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Houses of the Oireachtas

An Oifig Buiséid Pharlaiminteach
Parliamentary Budget Office

# Economic and Fiscal Commentary

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## Séanadh

Is í an Oifig Buiséid Pharlaiminteach (OBP) a d'ullmhaigh an doiciméad seo de réir na feidhmeanna atá leagtha síos san Acht um Choimisiún Thithe an Oireachtais, 2003 (mar a leasaíodh),mar áis do Chomhaltaí Thithe an Oireachtais ina gcuid dualgas parlaiminteach. Féadfaidh an OBP aon fhaisnéis atá ann a bhaint as nó a leasú aon tráth gan fógra roimh ré. Níl an OBP freagrach as aon tagairtí d'aon fhaisnéis atá á cothabháil ag tríú páirtithe nó naisc chuig aon fhaisnéis den sórt sin ná as ábhar aon fhaisnéise den sórt sin. Tá baill foirne an OBP ar fáil chun ábhar na bpáipéar seo a phlé le Comhaltaí agus lena gcuid foirne ach ní féidir leo dul i mbun plé leis an mórphobal nó le heagraíochtaí seachtracha.

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# Contents

# Introduction



This is the first of a revised format *PBO Economic and Fiscal Commentary*. In 2020, due to the COVID-19 pandemic, the PBO's quarterly commentaries were suspended and replaced with more focused analysis of the situation and monthly publications on the outturns of both the revenue and expenditure side of the Budget based on the Government's monthly Fiscal Monitor.

In 2021 the PBO aims to move the monthly analysis of the Fiscal Monitor to a visual presentation of the data supplemented with analysis bringing Members' attention to key issues. In addition, it will produce occasional Commentaries that summarise and supplement the main points of the monthly analysis. The commentary will also include a focus on the economic situation. The monthly analysis of the Fiscal Monitor will begin later in 2021 when monthly profiles of revenue and expenditure are produced.

The aim of this Commentary is to provide high level analysis and commentary without all the detail that the previous iteration of the commentary had which will now be presented separately in the regular online visual presentations. These will be available on the PBO's webpage *www.oireachtas.ie/pbo*.

# Summary and key messages

## Economic situation

- GDP was positive in 2020 increasing by 3.4%. However, this masks significant sector level divergences, with the domestic economy experiencing a contraction and the international traded sectors (especially Information Technology and Pharmaceuticals) growing strongly.
- The COVID-19 adjusted unemployment rate in February 2021 was 24.8% with almost 469,000 claimants of the Pandemic Unemployment payment at the end of the month.
- Irish GDP is forecast to grow relatively strongly in 2021 with the average forecast of a range of institutions of real GDP growth of 4% in 2021 and 4.1% for 2022.
- However, economic uncertainty is high, and forecasts are based on certain assumptions about the restrictions due to the COVID-19 pandemic and the rollout of vaccines. Such assumptions could prove optimistic or pessimistic and thus over or underestimate economic growth.
- Some risks to the economy include COVID-19 variants, the scarring effect of long-term unemployment, Brexit related trade diversion and disruptions to supply chains. There are upside risks due to the significant level of savings built up during 2020.

## Tax

- New official tax revenue profiles will not be released until May 2021. More regular updates to official fiscal forecasts are needed for effective parliamentary oversight and scrutiny, particularly given the uncertain macroeconomic context at present.
- Tax trends in 2020 show how the pandemic has exacerbated the reliance of Ireland's Government finances on Income Tax and Corporation Tax, both of which are highly concentrated in a relatively small number of taxpayers.
- Value Added Tax (VAT) revenue was significantly affected by the restrictions in 2020 and this will continue into 2021. However, a sharp rebound in consumption would buoy receipts in the latter part of the year if restrictions are eased.

## Spending

- Gross voted spending, as set out in the *Revised Estimates for Public Services 2021* (published December 2020) proposed reduced allocations to some Votes including Social Protection, and Enterprise, Trade & Employment which are particularly affected by the economic costs of the pandemic.
- However, the Government will have to re-publish the Revised Estimate for Social Protection. Social Protection spending in 2021 will considerably exceed the levels set out in December 2020 due to increased spending on the Employment Wage Subsidy Scheme (EWSS) as well as providing a larger subvention to the Social Insurance Fund to enable it to meet its increased spending. The extension of Level 5 public health measures has already exhausted the provision made for the Pandemic Unemployment Payment (PUP) in 2021.
- A total of €5.5 billion was set aside in Budget 2021 under the headings of the COVID-19 Contingency Reserve (€2.1 billion) and the Recovery Fund (€3.4 billion) to be allocated to Votes if necessary. It is unclear how much of this funding will be spent in 2021 but given the Level 5 restrictions in Q1 and the extension of the PUP and EWSS to end Q2 it is likely that most of it will be.
- COVID-19 spending in 2021 is projected to be less than in 2020; however, non-COVID spending is due to increase significantly. Significant increases in Health staffing in 2020/2021 will drive increased allocations to this Vote over the long-term. The impact of COVID-19 on the health sector is complex and, while the provision of COVID specific subheads is welcome, the PBO notes that distinguishing between COVID and non-COVID spending in a practical and meaningful sense may not be entirely possible for healthcare services delivery.
- A more medium-term issue is how accurately COVID-19 spending is being isolated from 'core' spending and whether this money will be prove temporary i.e. be removed from allocations when and if the public health emergency ameliorates or ends.
- Approximately €10.8 billion is available for capital spending in 2021, including an unprecedented carryover of €0.7 billion from 2020. Public health restrictions may mean that this allocation cannot be fully spent.

## Overall balance and debt

- The overall General Government Balance in 2020 is likely to be significantly lower than projected at Budget time given that the outturn for the Exchequer balance was €4.4 billion better than expected.
- The fiscal forecasts for 2021 need significant revision but the overall balance may still be in the region set out in Budget 2021 (€20.5 billion).
- Findings from a forthcoming PBO analytical note, show that despite a high and growing level of debt, the debt burden will still be on a sustainable path over the next 10 years (under baseline scenario assumptions).

# Economic situation

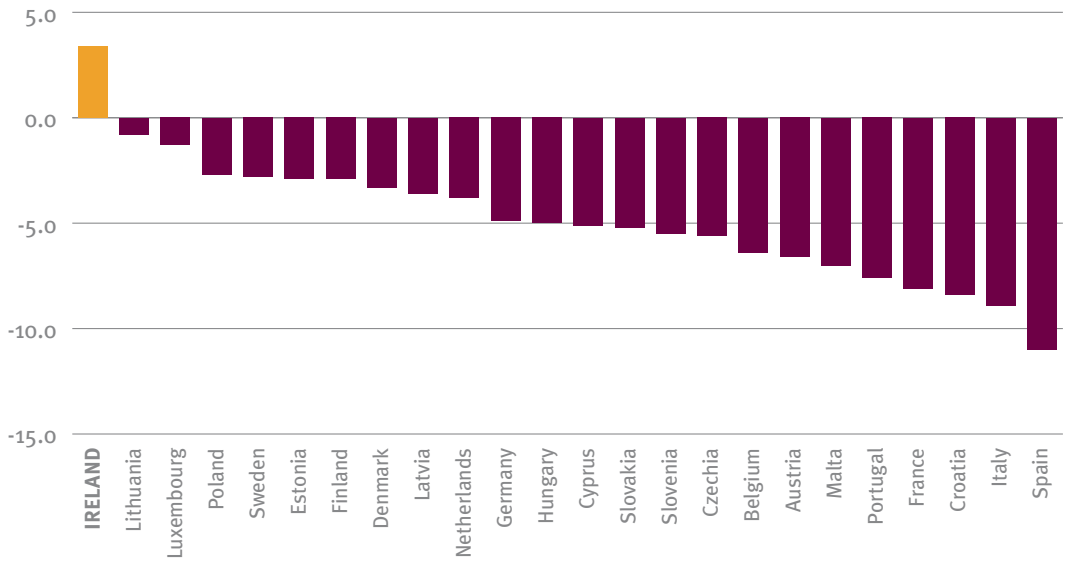


## Economic activity in 2020

Economic activity in Ireland, as measured by GDP, increased by 3.4% in 2020 according to preliminary estimates by the CSO. By contrast, Modified Final Domestic Demand (which better captures trends in the domestic economy) decreased by 5.4%. This divergence reflects the contribution to the Irish economy of industries dominated by multinationals, particularly in pharmaceuticals, medical devices and information and communication, and their contribution to net exports.

