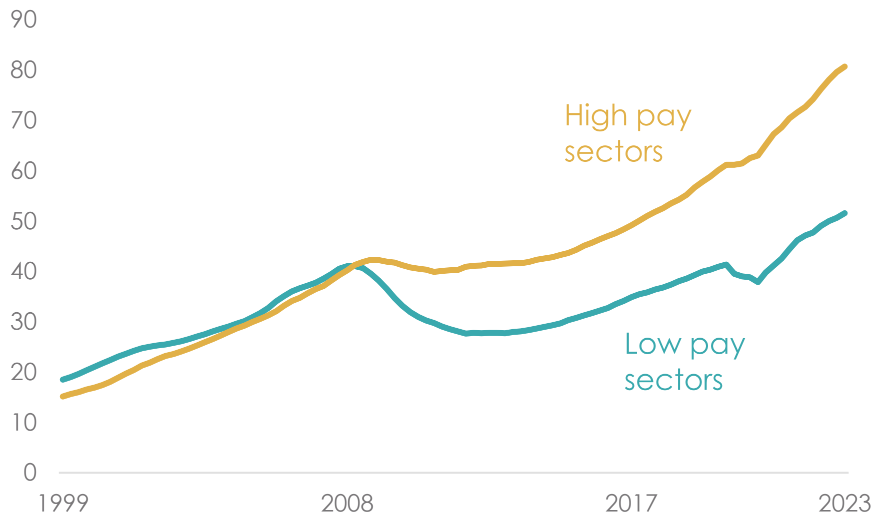
The growth in real wages comes despite modest productivity growth being forecast (N°11). Ordinarily, one would expect real wages to broadly grow in line with productivity growth. This potential inconsistency in SPU forecasts is explored further in our Endorsement Note (Fiscal Council, 2024).

As Timoney (2022) has previously highlighted, the high-paying sectors in Ireland have become increasingly important since the pandemic. Looking at overall compensation of employees, high-wage sectors are responsible for an increasing share of total pay (N°6). This is mainly driven by stronger increases in actual hours worked in high paying sectors.[3] This has significant fiscal implications. Timoney (2022) shows how strong income tax receipts in recent years have been largely driven by growth in high-paid sectors. High-paying employments ordinarily have higher average and marginal tax rates.

[3] Employment has grown more strongly in high-paying sectors, but hours worked per worker has also fallen more sharply in lower-paid sectors, which also contributes to the increasing divide in actual hours worked in the low and high-paying sectors.

N°6 High-paying sectors account for more of the pay bill

€ billion, compensation of employees, 4 quarter sum.



Sources: CSO and Fiscal Council workings.
Notes: The economy is divided into high and low-paying sectors, based on compensation of employees per hour worked. Get the data.

While the economy is set to grow at a slower rate in the coming years, overall conditions remain favourable for the Government's finances. Employment is forecast to continue growing over the medium term. Given the tight labour market conditions, this is expected to lead to strong wage increases. These developments would provide additional boost to income tax and PRSI revenue. Moreover, the persistence of low unemployment implies that government spending on unemployment supports will continue to be limited.

Inflationary pressures are abating

The rate of inflation has been slowing since the second half of 2023, with Harmonised Index of Consumer Prices (HICP) inflation in May 2024 falling to 1.9%.[4] Much of this fall in inflation has been driven by energy price falls. However, underlying measures of inflation have also fallen, though some remain elevated (N°7). Core HICP – HICP excluding food and energy – fell to 2.3% year-on-year in April, down from a peak of 5.8% in July 2022.[5]

Domestically generated inflation – inflation of goods and services with low import content – also peaked in July 2022 at 6.8% and has since moderated but remains elevated at 4.4%. A further measure of underlying inflation is the Irish Persistent and Common Component of

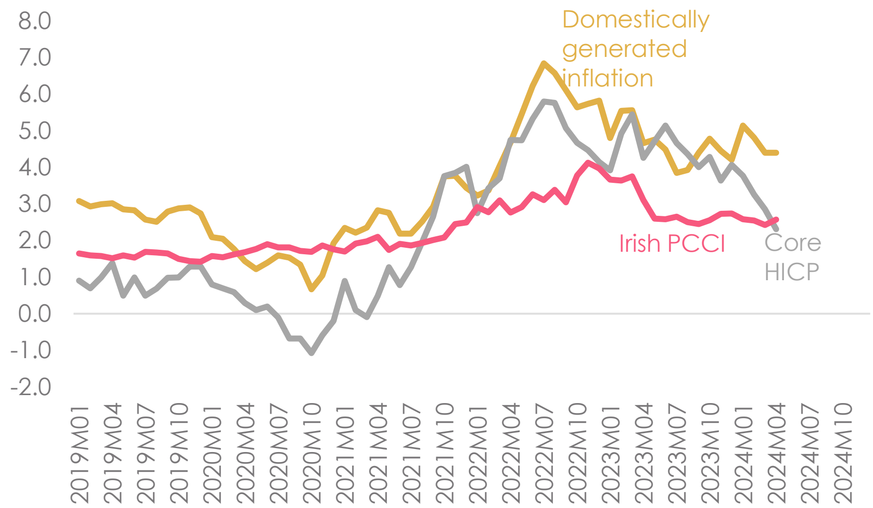
[4] This is based on the flash estimate of HICP for May. The latest available official estimate for HICP is for April, showing an inflation rate of 1.6%.

[5] The fall in core inflation is driven by falls in goods prices. Services prices continue to grow quickly.

Inflation (PCCI). Based on work by Banbura and Bobeica (2020), this measure aims to capture price pressures which are common across the consumption basket and are persistent over the medium term. This measure peaked at 4.1% in November 2022 but has since fallen back to 2.6% in April.

N°7 Underlying inflation has fallen, but remains high

% change year on year



Sources: CSO; Eurostat; and Fiscal Council workings.
Notes: Core HICP excludes energy and food. Domestically generated inflation captures the inflation of goods and services with low import content. Domestically generated inflation is based on work by Fröhling et al. (2022). See Fiscal Council (2022a) for further details. Irish PCCI is the persistent and common component of inflation (PCCI) for Ireland which is developed by the Council based on work by Banbura and Bobeica (2020). PCCI is a measure of underlying inflation that aims to capture price pressures which are common across the consumption basket and are persistent over the medium-term. Get the data.

Following Fagandini et al. (2024), input-output tables can be used to identify the components of core HICP – HICP excluding food and energy – that are sensitive to energy price increases and components that are sensitive to wage increases.[6] Using these identified

[6] Using input-output tables allows for both the direct and indirect impact of energy and wage price changes to be considered. Components are identified as energy-sensitive if their energy cost share is greater than average. For non-energy industrial goods (NEIG) components, this is an energy cost share greater than 6.1% and, for services, an energy cost share greater than 4.4%. In Ireland, in 2024, energy-sensitive components of core HICP make up 36% of the overall HICP basket. Components are identified as wage-sensitive if the direct wage cost share is greater than 38%. No component of NEIG is identified as wage-sensitive, meaning the wage-sensitive core HICP only consists of services. In Ireland, in 2024, wage-sensitive components of core HICP make up 14% of the overall HICP basket. Energy-sensitive components and wage-sensitive components are not mutually exclusive, but there is relatively little overlap between the two. A tenth of energy-sensitive core HICP is also wage-sensitive.

components, Figure N°8 shows the inflation rates for energy-sensitive and wage-sensitive core HICP in Ireland since 2018.[7]

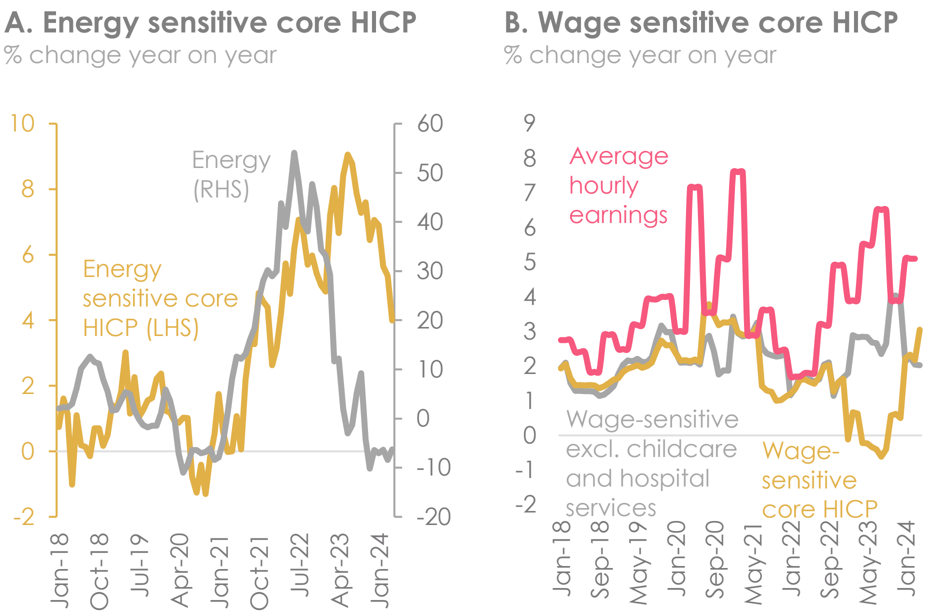
Energy inflation peaked in June 2022, while energy-sensitive core HICP peaked 12 months later (N°8A). Since then, energy prices have fallen, while energy-sensitive core HICP remains elevated, at 4% in April 2024. Energy price deflation began in June 2023; since then, energy-sensitive core HICP inflation has moderated, with prices increasing by only 0.7%. Given the previous lag time in the passthrough, energy-sensitive core HICP inflation could be relatively low in the second half of the year.

Figure N°8B shows wage-sensitive core HICP inflation in Ireland since 2018. In March 2024, wage-sensitive core HICP inflation was 3.1%. This index has been heavily influenced by changes in government policy over this period, with childcare and hospital prices being cut by government decisions. Excluding these components, wage-sensitive HICP inflation peaked in November 2023 at 4%, but has since declined to 2%. In comparison, nominal hourly wages grew by 5.1% in Q1 of 2024, a relatively fast pace. In addition, real wages are forecast to grow relatively quickly in 2024, which might result in a pickup in wage-sensitive inflation over the next 18 months.[8]

[7] Energy-sensitive core HICP makes up 48% of core HICP, while wage-sensitive core HICP makes up 19% of core HICP.

[8] This is excluding hospital and childcare services prices. Further government policies that will reduce the price of childcare services are due to kick in in the latter part of 2024.

N°8 Inflationary pressures are abating



Sources: CSO; Eurostat, and Fiscal Council workings.
Notes: Energy-sensitive core HICP is the components of core HICP identified by Fagandini et al. (2024) that have above average energy cost share. Likewise, Wage-sensitive core HICP is the components of core HICP identified to have above average wage cost share. Average hourly earnings are available on a quarterly basis and exclude irregular earnings. The peaks in average hourly earnings in 2020 and 2022 are affected by compositional issues related to the Covid-19 pandemic. Get the data.

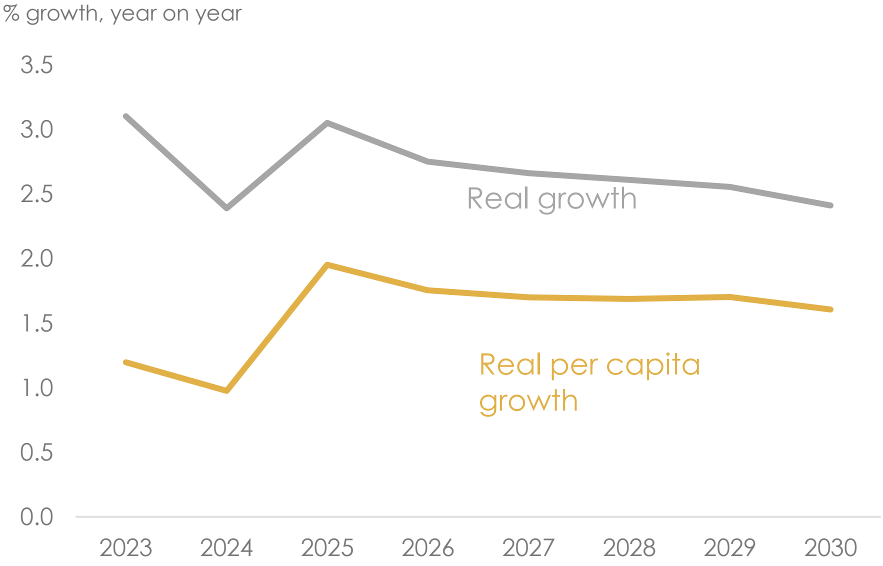
Overall, inflationary pressures are abating and *SPU 2024* forecasts a significant fall in inflation in 2024, but risks remain.

Consumption moderating

Personal consumption growth is expected to weaken to 2.4% in 2024, from 3.1% in 2023 (N°9). This fall in growth in 2024 follows on from a slow-down in growth in the second half of 2023. Despite the introduction of an auto-enrolment pensions scheme, which is planned for 2025, consumption growth is forecast to rebound in 2025 as inflationary pressures continue to ease.

This rebound in consumption growth outpaces disposable income growth, resulting in lower savings. The household savings ratio is expected to continue falling out to 2025 (N°10).

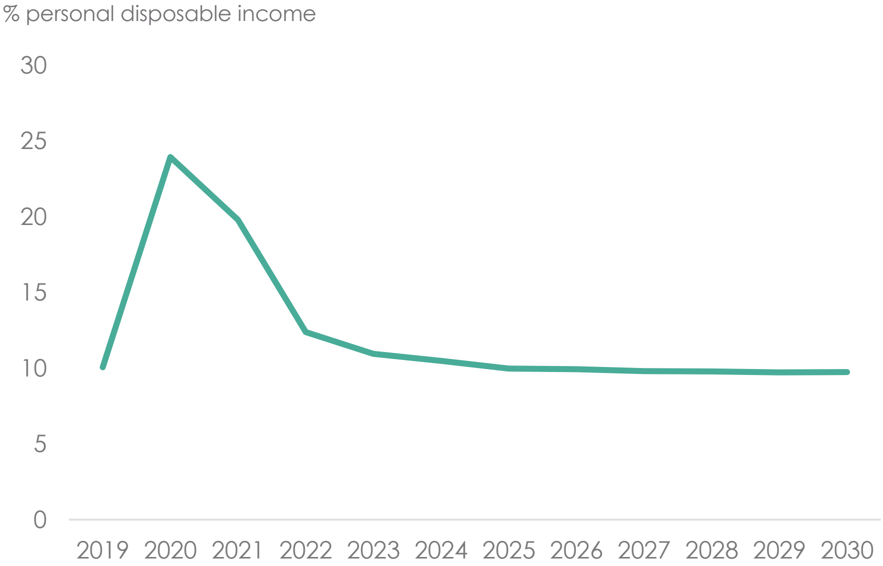
N°9 Consumption growth expected to moderate over the medium term



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

Over the medium term, consumption growth is expected to be moderate (N°9). Real per capita growth is expected to be 1.7% on average over 2026-2030. Overall, the savings rate is largely flat in the medium term, settling at close to pre-pandemic levels (10%).

N°10 Savings ratio forecast to stabilise at pre-pandemic levels



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

How will the Irish economy transition over the medium term?

The nature of the economy's transition to medium term will also have significant fiscal implications. Stronger productivity growth would lead to stronger wage growth. This in turn would be reflected in income tax and PRSI receipts.

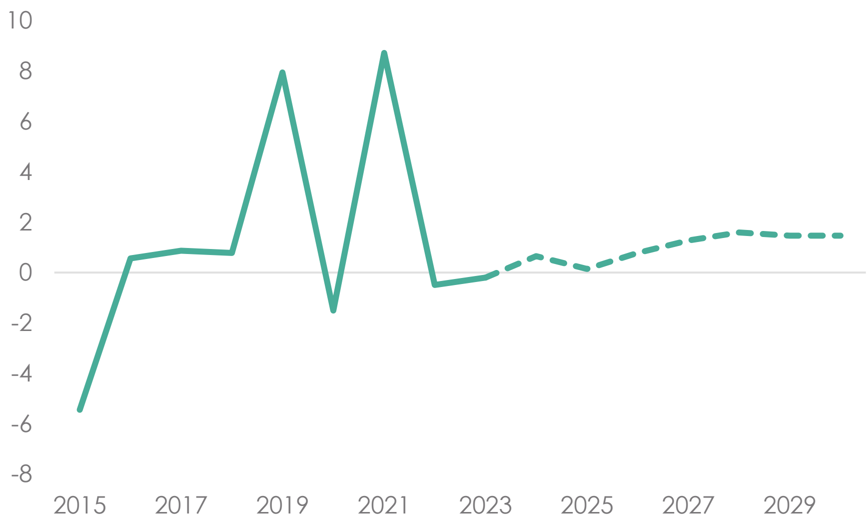
As outlined above, the Irish economy has performed extraordinarily well over recent years. *SPU 2024* forecasts the economy to smoothly transition to its medium-term growth rate of around 2–2.5% (N°3).

Productivity growth will be a key determinant of how the Irish economy transitions to its medium-term growth path. This is because increases in employment or hours worked are limited in the medium to long term, leaving productivity as the key growth driver.

Many standard measures of productivity in Ireland are distorted due to the impact of foreign multinationals. A more reliable measure of productivity is real GNI* per hour worked. *SPU 2024* forecasts imply almost no productivity growth for 2024 and 2025, before rising to 1.5% by the end of the forecast horizon (N°11).

N°11 Productivity growth forecast to recover over the medium term

Real GNI* per hour worked, percentage growth



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

Infrastructure and the capital stock will likely influence this transition and productivity growth more generally. If Ireland's capital stock and infrastructure remain stretched, the economy may struggle to have a high productivity transition to its medium-term trajectory. Below we explore how Ireland's overall capital stock compares to other high-income EU countries and potential issues in the supply of construction workers to deliver additional infrastructure (Box A).

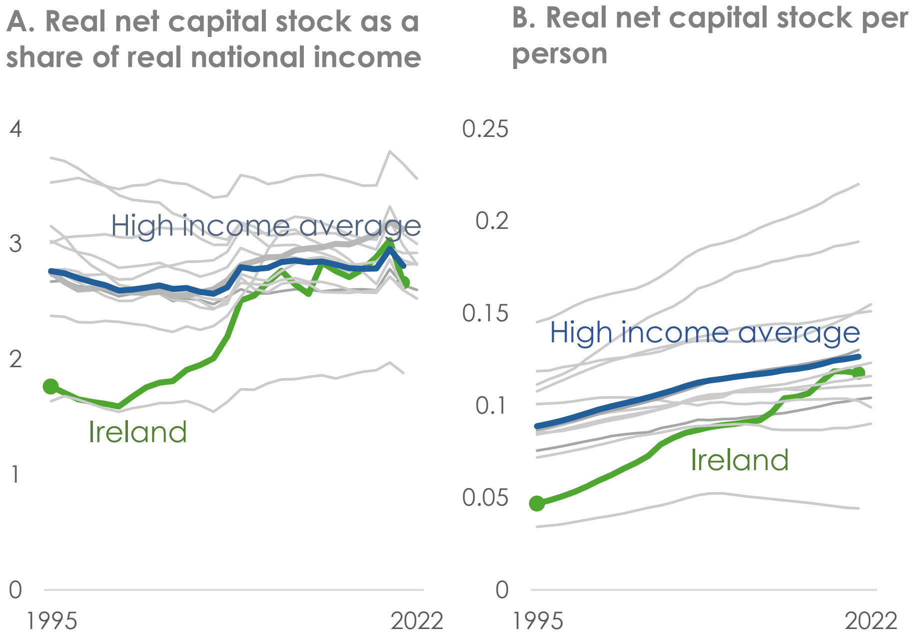
Ireland's infrastructure deficits persist

The recent growth in economic activity and population has not been matched by infrastructure investment. As a result, Ireland's capital stock has become more stretched. The Fiscal Council (2023b) showed some evidence of low levels of infrastructure in housing, health and transport.

Using an economy-wide measure, we can compare Ireland's infrastructure to that in other high-income EU countries (N°12). Whether national income or population is used as a scale factor, a similar picture emerges. Compared to other high-income EU countries, Ireland has risen from well below average in the 1990s to around average at present.

It is worth noting that the Eurostat data end in 2021 for Ireland. Given the strength of national income and population growth in the meantime, it is likely that the capital stock has not kept up with population or economic growth. So, Ireland's position could be slightly worse than is shown in N°12A and N°12B.

Nº12 Ireland's capital stock has risen to mid-table EU levels



Sources: Eurostat, CSO, and Fiscal Council workings.
Notes: GDP is used for national income for all countries apart from Ireland, where GNI* is used. Capital in the manufacturing and ICT sectors is excluded for all countries due to distortions in the Irish data. The countries used are Belgium, Denmark, Germany, Ireland, Greece, France, Italy, Luxembourg, Netherlands, Austria, Finland, Sweden and Norway. In panel B, the real net capital stock (2015 prices, € millions) is divided by total population. Get the data.

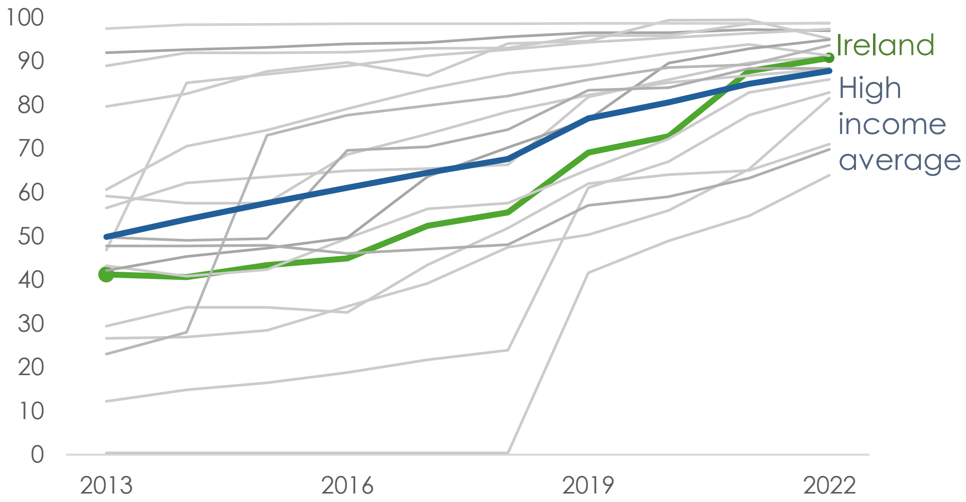
As well as catching up with areas where the capital stock is stretched (such as housing, health and transport), there will be significant investment needs for the transition to a zero-carbon economy. The overall capital stock is driven not just by government capital spending, but also by private sector firms and households. Facilitating and incentivising the private sector to invest and add to the productive capacity of the economy should be a key consideration in addressing these infrastructure deficits. This can include providing policy certainty to the private sector. However, some of the most acute shortages in Ireland's infrastructure are in areas that are predominantly publicly funded (transport and health).

Post-pandemic, remote working has become much more commonplace globally. This is particularly the case for high-value services sectors. With that in mind, high-speed broadband for households has become much more important, not just for personal use, but also for working remotely.

The percentage of households with access to high-speed broadband in high-income European countries is shown in N°13.[9] Ireland, like most other countries has seen high-speed broadband coverage increase substantially over the last decade. Despite this increase, Ireland ranks around the middle of the high-income European countries for such coverage. Given that Ireland has a large number of leading technology firms, one might expect Ireland to be a leader in high-speed broadband coverage in Europe.

