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.

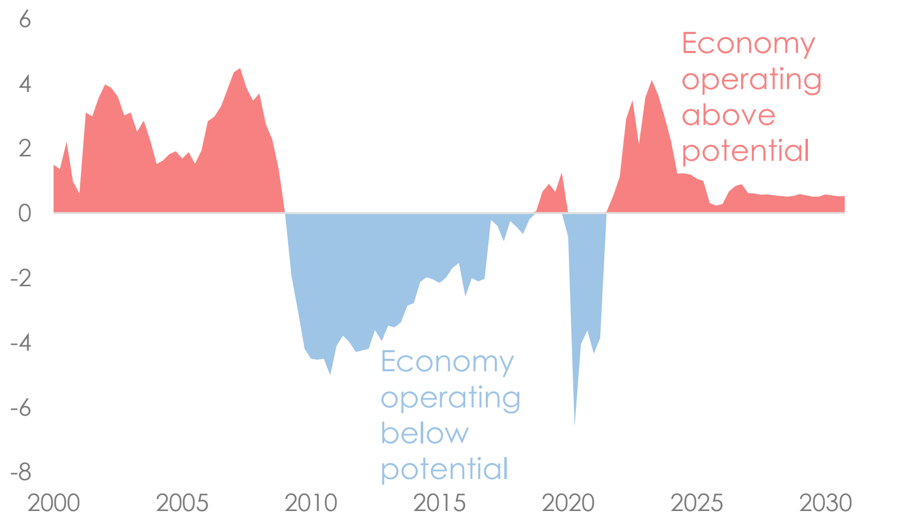
The economy is already operating at or above capacity

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.

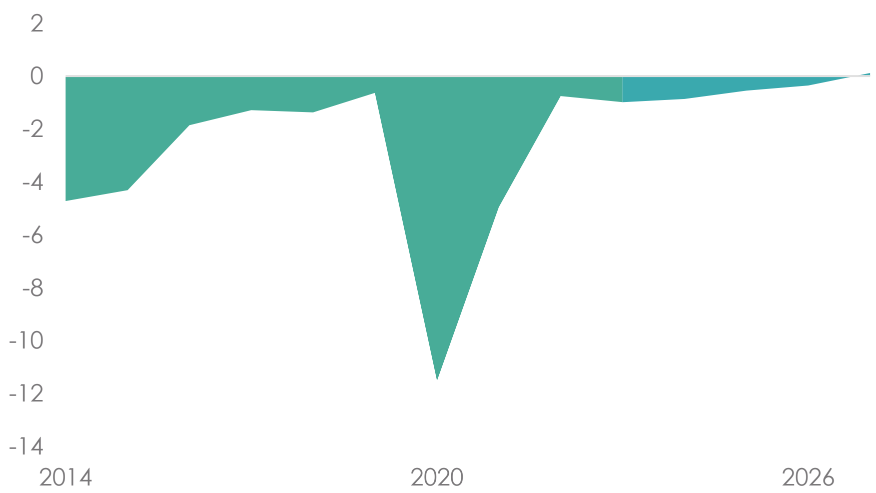
Underlying budget deficits continue

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?