Ireland outperformed the European Union in GDP growth for 2020 (Figure 1 below). Indeed, it is the only EU country that recorded growth in 2020.

**Figure 1: GDP – annual % change, 2020**

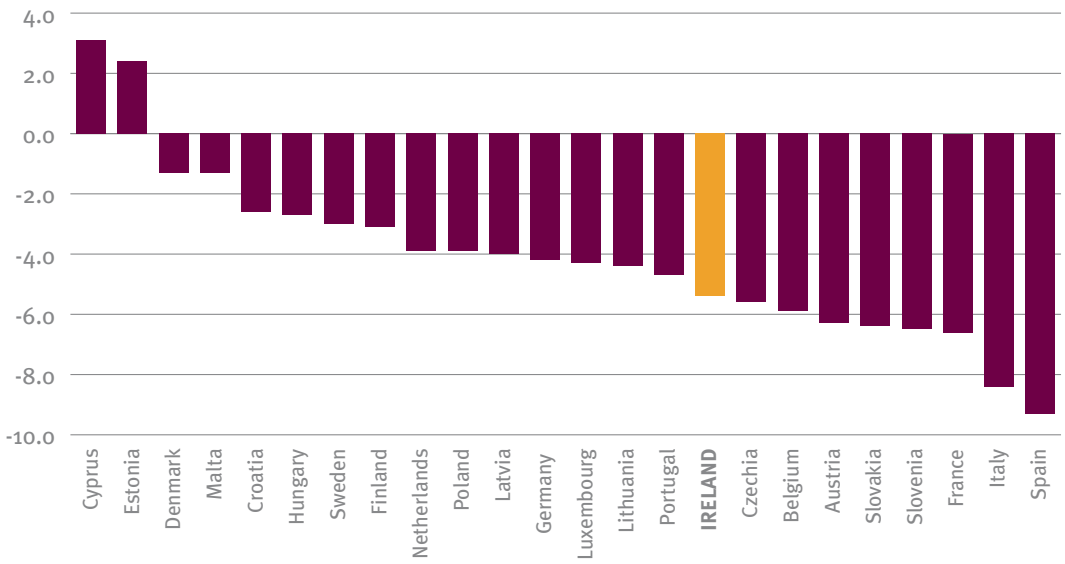



**Source**: *Eurostat.*

However, if a comparison between EU countries is made using domestic demand, Ireland is not an outlier. Its domestic demand fell by 5.4% in 2020, significantly less than Italy or Spain and comparable to many countries. However, some countries such as Estonia and Cyprus had growth in domestic demand in 2020. (See Figure 2 – modified domestic final demand is used for Ireland).



**Figure 2: Domestic Demand – annual % change, 2020**




**Source**: *Eurostat & CSO.*

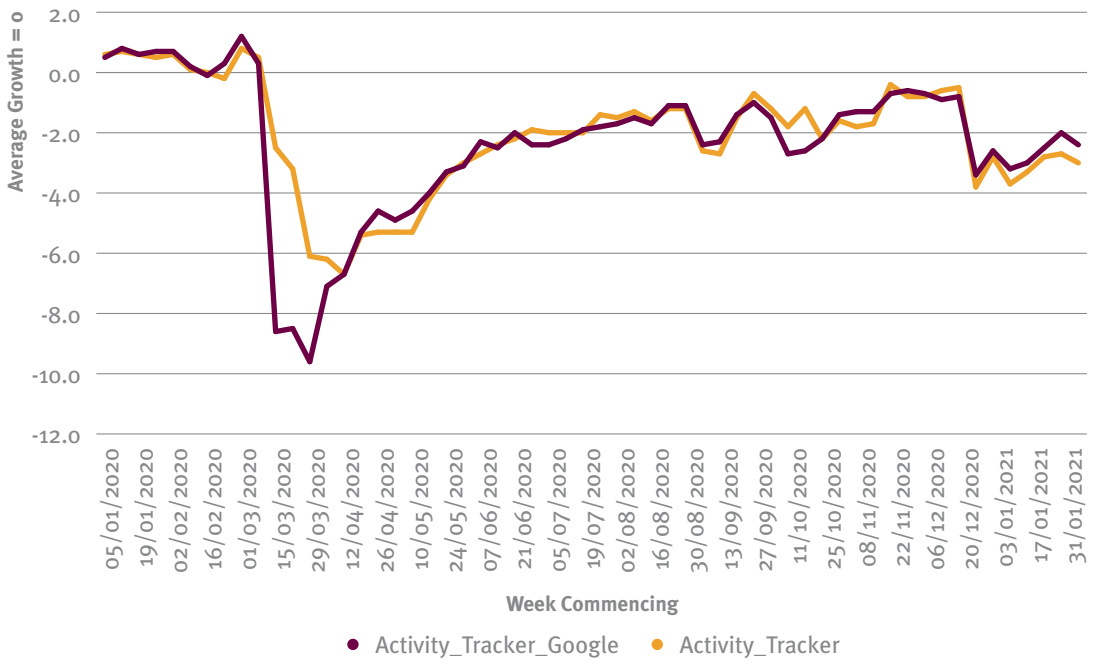
**Note**: *Modified Final Domestic Demand is used for Ireland. Data not available for all EU countries.*

According to the CSO, there was annual growth in the Industry (excluding Construction) (15.2%) and the Information and Communication sectors (14.3%). There was a contraction in Arts, Entertainment and other services (-54.4%), the Distribution, Transport Hotels & Restaurants sectors (-16.7%), and Professional & Administrative Services (-15.5%) and Construction (-12.7%). Overall Personal Consumption Expenditure on Goods and Services was down 9% in 2020 reflecting the COVID-19 related restrictions.

## Current economic developments

The PBO tracks ongoing trends in the Irish economy via the *PBO's Domestic Economic Activity Tracker.* The tracker is an index based on several high frequency data series that are available on a weekly basis.[1] It shows the extent to which the pandemic caused an unprecedented shock to the Irish economy in Q2 2020. Activity improved significantly once restrictions were lifted from May. More recent developments show that domestic economic activity slowed significantly in January 2021 following Level 5 restrictions, although not to the same extent as the March 2020 lockdown. The tracker indicates that economic growth is currently nearly 4 percentage points lower than average economic growth over the last 5 years.

**Figure 3: PBO's Domestic Economic Activity Tracker (Up to 14th of February 2020)**




**Source**: *PBO.*

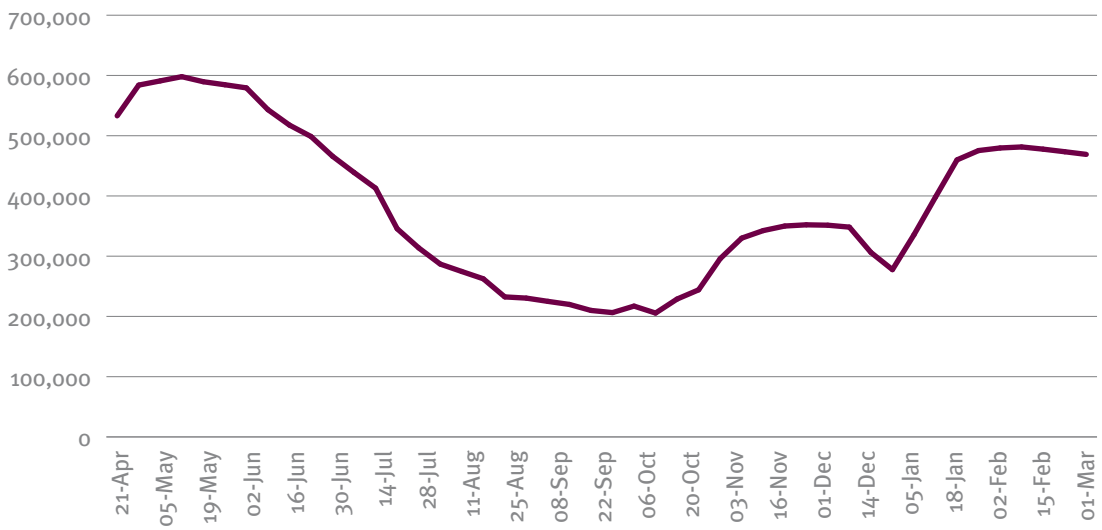
**Note:** *Values above 0 indicate periods of above average economic growth, while values below 0 suggest that the economy is operating below average growth. Activity_Tracker_Google includes data on Google searches for "unemployment" and "social welfare".*