N°13 Ireland's high-speed broadband coverage has improved

Percentage of households with broadband of 100 megabits per second or faster



Source: Eurostat.
Notes: The countries used are Belgium, Denmark, Germany, Ireland, Greece, Spain, France, Italy, Luxembourg, Netherlands, Austria, Portugal, Finland, Sweden, Iceland, Norway, Switzerland and the United Kingdom. Get the data.

Significant investment will be required

Housing completions in 2023 were higher than expected, leading to an upward revision in the forecast. After a modest increase this year, housing completions are projected to rise more notably over the medium term (N°14). Evidence of some reallocation of activity from commercial to residential real estate supports these projections. Box A explores the challenges of increasing the number of construction workers to ramp up the number of house completions and deliver other infrastructure projects.

There has been a strong increase in commencement of housing projects. However, this likely reflects timing effects rather than a sustained increase in housing activity. Residential projects that started

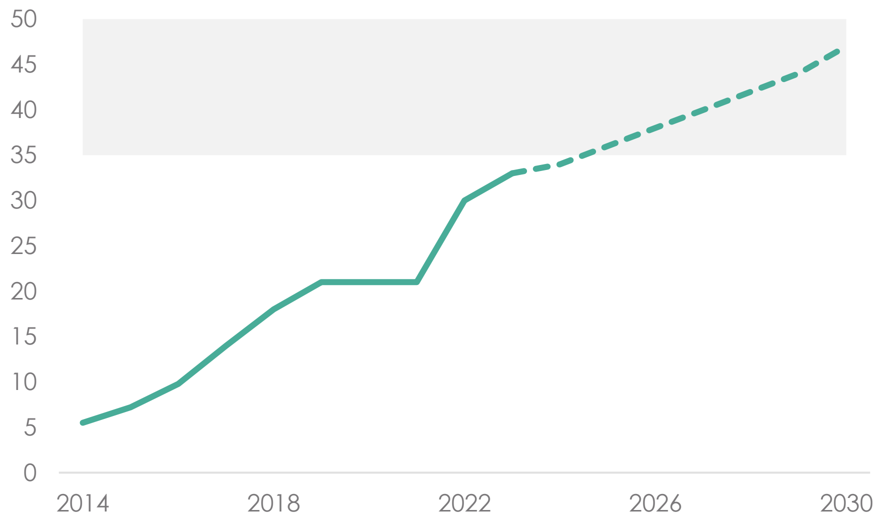
[9] For the purposes of this exercise and due to data availability and comparability, high-speed broadband is defined as 100 megabits per second or faster.

before 24th April 2024 could avail of a waiver for development contributions and a water connection charges refund scheme.[10] As a result, projects that might ordinarily have commenced later in the year may have been pulled forward to the early part of this year.

Even with these higher forecasts of completions Ireland's stock of housing is set to remain low relative to its population for some time. This shortage of housing is one of the key infrastructural challenges Ireland is facing. Addressing the multiple areas with infrastructure shortfalls is key to supporting productivity growth in the coming years.

Nº14 Completions to increase

Thousands of dwellings



Sources: *SPU 2024* and Fiscal Council workings.
Notes: The shaded area provides a range of estimates of the annual requirement for housing completions. Get the data.

Modified investment is forecast to grow strongly over 2026-2030 (averaging over 5%). As a result, investment is forecast to grow as a share of output. This is mostly driven by increased housing completions and investment in machinery and equipment.

Investment in machinery and equipment is forecast to be weak this year. This is largely due to base effects, with some large projects completed last year. Thereafter, machinery and equipment investment is forecast to outpace output growth. This would be

[10] The waiving of development contributions has since been extended to projects that commence before the end of 2024. The refunding of water connection charges has been extended until 30 September 2024. To qualify for the waiver and the refund scheme, all units must also be completed by 31 December 2026 (Department of Housing, Local Government and Heritage, 2024).

consistent with the large investment required for the transition towards a zero-carbon economy.

As noted earlier, there are likely to be substantial investment needs in the coming years. These are driven by infrastructure shortfalls in certain areas, such as housing, health, and transport. In addition, substantial investment is required for the transition to a zero-carbon economy. Resolving these infrastructural deficits may be key to ensuring that productivity growth can be maintained in the medium term. Doing this, while the economy is operating at or above capacity, could be challenging.

Box A: Where will additional construction workers come from?

Ireland needs construction workers to address the housing crisis, to address infrastructural deficits and to meet climate transition targets. Addressing infrastructural deficits is key to ensuring sustained productivity growth and maintaining competitiveness internationally.

At a time when housing needs are acute, there is also a need to retrofit the existing housing stock to meet climate targets. This will place significant demands on the construction sector which will require increased numbers of construction workers. This box explores where these workers might come from.

There are both domestic sources of additional labour supply and international sources. On the domestic front, further labour supply could come from:

1) Unemployed or inactive workers: Figure N°150.A show the unemployment rate for workers in the construction sector. Unemployment in construction is at very low levels, under 1.5%, much lower than in the broader economy. As a result, this is unlikely to be a source of many workers over the medium term.

   While there has been a large increase in the inflow of refugees since 2022, at present, it seems that this is unlikely to add to the potential labour force for the construction sector given the skills and training required. For instance, 5.7% of Ukrainian refugees who are employed in Ireland, are employed in the construction sector. This is a marginally lower share of construction employees than for the economy as a whole (6.2% in 2023).

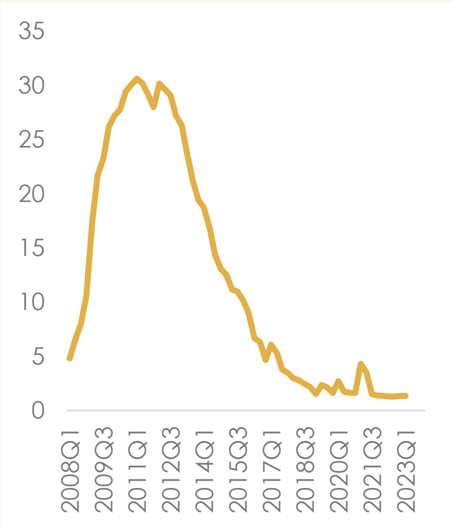
2) A switch from commercial real estate activity to residential and civil activity: Since the onset of the Covid-19 pandemic and the resultant changing work patterns, there has been a big fall-off in the demand for office space. This has resulted in a slowdown in construction in the commercial real estate sector. As activity in this sector moderates, there is the potential for workers who had been employed building commercial real estate to switch to building residential properties or other civil engineer projects. This reallocation of workers might help to address the additional labour needs.

3) Apprenticeship and college courses: Given the skills required in construction, it seems unlikely that people already in the labour force would switch sectors to the construction sector, without partaking in an apprenticeship or other training course.

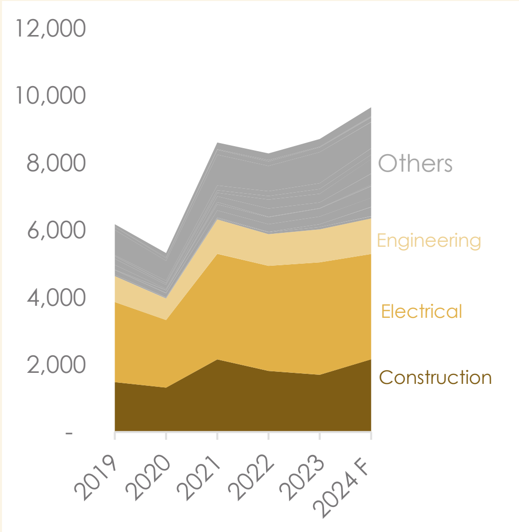
   The government has a target of 10,000 apprenticeship registrations per annum by 2025. A large proportion of these would be in areas outside of construction. In 2023, there were 8,712 registrations, with almost 70% of these in construction, electrical and civil engineering (N°15.B). The growing numbers on apprenticeship programmes should add to the domestic labour supply over the medium term provided that the apprentices do not emigrate once they complete their training.[11]

N°15 Additional construction labour supply looks limited

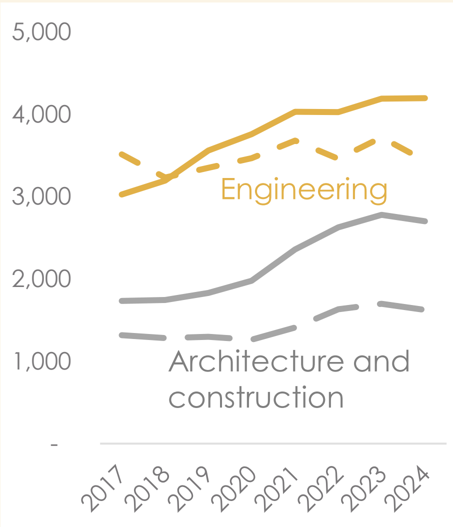
A. Unemployment rate in construction



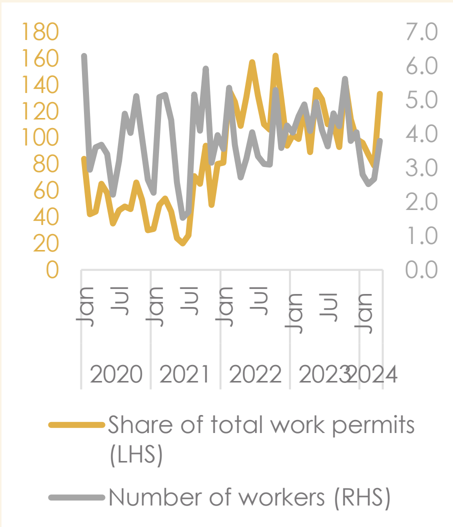
B. Apprenticeships
No. of Apprenticeship registrations



C. College applications
No. of first preferences



D. Work permits for construction
No. of permits % of total permits



Sources: CSO; Central Applications Office (CAO); Department of Enterprise, Trade and Employment; National Apprenticeship Office; and Fiscal Council workings.
Notes: In panel C, solid lines represent first preferences for level 8 courses, dashed lines represent first preferences for level 6 and 7 courses. Get the data.

Outside of apprenticeships, another way to learn the skills necessary to work in the constructions sector is through college courses. Figure N°150.C shows the number of first preferences listed on CAO applications for third-level courses for engineering

[11] A recent paper by officials at the Department of Public Expenditure discusses the trends in apprenticeships in more detail (Department of Public Expenditure, 2024).

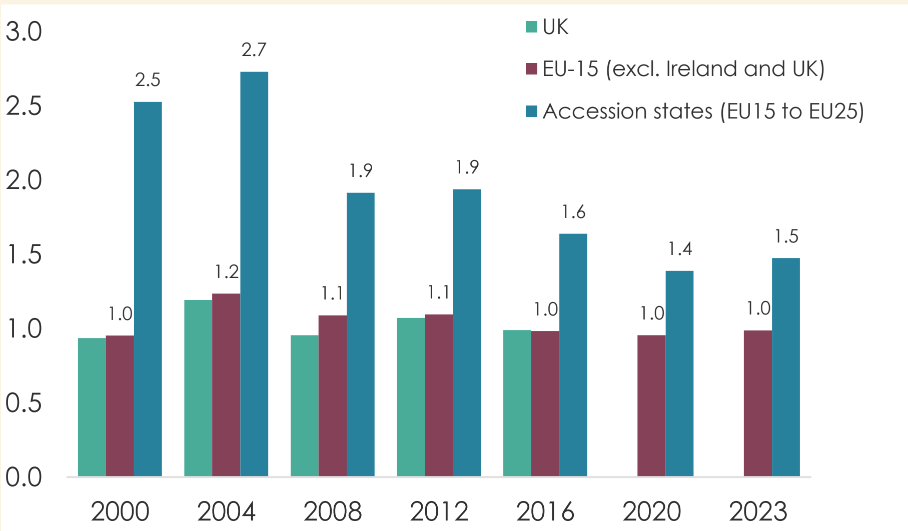
and architecture and construction. There were around 6,000 level 8 first preferences for these courses. However, first preference does not equal places in college courses.

On the international side: International labour supply channel:

1) Wage differentials: In the early 2000s Ireland's construction sector benefited from a large inward supply of migrants from other EU countries, particularly after the 2004 accession of an additional 10 countries to the EU. Part of the pull factor for this inward migration was the wage differential between these EU countries and Ireland. This differential has reduced substantially, by almost half since 2004 (N°16).
2) Work permits: The other potential source of emigration is from non-EU countries. In recent years, this has been a very limited source of construction workers. Since 2020, on average only 85 work permits per month have been issued (0.D). This is a very low proportion of total work permits, with the share of work permits issued in construction averaging 3.8% per month. This is a relatively low share as construction employment made up on 6.1% on average over the same period.
3) Returning workers from abroad. Previous work by Conefrey & McIndoe-Calder (2018) showed that many of Ireland's construction workers emigrated after the property bubble burst. Given this, there is a large stock of Irish construction workers abroad that may return. However, given the lapse in time since then, it is likely these workers are now settled, and it is unlikely that a large proportion of them will return in the near future.

N°16 Ireland is not as attractive as it once was for construction workers

Construction wage differentials. Hourly wages, Ireland relative to region specified, PPS adjusted



Sources: Eurostat; Department of Enterprise, Trade and Employment; and Fiscal Council workings. [Get the data.]

Conclusion

According to the recent Report on the Analysis of Skills for Residential Construction & Retrofitting 2023–2030 (Department of Further and Higher Education, 2023), Ireland needs over 50,000 new construction workers to meet its retrofitting and housing targets between 2023 and 2030. However, this is before any increase to the housing targets—which will require additional workers—and it does not include the need for construction workers for other badly needed infrastructure projects.[12] There is clearly an acute need for more construction workers.

However, taken together, there is not a large stock of unused domestic labour supply. While apprenticeship numbers and CAO applications in construction-related activities are growing, these numbers are still relatively small.

Internationally, the attractiveness of Ireland as destination for intra-EU migration has fallen substantially over the past two decades, meaning that this is unlikely to be a major channel. In addition, the number of work permits issued to non-EU workers in construction is very low. However, this may be one policy lever that could be used to increase the labour supply of construction workers.

Potential output growth slowing

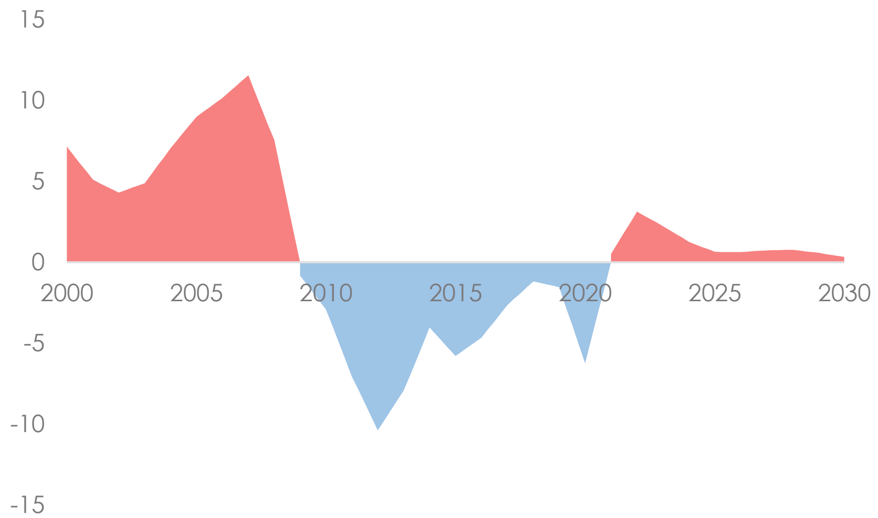
The Department of Finance uses a range of models to estimate potential output and the output gap. The midpoint of these estimates shows a positive output gap of over 3% in 2022, which then declines gradually in 2023 and 2024 (N°17). A positive output gap of less than 1% is forecast for 2025-2030. This would be consistent with an economy operating at or just above its potential capacity.

The Department estimates potential output growth to be an average of 2.2% over 2025-2030. As employment growth slows, labour makes less of a contribution. This means that capital deepening and productivity growth are the main drivers of potential output growth.

[12] The report assumes that housing completions average 34,500 each year from 2025 to 2030. Actual housing need is likely to be higher than this.

N°17 Modest positive output gap forecast

Output gap, percentage of potential output



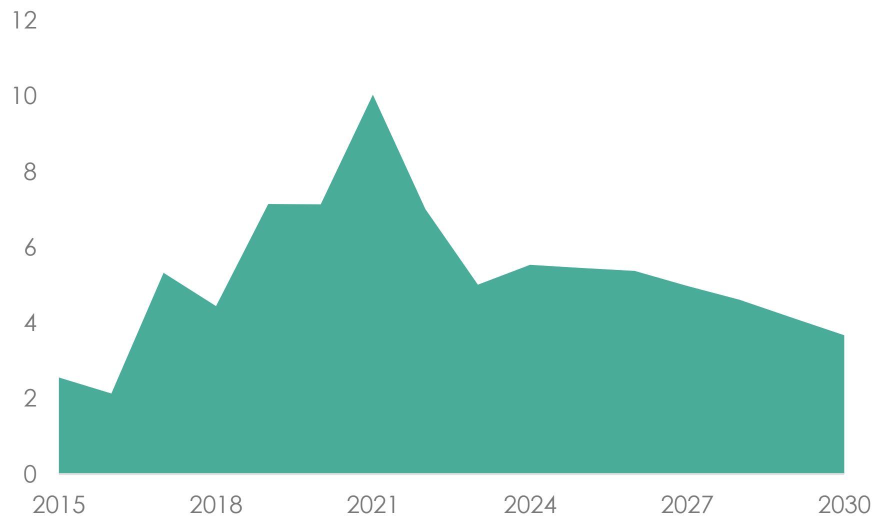
Sources: *SPU 2024*, midpoint of estimates shown.
Notes: Positive/negative output gaps indicate output is above/below its potential level.
Get the data.

Modified current account

The modified current account surplus is projected to fall over the forecast horizon (N°18). This is partially driven by the fall in the household savings rate. The forecast government surpluses contribute to the current account remaining at high levels over the medium term.

N°18 Current account surplus falling in the medium term

Modified current account balance (as a share of GNI*)



Sources: *SPU 2024* and CSO. Get the data.

Risks are broadly balanced

The supporting information section, S3, assesses the macroeconomic risks outlined in *SPU 2024* as well as additional risks identified by the Council. Overall, the Council sees macroeconomic risks as broadly balanced. Both fiscal and monetary policy are likely to be looser than ideal. This would add to price pressures and risks of the economy overheating. Higher migration or a faster fall in inflation would pose upside risks for the economy.

Budgetary Assessment

Spending forecasts are unrealistic

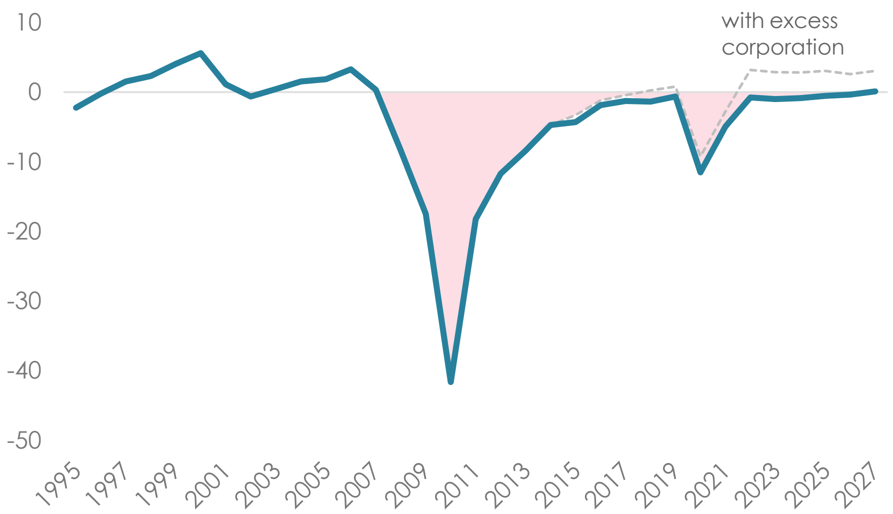
2 BUDGETARY ASSESSMENT

Spending forecasts are unrealistic

The Council is required to assess the fiscal forecasts produced by the Department of Finance for the *Stability Programme Update (SPU) 2024*. This section outlines the Council's thinking on some of the key budgetary issues arising from *SPU 2024*.

N°19 Government plans mean 19 years in deficit without excess corporation tax

General government balance excluding excess CT receipts, % GNI*



Sources: Department of Finance and Fiscal Council workings.
Notes: For excess corporation tax, *SPU 2024* figures are used for 2021-2027. For 2014-2020, Fiscal Council estimates are used. [Get the data.]

Despite favourable economic conditions, the Government is planning to run an underlying deficit out to 2026 (N°19). A key aspect of the budgetary figures considered by the Council is the quality of expenditure forecasts in *SPU 2024*. Large health spending overruns seem likely this year. These overruns are predictable, due to poor budgeting.

Budgetary figures are forecast to only 3 years ahead (N°20). This short forecast horizon does not aid strategic planning. It means the impacts of medium-term fiscal risks, like an ageing population and climate change, are not evident in *SPU 2024* projections. Other aspects explored in the section include shortcomings in general government forecasting and the continued use of fiscal gimmickry.

Nº20 *SPU 2024* fiscal forecasts

€ billions

	2023	2024	2025	2026	2027
General Government Revenue	123.7	130.2	137.3	141.9	148.7
Income tax	32.9	34.8	36.9	39.0	41.0
VAT	20.3	21.3	22.8	23.9	25.1
Corporation tax	23.8	24.5	25.6	24.7	25.8
of which excess	11.2	11.2	11.5	9.9	10.3
PRSI	15.5	16.8	18.1	19.5	21.0
Excise	5.6	6.2	6.7	7.1	7.4
Stamp duties	1.8	1.7	1.7	1.8	1.9
Other general government revenue	12.5	13.7	13.9	15.9	16.1
General Government Expenditure	115.4	121.6	127.5	133.1	137.9
Social payments	39.8	42.0	44.2	45.8	47.6
Compensation of employees	31.1	33.0	34.6	36.3	38.1
Intermediate consumption	19.0	19.2	19.4	19.7	20.0
Capital expenditure	11.8	13.2	15.0	16.6	17.0
Interest expenditure	3.5	3.4	3.3	3.5	4.0
Subsidies	2.5	2.6	2.6	2.6	2.6
Capital transfers	2.2	2.5	2.5	2.5	2.4
Other	5.5	5.8	5.9	6.1	6.4
Primary expenditure	111.9	118.2	124.2	129.6	133.9
Current primary expenditure	100.1	105.1	109.3	113.1	117.0
General Government Balance excl. windfall corporation tax	-2.9	-2.6	-1.8	-1.2	0.4
General Government Balance	8.3	8.6	9.7	8.7	10.7

Sources: CSO; Department of Finance, and Fiscal Council workings.
Notes: Estimates of windfall corporation tax receipts are the Department of Finance's estimates published in *SPU 2024*. Other general government revenue includes accrual adjustments. Get the data.