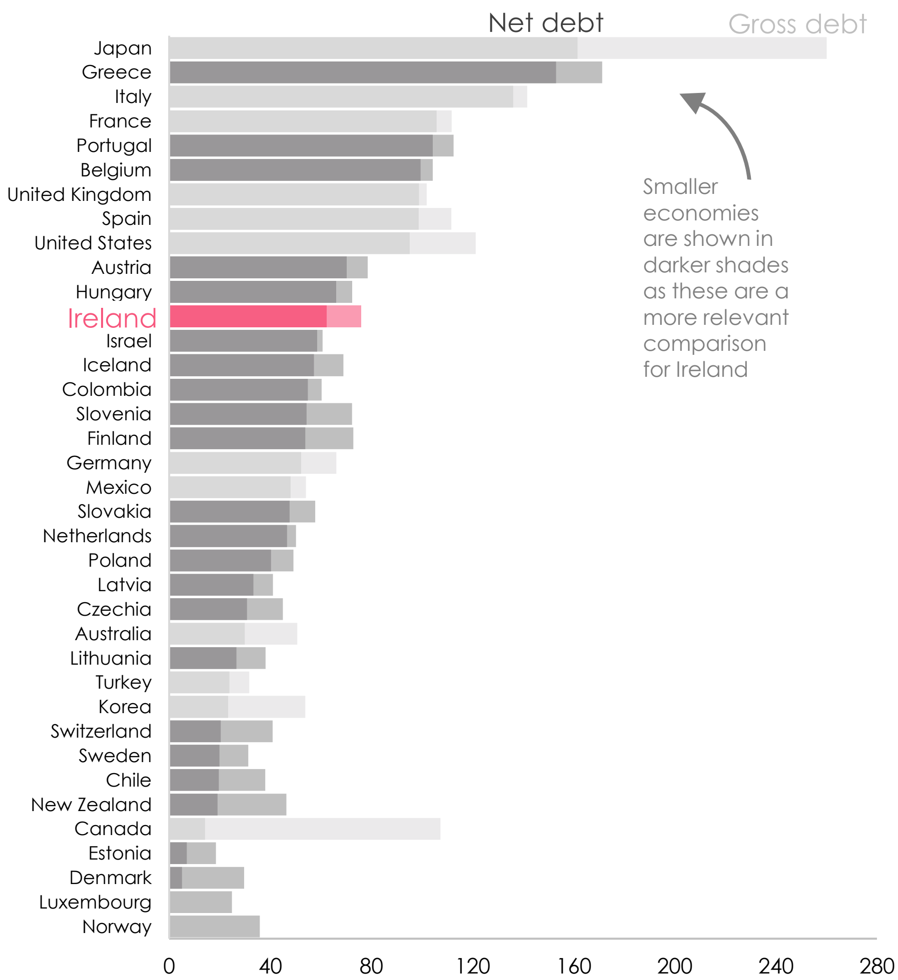
Debt and debt dynamics are sustainable

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)



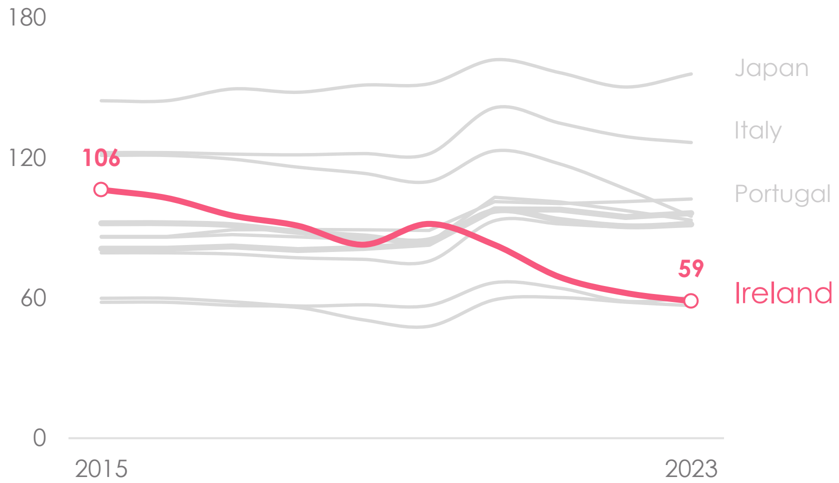
Sources: Eurostat, CSO, IMF, and Fiscal Council workings.
Notes: Small OECD countries are a better comparator for Ireland. We define big as above a certain level of nominal GDP in US dollars, which leaves US, UK, Japan, Italy, France, Spain, Germany, Australia, Canada, Mexico, Turkey, and Korea as the '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

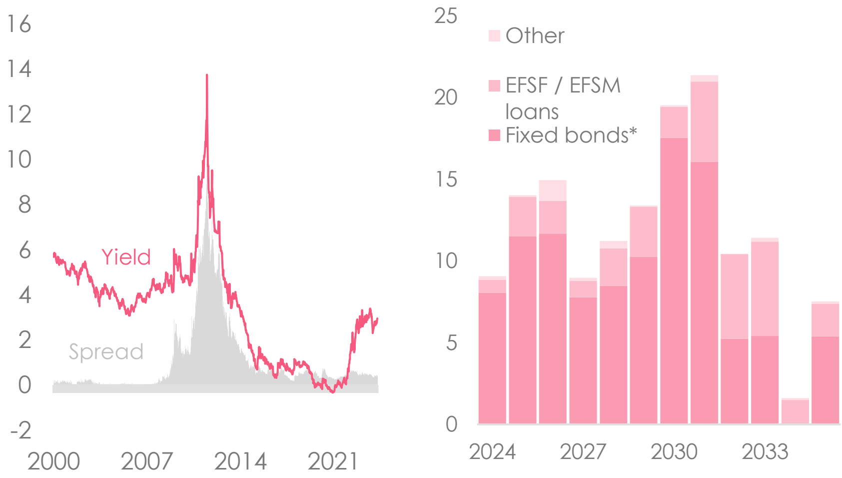
[34] Ireland's public debt has one of the longer average maturities in Europe.