1 *For more information on data and methodology please refer to PBO publication 51 of 2020.*

## Labour market

COVID-19 has had a significant impact on the Irish labour market. On the 1st March 2021, there were 468,847 Pandemic Unemployment Payment (PUP) claimants. The number of PUP claimants declined during Q3 2020 as some COVID-19 restrictions were lifted, however there was an increase in Q4 2020 and again in January 2021, as restrictions were re-imposed due to a surge in COVID-19 case numbers (Figure 4).

**Figure 4: No. of PUP claimants**

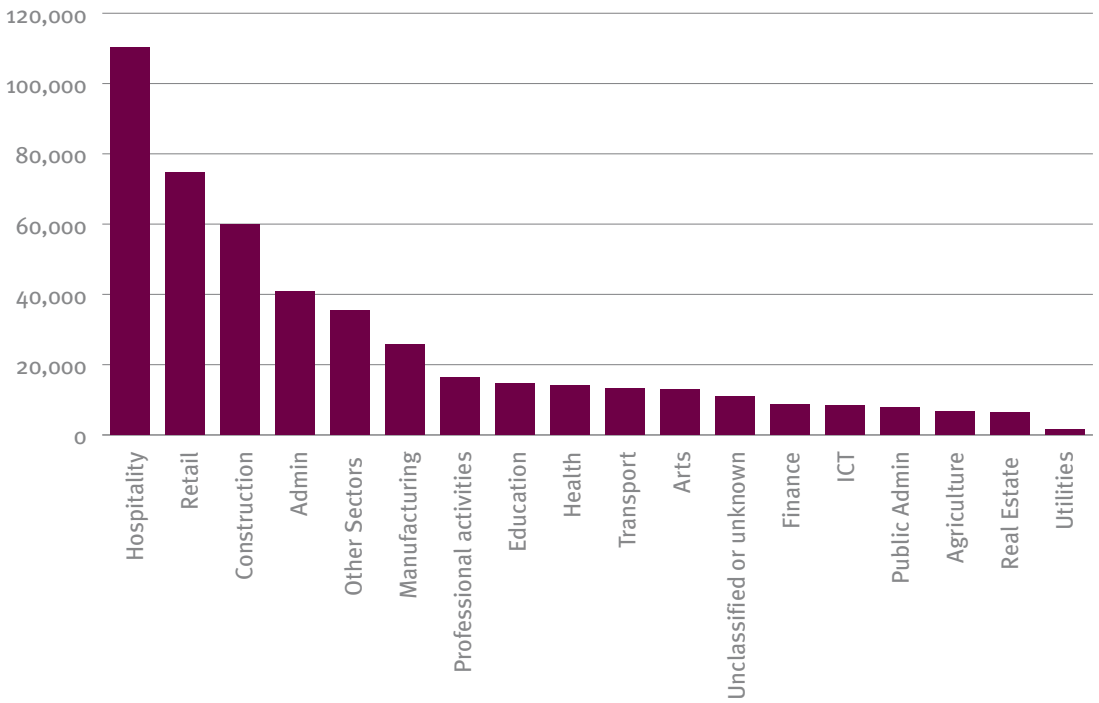



**Source**: *Department of Social Protection various updates "Update on payments awarded for COVID-19 Pandemic Unemployment Payment".*

The combined number of persons on the Live Register or PUP was 655,549 claimants in February 2021, which is less than the peak of 816,848 claimants in April 2020. To put this into context, the highest number of Live Register claimants during the Financial Crisis (2008-2013) was 448,800 in August 2011.

The COVID-19 Adjusted Measure of Unemployment (produced by the CSO) was 596,668 persons at end-February 2021 and the COVID-19 Adjusted Unemployment Rate was 24.8%. The COVID-19 Adjusted Measure of Unemployment includes persons in receipt of the Pandemic Unemployment Payment (PUP) and the peak rate was 30.5% in April 2020. The highest unemployment rate during the Financial Crisis was 16.1% in December 2011.

**Figure 5: No. of PUP claimants by sector, March 2021**




**Source**: *Department of Social Protection*

Due the re-imposition of stricter restrictions, the number of PUP claimants has been increasing since October 2020, particularly in the hospitality and retail sectors. The accommodation sector had 110,216 PUP claimants and the wholesale and retail trade sector had 74,589 PUP claimants on the 1st March 2021. The construction sector with 59,867 PUP claimants is also affected by new restrictions from January 2021.

## Overview of forecasts for the Irish economy

Forecasting is very challenging in the current uncertain environment. For example, in the Summer 2020, the European Commission estimated that the Irish economy would contract by 8.5% in 2020. By the Winter 2020 economic forecasts, the European Commission had revised their estimates to 3% growth. This highlights the difficulty in predicting the direction of the economy and the trajectory of the COVID-19 virus.

The below table shows the most up to date forecasts for Ireland's GDP growth as produced by the European Commission, the Central Bank of Ireland and the Economic and Social Research Institute (ESRI). The average forecast of the institutions points to a relatively strong recovery in the near future and estimate that real GDP will increase by 4% in 2021 and 4.1% for 2022.

**Table 1: Overview of selected GDP forecasts for Ireland**

| Most up to date GDP growth forecasts (y-on-y %) | 2021 | 2022 |
|---|---|---|
| European Commission (February 2021) | 3.4 | 3.5 |
| Central Bank of Ireland (January 2021) | 3.8 | 4.6 |
| ESRI (December 2020) | 4.9 | – |
| Average forecast | 4.0 | 4.1 |

**Sources**: *European Commission, Central Bank of Ireland and ESRI.*

## Key economies and trade partners

The global economic outlook is also very uncertain, depending on worldwide deployment of COVID-19 vaccines and the direction of the virus and its variants. The main economies driving global growth and Ireland's key trading partners are the Euro area, the United States and China.

The global economy is estimated to have contracted by 4% in 2020 but is expected to increase by 4.8% in 2021 and 3.8% in 2022, according to the average forecast of the three main international institutions (OECD, IMF and European Commission). The table below shows the average growth forecast for Euro Area, USA, UK and China, for 2020 to 2022, and their respective share of Irish goods exports and imports in 2020.

**Table 2: Overview of selected international GDP forecasts**

| Average real GDP forecast (%) | 2020 | 2021 | 2022 | Exports goods (% of Irish total) | Imports goods (% of Irish total) |
|---|---|---|---|---|---|
| World | -4.0 | 4.8 | 3.8 | | |
| Euro area | -7.2 | 3.8 | 3.5 | 37 | 30 |
| USA | -3.9 | 4.0 | 2.8 | 31 | 15 |
| UK | -10.5 | 3.8 | 3.7 | 9 | 23 |
| China | 2.1 | 7.8 | 5.4 | 7 | 7 |

**Source:** *OECD, IMF and European Commission*

Relatively robust growth is forecast for the world economy in 2021 and 2022. This is positive for Ireland given its international focussed economy. However, robust growth especially in the USA has given rise to concerns regarding inflation and thus future interest rate rises. This is unlikely to arise in 2021 but may become an issue in the medium-term.