2.1 Forecasts for 2024 — overruns likely and fiscal gimmickry persists

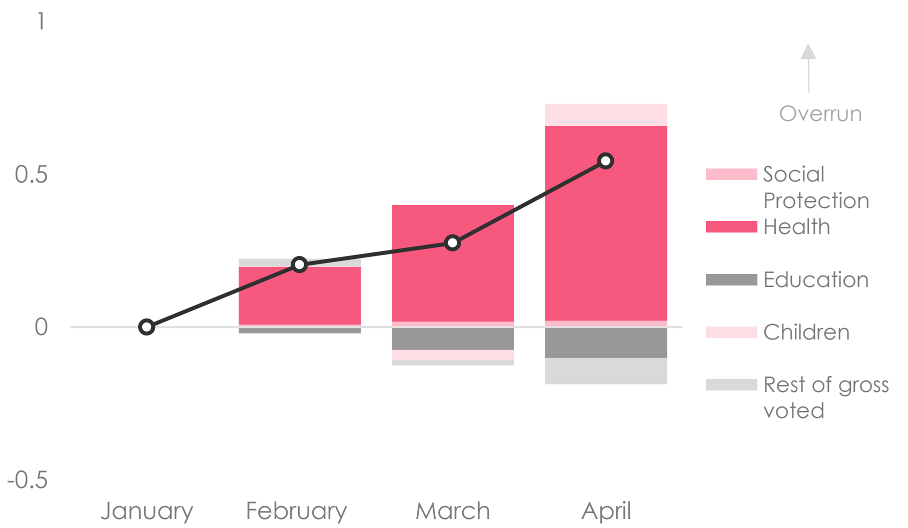
Stability Programme Update 2024 core spending forecasts for 2024 are €0.5 billion higher than forecast at budget time. This reflects costs associated with the new public sector pay deal, over and above what was already included in *Budget 2024*. The Department is now forecasting an underlying deficit (excluding windfall corporation tax receipts) of €2.6 billion, or 0.9% of GNI* for 2024. However, this is before likely overruns in health spending are accounted for.

Health overruns likely again in 2024

SPU 2024 forecasts for spending in 2024 underestimate spending and look unrealistic. After just four months of the year, overruns are mounting. Gross voted current expenditure at the end of April was already €0.5 billion, or 2% ahead of forecast (N°21).

N°21 Current spending vs original profile (*Budget 2024* forecast)

€ billion, gross voted current spending



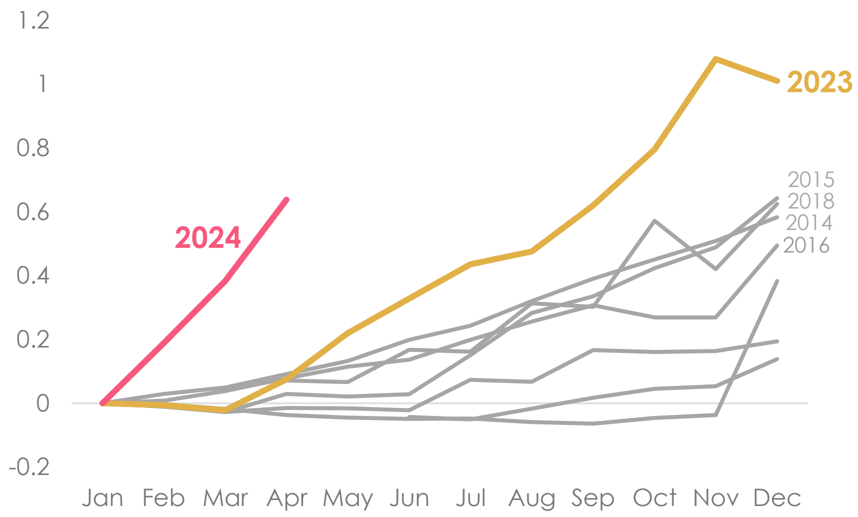
Sources: Department of Finance and Fiscal Council workings.
Note: Education includes higher and further education. Get the data.

This overspend is mainly driven by overruns in health, which is €0.6 billion or 9.2% ahead of forecast at the end of April. Health overruns are materialising much sooner this year than in the past (N°22). The overrun at the end of April was already on par with the worst pre-pandemic end-of year overrun. Were the rest of the year to see overruns grow at a similar rate as last year, the total overrun would be €1.6 billion. However, if the overrun continues at a rate of 9.4% above forecast for the rest of the year, the overrun would be €2 billion – more than the entire annual budget for the Department of Agriculture in 2024.

These overruns in health were well flagged. As the Council outlined in its December 2023 Fiscal Assessment Report (Fiscal Council, 2023b), the budgetary allocation to the Department of Health was insufficient to cover stand-still costs. This inappropriate budgeting all but guaranteed overruns in 2024. As an illustration of this, the *Revised Estimates for 2024* published by the Department in December, which fully incorporated 2023 overruns, detail a bizarre situation in which the pay bill in health is expected to fall in 2024. This is despite an expected increase in staffing and an improved public sector pay deal.[13]

N°22 Health overruns are larger and materialising sooner this year

€ billion, cumulative monthly health spending overruns in years 2014–2023



Sources: Department of Finance and Fiscal Council workings.
Note: Figures exclude Covid-19 years 2020-2022. Figures for July to December 2023 reflect the transfer of the Disability function from the Department of Health to the Department of Children. Figures for the previous months do not reflect this transfer. Get the data.

As highlighted by Casey and Carroll (2021), overruns have been a regular occurrence in health budgeting in Ireland. Part of the problem seems to be that hospital and primary care budgets are often set very tight, maybe with the expectation that efficiencies will be generated. This might be credible if it had a record of producing savings or preventing overruns. Instead, this seems to have led to what economists call a 'soft budget constraint' (Kornai, 1979), where

[13] The revised estimates incorporated €0.7 billion for a new pay deal in 2024. The actual cost of the pay deal in 2024 is €1.1 billion. The only other Department with a falling pay bill in 2024 is the Department of Defence. The pension bill in health is also expected to fall in 2024 by 2%, despite an increase in pensioners of 3%. In 2023, the pension bill was also expected to fall by €50 million relative to 2022. The pension bill in 2023 ended up increasing by €20 million, €70 million more than forecast.

managers know that overruns will be financed and so there is little incentive to stick to ceilings and create efficiencies. As a result, there is limited/no incentive to produce savings or prevent overruns. Instead, providing limited budget increases in big spending areas appears to have set the scene for spending overruns. This points to a failure of planning.

That is not to say that healthcare spending cannot be made more efficient. Ireland ranks as a high spender on health internationally, even with a relatively young population today. This is particularly evident for outpatient services — daily hospital services excluding overnight or longer-term hospitalisations. Shine and Hennessy (2024) found that between 2016 and 2022 complexity-adjusted activity in acute hospitals increased by 3.8%, whereas real expenditure increased by 45% over the same period.[14] There is also a large variance across hospitals in the increased expenditure and the increased complexity-adjusted activity over this period. Shine and Hennessy (2024) put forward several recommendations to improve productivity and expenditure management in acute hospitals.

Budget 2025 needs to appropriately factor in overruns

As the Council discussed in its December 2023 Fiscal Assessment Report, in-year health overruns were not adequately accounted for in *Budget 2024*. This led to poor forecasts for spending in 2023, with a knock-on impact into 2024.

This approach should not be repeated in *Budget 2025* (or the *Summer Economic Statement*). Health spending overruns in 2024 should be adequately built into the base for 2025 and not repeat the mistakes of *Budget 2024*. In particular, it is not credible that the pay bill would be falling in a situation where there is an expected increase in staff numbers and an increase in pay scales.

Fiscal gimmickry should end

Fiscal gimmickry – a term used in the literature to describe creative accounting techniques aimed at making the government's fiscal numbers look more favourable – is continuing in *SPU 2024*.

[14] Complexity-adjusted activity is a measure of activity which accounts for variations in the complexity of care delivered across hospitals and inpatient and day care in each hospital.

The Government has classified several expenditure measures as non-core and therefore falling outside what is to be assessed under the Government's National Spending Rule. This has flattered the Government's spending figures. As highlighted by the Council in Box D of the its December 2023 Fiscal Assessment Report (Fiscal Council, 2023b), there is limited rationale for classifying these measures as non-core in 2024. These measures include health spending to deal with the post-pandemic escalation of health sector costs from increased activity and demand across acute hospitals, funding to continue reduced public transport fees, and spending on International Protection Accommodation Services.[15]

All of these spending items are likely to be permanent in nature and should be treated like other core areas of spending. There is no rationale for treating these as non-core in 2025, and *Budget 2025* should stop this fiscal gimmickry. These measures should be treated alongside other expenditure and fall within the scope of the Government's National Spending Rule.

Tax and PRSI revenue remains buoyant

Revenue has shown a strong performance at the start of the year, with tax and PRSI revenue (excluding corporation tax) at the end of April up 7.2% on last year. In real terms (HICP deflated), this represents revenue growth of 5.5%.

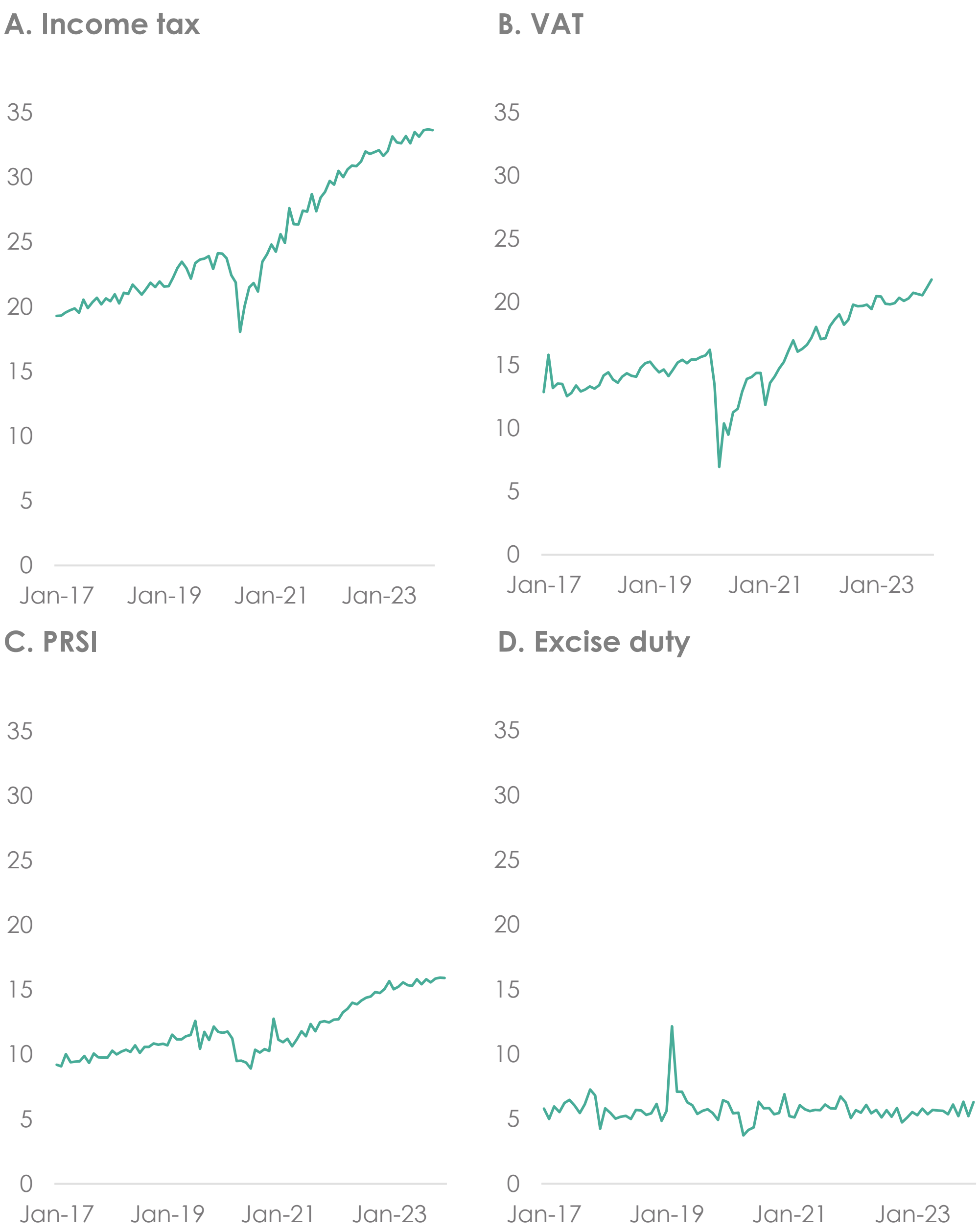
However, corporation tax has shown continued volatility, with receipts at the end of April down 24%. This may be related to the timing of payments, with higher offsetting payments expected in August.

Looking at individual revenue sources, both income tax and PRSI at the end of April were up over 7% year on year (N°23). VAT was also up by 6.3%, while excise duty was up by 14%, in part reflecting the reversal of the rate cuts on petrol and diesel. In all, receipts are broadly on track with Budget forecasts.

[15] This spending is unrelated to the war in Ukraine and is used to fund accommodation for non-Ukrainian refugees.

Nº23 Tax and PRSI revenue performing well

€ billion, annualised seasonally adjusted receipts



Sources: Department of Finance; and Fiscal Council workings.
Notes: Monthly tax data are seasonally adjusted and annualised (× 12). Get the data.

2.2 Outturns for 2023 and issues in forecasting general government figures

Budget balance €0.5 billion lower than forecast

As the Council outlined in its December 2023 Fiscal Assessment Report (Fiscal Council, 2023b), it was clear that *Budget 2024* forecasts for government gross voted spending in 2023 were too low. Anticipated overruns, particularly in the Department of Health, had not been adequately factored into the budgetary figures.

Gross voted spending in 2023 was €94.7 billion, €1.3 billion higher than forecast in *Budget 2024*. This was made up by higher-than-expected current spending of €670 million and higher-than-expected capital spending of €650 million.

Tax revenue of €88.1 billion was broadly in line with Budget forecasts, with higher than anticipated corporation tax receipts broadly offsetting lower than expected capital gains tax.

However, in general government terms, things are different. Despite the €1.3 billion higher than expected Exchequer spending, general government spending was €0.8 billion lower than anticipated. And while tax revenue was broadly in line with forecasts, general government revenue was €1.2 billion lower than forecast. These different forecast errors for Exchequer figures relative to general government figures point to some issues with the current forecasting approach. These are discussed in further detail below.

General government figures should be given priority

General government revenue and expenditure are broader and more comprehensive measures of revenue and spending than Exchequer revenue and spending. General government figures provide a more wholistic measure of government revenue and spending as they incorporate not only Exchequer figures but also PRSI revenue and social insurance fund spending, revenue and spending of local governments, non-commercial semi-state bodies and other extra-budgetary funds. General government figures are compiled to an internationally agreed accounting standard, thus allowing cross-country comparisons. These figures are also consistent with other macroeconomic data compiled by the CSO. In addition, it is the general government revenue and expenditure figures that are used for assessing legal compliance with both the EU's fiscal rules and Ireland's domestic budgetary rule.

Given their breath, consistency, comparability across countries and requirements under the fiscal rules, general government figures are among the most important budgetary figures. Despite the importance of these figures, the Department's current approach to forecasting general government figures is inadequate.

White paper spending estimates should be on a departmental basis

On the Friday before Budget day, the white paper is published which details estimates of revenue and expenditure on a 'no policy change' basis for the current year and the year ahead. These white paper estimates are the baseline for the Budget forecasts.

White paper expenditure estimates are produced on a top-down basis – taking into account aggregate spending dynamics within a year – and not based on estimates for each individual department. The top-down approach can potentially conceal some key dynamics in underlying expenditure. For instance, were estimates produced on a departmental basis, it would have been clear that the forecasts for spending in 2023 and 2024 were too low as anticipated overruns in health were not adequately factored in.

The underestimated spending from the white paper feeds into errors in forecasting the Exchequer balance and the general government balance. Errors in the white paper estimates are a particular cause for concern; if there are obvious errors in the starting point, these are likely to be compounded in the forecasts for later years.

The approach to forecasting the general government figures is inadequate and lacks transparency

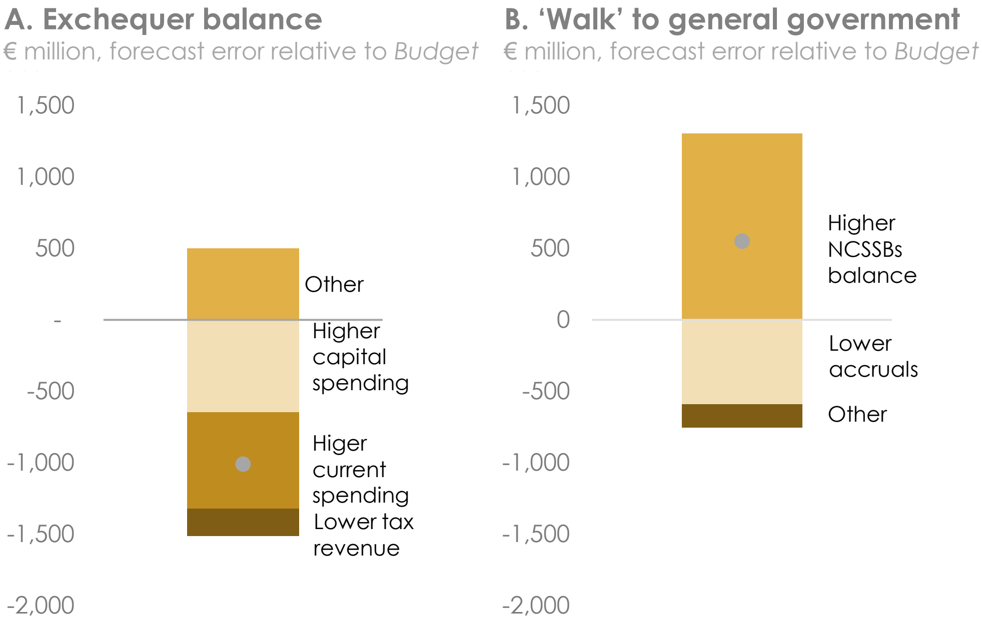
The Department's approach to forecasting the general government balance is to first forecast the Exchequer balance using the white paper estimates taking into account policy changes. Then the Department estimates the 'walk' from Exchequer balance to general government balance.[16] From there, forecasts of general government expenditure and general government revenue are backed out so that they are consistent with the derived balance using the 'walk' approach.

This approach has several shortcomings. First, it does not give accurate forecasts of general government expenditure and revenue, as well as their subcomponents. Despite efforts to make reasonable forecasts, these forecasts are essentially a residual with the components adjusted so that the resultant budget balance is the same as in the 'walk' approach. Second, this approach can potentially lead to inconsistencies and violations of national accounting identities. This has been the case in the past (see Box C of the June 2023 Fiscal Assessment Report, Fiscal Council, 2023a). It can also lead to inconsistencies in the forecasts of general government spending and Exchequer spending (see Nº26 below). Third, the Department publishes limited information on the 'walk' to general government, publishing only net figures for several items, not the gross flows.[17] This lack of information makes it difficult to assess whether the Department is underestimating or overestimating expenditure or revenue items. However, large forecast errors in a short space of time indicate that there are significant underestimates of revenue or overestimates of expenditure for some 'walk' items in recent years.

[16] See Table A3 of the *Stability Programme Update* 2024 for details of the forecasts for the "walk". The "walk" includes accrual adjustments, adjustments for equity and loan transactions (including the impact of the Future Ireland Fund (FIF) and the Infrastructure, Climate and Nature Fund (ICNF)), net lending of non-commercial semi-state bodies, net lending of the Social Insurance Fund, net lending of local government, net lending of other extra-budgetary funds and the impact of the Irish Strategic Investment Fund.

[17] For instance, the Department only publishes information on the net balance of extra-budgetary funds, of non-commercial semi-state bodies, of local government, and of the social insurance fund. It does not publish the gross expenditure and revenue flows that are used to arrive at these net positions.

Nº24 *Budget 2024* forecast errors for 2023 for components of the general government balance



Sources: Department of Finance and Fiscal Council workings.
Notes: NCSSBs are non-commercial semi-state bodies. Get the data.

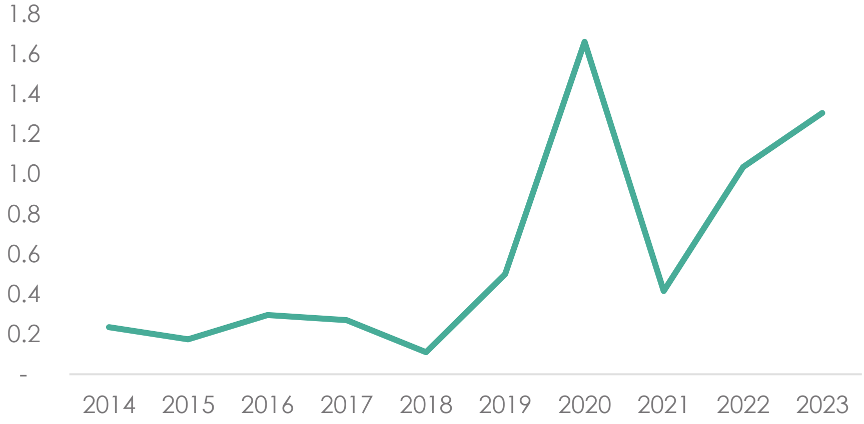
As an example of the shortcomings, in 2023 there were large forecast errors in some of the 'walk' measures, despite two quarters of general government data and nine months of other cash data being available.

The *Budget 2024* forecast of net lending of non-commercial semi-state bodies (NCSSBs) in 2023 was €1.3 billion too low. Given the corresponding revenue and expenditure flows of non-commercial semi-state bodies were in the region of €14 billion, this is a very large forecast error given that only three months of the year were remaining.

This issue is not new. In recent years, there have been large in-year forecast errors for the net lending of non-commercial semi-state bodies (Nº25). The in-year forecast (essentially a three-month-ahead forecast) for net lending of non-commercial semi-state bodies has an average absolute forecast error of €1 billion a year since 2019. While part of this period covers an extremely volatile period, these are large forecast errors given the forecast is essentially for three months ahead.

N°25 Large forecast errors for non-commercial semi-state bodies in recent years

€ billion, absolute forecast error for year t = | SPU in year t+1 – Budget for year t +1 |



Sources: CSO, Department of Finance, and Fiscal Council workings.
Notes: Figures show the absolute forecast error for the in-year forecast between the outturn in an SPU and the previous Budget. For instance, the figure for 2022 shows the forecast error between the *Budget 2023* forecast for the year 2022 and the outturn in *SPU 2023*. Get the data.

Despite Exchequer spending being higher than forecast in Budget 2024 (+€1.3 billion), general government spending was much lower (–€2.3 billion) than forecast (N°26). Given that Exchequer spending makes up most of the general government spending, the disconnect between the two forecast errors illustrates the inappropriateness of the current approach to forecasting general government figures.

The largest forecast errors for general government spending were for capital transfers (€1.1 billion, or 52% of the outturn) and subsidies (€0.7 billion, or 27%) (N°27).[18]

On the revenue side, the bulk of the revision comes from the 'other' category (€1.2 billion). The majority of this is made up of the sale of goods and services by government, which is made up of revenue from items like hospital fees, tuition fees and admission fees to public museums or parks.[19] The forecast error for this component was almost 18%, with only two quarters to forecast.[20]

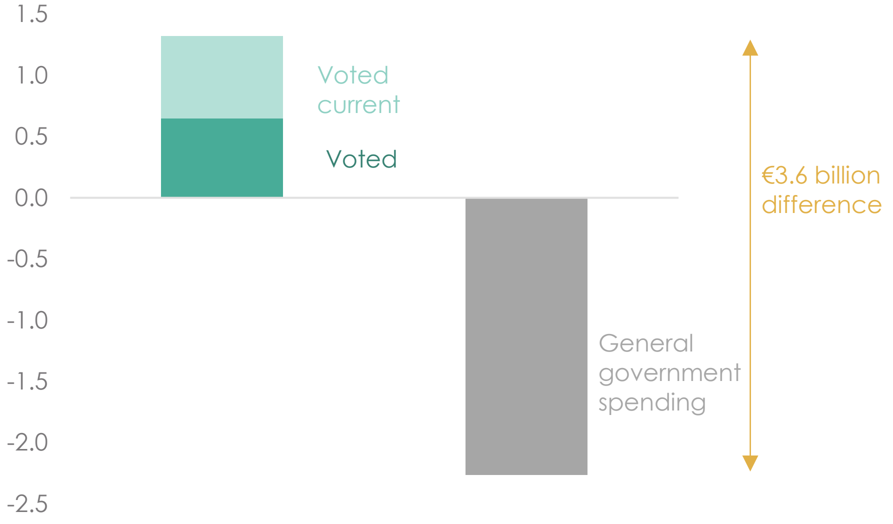
[18] Percentage forecast errors here are expressed as a percent of the full-year outturn. The percent forecast errors are larger when compared to only the last two quarters of the year, at 102% for capital transfers and 51% for subsidies.