[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

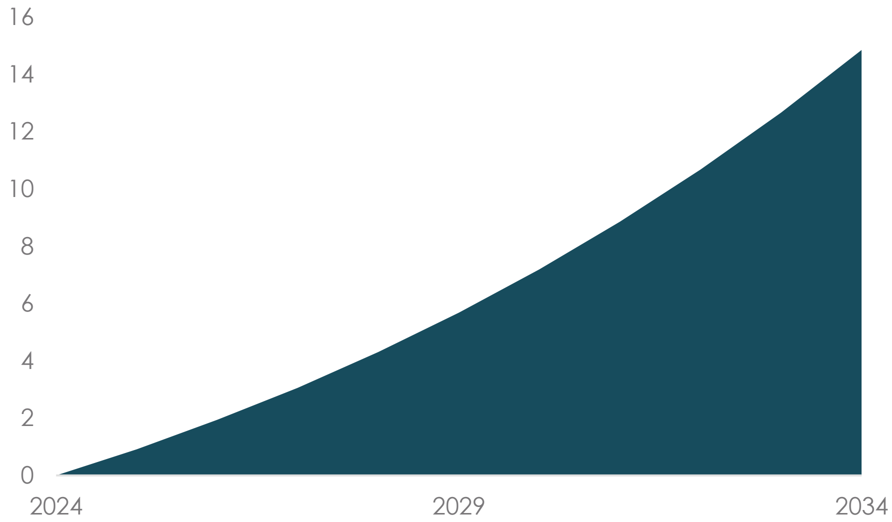
An anchor for medium-term spending (net of new tax measures) is sensible. Tying medium-term net spending to a sustainable growth rate of the economy is desirable. This ensures prudent fiscal policy is followed and prevents unsustainable expenditure drift. This is key as Ireland is currently in a strong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

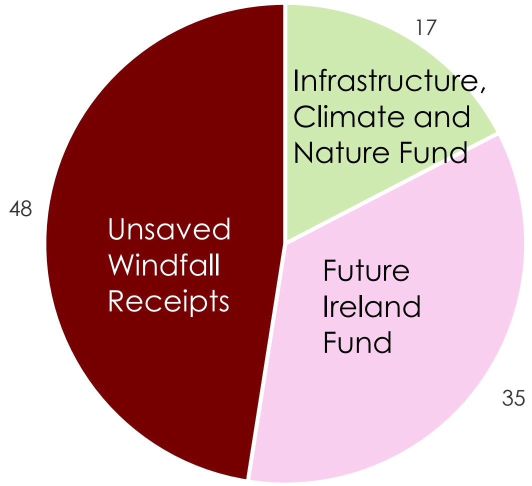
The Council welcomes the recent establishment of two savings funds.[38] These funds will see some of the windfall corporation tax receipts saved today and invested to generate a return. This will also help avoid overreliance on windfall corporation tax for recurrent spending.

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.

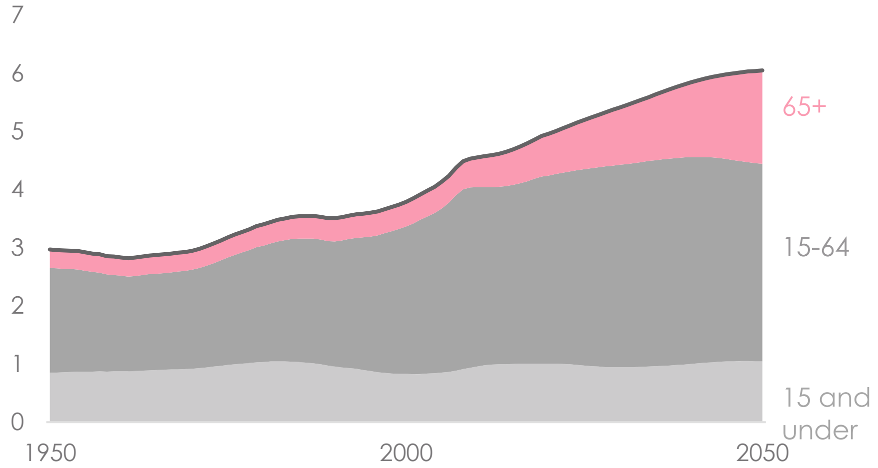
But increased life expectancy does have budgetary implications. The fiscal implications of an ageing population are the largest fiscal challenge the country is facing. This is no longer a challenge which is far away in the distance.