## Selected macro-economic risks

There are a number of core macroeconomic risks facing Ireland in the short to medium-term with some probability of materialising. In particular, there is an elevated level of uncertainty arising from Brexit and COVID-19. These include:

- COVID-19 mutations triggering the spread of vaccine resistant variants of the virus, resulting in prolonged periods of restrictions.
- Brexit could drive divergence between the UK and the EU on key policy areas, potentially impacting Irish exports and imports. Adjustments to supply chains could mean additional costs to the Irish economy.
- There is significant employment in highly productive sectors such as Information Technology and Pharmaceuticals, which have helped the Irish economy to better cope with the economic impact of the pandemic. COVID-19 has also accelerated beneficial structural changes, such as the process of digitalisation (e.g. online and remote working) with potential gains in terms of efficiency and innovation in organisations.
- There is the potential for scarring in the labour market post-COVID-19 with a significant number of people out of work for a prolonged period. This could lead to skill deterioration and issues on re-entering the labour market. Further, certain businesses in the most impacted sectors may not be viable anymore once COVID-19 supports are withdrawn.
- There is currently a high level of savings, with Irish households collectively having €126.4 billion in deposits in January 2021. A quick economic recovery could be facilitated if these savings were spent or invested in the economy as soon as the pandemic ends.

# Taxation

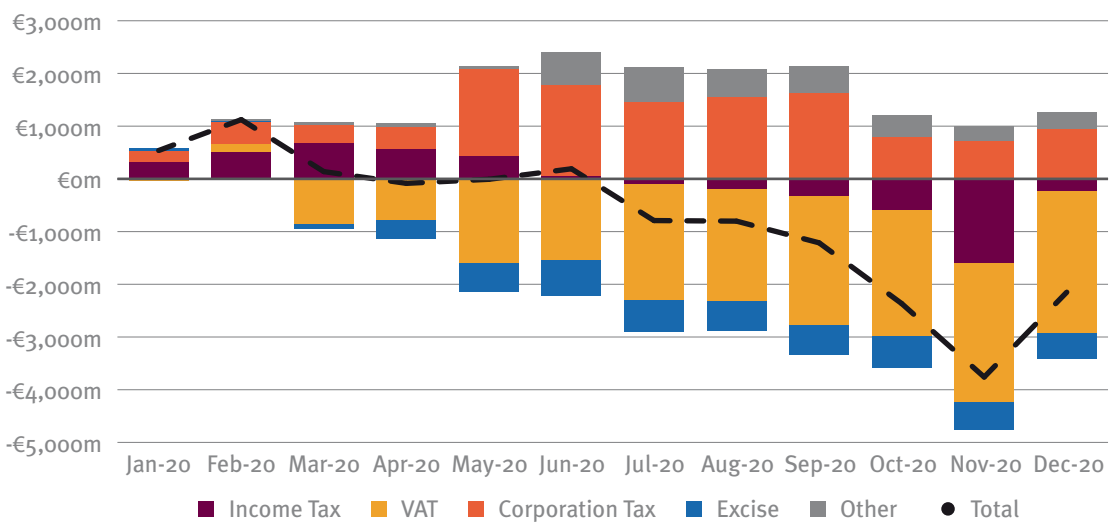


## Tax revenue in 2020

Overall, the impact of the pandemic on tax receipts in 2020 was substantially less than anticipated. In the face of a severe economic shock, and despite substantial restrictions on commercial activity to contain the spread of the virus, tax revenue continuously outperformed initial expectations. Receipts for the year, at €57.2 billion, were €6.3 billion below pre-COVID-19 forecasts (Medium-Term Fiscal Strategy; January 2020),[2] but €7.6 billion greater than the initial forecasts aimed at capturing the impact of the pandemic (included in last year's Stability Programme Update, April 2020).[3]

On an annual basis, receipts in 2020 were just €2.1 billion lower than in 2019. As shown in Figure 6, much of the annual decline in tax revenue throughout 2020 was driven by a significant drop in VAT (a consequence of the severe restrictions on commercial activity enforced throughout the year). There was a relatively more modest fall in Income Tax, while a strong performance of Corporation Tax had an offsetting effect.

**Figure 6: Annual change in tax revenue, January 2020 – December 2020 (cumulative)**




**Source:** *PBO based on data from the Department of Finance.*

2 *Medium-Term Fiscal Strategy, Department of Finance, 9 January 2020.*

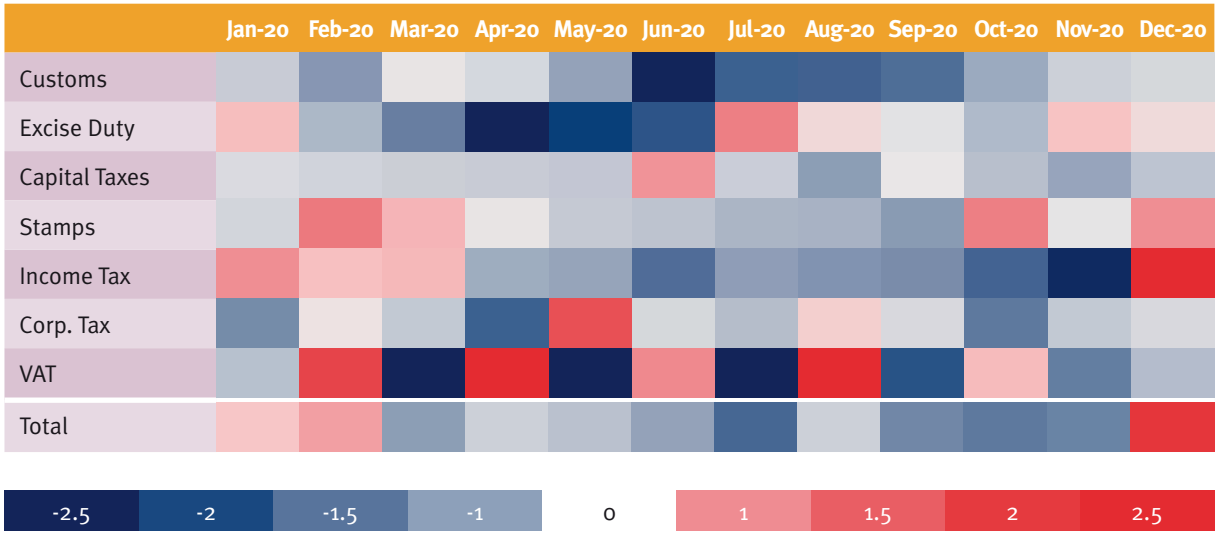
3 *End-year receipts were also €470 million above the updated forecasts published in Budget 2021 (October 2021).*

The "heat map" graphic in Figure 7 illustrates the extent to which the annual revenue growth rate of each tax deviates from the average growth rate for that tax in that particular month (in terms of the standard deviation). This method illustrates imbalances in the collection of tax receipts each month, relative to what would typically be expected for the month, and can be used to prompt or steer further investigation.

For example, the growth in VAT receipts for April 2020 far exceeded typical VAT growth for April, due to the significant repayments made in April 2019. Similarly, the decline in Income Tax receipts for November (typically a large month for the tax) is evident. This was a result of the deferral of self-employed Income Tax, with these receipts instead collected in December and contributing to the stronger than average growth of the tax for that month. Overall, the poor performance of tax revenue throughout the year (i.e. the blue boxes) relative to the average growth rate for each month is observed.

Certain measures introduced in 2020 (e.g. forbearance measures and temporary tax-policy changes) make annual comparisons and comparisons against profile more challenging. For this reason, it is important to interpret monthly tax figures within the broader context of policy and administrative changes.