[19] In 2023, approximately 70% of the 'other' category was made up of the sale of goods and services by government.

[20] Again, the percentage forecast error here is expressed as a percent of the full-year outturn. The percent forecast errors are larger when compared to only the last two quarters of the year, at 35%.

N°26 *Budget 2024* forecast errors for government spending in 2023

€ billion, 2023 outturn – *Budget 2024* forecast. Positive value = forecast too low. Negative value = forecast too high.



Sources: Department of Finance and Fiscal Council workings.
Note: The general government spending figure is adjusted for revisions by the CSO for data for Q1 and Q2 2023. See Table N°27 for details. These revisions revised up government spending data for Q1 and Q2 by a total of €1.5 billion. The unadjusted forecast error for general government spending is –€0.7 billion. On an unadjusted basis, the difference between the Exchequer and general government forecast errors would be €2.1 billion. Get the data.

N°27 *Budget 2024* forecast errors for 2023

General government, outturn – *Budget 2024 forecast*. Positive value = forecast too low. Negative value = forecast too high.

	Error	Error	CSO revisions to Q1 and Q2 data	Error adjusted for revisions	Error adjusted for revisions	Error adjusted for revisions,
	€ million	% of full-year outturn	€ million	€ million	% of full-year outturn	% of outturn of last two quarters
General government revenue	–1,185	**–1.0**	**151**	**–1,336**	**–1.1**	**–2.0**
Taxes on production and imports	90	0.3	2	88	0.3	0.5
Current taxes on income, wealth	–200	–0.3	89	-289	–0.5	–0.9
Capital taxes	10	1.6	0	10	1.6	1.9
Social contributions	–170	–0.8	5	–175	–0.8	–1.6
Property Income	195	9.7	0	195	9.7	14.9
Other	–1,115	–16.8	55	–1,170	–17.6	–34.5
General government expenditure	–735	**–0.6**	**1,531**	**–2,266**	**–2.0**	**–3.7**
Compensation of employees	765	2.5	513	252	0.8	1.6
Intermediate consumption	–480	–2.5	218	–698	–3.7	–6.8
Social payments	760	1.9	477	283	0.7	1.3
Interest expenditure	125	3.6	–119	244	7.0	14.0
Subsidies	–665	–26.2	11	–676	–26.6	–50.8
Gross fixed capital formation	165	1.4	250	–85	-0.7	–1.2
Capital transfers	–1,145	–51.7	–3	–1,142	–51.6	–102.1
Other	–260	–4.7	184	–444	–8.1	–18.9

Sources: CSO, Department of Finance, and Fiscal Council workings.
Notes: Positive values indicate the forecast was too low. Negative values indicate the forecast was too high. Data for two quarters, Q1 and Q2 of 2023 were available at the time of Budget 2024. These data were subsequently revised by the CSO. In nearly all cases, these data were revised upwards. This would mean, all else equal, forecast errors would be positive (i.e. forecasts would be too low, as the forecasts would not have reflected the upward revision to the historical data). In the last column the percentage forecast error is calculated based on the outturns for the last two quarters. Given that the Department was forecasting only two quarters of data, it may be more appropriate to scale the forecast errors on this basis. Get the data.

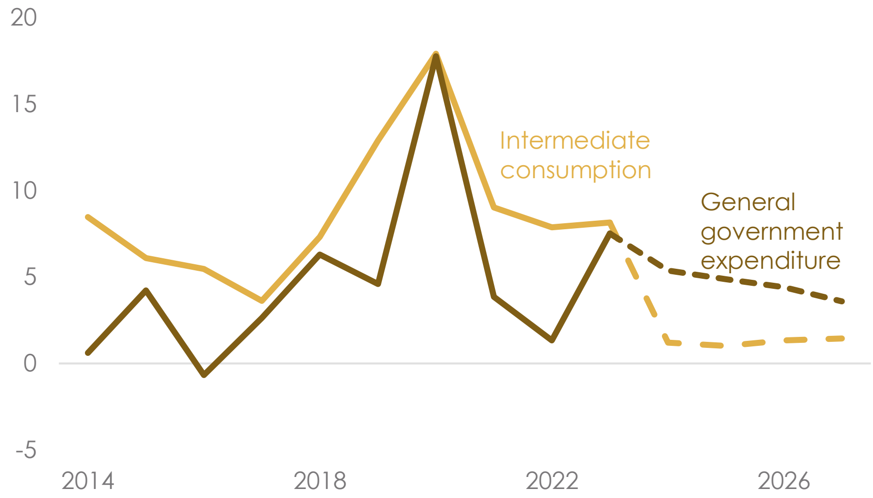
Looking further ahead, the *SPU 2024* forecasts for spending on intermediate consumption, which was €19 billion or 16% of general government spending in 2023, look too low (N°28). While total general government expenditure is forecast to grow by an average of 4.6% per year over 2024-2027, intermediate consumption is forecast to grow by an average of only 1.3% over the same period.[21] Between 2014 and 2023, total general government expenditure grew by an average of 4.8% per year, while intermediate consumption grew by an average of 8.7% per year. Absent significant policy changes, it is unclear why government expenditure patterns would change

[21] Between 2014 and 2023, general government expenditure growth averaged 4.8% per year. Over the same period, intermediate consumption growth averaged 8.7%.

dramatically over the forecast horizon, resulting in this low forecast for intermediate consumption.

Nº28 Intermediate consumption forecasts unrealistically low

% change y/y



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

2.3 The costs of maintaining existing services are high

To gauge the cost of current policy decisions into the future, the Council estimates the costs of maintaining the existing level of services, or 'Stand-Still' costs. These 'Stand-Still' estimates factor in the expected costs of demographic changes and inflationary pressures on the public services, as well as the costs of maintaining welfare rates relative to wages. It is also ultimately a policy choice whether to maintain welfare rates relative to economy-wide wages. This approach assumes that there are no efficiency gains in the provision of public services.

To assess the potential medium-term 'Stand-Still' costs, the Covid-19 and Ukrainian spending are included in the baseline costs for 2024. As there is likely to be an overrun in health this year, this needs to be factored in, to accurately gauge the costs of maintaining existing services into next year. If the overrun grows at the same pace as last year, this would result in a total overrun of €1.6 billion for this year.[22] This is the baseline assumed here for the 'Stand-Still'.[23]

Over 2025-2027, 'Stand-Still' costs are set to average €4.7 billion (N°29). This is €0.7 billion a year more than what the Government currently plans to increase current spending by. Demographic costs are set to average €1.5 billion over 2025-2027, while the impact of price, wage and welfare increases is set to cost €3.1 billion per year over the same period.

Looking at the key areas, the biggest 'Stand-Still' costs are from health and the state pension, averaging €1.6 billion and €1.2 billion.

[22] As mentioned in Section 2.2, at the end of April the overrun was 9.4%. If this rate was maintained for the rest of the year, the overrun could be as large as €2 billion.

[23] The total assumed overrun in health in 2024 is €1.6 billion. Some of this overrun is already incorporated in *SPU 2024* figures to deal with the extra cost from the public sector pay deal. We assume that health's share of these extra funds is €150 million, meaning that €1.45 billion is the amount added to the total spending for 2024.

Nº29 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

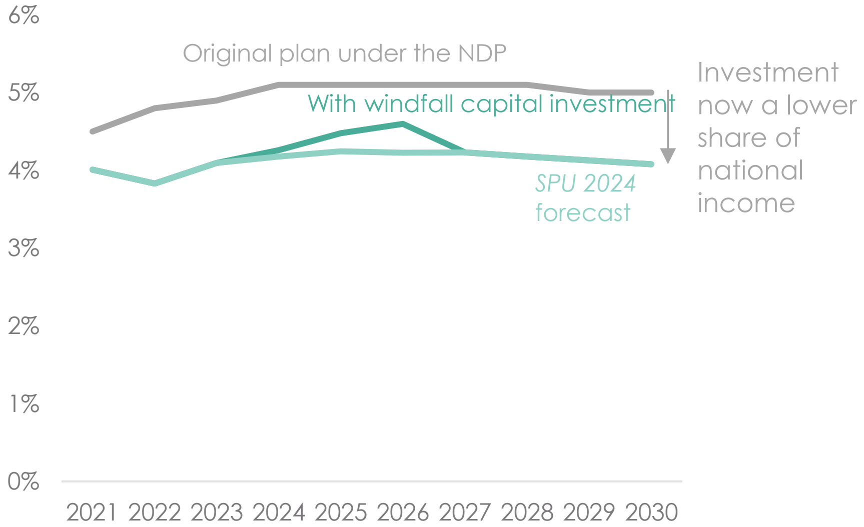
Sources: Fiscal Council workings.
Notes: The total assumed overrun in health in 2024 is €1.6 billion. Some of this overrun is already incorporated in *SPU 2024* figures to deal with the extra cost from the public sector pay deal. We assume that health's share of these extra funds is €150 million. Wages are set to grow in line with the new public sector pay deal for 2025-2026. As this expires in the middle of 2027, from there, public sector wages grow in line with forecasts of private sector pay growth. Get the data.

2.4 Capital spending eroded by inflation

Despite additional planned spending on capital, through 'windfall capital investment', under the Government's latest plans capital spending is forecast to be a smaller share of national income than originally planned (N°30). Investment spending over 2024-2030 is now forecast to average 0.8 percentage points of GNI* lower than originally planned under the National Development Plan (NDP). As Section 1 outlines, this is at a time of substantial infrastructural deficits.

N°30 Investment spending is now almost 1% of national income lower than previously planned

Gross voted core capital spending, % of GNI*



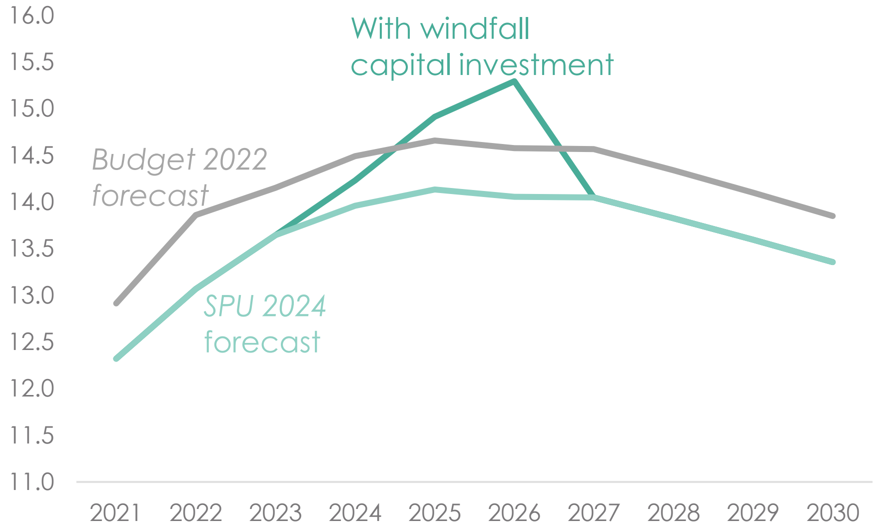
Sources: NDP, Department of Finance, and Fiscal Council workings. Get the data.

Since the 2022 inflation shock, core capital spending has not been revised up by as much in response to inflation, meaning the share of total spending on capital has fallen (N°31). In contrast, core current spending has been revised up significantly. At the same time, planned tax reductions more than doubled, from €0.5 billion, to €1.1 billion per year. With the addition of windfall capital investment – which is not considered core spending by the Government – the share of capital spending rises above the original plans for only two years, 2025 and 2026.

The Council has been heavily critical of the classification of this spending as 'windfall capital investment' and outside of core spending. The Council does not have an issue with more capital spending, particularly at a time of large infrastructural deficits, provided that the overall package of tax and spending is sustainable and value for money can be achieved.

N°31 The ratio of capital spending to current spending is lower than originally planned

Gross voted core capital as a share of core total gross voted spending

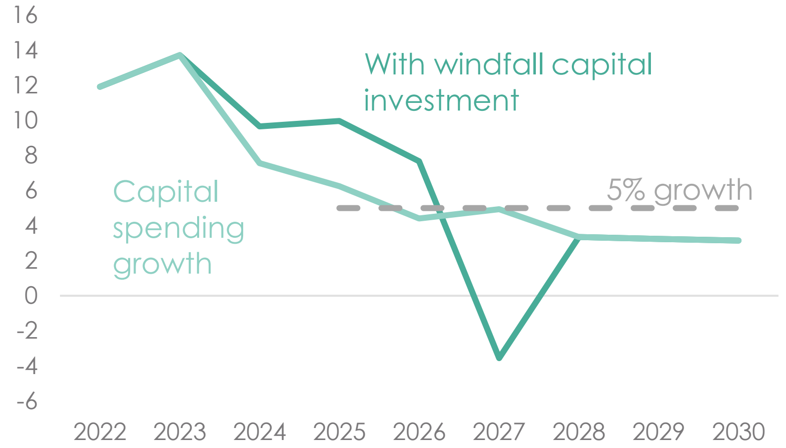


Sources: NDP, Department of Finance and Fiscal Council workings.
Note: Core total gross voted spending is assumed to grow at a 5% rate for 2028-2030.
Get the data.

Capital spending's share of total spending is forecast to fall from 2027 onwards. This is due to low growth rates forecast under the NDP for 2028-2030. Capital spending under the NDP for 2028-2030 is forecast to grow by only 3.2% per year (N°32). This suggests that not only is there no catch-up to previous NDP plans, but also that the share of investment to national income will fall (N°30). Under a 5% net spending rule, this means capital spending would grow by less than current spending (unless there were additional tax cuts), at a time in which there are large infrastructural deficits.

N°32 Growth in capital spending forecast to fall below 5%

% change y/y

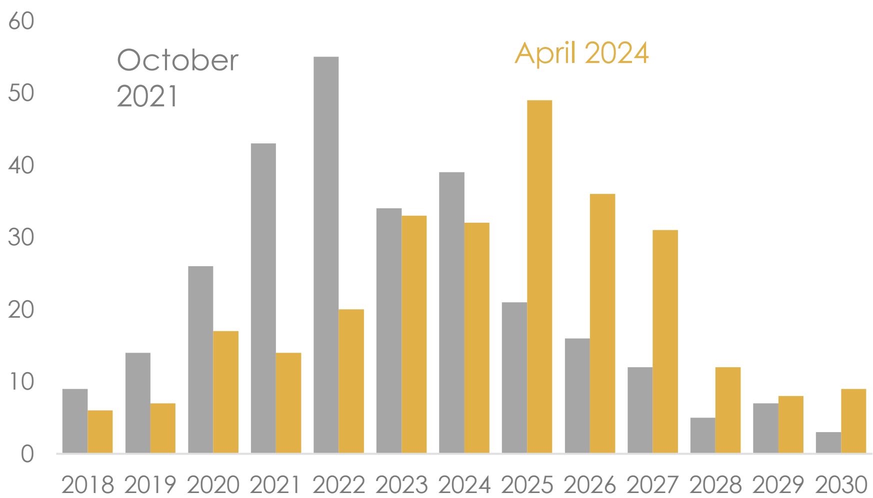


Sources: NDP, Department of Finance and Fiscal Council workings. Get the data.

Looking at the delivery of NDP projects, it is clear that significant delays have occurred relative to original plans. There was a substantial rightward shift in the distribution of estimated (or actual) completion times of large NDP projects (N°33) between October 2021 and April 2024.

N°33 Significant delays evident in NDP delivery

Number of projects by estimated (or actual) completion date

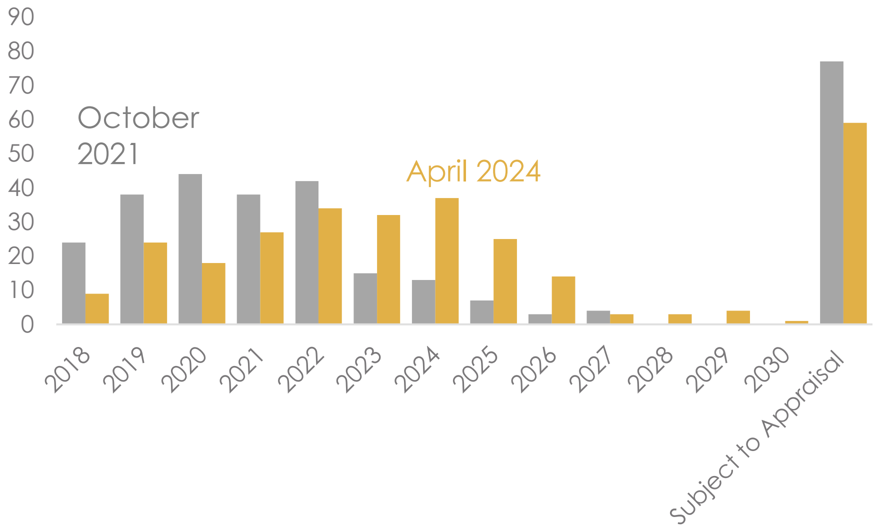


Sources: NDP, Department of Public Expenditure, and Fiscal Council workings.
Notes: Figures show estimated (or actual) completion dates from the Investment projects and programmes tracker from October 2021 and from April 2024. The Investment projects and programmes tracker reflects projects with a cost exceeding €20 million. Get the data.

While part of these delays in delivery may be due to construction being behind schedule, there appear to be significant delays in the planning phase of the projects. Figure N°34 shows another rightward shift in the distribution of the estimated (or actual) commencement dates between October 2021 and April 2024 which is indicates significant delays in the planning phase of projects.

N°34 Planning delays are evident

Number of projects by estimated (or actual) commencement date

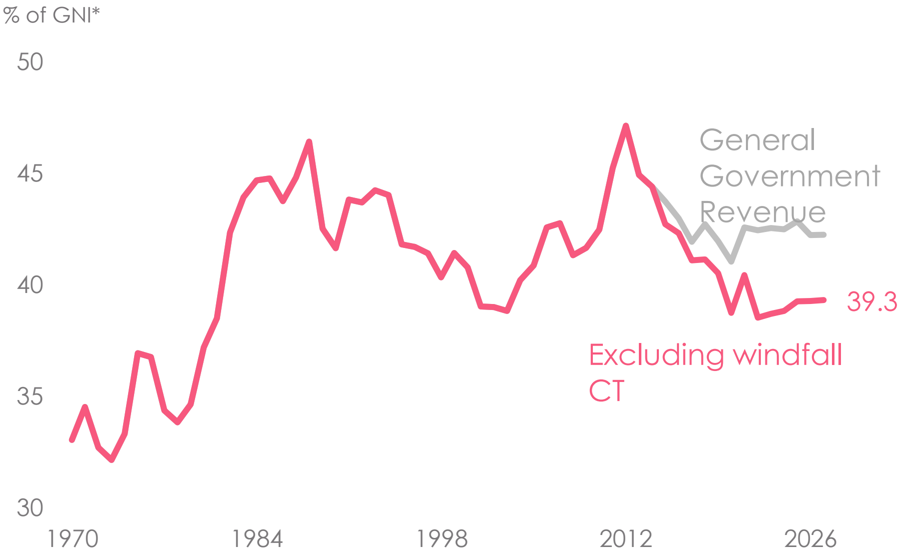


Sources: NDP, Department of Public Expenditure, and Fiscal Council workings.
Notes: Figures show estimated (or actual) commencement dates from the Investment projects and programmes tracker from October 2021 and from April 2024. The Investment projects and programmes tracker reflects projects with a cost exceeding €20 million. Projects subject to appraisal do not have a timeline for commencement yet. Get the data.

2.5 Government revenue is concentrated

Excluding windfall corporation tax receipts, tax revenue is forecast to grow by an average of 5.4% per year over 2024-2027. Over the same period, nominal modified gross national income (GNI*) is forecast to grow by an average of 4.9% per year. Taken together, this means the tax share of national income is forecast to rise slightly to 39.3% by 2027 (N°35).

N°35 Revenue to rise slightly but to remain low as a share of national income



Sources: Department of Finance and Fiscal Council workings.
Notes: Fiscal Council estimates of windfall corporation tax are used for 2015-2021. *SPU 2024* estimates are used for 2022-2027. Prior to 1995, current and capital receipts (excluding borrowing) are used to extend the general government series back (from the historical Annual National Accounts, 1970-1995). Get the data.

This current tax burden is at a relatively low share by post-1990 historical standards, with the average share between 1995-2019 being 41.8% of GNI*.[24] This lower share of revenue to GNI* is mainly driven by a declining share of taxes on production and imports. Taxes on production and imports are forecast to be 11.3% of GNI* in 2027, a fall of 3.2 percentage points relative to the 1995-2019 average (N°36).

Taxes on production and imports are made up mainly of VAT, excise, customs and stamp duty. The fall relative to the long-term average is across the three main items, with excise in 2027 falling by 1.8 percentage points, relative to its 1995-2019 average, and both VAT

[24] Excluding the crisis period of 2009-2014, this average would be 41.1% of GNI*.

and stamp duty falling by 0.6 percentage points. The fall in the excise receipts to GNI* share is due to declines in both revenue from fuel duty, and alcohol and tobacco duty.[25] The decline in taxes on production and imports is offset by a rise in the share of income taxes and social contributions (PRSI), both increasing by 1.4 percentage points.

The 'other' revenue category has also seen a large decline relative to its long-run average. The largest component of this category is the sale of goods and services, making up 70% of the category in 2023. This constitutes revenue items such as hospital fees, tuition fees and admission fees to public museums and parks. By 2023, the sale of goods and services had fallen by 0.8% of GNI*, relative to its long-run average.

Nº36 Changes in revenue composition over time

% of GNI*

General government revenue	2027	1995-2019 average	Change
Taxes on production and imports	11.3	14.5	–3.2
Taxes on income, wealth (excl. windfall corporation tax)	17.0	15.6	1.4
Capital taxes	0.2	0.2	0.0
Social contributions	8.2	6.8	1.4
Property income	0.5	1.2	–0.6
Other	2.0	3.6	–1.6
Total revenue (excluding windfall corporation tax)	39.3	41.8	–2.5
Exchequer revenue	**2027**	**1995-2019 average**	**Change**
VAT	7.1	7.7	–0.6
Stamp duty	0.5	1.1	–0.6
Excise duty	2.1	3.9	–1.8
Corporation tax	4.4	3.6	0.8
Income tax	11.6	9.8	1.9
General government	**2022**	**1995-2019 average**	**Change**
Excise duty on alcohol and tobacco products	0.9	1.7	–0.8
Excise duty on hydrocarbon oil products (ex. carbon tax)	0.6	1.5	–0.9

Sources: CSO; Department of Finance, and Fiscal Council workings.
Notes: Estimates of windfall corporation tax receipts are the Department of Finance's estimates published in *SPU 2024*. VAT, excise and stamp duty are all components of 'Taxes on production and imports'. Get the data.