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).

N°54 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

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[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.

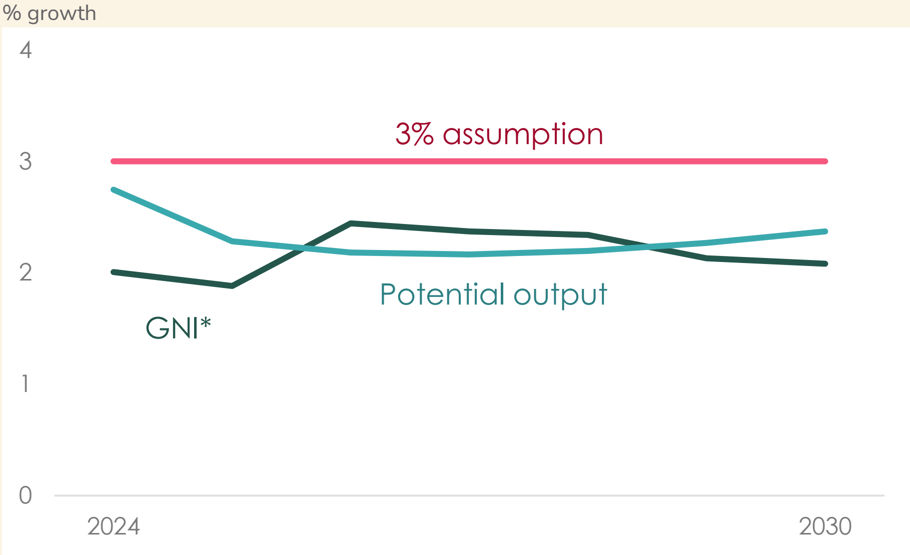
The Council has previously suggested that, as part of the National Spending Rule, there should be periodic reviews of the sustainable growth rate of the economy. Since the Irish economy may be heading for a more mature growth phase (see Section 1), now might be an appropriate time to review the sustainable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



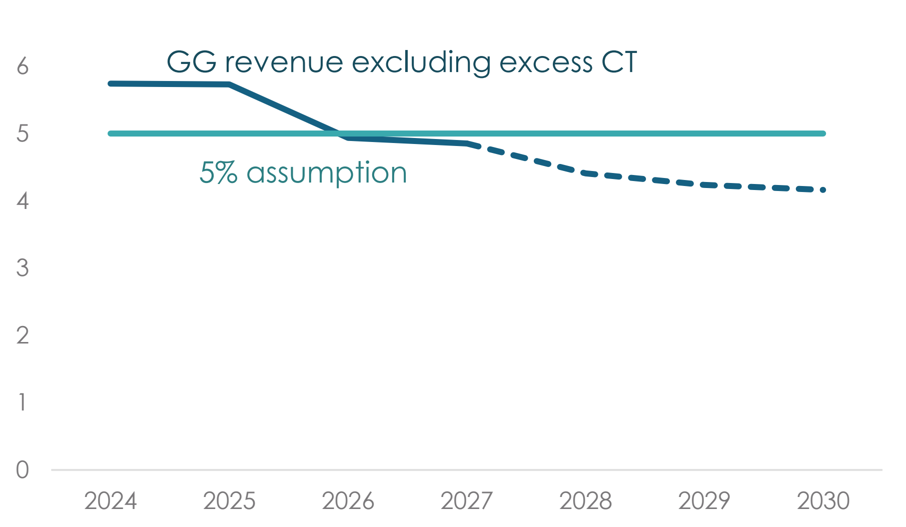
Sources: *SPU 2024*; and Fiscal Council workings. Get the data.

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.