### Figure 7: Heat map capturing tax revenue volatility




**Source**: *PBO based on data from Department of Finance.*

**Note:** *For each tax, the colours in the map indicate how far annual revenue growth for the month was relative to the long-term average growth for the tax for that month, in terms of standard deviations. Shades of red indicate that annual revenue growth was above average for the tax in that month, while shades of blue indicate that annual revenue growth was below average.*

## Lack of tax forecasts for 2021

The Fiscal Monitor publication for January states that profiles of tax revenue for 2021 will not be published until May 2021. These profiles will be based on forecasts set out in the upcoming Stability Programme Update (SPU). This means that the latest set of official forecasts available to Members are those included in October's Budget. However, the macroeconomic context has changed considerably since then. Forecasts of tax revenue published in the Budget (of approximately €60.3 billion) did not account for the imposition of Level 5 restrictions in Q4 2020 (extended through Q1 2021) and assumed that no vaccine for COVID-19 would be available for widespread use in 2021. These forecasts were also based on a "no-deal" Brexit scenario.

In the interest of effective parliamentary oversight and scrutiny, the PBO believes it is fundamental that more regular updates of tax revenue forecasts (and corresponding monthly profiles) are published, at least for the duration of the current crisis (e.g. on a quarterly basis).

As was the case in 2020, forecasts published in the SPU in April, could lose relevance quickly if the macroeconomic context changes further. Absent more regular reporting by the Department, the Oireachtas risks operating in an information vacuum for the six months between the SPU and the publication of Budget 2022. Reflecting the uncertain macroeconomic context at present, any update to official forecasts could be provided in the framework of a broader scenario analysis and/or presented as a range of potential estimates (rather than a single figure).

## Short-term tax outlook

Budget 2021 did not contain medium-term fiscal forecasts, owing to the significant uncertainty at present. The Government has indicated that these will be included in the SPU (April 2021), however, the future remains remarkably uncertain and will largely depend on the success of the COVID-19 vaccination campaign in suppressing the incidence of the virus.

Various factors will impact on tax receipts in 2021 and beyond. The temporary reduction in the standard rate of VAT (from 23% to 21%) expired on 28 February 2021, while the reduction in the rate applied in respect of hospitality and tourism (from 13.5% to 9%) is set to remain until the end of 2021. In addition, forbearance measures introduced in 2020 saw the warehousing of a substantial portion of Income Tax and VAT receipts, as well as overpayments under the Temporary Wage Subsidy Scheme (approximately €1.9 billion in total).[4] While a significant portion of this is expected to be recouped, this may be delayed until 2022, depending on the duration of the current restrictions. In addition, for Corporation Tax, the OECD BEPS initiative is expected to reduce receipts by approximately €500 million per year from 2022.[5]



4 *Revenue confirms Debt Warehousing Scheme remains available to support businesses impacted by current Level 5 restrictions*, *Revenue Commissioners, Press Release, 13 January 2021.*

5 *Medium-Term Fiscal Strategy*, *Department of Finance, 9 January 2020.*

Receipts for the year ahead will largely depend on the extent and speed at which restrictions are eased and commercial activity can resume. This will ultimately depend on the success of the vaccine rollout. A successful mass vaccination campaign should see a resumption in activity in the second half of 2021. A sharp rebound in consumption would buoy receipts from VAT (which has been the biggest contributor to the decline in tax revenue since the pandemic began – see Figure 6). In addition, the significant stock of household savings built-up during the pandemic is likely to be unwound over time increasing consumption.

There are also likely to be improvements in the labour market. However, a reduction in the number unemployed would lead to a relatively more modest rebound in Income Tax receipts, given that job losses incurred during the pandemic have been concentrated on the lower-end of the earnings distribution (and therefore contribute relatively less in Income Tax payments).

Against the backdrop of a scenario that assumes mass vaccination in the second half of 2021, the ESRI estimate that receipts for the three largest tax heads (Income Tax, VAT and Corporation Tax – which amounted to €46.9 billion in 2020), will be €46.7 billion for the year. A similar scenario modelled by the Fiscal Council predicts receipts from these three taxes of €50.9 billion.

## Tax revenue trends highlight key risks

While the restrictions imposed to curb the spread of COVID-19 did not impact on tax revenues to the full extent that was initially expected, the pandemic has highlighted and exacerbated potential imbalances inherent in the tax system.

The resilience of Income Tax receipts reflects the relatively high concentration of payments from those on the upper-end of the earnings distribution. The reliance of the Exchequer on these groups increased during the last 12 months as COVID-19 related job losses disproportionately impacted those on the lower-end of the earnings distribution.[6]

Similarly, the reliance of the Exchequer on Corporation Tax receipts (which are also concentrated around relatively few taxpayers)[7] grew substantially in 2020, as other revenues dropped. Corporation Tax receipts were just €600m lower than VAT receipts (the second largest tax head) for the year. The precarious nature of Corporation Tax receipts though was highlighted in October, with a substantial shortfall for the month (receipts were €655m below expectations).

The PBO has cautioned previously about the risk of relying on a relatively narrow tax base to fund ongoing spending and has highlighted the importance of pursuing base-broadening measures.

6 *See PBO Publication 9 of 2020 – Employment in Sectors Most Exposed to the COVID-19 Pandemic, 30 March 2020.*

7 *See McCarthy, L. 2020, Corporation Tax 2019 Payments and 2018 Returns, Revenue Commissioners.*

# Voted spending



## Spending 2009-2021

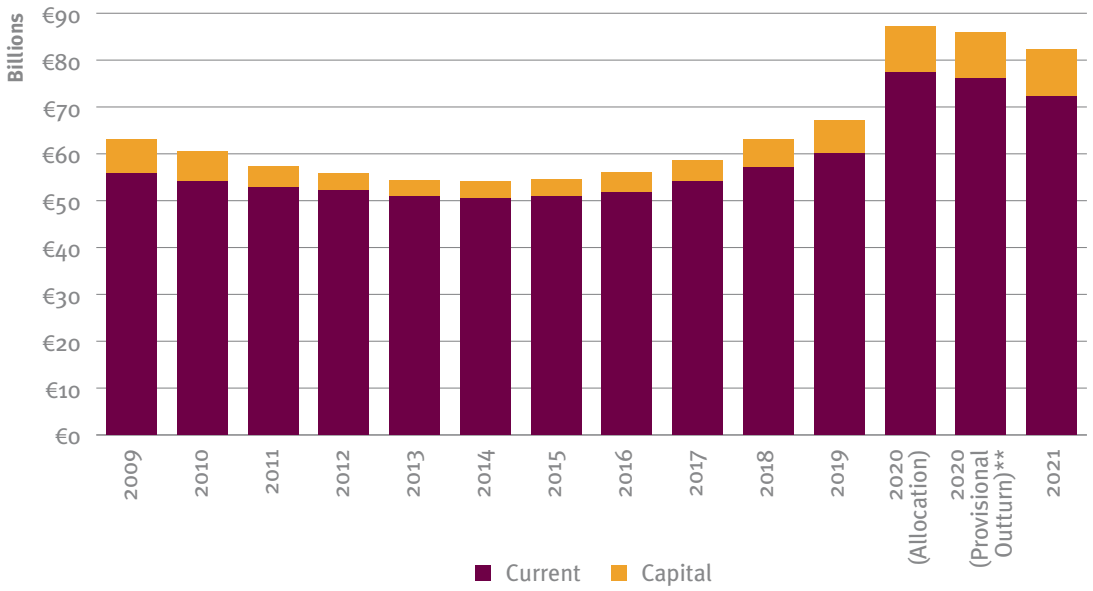
In 2020, gross voted spending increased considerably in response to the COVID-19 pandemic. Provisional outturn in 2020 (€85.15 billion) is almost €2.16 billion less than provided for in the various Estimates throughout 2020, although **€710 million will be carried forward into 2021 as capital carryover.**

Figure 8 places this level of expenditure in the context of the period from 2009 to 2021. Gross Voted spending fell between 2009 and 2014 reflecting a period of fiscal consolidation. Capital spending which is more discretionary was reduced significantly – falling from €7.33 billion in 2009 to €3.39 billion in 2013 (a reduction of almost 54%). As the economy recovered, gross spending began to increase and by 2018 had returned to approximately 2009 levels in nominal terms.