Overall, there has been a marked shift over time from indirect taxation towards direct taxation. This shift has occurred mainly through implicit

[25] Fuel duty revenue in 2022 was 0.9 percentage points below its 1995-2019 average and alcohol and tobacco duty revenue in 2022 was 0.8 percentage points below its 1995-2019 average.

rather than explicit tax changes.[26] On the direct taxation side, fiscal drag – a tax increase, that arises when tax bands and credits do not rise in line with inflation, which sees the tax burden on individuals rise – has been responsible for this increase. Figure N°37 shows the explicit (i.e. announced) policy changes for income tax and PRSI announced on Budget day since 1995. Cumulatively, tax reductions of 5.4% of GNI* have been announced. Given that the income and PRSI tax burden has increased over this period, it is clear that the announced tax cuts were not sufficient to offset this fiscal drag.

On the indirect tax side, the reverse is true. Changing consumption patterns – for instance a shift from goods to services – also represent an implicit tax cut as a significant proportion of services are VAT exempt, with other services being taxed at a lower rate (13.5%) relative to goods (typically 23%). Likewise, not increasing excise duty rates results in the tax content of these products falling over time as prices rise—an implicit tax cut. On the indirect taxation side, explicit tax increases have cumulatively raised 3.1% of GNI* between 1995-2019. Given that the ratio of indirect tax to GNI* has fallen over the same period, it is clear that implicit tax reductions have substantially offset these explicit tax increases.

N°37 Explicit income and PRSI policy changes impact on revenue

% of GNI*

Sources: Conroy (2020), Department of Finance and Fiscal Council workings.
Notes: Figures show the discretionary tax policy changes for PRSI and income tax as a share of GNI* from 1995-2023. Get the data.

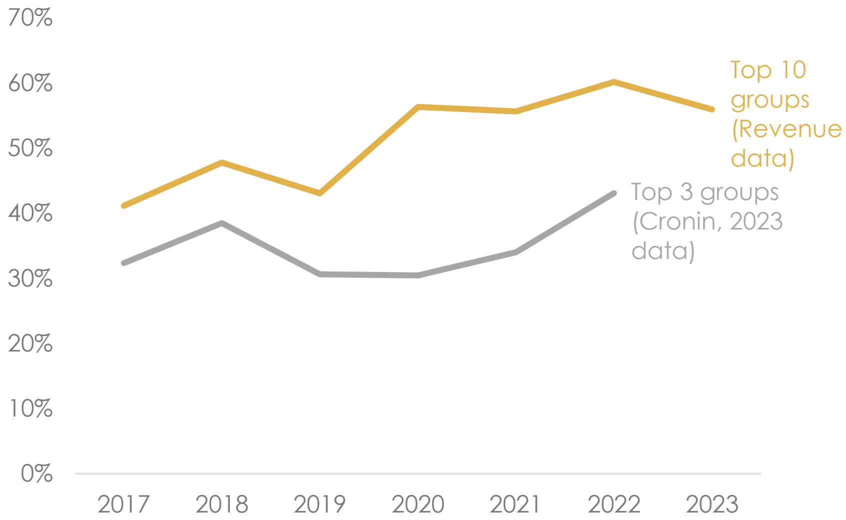
[26] Explicit tax changes are deliberate and announced policy changes. Implicit tax changes are the changes in composition of taxation due to inaction. For instance, more workers moving into higher tax brackets as wages increase, or not increasing excise rates in line with inflation resulting in the tax share in the price of these goods falling.

Corporation tax remains highly concentrated

The sustainability of corporation tax is a key fiscal risk as it is both a large share of total taxation and it is highly concentrated. New figures from the Revenue Commissioners show that the top 10 corporate groups accounted for 56% of corporation tax receipts in 2023 (N°38). Figures from Cronin (2023) show that this is even further concentrated with the top three groups accounting for 43% of corporation tax receipts in 2022. As Box B discusses, this is not the only source of concentration in the tax system.

N°38 The concentration of corporation tax has increased over time

% of total corporation tax



Sources: Revenue Commissioners, Cronin (2023), and Fiscal Council workings. [Get the data.]

SPU 2024 incorporates the potential impact of Base Erosion and Profit Shifting (BEPS) reforms into the fiscal forecasts. There are two pillars to these reforms. Pillar I will see corporation tax paid based more on the location of sales rather than where profits are ordinarily booked. This would likely see a fall in corporation tax receipts in Ireland. However, it is unclear when there will be full agreement on Pillar I and its implementation timeline is unclear.

Pillar II sees a minimum effective rate of 15% applied to corporate groups with a global turnover of €750 million or more. Given that Ireland's headline corporation tax rate is 12.5%, large firms paying corporation tax here would have to top up their payments to reach a 15% rate. This could lead to significant additional revenue. Unlike Pillar I, these reforms have already been agreed and implemented. As a result, Ireland is likely to see additional revenue from this source as soon as 2026, with the full impact being seen in 2027. Since Pillar II has already been fully implemented and the implementation of Pillar I is unclear, and since the Department assume the overall impact of BEPS reforms will be negative for Ireland, there may be a significant upside risk to *SPU 2024* forecasts of corporation tax for 2026 and 2027.

Box B: How narrow is Ireland's tax base?

As a small open economy, Ireland is highly vulnerable to external shocks. Having a narrow tax base exacerbates the vulnerability of the public finances to these potential shocks.

In the run-up to the financial crisis Ireland's tax revenue became highly dependent on receipts from property which were boosted by the bubble. In turn, these receipts were used to reduce the tax rates in other areas, such as income tax, or to increase government spending. These policies further exacerbated the property bubble while weakening Ireland's tax base resulting in an amplified boom-bust cycle (O'Rian, 2017).

The concentration of taxation can be assessed across several dimensions: concentration of taxes within sectors; concentration of tax revenue among certain taxes; concentration of tax revenue within certain taxes (i.e. concentration of taxpayers); concentration of tax revenue from the same tax base; and concentration of tax revenue from a certain location. Some dimensions of concentration, like concentration of taxpayers or concentration among certain taxes, poses greater fiscal risks than others. This box looks at some high-level measures of Ireland's tax base across these key dimensions.

Measuring how concentrated Ireland's taxes are

One summary measure commonly used to assess concentration is the Herfindahl-Hirschman Index (HHI).[27] Figure N°39 shows this concentration measure from 2007 to 2022 based on the concentration among all tax heads (income tax, VAT, excise duty, etc), among the tax base on which taxes are levied on (income, consumption, capital, etc), among the sectors (manufacturing, construction etc.), and among locations (Dublin, Donegal, etc.) from which the taxes come from.[28] The higher the value, the higher the level of concentration. Typically, values above 2,500 indicate high levels of concentration.

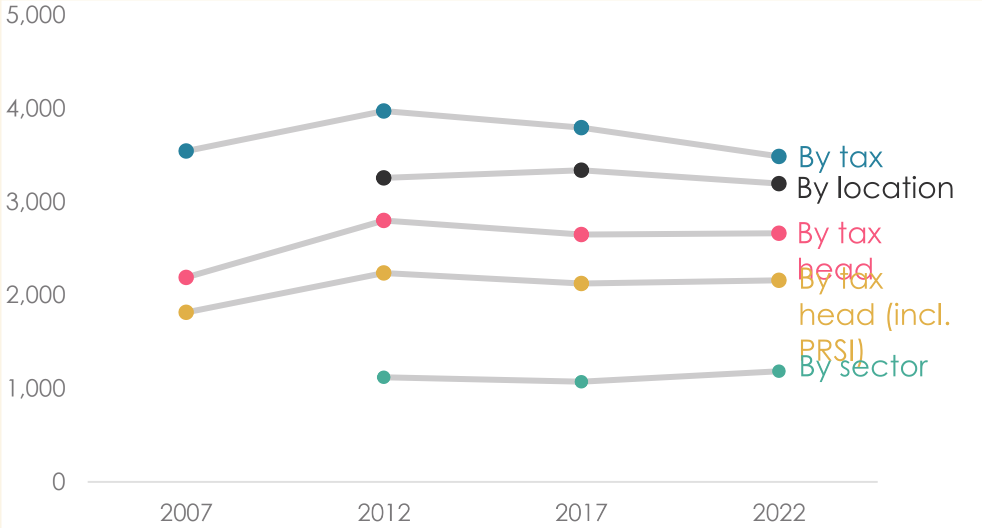
When looking across sectors of the economy, Ireland's overall tax receipts have tended to be spread relatively well. That is, they have not shown a high degree of concentration in any one particular sector. The concentration is slightly higher when focusing on tax heads (including PRSI). Approximately 32% of tax and PRSI revenue in 2022 came from income tax, with a further 23% from corporation tax.

[27] The HHI index is constructed as the sum of the squares of the share of tax revenue: $HHI = s_1^2 + s_2^2 + \cdots + s_n^2$, where s_n is the share of tax revenue from a sector, a base, or a tax head.

[28] For the base on which taxes are levied, Exchequer tax and PRSI are grouped into five categories: household income, consumption, business income, capital, and taxes on production. Household income includes income tax, PRSI and capital gains tax. Consumption includes customs duty, excise duty and VAT. Business income includes corporation tax. Capital includes capital acquisitions tax and local property tax. Production includes motor tax and stamp duty. These categories are ad hoc and do not necessarily align with national accounts groupings for taxes. Sectors aare based on NACE Rev 2 classifications. For tax heads, the typical Exchequer classifications are used.

N°39 The tax base is highly concentrated

Herfindahl-Hirschman Index (HHI) measure of concentration



Sources: Revenue Commissioners; Department of Finance; and Fiscal Council workings.
Notes: For the base on which taxes are levied, Exchequer tax and PRSI are grouped into five categories: household income, consumption, business income, capital, and taxes on production. Household income includes income tax, PRSI and capital gains tax. Consumption includes customs duty, excise duty and VAT. Business income includes corporation tax. Capital includes capital acquisitions tax and local property tax. For tax heads, the typical Exchequer classifications are used. Sectors are based on NACE Rev 2 classifications. Get the data.

While Ireland's tax heads do not show high levels of concentration, the tax base does. This is due to the fact that two main tax heads, PRSI and income tax, have broadly the same base — household income. More than 47% of tax and PRSI revenue comes from this base. A further 25% comes from consumption taxes, while only 0.6% comes from taxes on capital.[29] Similarly, there is high concentration of taxes from certain locations, with over 50% of taxes attributed to Dublin and 19% to Cork.[30]

Income tax

As mentioned above, in the run-up to the financial crisis Ireland's tax base was narrowed on the back of transitory windfall receipts from the property bubble. This can be seen in Figure N°40.A as the distribution of income tax paid shifted downwards and to the right between 1994 and 2006.

Today, Ireland's income tax revenue is relatively concentrated across the income distribution (N°40.B). In 2021, the bottom 50% of taxpaying units paid 3% of all income tax. The distribution of income tax paid in 2021 was broadly similar to that in 2006, pre-financial crisis.

However, once USC revenue is included, the base becomes noticeably broader. The bottom 50% of units paid approximately 36% of income and USC revenue.

That being said, the USC base has also become narrower over time. In 2012, 27.2% of tax units were exempt from USC. This rose to 35.7% by 2021. Estimates by the Revenue Commissioners suggest that, after *Budget 2024* measures, this distribution has shifted rightwards, towards a narrow tax base, with 37% of

[29] Excluding windfall corporation tax receipts, household income would account for 54% of tax revenue in 2022. Consumption taxes would account for 29% of tax revenue, and capital accounts for 0.7%.

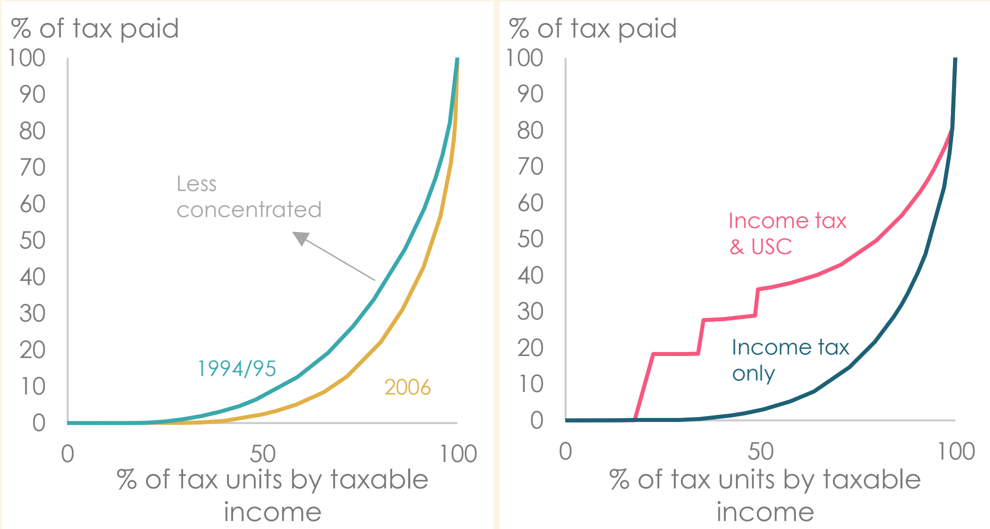
[30] This high concentration holds even if corporation tax is excluded. Dublin accounts for over 50% of tax revenue, and Cork remains the next highest payer, but at only 10% in this case.

taxpayers now exempt from USC.[31] Further estimates from the Revenue Commissioners suggest that in 2024, almost 80% of income tax will come from under 20% of taxpayers (Revenue Commissioners, 2023).

N°40 Excluding USC, Ireland's income tax base is narrow

A. Pre-financial crisis **B. 2021**

Tax paid vs income distribution



Sources: Revenue Commissioners and Fiscal Council workings.
Notes: Figures relate to the 2021 income tax year. Get the data.

Corporation tax

Corporation tax receipts are highly concentrated, and this concentration has increased over time (N°41). In 2022, the top 3 corporate groups accounted for 43% of corporation tax receipts while only 0.02% of companies accounted for 80% of corporation tax receipts (N°41A).

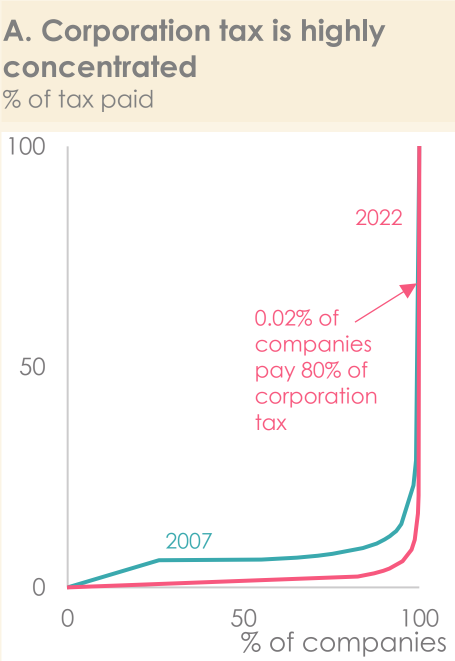
Excise duty

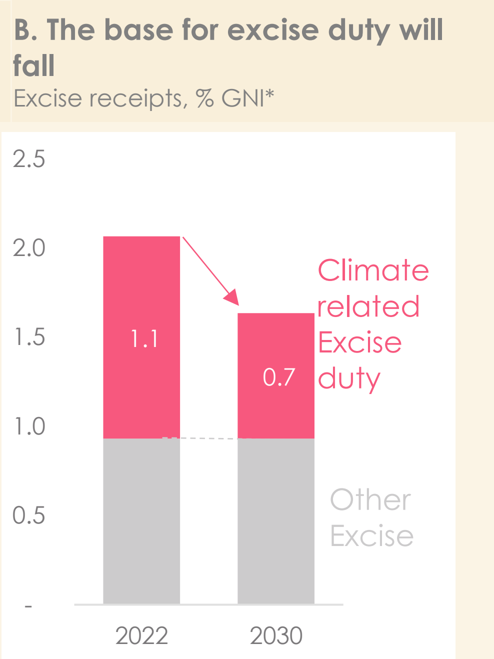
Excise duty is also highly concentrated, with several fossil-fuel related duties accounting for the bulk of revenue. In 2022, approximately 55% of all excise duty receipts were from climate-related taxes (Figure N°41B). By 2030, if Ireland meets its climate targets, this climate-related excise duty is likely to fall as a share of national income by almost 40%.

Outside of excise duty, further losses of revenue will occur from meeting Ireland's climate objectives through lower VAT receipts on energy and motor taxes. This would see tax revenue as a share of national income fall by 0.9 percentage points by 2030 (Casey & Carroll, 2023).

[31] Revenue Commissioner estimates for 2024 are based on 2021 data projected forward to 2024 and factoring in policy changes. See Revenue Commissioners (2023) for details.

N°41 Corporation tax and excise also have highly concentrated tax bases





Sources: Revenue Commissioners; Casey & Carroll (2023) and Fiscal Council workings.
Notes: For illustration purposes, 'other excise' is assumed to be unchanged as a share of GNI*. However, this may require policy changes to ensure this is unchanged as a share of GNI*. Get the data.

Several approaches to broadening the tax base have been recommended

Ireland has a narrow tax base across some dimensions. In particular, the reliance on income and corporation tax receipts has increased fiscal vulnerabilities (International Monetary Fund, 2022). In addition, future expenditure needs will require more taxation.

With those considerations in mind, the Commission on Taxation and Welfare has argued that it is necessary to broaden the tax base to ensure the sustainability of tax revenue as the population ages (Commission on Taxation and Welfare, 2022). The Commission argued that this would entail widening the tax base within tax heads and increasing the tax take from less distortionary taxes that would promote other governmental goals, such as environmental and health goals. Similar base-broadening recommendations were advocated by the Commission on Pensions.

2.6 Debt and interest trajectory remain favourable

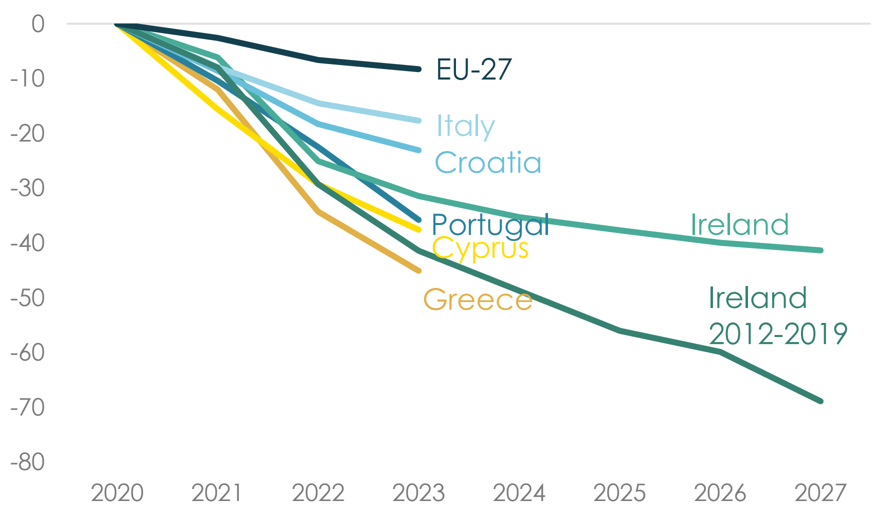
Since the gross debt-to-GNI* ratio peaked in 2020 at 107% of GNI*, Ireland has had a remarkable pace of debt reduction, mainly driven by a strong real growth since the pandemic, coupled with higher inflation.

The reduction in the debt ratio is the fourth fastest in the EU, behind only that of Greece, Cyprus and Portugal (N°42). While rapid, the pace of debt reduction is slightly slower than after the financial crisis.

However, the pace of debt reduction is forecast to slow. Between 2020 and 2023, the debt ratio fell by 32 percentage points (N°42). Over the same length of time, 2023-2027, the gross debt ratio is forecast to fall by only 10 percentage points.

N°42 The recent pace of debt reduction has been fast relative to other EU countries

Reduction in gross debt ratio since peak, pp of GDP (GNI* for Ireland)

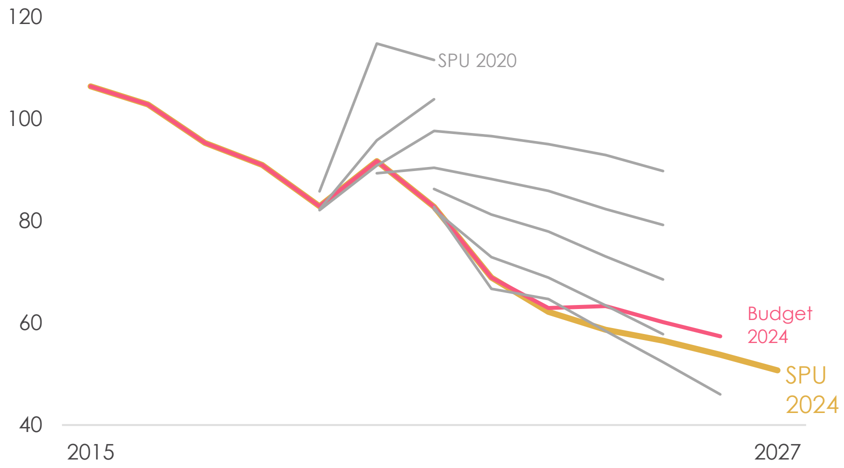


Sources: CSO; Eurostat; Department of Finance and Fiscal Council workings.
Notes: Figures show the six countries with the fastest pace of debt reduction in the EU from 2020 alongside the pace of debt reduction in Ireland from 2012 to 2019. In 2020, Irish debt-to-GNI* ratio peaked at 107%. In 2012, Irish debt-to-GNI* ratio peaked at 166% of GNI*. Get the data.

The forecast for the net debt ratio – gross debt ratio adjusted for liquid assets – has been revised down relative to *Budget 2024* forecasts (N°43). The net debt to GNI* ratio in 2026 is now forecast to be 53.8%, a fall of 3.6 percentage points relative to *Budget 2024* forecasts.

N°43 Net debt continues to fall rapidly

% of GNI*, net debt

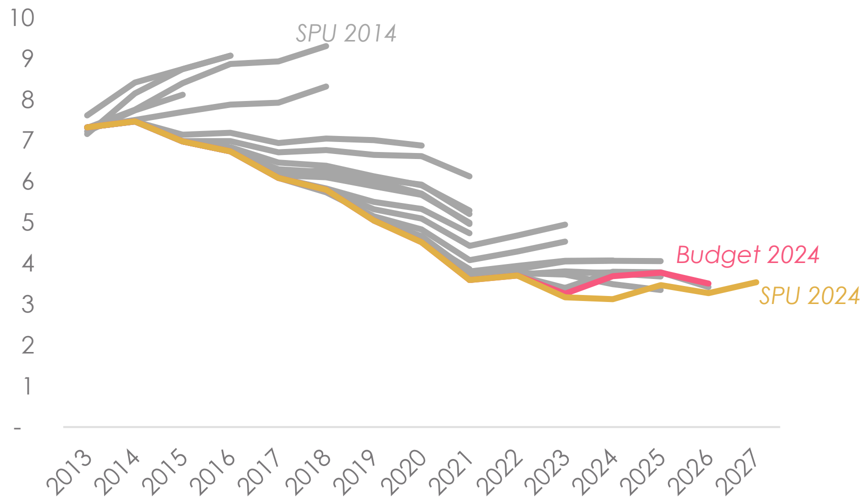


Sources: CSO, Department of Finance, and Fiscal Council workings. Get the data.

Interest payments also continue to be revised downwards (N°44). This is largely due to lower gross debt forecasts. The impact of which is slightly offset by higher interest rates. The interest forecast to be paid in 2027 is roughly equal to that paid in 2021 (€3.6 billion), while the gross debt in 2027 is forecast to be €3.7 billion lower than in 2021.