Notwithstanding what was set out in the version of the *Revised Estimates for Public Services 2021* published in December, intensified public health restrictions in early 2021 have increased Social Protection expenditure. However, a total of €5.5 billion was set aside in Budget 2021 to be allocated to Votes, if necessary, under the headings of COVID-19 Contingency Reserve (€2.1 billion) and Recovery Fund (€3.4 billion) – see PBO infographic *here*. It is unclear at this stage how much of these funds will be spent in 2021 but given the Level 5 restrictions in Q1 and the extension of the Pandemic Unemployment Payment and Employer Wage Subsidy Scheme to end Q2 (see below) it is likely that most of it will be.

Preparations for mass vaccination of the population during Q2 and Q3 of 2021 suggests a reduction in gross spending could be possible in the latter part of 2021, particularly for those Votes which have addressed the economic costs of the pandemic (Social Protection, and Enterprise, Trade & Employment). Spending on Health is however forecast to increase by €1.25 billion in 2021.

**Figure 8: Gross Voted spending 2009-2021***




**Source:** *Revised Estimates for Public Services 2021 (December 2020) and DPER Databank.*

** The disestablishment of the HSE vote from 2015 has led to a discontinuity in the series due to the treatment of HSE income. Reported gross spending in 2015 (and subsequent years) is approximately €1 billion lower due to this change.*

*** Provisional outturn in this chart for 2020 includes €711 million capital spending that is deferred to 2021. This is discussed in more detail in Capital Spending (p.8).*

## Gross Voted spending – February 2020 vs February 2021

Table 3 illustrates, at Vote group level, the change in spending at end-February 2021 compared to end-February 2020. Year-on-year comparisons are complicated by the transfer of functions between various votes; however, total gross spending is clearly up year-on-year, with an overall increase of 20.5% (€2,110 million).

**Table 3: Year-on-year change in gross spending by Vote Group at end-February (2020-2021)**

| Vote Group | Change (€m) | Change (%) |
|---|---|---|
| **Social Protection** | €1,806 | 51.3% |
| **Further & Higher Education, Research, Innovation and Science** | €445 | – |
| **Transport*** | €84 | 44.7% |
| **Health** | €76 | 2.8% |
| **Tourism, Culture, Arts, Gaeltacht, Sport and Media*** | €57 | 130.5% |
| **Public Expenditure and Reform** | €24 | 16.4% |
| **Foreign Affairs** | €17 | 18.9% |
| **Children, Equality, Disability and Youth*** | €16 | 5.0% |
| **Agriculture, Food and the Marine** | €13 | 6.7% |
| **Enterprise, Trade and Employment** | €9 | 7.6% |
| **Rural and Community Development*** | €2 | 4.1% |
| **Finance** | -€2 | -2.1% |
| **Defence** | -€3 | -2.2% |
| **Taoiseach's Group** | -€5 | -15.1% |
| **Justice*** | -€29 | -6.2% |
| **Housing, Local Government and Heritage*** | -€46 | -13.4% |
| **Environment, Climate and Communications*** | -€49 | -61.8% |
| **Education*** | -€303 | -17.6% |
| ***Total*** | ***€2,110*** | ***20.5%*** |

** Year-on-year comparisons impacted by transfer of functions*

**Source:** *PBO based on Fiscal Monitor: February 2021 (March 2021).*

The largest decrease in spending, year-on-year, is in Education (Vote 26); however, this is primarily due to the creation of a new Vote (Vote 45) for Further & Higher Education, Research, Innovation and Science. Overall, the spend on the Education **sector**, i.e. Votes 26 and 45 combined, has seen a modest increase at end-February 2021 compared to this point last year.

The Vote Group experiencing the largest increase in spending (in cash terms rather than proportionately) is Social Protection. Compared to February 2020, spending in 2021 is in excess of €1.8 billion (51%) higher. This illustrates the significant impact of Level 5 restrictions in place in January/February 2021 as a driver of Social Protection spending. Spending in the Vote is €425 million higher than profiled, again illustrating the effect of the restrictions.

# Gross Voted spending 2021 – key risks



## Social Protection spending in 2021

There are two primary drivers of uncertainty in relation to spending on Social Protection in 2021 – the two primary supports for workers affected by the public health restriction response to the COVID-19 pandemic:

i. the Pandemic Unemployment Payment (PUP) for those who are unemployed – funded from the Social Insurance Fund; and

ii. the Employment Wage Subsidy Scheme (EWSS) which superseded the Temporary Wage Subsidy Scheme (TWSS).[8]

**The PUP is entirely funded from the Social Insurance Fund (SIF) in 2021.** In the week commencing 15 February 2021 some 477,700 people were due to receive the Pandemic Unemployment Payment (PUP) at a cost of €143.3 million.[9] The provision made for the PUP in 2021 was €642 million. Therefore, that provision was probably exhausted after the first week of February.

While claimant numbers for the PUP were down on the previous week (-3,666), short of an easing of Level 5 restrictions it seems unlikely that claimant numbers will fall to any significant degree. As such, it is likely that for each week that Level 5 restrictions continue that approximately €140 million in PUP expenditure will be incurred.

When the revised Living with COVID-19 plan was published, the PUP was extended to end-June 2021 and this extension was expected to cost approximately €1.6 billion. **Such projections are highly uncertain**, not least because it is not yet possible to determine when restrictions will ease (or to what extent) but also it is likely there would be a reduction in claimant numbers prior to a reopening of the economy as employees are called up for various tasks necessary before businesses could reopen e.g. restocking stores.[10] It is, on the other hand, also unclear how many people may move from the PUP to Jobseekers Benefit (JB)/Jobseekers Assistance (JA) over time.

The EWSS was also extended to end-June and this extension is expected to cost approximately €1.3 billion.

The imposition of public health measures to contain the spread of COVID-19 are therefore resulting in significant unbudgeted levels of Social Protection spending in 2021. The *Revised Estimates for Public Services 2021* (December 2020) do not reflect the likely spending of either the Vote or the Social Insurance Fund in 2021.

Level 5 public health measures are also likely to contribute to reduced SIF income (the SIF is normally primarily funded by Pay Related Social Insurance (PRSI) contributions). **Reduced income combined with increased SIF spending on the PUP make it highly likely that the subvention (as currently projected) from the Vote to the SIF of €584 million for 2021 will be inadequate to meet the SIF's liabilities.**

8 *The EWSS currently applies to 31 March 2021. See Department of Finance, 'Government extends subsidy rates for the Employment Wage Subsidy Scheme until March 31st' (06 January 2021).*

9 *Department of Social Protection, 'Update on payments awarded for COVID-19 Pandemic Unemployment Payment and Enhanced Illness Benefit' (15 February 2021).*

10 *Social Protection data has also exhibited declining PUP recipient numbers consistently since 02 February, with some 10,201 persons reported as returning to work up to the 16th of February. See Department of Social Protection, Update on Payments Awarded for Covid-19 Pandemic Unemployment Payment And Enhanced Illness Benefit – Statistics (15 February 2021) pp.7-8.*

Social Protection spending in 2021 is therefore likely to considerably exceed the levels set out in the Revised Estimate due to an increase in Voted spending on the EWSS as well as providing a larger subvention to the SIF to enable it to meet its increased spending alongside likely income reductions.