N°44 Interest payment continuing to come in under forecast

€ billion, cash interest



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

2.7 Upside and downside fiscal risks are apparent

The fiscal projections have a number of upside and downside risks.

The most apparent near-term downside risk is the overspending in health. *SPU forecasts* are based on the *Budget 2024* allocation for health spending (adjusted upward for the pay deal). In the first 4 months of the year, current health spending is 9.4% (€638 million) above budgeted levels. This risk relates not just to 2024 forecasts but could apply to the full forecast horizon. Health spending overruns tend to carry through to the following year, so higher health spending in 2024 would likely feed into 2025 and beyond. Overspends in health have been a persistent issue for several years. Unless health is, first, properly funded, and secondly, appropriate expenditure management is put in place, these overspends will continue.

Given the short forecast horizon in *SPU 2024*, some of the medium-term challenges to the public finances are not fully felt within the forecast horizon. This is most acute for the ageing population.

Another budgetary risk relative to *SPU 2024* relates to climate change. Casey and Carroll (2023) estimate how transitioning to a zero-carbon society will imply lower government revenue and higher spending. *SPU 2024* does not incorporate these types of effects on revenue or spending. Indeed, the Department of Finance's own work (Department of Finance, 2023) points to falling revenue from excise duty in the latter part of this decade, yet there is little evidence of this in their forecasts for excise duty.

Contingency funding of €4.5 billion has been set aside for every year out to 2027. This incorporates health spending related to Covid-19 and supports for Ukrainian refugees, as well as EU-funded expenditure. Spending on supports for Ukrainian refugees may be expected to fall by 2027. As more of these migrants integrate into society, spending on accommodation may fall. The supporting information section, S3, assesses the fiscal risks outlined in *SPU 2024* as well as additional risks identified by the Council.

On the upside, there are potentially large upside risks related to the proceeds of fines issued by the Data Protection Commission. This is discussed in more detail in Box C. These proceeds are currently subject to litigation, but, should they arise, they would be one-off and windfall in nature and so should be treated like other windfalls.

As discussed in the tax section, there is potentially significant upside to the corporation tax receipts given the implementation of Pillar I of the OECD BEPS reforms and the as yet unclear implementation of Pillar II of the reforms.

Box C: Potential windfall revenues from Data Protection fines

On 25th May 2018, the General Data Protection Regulation (GDPR) came into effect across the EU. It regulates the use of private personal information. In Ireland, the Data Protection Commission (the Commission) is the supervising agency responsible for ensuring that the GDPR is adhered to. If an organisation has been found to be non-compliant with GDPR, the Commission may issue fines. This box looks at the potential revenue that may arise as a result of some of the recent fines issued by the Commission.

Ireland is the European headquarters for several large ICT and social media firms that collect and hold a lot of personal information. As a result, the Commission plays a key role in ensuring that these companies comply with GDPR.

In May 2020, the Commission issued its first fines for non-compliance with GDPR. Since then, it has issued several fines in excess of €5 million, with the fines amounting to almost €3 billion (N°45). Several of the fines exceed €100 million, and one fine exceeds €1.2 billion. However, many of the large fines issued to date are subject to appeals process.

N°45 Fines totalling close to €3 billion have been issued under GDPR

Fines in excess of €5 million

Company	€ million	Date Issued	Status
TikTok	345	Sept-23	Appeal ongoing
Meta	1,200	May-23	Appeal ongoing
WhatsApp	5.5	Jan-23	Appeal ongoing
Meta	17	Mar-22	Confirmed by court and collected
Instagram	405	Sep-22	Appeal ongoing
Facebook	265	Nov-22	Appeal ongoing
Meta (Facebook)	210	Dec-22	Appeal ongoing
Meta (Instagram)	180	Dec-22	Appeal ongoing
WhatsApp	225	Aug-21	Appeal ongoing
Total	2,852.5		

Sources: Data Protection Commission's annual reports and Fiscal Council workings.
Notes: Figures relate to fines in excess of €5 million, issued by the Data Protection Commission since 25 May 2018. Get the data.

The proceeds of fines issued by the Commission are required to be transferred to the Exchequer. However, as the cases involving the largest fines are undergoing appeals processes, the amounts transferred to the Exchequer have been relatively low so far. Approximately €17.5 million and €1.8 million was transferred to the Exchequer in 2022 and 2023 respectively (N°46).

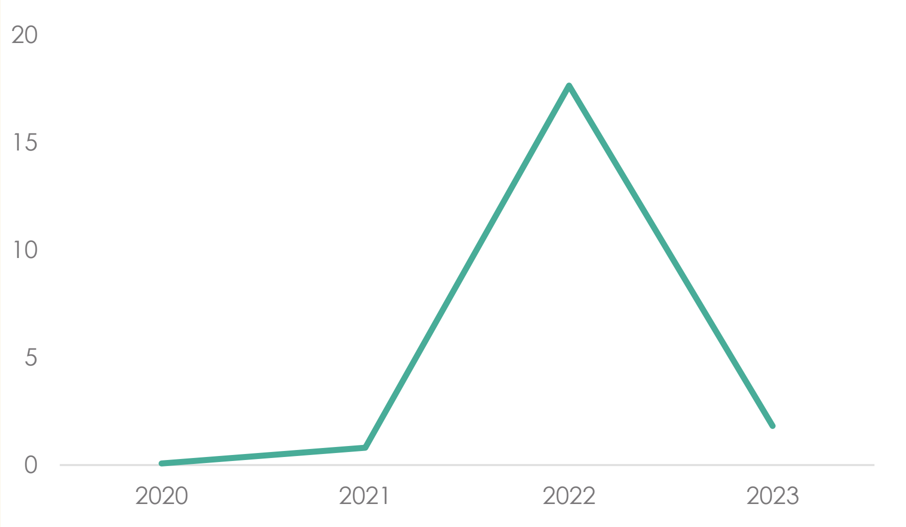
Conclusion

Given there are appeals processes ongoing, it is prudent not to incorporate the potential revenues from these fines in the budgetary figures until the appeals processes have concluded.

However, given the number and size of fines issued, it is possible that there will be substantial windfalls arising from these fines. As these receipts would be inherently one-off in nature, the receipts from these fines should be treated in a similar fashion to other windfall receipts – not used to fund permanent spending increases or tax cuts.

N°46 So far, the benefit to the Exchequer from fines has been low

€ million, fines remitted to the Exchequer



Sources: Data Protection Commission Annual reports, and Fiscal Council workings. Get the data.

Fiscal Stance

A fiscal framework worth following

3 FISCAL STANCE

A fiscal framework worth following

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

3.1 Where are we in the cycle?

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

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

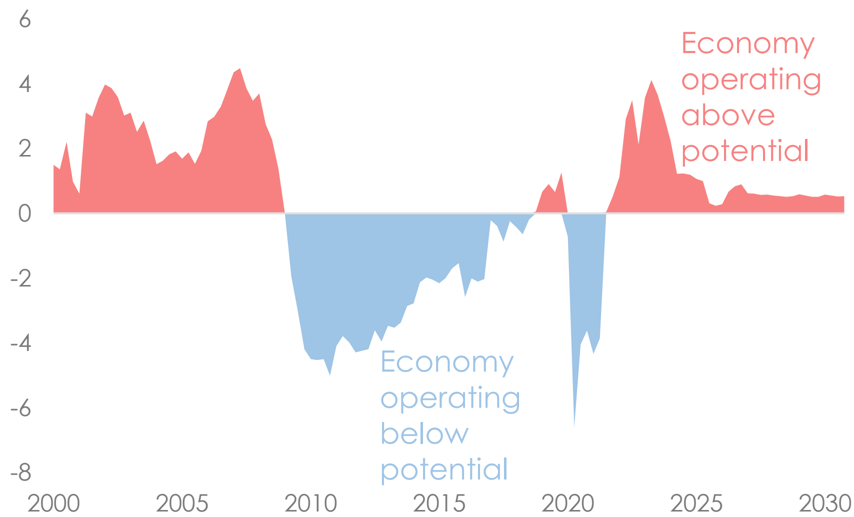
The economy is already operating at or above capacity

Section 1 shows how the Irish economy has performed well in recent years, despite a global pandemic and the war in Ukraine.

Models used by the Council to assess how the economy is performing relative to its potential are signalling some degree of overheating. Applying these models to the macroeconomic projections in *SPU 2024* suggests overheating this year (around 1.5% of potential output). The economy is then operating at just over capacity out to 2030 (N°47).

N°47 Economy operating above its capacity

Output gap, percentage of potential output



Sources: *SPU 2024* macroeconomic forecasts are used as inputs into the Council's suite of potential output models. The midpoint of estimates is shown.
Notes: Positive/negative output gaps indicate output is above/below its potential level.
Get the data.

Historically, a tight labour market, strong price pressures and large inward migration have tended to suggest that the Irish economy is performing above normal levels of activity.

However, persistent (or persistently large) current account surpluses and low levels of household debt tend to mitigate overheating concerns. [32]

Overall, the Council's assessment is that the Irish economy is currently operating at or just above capacity; hence a slightly contractionary or neutral fiscal stance seems appropriate.

As is always the case, there are several seemingly compelling demands for public spending and tax cuts. Given some of the evident infrastructure shortfalls (Section 1), it is tempting to increase public capital spending to address these. However, choices must be made. This is not a time for the 'everything now' approach of tax cuts, increases in current spending and ramping up capital investment all at once. Doing everything now would intensify price and wage pressures. It would also likely achieve poor value for money on public spending.

If there is a strong appetite to increase capital spending, this could be done by increasing taxes or containing current spending. In this way, the overall impact on domestic demand would be minimal. Box B shows that Ireland's tax base has become rather narrow. Widening the tax base could be an avenue to fund increases in capital spending and make the public finances more resilient.

[32] Typically, current account surpluses and low levels of debt would indicate that the economy is not overheating. Household debt at the end of 2022 was 94% of household disposable income, the lowest level since 2001.

3.2 How sustainable are the public finances?

As well as assessing the economic cycle and the possibility of major imbalances, the Council assesses fiscal sustainability as part of its broad economic assessment.

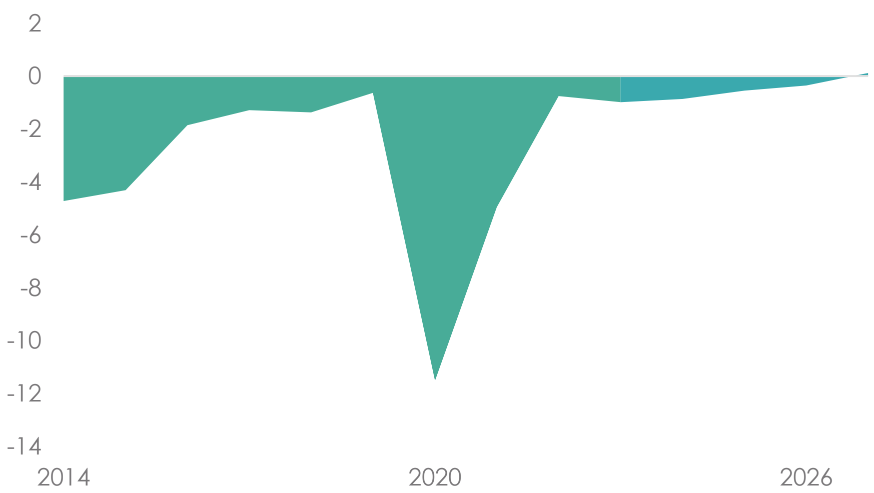
Underlying budget deficits continue

When excluding excess corporation tax receipts, the general government balance is forecast to remain in deficit out to 2026 (N°48).[33] Under this metric, a deficit has been run in every year since 2008. In effect, this means that windfall corporation tax receipts are being used to fund day-to-day expenditure.

While the projected underlying deficits are small, one has to take into account the economic conditions. As outlined above, the economy is performing extremely well overall. This has a direct impact on the public finances. Employment being at record highs means more income tax and PRSI revenue. Unemployment being at record lows means less spending on unemployment benefits.

N°48 Underlying deficits continue

General government balance (excluding excess CT), % GNI*



Sources: CSO, *SPU 2024*, and Fiscal Council workings.
Notes: *SPU 2024* estimates of excess corporation tax are used for 2023 onward. Fiscal Council estimates are used for earlier years. Get the data.

[33] As noted in Section 2, health spending overruns could mean the underlying deficit this year could be higher than that projected in *SPU 2024*. If underlying deficits were run out to 2026 as planned, that would be 19 consecutive years of deficits.

Countercyclical fiscal policy demands running budget surpluses in good times, so that there is space to run deficits in bad times. So, if now is not the time to run underlying surpluses, when is?

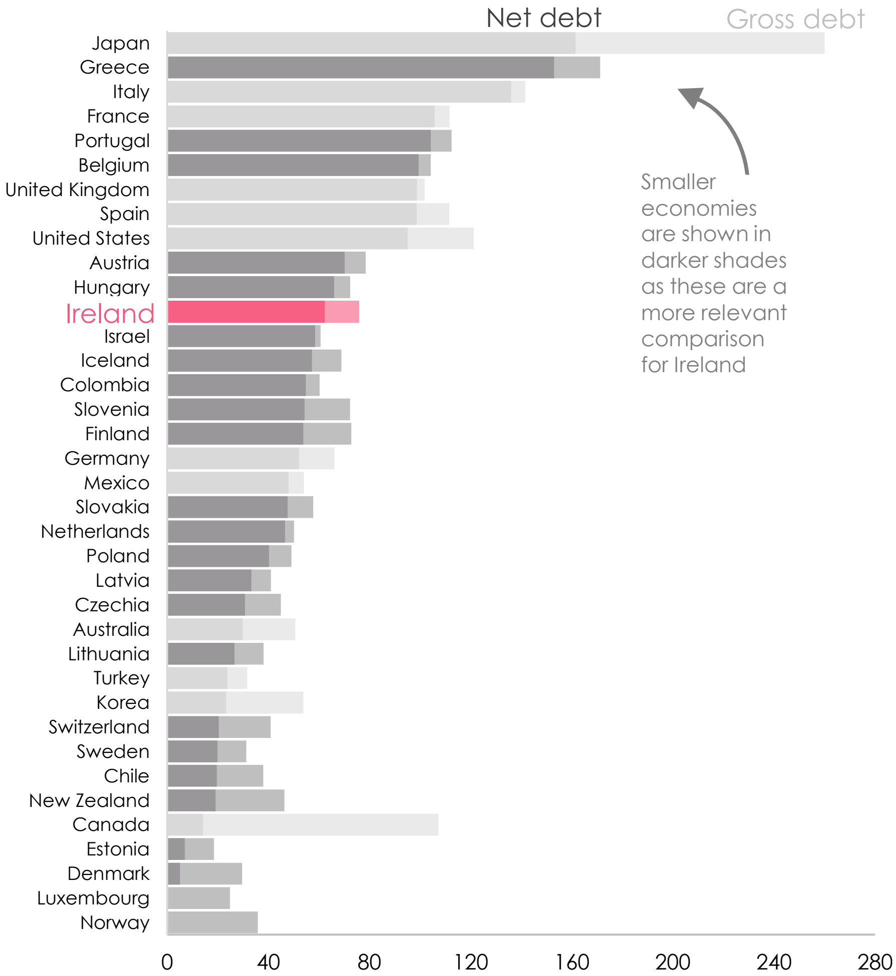
Debt and debt dynamics are sustainable

Ireland's debt has fallen sharply in recent years. As a result, it is no longer among the highest in the OECD. However, debt remains high relative to other small economies.

Using net debt—debt adjusted for cash on hand—and focusing on smaller economies, Ireland is the sixth highest in the OECD (N°49). Smaller economies tend to have more volatile growth and a greater exposure to economic shocks (Furceri and Karras, 2007 and 2008). In particular, they cannot rely on a large domestic market to help offset economic turbulence coming from elsewhere. The implication is that they are more vulnerable to downturns and to sudden changes in debt sustainability. As a result, smaller economies should target lower debt levels in good times to allow for this greater volatility and vulnerability.

N°49 Ireland's Debt levels no longer among OECD highest

% GDP (% GNI* for Ireland)



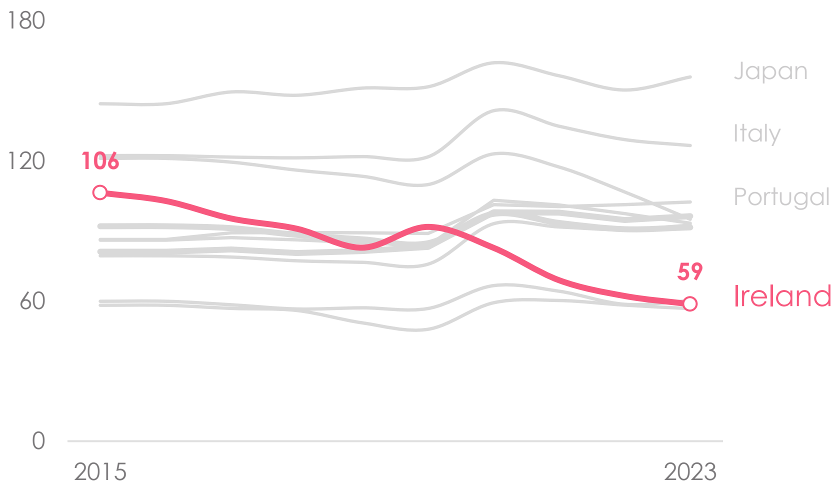
Sources: Eurostat, CSO, IMF, and Fiscal Council workings.
Notes: Small OECD countries are a better comparator for Ireland. We define big as above a certain level of nominal GDP in US dollars, which leaves US, UK, Japan, Italy, France, Spain, Germany, Australia, Canada, Mexico, Turkey, and Korea as the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

Ireland has been able to reduce its net debt ratio relatively quickly. This has been exclusively due to strong growth in national income. Nominal GNI* has grown by 7.7% per year on average between 2015 and 2023. Both gross and net debt are higher in nominal terms in 2023 than was the case in 2015.

The fall in the net debt ratio comes despite numerous challenges, including the pandemic and the war in Ukraine. Indeed, since 2015, the reduction in the net debt ratio has been almost 50 percentage points (N°50). This steady reduction is unlike experiences in any of the other high-debt countries in the OECD. With the exception of Portugal, high debt countries have seen their debt ratios remain broadly at the same rate and in some cases increase.

N°50 Ireland has been able to reduce its high debt quickly

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



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

Financing conditions remain relatively favourable

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

Interest costs are manageable. Yields on Ireland's 10-year bonds have stabilised just below 3% (N°51). While this is higher than experienced in recent years, it is still below the pre-financial crisis rates that prevailed during the 2000s. Almost all of Ireland's outstanding government debt is at fixed interest rates.[34] This means that changes in interest rates have little bearing on the existing stock of debt and interest costs attached to it. The effective interest rate is projected to remain around 1.6% out to 2027. Of course, if interest rates remained high much further out, this would gradually add to annual interest costs.

There are also large buffers available to the State. Cash and liquid assets remain high at just under €20.3 billion as of April 2024. These are almost sufficient to cover maturing debt out to the end of 2026 even if no Exchequer surpluses are run.[35] As it stands, the Department projects

[34] Ireland's public debt has one of the longer average maturities in Europe.

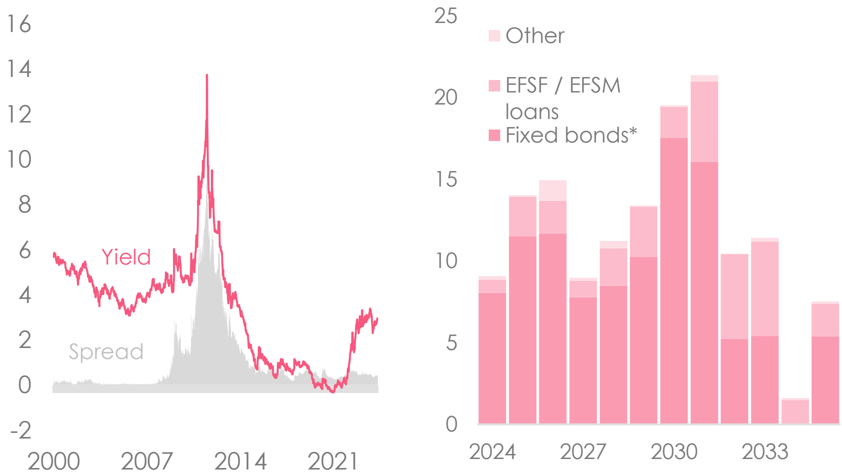
[35] The cash balance includes the National Reserve Fund. When the funds transferred to the Future Ireland Fund and the Infrastructure, Climate and Nature Fund are invested in illiquid assets, the cash balances will reduce correspondingly.

annual average Exchequer surpluses of about €0.5 billion between 2024 and 2026. This reduces the need to draw on existing cash buffers.

N°51 Funding is broadly favourable despite higher interest rates

A. % 10-year bond yields, weekly data

B. € billions of maturing debt



Sources: Macrobond, NTMA, and Fiscal Council workings.

Overall, Irish government debt seems to be at a sustainable level, having fallen substantially in recent years. This should assist in having the space to run countercyclical budgetary policy in future downturns. The lower debt level also puts Ireland in a better position as future budgetary challenges emerge, such as an ageing population and climate change.

3.3 Assessment of the Government's fiscal stance

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

The Budget 2024 package was larger than previously thought

Budget 2024 is more expansionary than first estimated. The recently agreed public sector pay deal will cost €1.1 billion in 2024. *Budget 2024* had assumed a cost of €0.7 billion. As a result, core spending has been revised up. In addition, *Budget 2024* had left some unallocated spending for 2024. This has been all allocated, along with an additional €85 million. Overall, it appears that the budget package for 2024 is €0.5 billion higher than was estimated after *Budget 2024*.

Fiscal stance is deemed as not prudent

The Council is of the view that the fiscal stance for 2024 is not conducive to prudent economic and budgetary management.

The Government is planning on breaching the National Spending Rule in 2024. The large budget package for 2024 adds further demand to the economy. This comes at a time when the economy is performing well, with output at or above its capacity. The expansionary stance of the Government's fiscal policy adds to inflation and exacerbates capacity constraints which are already apparent in the economy.

Section 4 shows an assessment of compliance with the National Spending Rule. Significant breaches of the National Spending Rule are highlighted. Due to repeated breaches, a sizeable gap has opened up between net spending and a sustainable path for net spending. SPU forecasts suggest this gap will remain wide out to 2027.

An anchor for the public finances is needed

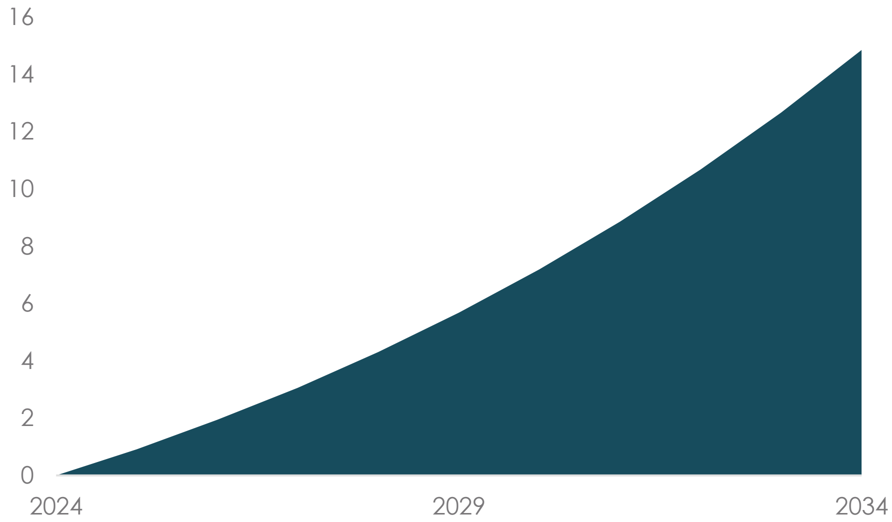
An anchor for medium-term spending (net of new tax measures) is sensible. Tying medium-term net spending to a sustainable growth rate of the economy is desirable. This ensures prudent fiscal policy is followed and prevents unsustainable expenditure drift. This is key as Ireland is currently in a strong budgetary position overall. An anchor for net spending is an important part of an overall fiscal framework.

An anchor for budgetary policy also helps to guide Ireland away from boom-bust budgetary policies of the past. Limiting net spending increases to 5% in good times such as now avoids amplifying the swings in the economy.[36] It is tempting to increase net spending at a faster rate when the economy is performing well, and price pressures are strong. This is exactly when a fiscal rule like the National Spending Rule is valuable.[37] Given that the EU fiscal rules are unlikely to bind for Ireland for some time, the National Spending Rule is the only anchor for budgetary policy.

What may look to be relatively minor breaches of the spending rule can cumulate into large amounts. For example, growing net spending by 6% per year rather than 5% over a 10 year period would result in net spending being €14 billion higher (N°52).

N°52 Spending rule breaches would cumulate quickly

€ billion, difference in net spending if growing by 6% rather than 5%



Source: Fiscal Council workings. This assumes the starting point for net spending in 2024 is €91.7 billion, as per SPU 2024. Get the data.

The National Spending Rule can help guide budgetary policy

While some aspects of the National Spending Rule could be improved, overall it provides a good guide for fiscal policy in Ireland. It is a net spending rule. As a result, spending can be increased by more than the 5% limit set, provided that revenue-raising measures are introduced. This aspect is often ignored in discussions around the

[36] If cyclical unemployment spending were excluded from the National Spending Rule, the rule would be even more countercyclical.

[37] When inflation is high, growing net spending by 5% is countercyclical, as price pressures are not being fully offset by higher net spending.

National Spending Rule. Similarly, if a large amount of tax reductions is made, more modest spending growth is required to comply with the rule.

The National Spending Rule is also relatively easily understood. The 5% growth rate for net spending is informed by the assumed long-run nominal potential growth rate of the economy.

The National Spending Rule can help guide budgetary policy in the coming years. Significant budgetary pressures are about to materialise. An ageing population and climate change will have significant negative implications for the public finances. Sticking to the National Spending Rule will help mitigate the budgetary impact of these future challenges.

In the short run, adhering to the National Spending Rule will help avoid boom-bust budgetary policies of the past. The economy is already operating at or above capacity. In these circumstances, large budgetary packages would simply add to price and wage pressures in the economy.

Limiting spending increases net of tax changes to 5% should avoid amplifying the economic cycle. If spending requirements in excess of 5% are deemed necessary, they can be facilitated by introducing revenue-raising measures.

The two new savings funds are also crucial

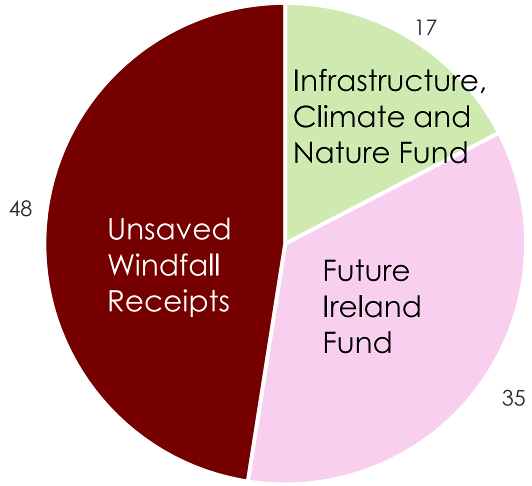
The Council welcomes the recent establishment of two savings funds.[38] These funds will see some of the windfall corporation tax receipts saved today and invested to generate a return. This will also help avoid overreliance on windfall corporation tax for recurrent spending.

The scale of contributions to these funds determines if this will be a small, medium or large step towards preparing for an ageing population and climate change. Just over half of the windfall corporation tax receipts are planned to be saved into these funds (N°53). Given the uncertainty around the size and durability of these windfall receipts, the Council is of the view that all estimated windfall receipts should be invested into such funds.

[38] The Future Ireland Fund and the Infrastructure, Climate and Nature Fund.

N°53 Only a fraction of windfalls are being saved

Percentage of windfall corporation tax receipts, 2025



Source: *SPU 2024* and Fiscal Council workings. Get the data.

Sticking to the National Spending Rule and contributing to these two funds are mutually supportive pillars of a prudent forward-looking fiscal policy. Sticking to the National Spending Rule means fiscal policy will not add to overheating risks in the short run. Making contributions to these funds fosters medium-term fiscal sustainability by helping to offset the costs of an ageing population and climate change. As a result, making contributions to the two funds is not a substitute for sticking to the National Spending Rule.

Monetary policy may become too loose for Ireland

Fiscal policy is not the only policy lever affecting the Irish economy. Monetary policy can also play an important role. While interest rates have risen significantly since 2022, policy rates seem likely to have peaked. It is widely expected that interest rates will be cut over the next 18 months. This would add to demand in the Irish economy and would not be an appropriate policy for the Irish economy, which is already operating at or above capacity.[39,40]

The likely monetary policy stance over the coming years is another factor which would suggest a tight fiscal policy will be needed in Ireland. As well as an economy operating at or above capacity, fiscal

[39] A tightening of macroprudential policy could offset some of the stimulus provided by a cut to interest rates.

[40] In addition, falling energy prices may also provide a stimulus of sorts, as households would see their disposable income rise. However, if government cost-of-living supports are phased out, this may reduce the impact of energy price falls for households.

policy may also need to offset the expansionary effect of monetary policy.

Fiscal gimmickry should be avoided

Fiscal gimmickry is not a term invented by the Council. Fiscal gimmickry is a well-established term used by those examining government accounts in detail. Almost 2,000 academic articles can be found on the topic when searching Google Scholar. There are several types of fiscal gimmicks (Koen and van den Noord, 2005). These include creative accounting, excessive use of one-off measures and public private partnerships which keep government deficits and debt lower than they would otherwise be.

The use of fiscal gimmicks undermines the purpose of a fiscal anchor. As outlined above, an anchor for budgetary policy in Ireland is crucial. Excluding one-off measures from a net spending rule makes sense, provided that the definition of one-off is not abused. This would represent fiscal gimmickry that would undermine the rule itself. Presenting large amount of spending as 'one-off' in an attempt to reduce the size of breaches of the National Spending Rule is extremely bad practice.

Transparency needs to be enhanced

The transparency around budgetary measures classified as temporary has been poor. Many of the measures labelled as 'non-core' or one-off look likely to persist beyond 2024. Some of the cost-of-living measures introduced, such as mortgage interest relief, look unlikely to be reversed in the short term. Measures to support Ukrainian refugees as well as Covid spending in health are also likely to persist over the medium term. In addition, a third category of spending has been introduced, labelled 'windfall capital investment'. This is just additional capital spending and yet has been treated by the Department as being outside of both 'core' and 'non-core' spending.

These deliberate attempts to adjust fiscal assessments are deeply concerning. Gimmicks like those above tend to crop up when governments want to make budgetary figures look more favourable than they really are. The Council will continue to monitor and highlight these attempts in future.

There are major costs ahead not factored into plans…

Ireland needs to face up to the budgetary impacts of the climate transition and the rapidly ageing population. While the Government has acknowledged the budgetary implications of an ageing population and climate change, budgetary forecasts and plans still do not incorporate these costs. The Council has repeatedly recommended incorporating these costs in order to strengthen the process of medium-term budgeting.

…Such as the rapidly ageing population…

Ireland's population is ageing rapidly. This is mainly due to increased life expectancy. This increased life expectancy is something to be celebrated and is a sign of progress for a developed society.

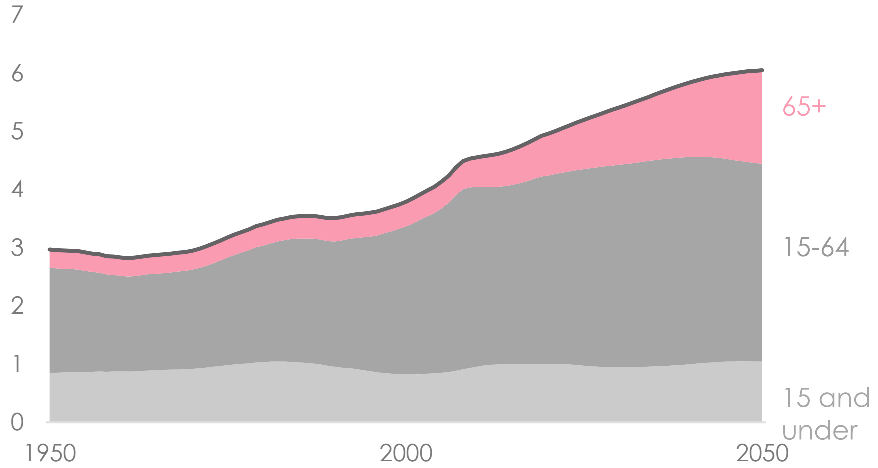
But increased life expectancy does have budgetary implications. The fiscal implications of an ageing population are the largest fiscal challenge the country is facing. This is no longer a challenge which is far away in the distance.

Ireland faces a sharp increase in pensioners relative to workers in the coming years. In addition, those who are retired will live longer in retirement.[41] These two factors will put substantial pressure on the public finances. It will mean higher expenditure, including for pensions and healthcare spending. It will also contribute to a slowdown in economic growth and tax revenues.

[41] How these additional years are lived will have important implications. If a greater fraction of these additional years are spent in poor health (expansion of morbidity), that would imply much higher healthcare spending than if those years were spent in good health (compression of morbidity).

Nº54 Older age cohorts will continue to expand sharply

Population in millions



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

While strong inward migration offsets some of these demographic changes, this can only delay their full impacts somewhat. Even sustaining the very strong levels of net inward migration in recent years would not offset the impact of population ageing. The ratio of the population aged over 65 to those of working age (20-64) will increase.

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

Despite these large costs, multiple governments have decided against increasing the statutory pension age.[42] Increasing the pension age in line with life expectancy would reduce the fiscal cost of an ageing population. Keeping the pension age at 66 would add 2% of national income per year to expenditure by 2050 (Fiscal Council, 2020), equivalent to around €5.5 billion today. Funding this will add significantly to future tax rises or require lower spending in other areas.

The Government's recent decision to approve a series of small multi-year increases in social contributions (PRSI) rates improves the sustainability of Ireland's pension system. However, the increases are

[42] The government has introduced a more flexible system for the state (contributory) pension. This will allow people to defer claiming the state pension at age 66 and receive a higher rate of payment starting at an older age (up to age 70). This flexibility is unlikely to result in significant savings or changes in behaviour.

much smaller than was envisaged in the Pension Commission's proposals, particularly for employers' PRSI.

Another factor related to Ireland's ageing population are Sláintecare health reforms. No updated costings have been made available since initial estimates in 2017. In addition, it remains unclear how much (if any) of the recent increases in health spending have been to address these costs. The continuing lack of detail over a seven-year period is worrying.

…And the climate transition

The transition to a net-zero society will affect public finances through three key avenues.

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

Second, there will be costs if Ireland misses its targets. Ireland is legally bound to achieve carbon neutrality by 2050 and to stay within three sequential carbon budgets between 2021 and 2035. Estimates by Walker *et al.* (2023) put the potential costs of non-compliance at about €0.35 billion annually up to 2030, when costs rise to €0.7 billion (0.2% of GNI*). Recent EPA (2024) projections suggest that emissions reductions out to 2030 looks set to fall well short of targeted levels.[43]

Third, there are likely to be costs associated with damage caused by extreme weather events and improving defences. Ireland has seen an increase in major weather events over time. Increased rainfall and rising temperatures carry risks of more regular flooding and wildfires.

[43] These reductions are relative to 2018 levels. Even with full implementation of all climate plans and policies, a reduction of 29% is projected. When only existing measures are considered, a fall of only 11% is expected. These both fall well short of the 51% reduction which has been targeted.

When these events occur, the costs associated with them could be in the region of 0.2% of GNI* (about €0.5 billion in today's money). Limiting these risks could require further adaptation costs beyond the €0.1 billion per annum allocated for flood defences in the National Development Plan.

While the costs involved in the climate transition are substantial, they can be managed.

Ireland needs to commit to a serious fiscal framework

Ireland needs a serious fiscal framework to face up to the costs not yet factored into official plans (population ageing and climate change) as well as other risks. While the Council has been calling for improvements to the current fiscal framework that would help for a considerable time, so far progress remains modest (N°55).

Several key aspects of Ireland's budgetary framework need to be strengthened.

The National Spending Rule ought to be enhanced. The rule is extremely important, as the EU fiscal rules are unlikely to act as a constraint. If the National Spending Rule is ignored, fiscal policy lacks compass. Adhering to the National Spending Rule would keep net spending on a sustainable path and reduce the risk of the economy overheating.

While some elements of spending plans look substandard, there have been improvements. *SPU 2024* spending forecasts now include a €4.5 billion contingency reserve for 2025-2027. This is to cover spending on Covid-19 related spending in health, humanitarian assistance for refugees and spending of EU funds. The Council had advocated for spending on these items to be included in expenditure forecasts, rather than being assumed to fall to zero immediately. Hence the Council welcomes their inclusion in *SPU 2024* spending forecasts.

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.

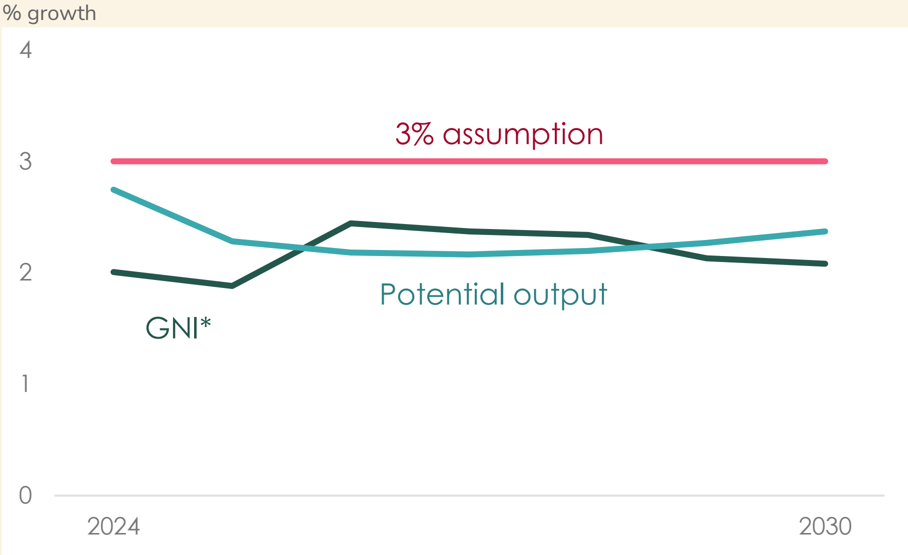
The Council has previously suggested that, as part of the National Spending Rule, there should be periodic reviews of the sustainable growth rate of the economy. Since the Irish economy may be heading for a more mature growth phase (see Section 1), now might be an appropriate time to review the sustainable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

N°56 Economic growth is projected to slow



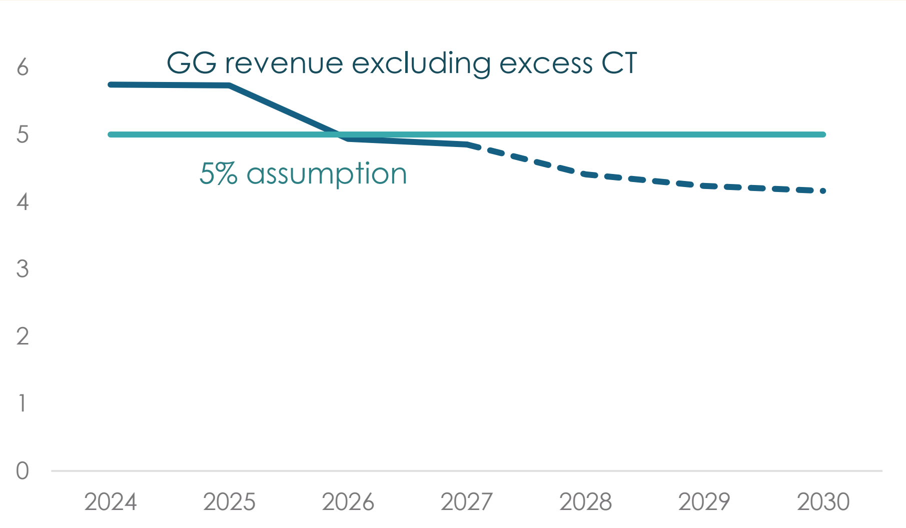
Sources: *SPU 2024*; and Fiscal Council workings. Get the data.

Another way to examine the appropriate growth rate for spending is to examine government revenue growth. The most comprehensive measure of government revenue is general government revenue. Given that they should not be used for permanent spending commitments, windfall corporation tax receipts are excluded from the analysis.

Using *SPU 2024* forecasts, we can see that nominal general government revenue (excluding windfall corporation tax) is forecast to grow at or above 5% out to 2027. Using macroeconomic projections in *SPU 2030*, we can extend the fiscal forecasts out to 2030. When this is done using standard elasticities and assumptions, it appears that revenue growth is likely to fall below 5% in later years. If one takes the period 2024-2030, the average growth for general government revenue is almost 5% (N°57). This may be more supportive of maintaining the spending rule at 5%.

N°57 Revenue growth forecast to moderate

% growth



Sources: *SPU 2024*, and Fiscal Council workings.
Notes: GG stands for general government. Dashed line shows Fiscal Council estimates to extend *SPU 2024* projections out to 2030. Specific revenue headings are extended to 2030 by using macroeconomic projections from SPU 2030 and using standard elasticities. Get the data.

Overall, it would appear that a growth rate of 5% may still be appropriate for the National Spending Rule. Adhering to the National Spending Rule at this rate is much more important, however. Doing so will ensure that net spending stays on a sustainable path. This does not mean that spending could not rise by more than 5%. This can be done while complying with the National Spending Rule, but it would require revenue-raising measures being introduced. This would leave the public finances well placed before large costs from an ageing population and climate change arise.

Fiscal Rules

Repeated breaches of the National Spending Rule

4 Fiscal Rules

Repeated breaches of the National Spending Rule

In this section, the Council assesses how Ireland is complying with its fiscal rules. It looks at whether the forecasts published in *SPU 2024* comply with Ireland's domestic rules, including the Domestic Budgetary Rule, as set out in the Fiscal Responsibility Act 2012. It also looks at the EU fiscal rules, as set out in the Stability and Growth Pact (SGP). In addition, the Council assesses compliance with the National Spending Rule. The Council considers this rule important, even though it lacks a statutory footing.

Further breaches of the National Spending Rule are planned

The National Spending Rule aims to limit core net spending growth to 5% each year, in line with the estimated trend growth rate of the Irish economy. The rule first guided spending in 2022 and seeks to anchor core expenditure growth over the medium term.

The rule is not legally binding. However, the Council considers the rule to be a vital tool to help ensure the public finances are managed sustainably. Its importance is magnified by the fact that the new EU rules are likely to prove less binding for Ireland in future, since GDP remains their main metric of reference (Casey and Cronin, 2023).

The Council assesses compliance with the rule on a net basis. That is, a rise in core net spending is offset by tax-raising measures but is added to by tax cuts.[45] This approach is in line with the Government's description of the rule (Department of Finance, *SPU 2023*, p. 30).

The Council assesses that the Government's plans breached the National Spending Rule in 2023. Core net spending increased by 8.4% in 2023, in excess of the 5% limit imposed by the rule (N°58). The original ceiling for core spending in 2023, set in *SES 2021*, was €84.1

[45] These tax measures include the expected yields arising from the non-indexation of the income tax system.

billion.[46] This ceiling was set in line with a 5% year-on-year growth rate, as per the rule. However, this original ceiling was repeatedly revised up in subsequent budgetary publications, taking spending to a level beyond what would be implied by a 5% growth path.

N°58 Government plans set to breach the 5% limit in 2024 and 2025

€ billions

	2021	2022	2023	2024	2025	2026	2027
Core net spending assessment (% year-on-year growth)							
5% limit		5.0	5.0	5.0	5.0	5.0	5.0
SPU 2024		8.0	8.4	5.1	5.1	4.7	3.3
SPU 2024 + health overrun		8.0	8.4	6.7	5.1	4.7	3.4
Cumulative assessment							
5% path	75.9	79.7	83.7	87.9	92.2	96.9	101.7
SPU 2024	75.9	80.0	86.7	91.1	95.8	100.4	103.8
SPU 2024 + health overrun	75.9	80.0	86.7	92.6	97.3	102.0	105.5
What goes into the *SPU 2024* cumulative assessment?							
Total spending		88.8	94.7	97.1	101.5	106.8	110.6
less one-offs *		8.8	7.5	5.1	4.5	4.5	4.5
Core spending		80.0	87.2	91.9	97.0	102.3	106.1
less revenue measures (net)		0.0	0.5	0.3	0.4	0.7	0.4
Core net spending		80.0	86.7	91.1	95.8	100.4	103.8
add health overrun				1.5	1.5	1.6	1.7
Core net spending + health overrun		80.0	86.7	92.6	97.3	102.0	105.5

Sources: Department of Finance and Fiscal Council workings.
Notes: *One-offs here include all expenditures related to Covid-19, Ukrainian supports, cost-of-living measures, and other expenditure, such as EU-funded spending for the Brexit Adjustment Reserve and the National Recovery and Resilience Plan, and other provisions such as the Temporary Business Energy Support Scheme (TBESS). Core net spending refers to core spending, adjusted for the impact of tax measures, and includes the expected yields arising from the non-indexation of the income tax system. Revenue-raising measures (such as tax increases) can be used to offset bigger spending increases, whereas revenue-reducing measures (such as tax cuts) would lower the scope for spending increases. Estimates of revenue-reducing and revenue-raising measures are those judged by the Fiscal Council. Health overruns are assumed to result in additional spending of €1.45 billion in 2024, relative to *SPU 2024* forecasts (see Section 2). These overruns enter the core spending base in 2025 and are assumed to grow at 5% year on year, in line with the National Spending Rule. Get the data.

[46] See page 34 of the Summer Economic Statement 2021 (Department of Finance, 2021).

The final outturn for core spending in 2023 amounted to €87.2 billion. Accounting for the net impact of new tax measures, core net spending in 2023 was €86.7 billion, €1.0 billion above the latest ceiling, set in *Budget 2024* (N°58). Current spending accounted for €0.3 billion of the overspend, with the capital overspend amounting to €0.7 billion.

The Government's plans are also set to breach the National Spending Rule in 2024 and 2025. The pace of the core net spending increase is currently projected at 5.1% for 2024 and 5.1% for 2025 (N°58).