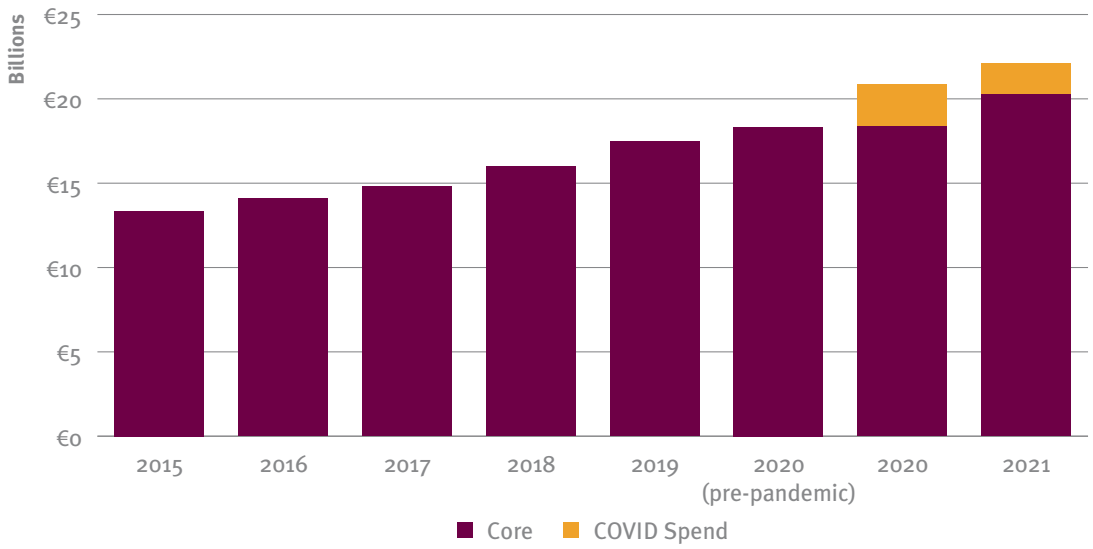


## Health spending in 2021

Spending on Health has been on a steady upward trajectory. Core health spending has increased from €13.34 billion to €20.25 billion, almost €7 billion (or 51.8%) between 2015 and 2021.[11] The PBO has previously highlighted the disconnect between the Revised Estimates and publicly funded health spending (see *The HSE National Service Plan and its Relationship with the Health Vote* (2018)). While various HSE publications such as the National Service Plan, Performance Reports, and Annual Reports contain useful data, they are not integrated with the Revised Estimates and are therefore of limited use in assisting the Dáil in the budgetary process.

Direct COVID-19 related spending in 2021 is projected to be less than in 2020; however, non-COVID spending is due to increase significantly. The impact on spending in Q1 2021 of significant levels of COVID-19 is unclear. It could drive increased spending on COVID specific aspects of the Health spending but is also likely to require some deferral of other services. This could place further pressure on service delivery and the budget later in 2021 or in 2022 – as the Health Service attempts to address the backlogs.

**Figure 9: Gross Health spending post disestablishment of HSE Vote (2015-2021)**




**Source:** *PBO based on DPER Databank, Revised Estimates for Public Services 2020 (December 2019), Revised Estimates for Public Services 2021 (16 December 2020).*

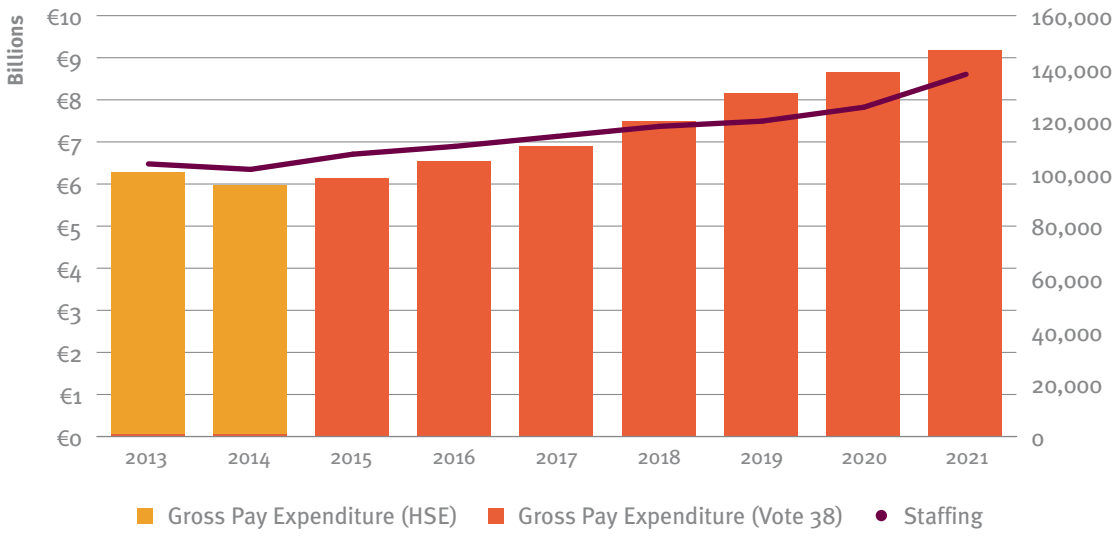
**Note:** *2020 figures are allocation.*

11 *Prior to 2015 the Health Service Executive (HSE) had its own Vote, since then the HSE has been incorporated within the Health Vote (the HSE Vote was disestablished), with funds allocated via the Minister in an annual 'letter of determination' in the form of a grant in line with the Health Service Executive (Financial Matters) Act 2014.*

The impact of COVID-19 on the Health sector is complex and, while providing COVID specific subheads is welcome, the PBO notes that distinguishing between COVID and non-COVID spending in a practical and meaningful sense may not be entirely possible for healthcare services delivery.

Following the disestablishment of the HSE Vote, the Exchequer pay costs associated with the Health Sector were consolidated under Vote 38 (from 2015 onwards). Since 2015, both staffing and the gross pay bill have increased. In 2021, staffing levels are projected to reach 137,639 (an increase of more than 30,360/28.3% over 2015 levels). **Staffing levels are projected to increase by 12,515 (10%) in 2021 over 2020**. However, **it is likely some of this increase occurred in 2020** as staffing level data, projected prior to the pandemic, were not revised to reflect the recruitment of (amongst others) a testing and tracing workforce.

**Figure 10: Health sector staffing & associated Exchequer gross pay bill (2013-2021)**




**Source:** *PBO based on Revised Estimates for Public Services 2021 (December 2020); and DPER Databank.*

## Will COVID-19 related spending be temporary?

Core pre-pandemic spending for 2020 was envisaged to be €70.4 billion – as set out in the Revised Estimates for that year (published December 2019). The difference between what was allocated for 2020 pre-pandemic and the provisional outturn post-pandemic was €15 billion. However, was this all temporary COVID-19 related and will it be reversed once the pandemic eases?

It is likely that the answer to both questions is no. Supplementary Estimates (which are often sought for the Health Vote, for example) would have probably increased spending in 2020 even in the absence of the pandemic. In addition, some changes during 2020 related to non-COVID policy adjustments due to the establishment of a new Government.

Most, but not all, Departments did establish COVID-19 specific subheads (see PBO infographic *here*). In the case of the Department of Health/Health Vote, the delineation between COVID and Non-COVID spending is likely to be highly challenging. While some costs can be clearly isolated such as those associated with COVID testing and tracing, other costs are likely to be challenging to categorise. Such costs could relate to the indirect effects of COVID-19 such as the inflated costs arising from deferred medical treatment and needing more intensive intervention later.

Thus, a more medium-term issue is how accurately COVID-19 spending is being isolated from 'core' spending and whether this money (approximately €11.9 billion in 2021) will prove temporary i.e. be removed from allocations when and if the public health emergency ameliorates or ends.

There is a strong case to closely scrutinise this question in relation to Departments that received additional allocations in 2020 and 2021 but which did not establish COVID-19 specific subheads and metrics.

Spending increases in 2020 and 2021 are funded by debt as tax revenue, while resilient, will not increase significantly over the period. If part of the COVID-19 related increase in spending in 2020 and 2021 proves permanent, consideration will need to be made as to how such spending is funded over the longer term.