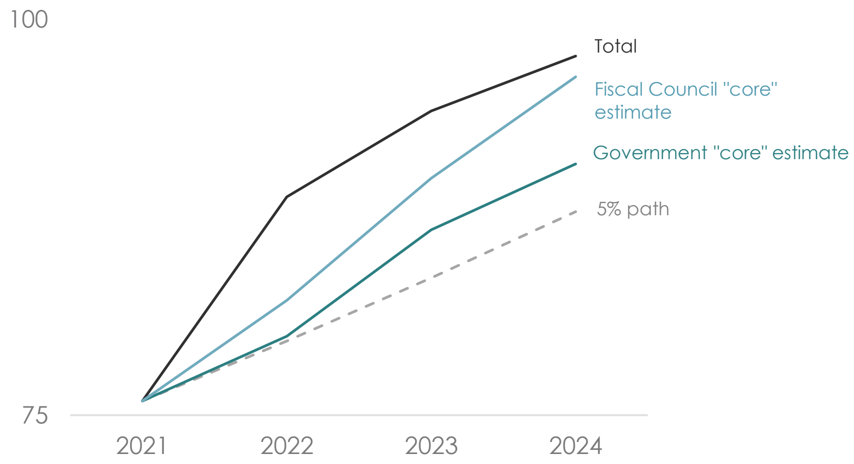
However, these spending forecasts lack credibility. They do not factor in expected overruns in health spending in 2024. Were the rest of the year to see health overruns grow at a similar rate as last year, these overruns would result in €1.45 billion of additional spending this year.[47] Adding this extra health spending, core net spending would grow by 6.7% in 2024 (N°58). What's more, the overrun in 2024 will then become part of the base for future years, taking spending to a much higher level.

Cumulatively, the breaches of the National Spending Rule are significant. The Government's estimate for core net spending is €3.0 billion above what a 5% path would imply in 2024 (N°59).

[47] The total health overrun is assumed to be €1.6 billion in 2024. This results in additional health spending of €1.45 billion in 2024 relative to *SPU 2024* forecasts, as *SPU 2024* included €0.15 billion for extra spending in health on foot of the public sector pay deal. See Section 2 for further details.

N°59 Different estimates for net spending exceed the 5% path

€ billions, core net spending



Sources: Department of Finance and Fiscal Council workings. Get the data.
Notes: The 5% path takes the total spending allocated for 2021 and grows it by 5% each year. The Government 'core' estimate includes all core spending, adjusted for the net impact of new tax measures. Estimates of the net impact of new revenue measures are those judged by the Fiscal Council. The Fiscal Council 'core' estimate begins with the Government 'core' estimate but also factors in additional spending measures. These include the portion of Covid spending likely to be permanent, all spending related to supporting Ukrainian refugees, windfall capital investment, and health overruns. Health overruns are assumed to result in additional spending of €1.45 billion in 2024, relative to *SPU 2024* forecasts (see Section 2). These overruns enter the core spending base in 2025 and are assumed to grow at 5% year on year, in line with the National Spending Rule. Total net spending equals gross voted expenditure and spending related to expected health overruns, adjusted for the net impact of new tax measures. Get the data.

However, there are a large number of measures which the Government classifies as temporary. Adding all these would take total net spending to a far higher level. Total net spending includes all expenditure treated as 'core' by the Government, as well as all expenditures related to Covid-19, Ukrainian supports, windfall capital investment and cost-of-living measures. It also includes the additional spending arising from the expected health overruns in 2024. Total net spending is forecast to reach €97.7 billion in 2024, €9.8 billion above a sustainable 5% path from 2021 (N°60).

Ultimately, the truth probably lies somewhere in between, yet always above a 5% growth path. The Fiscal Council's own assessment of core net spending begins with the Government's estimate for core expenditure. It then adds on all spending related to supporting Ukrainian refugees and the share of Covid-related spending likely to continue indefinitely.[48] It also includes windfall capital investment and the additional spending arising from the expected overruns in health

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

spending in 2024 (N°60). This Council estimate for net spending is €8.5 billion (9.7%) above what a 5% path would imply in 2024.

N°60 Walk to total net spending

€ billions

	2022	2023	2024
Government 'core' estimate	**80.0**	**86.7**	**90.9**
add potentially permanent Covid spending *	1.3	1.3	1.3
add Ukrainian supports	1.0	2.0	2.5
add windfall capital investment			0.3
add expected overruns in health**			1.5
Fiscal Council 'core' estimate	**82.3**	**90.0**	**96.4**
add temporary Covid spending	3.2	0.2	
add other ***	3.3	4.0	1.3
Total net spending	**88.8**	**94.2**	**97.7**

Sources: Department of Finance and Fiscal Council workings.
Notes: *Some amount of Covid-19 related expenditure is likely to become permanent or 'core' spending. *Budget 2024* allocated €1.3 billion for Covid-related expenditure for 2024. The Fiscal Council 'core' estimate considers this to be permanent spending and, therefore, treats it as 'core' in 2024. The Council's estimate also retrospectively treats €1.3 billion of the Covid-related spending in 2022 and 2023 as 'core', since it has transpired to be long-lasting. **Overruns in health spending are assumed to result in additional spending of €1.45 billion in 2024 (See Section 2). ***'Other' here includes all expenditures related to the cost-of-living measures, as well as EU-funded spending for the Brexit Adjustment Reserve and the National Recovery and Resilience Plan, and other provisions such as the Temporary Business Energy Support Scheme (TBESS). Get the data.

The way the *SPU 2024* document is set out continues a pattern in which the Department's forecasts lack transparency. Once again, there is no assessment of core spending provided in the report that adjusts for tax measures. In other words, the Department does not present whether its own tax and spending plans comply with the National Spending Rule. The Council will continue to assess compliance with the rule. However, the Department should present its own assessment of core net spending in SPU and budget documentation to make it easier for the public to understand whether its core net spending forecasts comply with the rule. In addition, the Department makes no reference to the original ceilings for core spending first set out in *SES 2021*. This is also bad for transparency.

Net spending drifts beyond a sustainable path

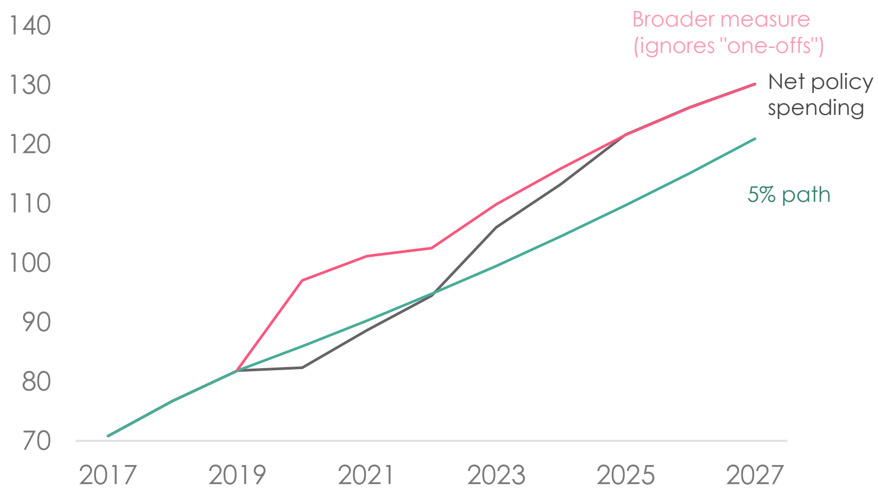
Another useful measure to assess fiscal policy with is 'net policy spending'. This measure bears some similarities to the 'core net spending' measure underpinning the National Spending Rule, but there are a couple of key differences. First, it is defined on a general government basis. This means it captures all government spending, including the one-fifth of spending which occurs outside the Exchequer. Second, it excludes the estimated savings or costs associated with cyclically low or high unemployment rates. Like the National Spending Rule, it takes account of new tax measures. That is, tax-raising measures can be used to offset spending increases, while tax cuts add to spending increases.

The Government's projections, set out in *SPU 2024*, see net policy spending drifting above what can be considered a sustainable path (N°61). The sustainable path here takes spending in 2019 (before the pandemic) as its starting point. This is a time when the economy was broadly in balance — the output gap was close to zero and unemployment was close to its long-run average. From there, actual and planned net policy spending is assessed relative to a sustainable path where it grows by 5% per year — broadly in line with potential output and normal rates of price inflation.

The difference between this "sustainable path" and the projected outturn for 2024 is €8.8 billion (+8.4%). This means that the impact of cumulative decisions to cut taxes and raise spending over and above what might be deemed sustainable equate to 2.9% of GNI* as of 2024. This gap widens further in 2025 (out to €11.9 billion), before being projected to fall back somewhat in 2026 and 2027.

N°61 Net policy spending has drifted above a sustainable path

€ billion, net policy spending



Sources: CSO, Department of Finance, and Fiscal Council workings.
Notes: Net policy spending is overall general government spending, excluding temporary factors like one-offs, and cyclical spending on unemployment benefits. As a net measure, it recognises the role of tax changes; that is, a rise in net policy spending is offset by tax-raising measures but is added to by tax cuts. Estimated proceeds from not indexing the tax system are also included. The "broader measure" line differs from net policy spending in that it includes all non-interest spending. It does not exclude one-off spending or cyclical unemployment spending. Windfall capital investment is included in net policy spending. As a result, windfall capital investment falling to zero in 2027 (as per *SPU 2024*) contributes reduces net policy spending in 2027. Get the data.

The Council's assessment of Net Policy Spending takes into account some non-core spending items — things that the Government labels as temporary. However, all spending from 2025 and beyond is considered to be core in this assessment. If one were to cut through all the temporary classifications included in *SPU 2024*, the path for net spending would look much further beyond a sustainable path in 2024. In this case, spending would be estimated to be €11.5 billion higher than the level suggested by a sustainable path.

The Council's assessment of Net Policy Spending takes *SPU 2024* forecasts of expenditure as given. However, as outlined in Section 2, health spending is likely to be significantly higher than *SPU 2024* projections for 2024 and beyond. In addition, Section 2 highlights how windfall capital investment is forecasts in *SPU 2024* to fall from €1.25 billion in 2026 to zero in 2027. These two issues suggest the path for net spending could be even further above a 5% path.

Ireland’s medium-term expenditure framework lacks credibility

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

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

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

Compliance with fiscal rules is mixed when assessed using the Council’s principles-based approach

The Council assesses whether the forecasts included in *SPU 2024* comply with Ireland’s Domestic Budgetary Rule, as set out in the Fiscal Responsibility Act 2012, and the EU fiscal rules, as set out in the Stability and Growth Pact (SGP).

At the onset of Covid-19, in 2020, so-called ‘exceptional circumstances’ and general escape clauses were activated. These applied to both the domestic and EU fiscal rules. They meant that Ireland could temporarily depart from the requirements under both sets of rules. These clauses remained in effect until the end of 2023.[49] However, neither clause applies from the beginning of this year.[50]

The Council has a mandate to monitor and assess compliance with the Domestic Budgetary Rule on at least an annual basis. Legal compliance with the fiscal rules continues to be assessed against GDP. However, GDP-based measures do not give an accurate picture of Ireland's fiscal position. The activities of a few large foreign-owned multinationals inflate the value of GDP and, thus, make debt ratios look smaller than they otherwise would be. This is a severe limitation of the Domestic Budgetary Rule.

Ireland's Domestic Budgetary Rule requires that the general government budgetary position be in balance or in surplus, or on an appropriate path to meet this condition. In practice, the Budgetary Rule is deemed to be achieved if the structural balance — a measure of the budget balance that strips out temporary and cyclical effects — meets a specified target, or is on an appropriate path towards it. This target is the so-called medium-term objective (MTO).

Compliance is assessed using the Council's principles-based approach to the Domestic Budgetary Rule. This approach addresses a number of shortcomings with the methodology used by the European Commission. For instance, it uses more appropriate measures of potential output for Ireland and more recent forecasts to estimate the structural balance. Thus, it provides a more appropriate assessment of Ireland's budgetary position.[51] The Council has previously assessed that Ireland has broadly complied with the Domestic Budgetary Rule when assessed on this basis (N°62).

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

[50] In the *December 2023 Fiscal Assessment Report* (Fiscal Council, 2023b), the Council stated that 'exceptional circumstances' would no longer apply as of 2024. Furthermore, the European Commission (2023a) announced that the general escape clause would be deactivated at the end of 2023. It noted that the European economy had recovered beyond its pre-pandemic level and had navigated the acute phase of the energy price shock caused by Russia's invasion of Ukraine. However, the Commission did note that uncertainty remained high.

[51] For further information on the Council's principles-based approach, see Table 7 in the Supporting Information.

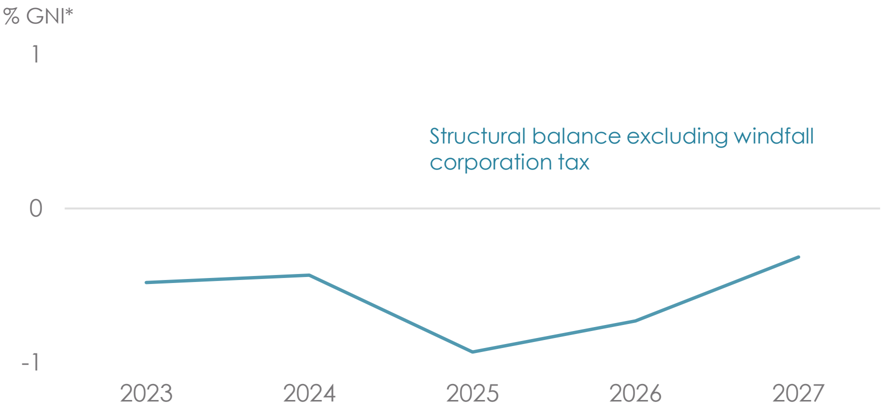
N°62 Exceptional circumstances in place from 2020 to 2023

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

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

Windfall corporation tax revenues continue to flatter Ireland's budgetary position. The windfalls are estimated to be some €11.2 billion in 2024, contributing greatly to the projected headline surplus of €8.5 billion. When these windfall receipts are removed and when other temporary factors are considered, the structural balance is projected to be in deficit each year from 2023 to 2027. The chart below shows the structural balance with these windfalls excluded as a share of GNI*, a more appropriate measure for the Irish economy (N°63).

N°63 Structural balance in deficit when windfalls are excluded



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

Supporting Information Section S.6 provides a full overview of compliance of the *SPU 2024* forecasts with the fiscal rules based on the Council's principles-based approach. In addition, the Council's assessment removes windfall corporation tax receipts when estimating the structural balance.

The official forecasts suggest that Ireland will comply with the structural balance requirement, the MTO, in 2024. Using the principles-based approach, the Council forecasts the structural balance to be –0.4% of GDP in 2024. This is marginally above the MTO of –0.5% of GDP. Therefore, current forecasts imply that Ireland will adhere to the Domestic Budgetary Rule in 2024.

Given Ireland is forecast to meet its structural balance target in 2024, the adjustment path condition does not apply. However, should the MTO not be achieved in 2024, the Domestic Budgetary Rule would likely be breached. Nationally financed net primary expenditure is projected to grow by 6.5% in 2024.[52] This is far in excess of the maximum growth rate set for the year of 5.3%.

In 2025, the official forecasts indicate a breach of the Domestic Budgetary Rule. The Council estimates the structural balance to be –0.6% of GDP in 2025, marginally below the MTO of –0.5% of GDP. This means the next step is to assess net primary expenditure growth. Nationally financed net primary expenditure is forecast to grow by 7.5% in 2025. This exceeds the net spending growth limit of 5.2%. This indicates that the Government is likely to breach both strands of the Domestic Budgetary Rule.

Overall, these assessments further highlight the very fast pace of net spending growth. Net spending is set to grow at an unsustainable rate in 2024 and 2025. This is reflected in net spending growing at a much faster pace than would be consistent with the Domestic Budgetary Rule.

The official forecasts are projected to comply with the Domestic Budgetary Rule in 2026 and 2027. The structural balance is forecast to achieve the MTO in each year.

However, the European Commission makes its own assessment of compliance with the EU fiscal rules. Its assessment is the legal basis for

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

compliance with these rules. It finds that Ireland's structural balance complied with the MTO in 2023 and is set to comply again in 2024 (European Commission, 2024). As a result, it recommends no fiscal adjustment as being required for 2024. The Commission forecasts nationally financed net primary expenditure to grow by 6.3% in 2024 (European Commission, 2023b). However, since Ireland's structural balance achieved the MTO last year, it does not assess this spending relative to a recommended maximum growth rate.

Ireland recorded a general government surplus of 1.7% of GDP in 2023, above the 3% of GDP budget deficit limit set out in the SGP. In headline terms, the Government projects further surpluses each year until 2027. In addition, Ireland's debt-to-GDP ratio stood at 43.7% at the end of 2023. This outturn was well within the 60% limit of the SGP. The debt-to-GDP ratio is forecast to fall further in each of the next four years. However, the Council advocates using GNI* as a more appropriate benchmark for assessing Ireland's fiscal position. Ireland's debt-to-GNI* ratio stood at 76% at the end of 2023. It is expected to fall to 66% by the end of 2027.

Overall, Ireland is on track to comply with the legislated domestic and EU fiscal rules in 2024. However, the EU's fiscal framework is set to change from the end of the year (Box F). Given that the new rules will still be assessed on a GDP basis, with limited recognition of the role played by excess corporation tax receipts, Ireland will likely face little scrutiny under the new rules.

Reforms to the EU fiscal rules come into effect this year

In April, a number of revisions to the EU's fiscal rules came into force (Box F). The main objective of the reform is to ensure sound and sustainable public finances, while promoting sustainable and inclusive growth in all member states through reforms and investment (Council of the EU, 2024).

A multi-year public net expenditure path will form the operational part of the new rules. The Government will publish a five-year medium-term plan in the autumn, setting out binding net expenditure limits which begin from 2025. These annual ceilings will apply to all government spending, rather than just core spending. The plan must be endorsed by the Council of the European Union and compliance will be assessed annually by the European Commission.

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

Box F: Substantial EU fiscal rule reforms come into force

In April, the Council of the European Union adopted significant reforms to the EU fiscal rules[53]. This followed extensive discussions among Member States around how best to enhance budgetary discipline and encourage greater compliance with the rules. The Fiscal Council previously published a detailed examination of what these reforms will mean for Ireland.[54] However, now that the revised rules have been finalised, we revisit their implications for Ireland.

Overview of the rules

The key objective of the new rules is to put a Member State's debt ratio on a plausibly downward path or to keep it at low levels. To achieve this, a multi-year net spending rule will form the operational part of the rules. All Member States must submit a 'medium-term fiscal-structural plan' by 20 September this year.[55] The plan will cover a four or five-year period,[56] although it can be extended by up to three years if the Member State commits to certain reforms and investments.[57]

The plan will set a maximum growth rate of nationally financed net primary spending each year.[58] This net spending limit will be binding once approved by the Council of the EU. The agreed net expenditure path will then remain unchanged for the duration of the five-year plan unless a new government assumes office (in which case the plan can, but does not have to be revised).

Every spring, countries are then required to submit Annual Progress Reports. The European Commission will use these to assess compliance with the maximum growth rate in net primary spending.[59] In doing so, the Commission will also set up a 'control account' — a way to keep track of the cumulative upward and downward deviations of actual net spending from the agreed path.

In the new framework, countries with debt ratios above 60% of GDP or deficits greater than 3% of GDP will come under much sharper focus. For these countries, the Commission will put forward a reference adjustment path for net spending that would ensure debt is put on a plausibly downward course, and the deficit is brought or kept below 3% of GDP over the medium term.[60] The Commission will issue this reference path by mid-June. These countries must then consider this reference path when designing their medium-term plans. These plans would be designed so as to cap net spending increases at a slower

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[53] See press release here.
[54] Box F of the June 2023 Fiscal Assessment Report explored these proposals in greater detail.
[55] This deadline may be extended if agreed with the European Commission.
[56] The number of years covered by the medium-term fiscal structural plan should be the same as the length of the national legislature; in Ireland's case this would be five years.
[57] The criteria include whether the reform and investment commitments are: 1) growth-enhancing; 2) support fiscal sustainability; 3) in line with common EU priorities, such as the European Green Deal; 4) address relevant country-specific recommendations issued by the Commission; and 5) keep public investment at or above previous medium-term levels of investment.
[58] Nationally financed net primary expenditure is defined as general government expenditure excluding interest, one-offs, EU-funded spending, national spending on programmes co-funded by the EU, and temporary spending on unemployment related to the cycle. It adjusts for the net impact of tax measures; tax-raising measures would allow for larger spending increases, whereas tax cuts would reduce the scope for spending increases. Unlike the Expenditure Benchmark it replaces under the current guidance, it does not smooth out investment costs over a four-year period.
[59] These will replace Stability Programme Updates and National Reform Plans.
[60] The reference path would also have to be consistent with the 'debt sustainability safeguard' and the 'deficit resilience safeguard'. The 'debt sustainability safeguard' requires debt to decline on average by at least 1 pp. of GDP per year as long as debt exceeds 90% of GDP, and by at least 0.5 pp. of GDP per year as long as debt stands between 60% and 90% of GDP. The 'deficit resilience safeguard' requires an annual adjustment of at least 0.4 pp of GDP (0.25 pp. in case of extension) in structural primary terms until the structural balance is above or equal to –1.5% of GDP.

rate than would otherwise be considered sustainable, with a view to steadily reducing debt ratios over time.[61]

However, those countries with debt ratios below 60% of GDP and a deficit below 3% of GDP will be subject to less scrutiny under the new rules. These countries, such as Ireland, will not be issued with a reference adjustment path. They will, in effect, fall outside the focus of the new rules. They may request 'technical information' from the Commission on the structural primary balance necessary to keep the deficit below 3% of GDP and the debt ratio below 60% of GDP during the period covered by the plan and the subsequent 10 years afterwards, assuming no policy changes.[62] However, these countries are not under any obligation to request this information.

Ireland will continue to face little scrutiny under the EU fiscal rules

Ireland is unlikely to come under much scrutiny under the new EU fiscal rules. GDP continues to form the basis of the Commission's debt ratio assessments despite it being an inappropriate measure of the Irish economy. This is because Ireland's GDP levels are artificially inflated by distortions linked to the activities of a relatively small number of foreign-owned multinational enterprises. Ireland's debt ratio is currently below 60% of GDP and is projected to stay below this level. In addition, substantial injections of windfall corporation tax receipts continue to flatter Ireland's budget balance and, thus, its debt path, even though there are serious concerns about the reliability of these revenues.

It is not clear what action, if any, the European Commission might take if a country like Ireland breaches annual limits. If Ireland were to exceed the binding annual limits on the growth in nationally financed net primary expenditure, it may not face any sanctions so long as the debt ratio remains below 60% of GDP and the deficit below 3% of GDP.

What this means for domestic legislation?

The new EU fiscal rules may require an updating of Ireland's Fiscal Responsibility Act (2012), which transcribes the fiscal rules for Ireland. The Act has an emphasis on structural balance targets and a debt rule. It does not explicitly mention a spending rule. However, the new EU rules abolish the '1/20th Debt Rule' and move away from a structural balance target to a target for net primary spending.[63]

Therefore, the new rules present an opportunity for the Government to put its own National Spending Rule on a statutory footing. In addition, the National Spending Rule could be amended such that it captures general government spending, is linked to debt targets, and protects public investment with a minimum steady state target set as a percentage of GNI*. These changes could ensure that the National Spending Rule becomes a cornerstone of fiscal policy — one better tailored to Ireland's domestic conditions and not subject to the distortions that come from more one-size-fits-all approaches that depend on GDP and harmonised estimates of potential output.

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

[62] This 'technical information' would also ensure the so-called 'deficit resilience safeguard' is fulfilled. In other words, the structural primary balance would be consistent with a structural budget deficit at or below 1.5% of GDP, even after the headline budget deficit is below 3% of GDP.

[63] If the debt-to-GDP ratio was above 60% of GDP, the '1/20th Debt Rule' required that the ratio fell by, on average, one-twentieth of the excess between the actual debt-to-GDP ratio and 60% of GDP. However, this rule has been abandoned under the new EU fiscal rules.

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