## Capital spending

In 2020, a total of €9.89 billion was allocated for capital spending, of this, €9.05 billion was spent (provisional outturn) in 2020. Of the balance (€839.9 million) the *Revised Estimates for Public Services 2021* (December 2020) provided for:

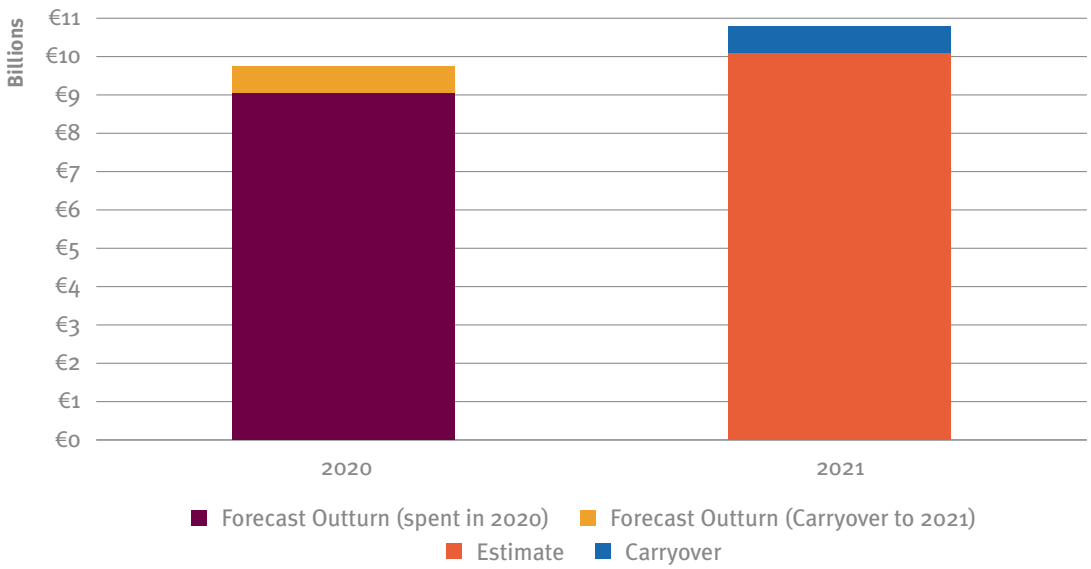
> *A sum of €748.5m in capital savings from 2020 is available for spending in 2021 under the multiannual capital envelopes carryover facility.*

This amount was later revised to €710 million but remains an usually large amount of capital spending to be carried over.

Figure 11 illustrates that €9.05 billion will be spent in 2020, with €710 million being proposed to be carried forward to be spent in 2021. This means that, in addition to the capital spending for which approval is sought in 2021, €10.08 billion (Estimate), there is an additional €710 million which is projected to be spent in 2021. **This amounts to a capital spend of €10.8 billion in 2021.**

If realised, in terms of in-year capital spending, this would represent an increase of €1.75 billion (19%) over capital expenditure in 2020 (€9.05 billion).

**Figure 11: Capital spending 2020-2021**




**Source:** *PBO based on Revised Estimates for Public Services 2021 (December 2020).*

The proposed levels of capital spending in 2021 are significant – but with the imposition of Level 5 COVID-19 public health measures early in 2021 (with the prospect these may continue to some degree into Q2) raises questions as to how realistic these spending projections remain. The difference between the spending provided for in 2020 and actual spending incurred in 2020 is indicative that public health measures may serve to constrain capital spending to a significant degree.

# Overall balance



The final Exchequer balance for 2020 was a deficit of €12.3 billion. This is an improvement from Budget 2021 forecast of a €16.7 billion deficit. This is likely to result in a General Government Balance in 2020 well below the Budget 2021 forecast of a €21.6 billion deficit. The Central Bank of Ireland estimated the 2020 deficit at €19.3 billion.

Budget 2021 forecast an overall deficit of €20.5 billion in 2021. However, as discussed in earlier sections, there are many factors already evident on both the tax and spending sides of the Budget that mean this forecast needs updating.

The ESRI predicted a deficit of €18.5 billion for 2021 in December but assumed that Level 5 restrictions would only last 6 weeks. The Central Bank of Ireland's most recent forecast was a €20.5 billion deficit in line with Budget 2021 forecasts.

The Stability Programme Update in April will update the forecast and set out a projection for the overall balance for the medium-term.

The pandemic has resulted in the non-implementation of both the EU and national Irish fiscal rules for 2020 and 2021. The Commission has announced[12] that the "level of economic activity in the EU or euro area compared to pre-crisis levels (end-2019) would be the key quantitative criterion for the Commission in making its overall assessment of the deactivation or continued application of the general escape clause" and "current preliminary indications would suggest to continue applying the general escape clause in 2022 and to deactivate it as of 2023. In any event, the SPU should set out if Ireland will be projected to comply with the fiscal rules during the period.



12 *European Commission (2021) Commission presents updated approach to fiscal policy response to coronavirus pandemic.*

# Debt and interest rate environment

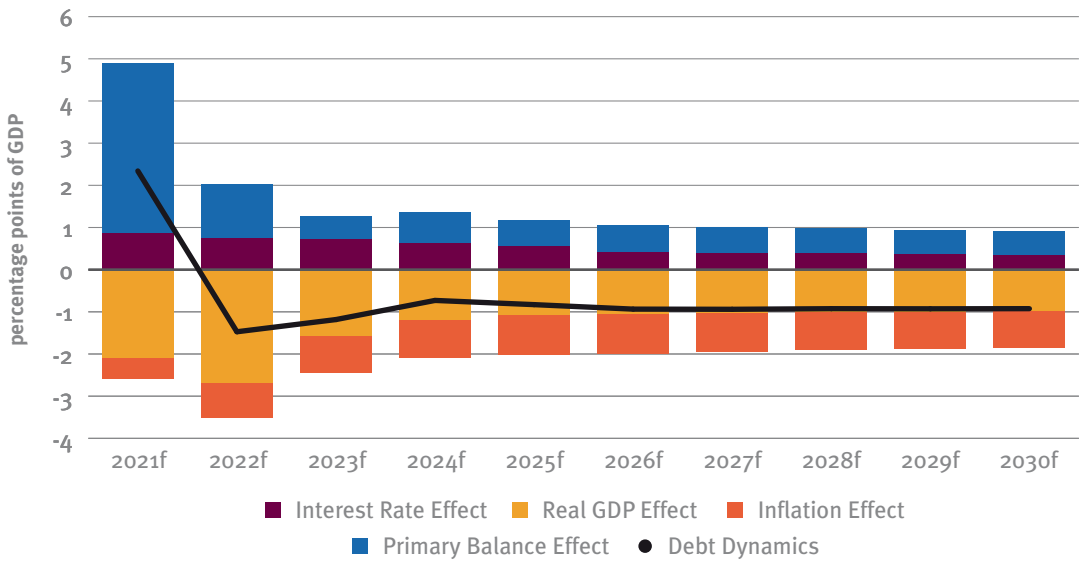


Government spending on measures to mitigate the impact of COVID-19 coupled with lower than expected tax revenue has resulted in a very significant rise in public debt. Budget 2021 estimated that Gross Government Debt would increase to €239 billion at end-2021 from €204.4 billion at end-2019.

Findings from a forthcoming PBO analytical note, show that despite a high and growing level of nominal debt, the debt burden should be on a sustainable path over the next 10 years. The PBO estimates that the debt-to-GDP ratio will peak at 61.2% in 2021 (107.8% as a percentage of GNI*). Despite the pandemic and its impact on public debt, borrowing costs have fallen significantly and are at their lowest level in a decade. Interest rates on Irish 10-year Government bonds were negative during the second half of 2020 but in recent weeks turned slightly positive. The borrowing costs for all Euro Area Member States, including Ireland, remain at historically low levels, mostly due to the actions of the European Central Bank.

Under a baseline scenario, it is expected that the debt-to-GDP ratio will be on a downward trajectory from 2022, reducing over time to below 50% by 2030. This happens without significant fiscal consolidation, as economic activity is the main driver of debt sustainability over the projection period. Figure 12 shows the contribution of different drivers of the debt dynamics from the model. The forthcoming paper will also show that negative shocks to interest rates (assessed in isolation), will not have large detrimental effects on the debt dynamics out to 2030, given the long-term maturity profile of Irish debt and the large share of the debt that is held at fixed rates. The baseline scenario assumes relatively conservative economic growth rates post-2025 and no large economic or fiscal shock during the period.

**Figure 12: Composition of the debt-to-GDP ratio dynamics – baseline scenario**




**Source**: *PBO Analytical note, forthcoming.*

**Note**: *Negative numbers imply a reduction in the debt-to-GDP ratio*

# Notes



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# Notes

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