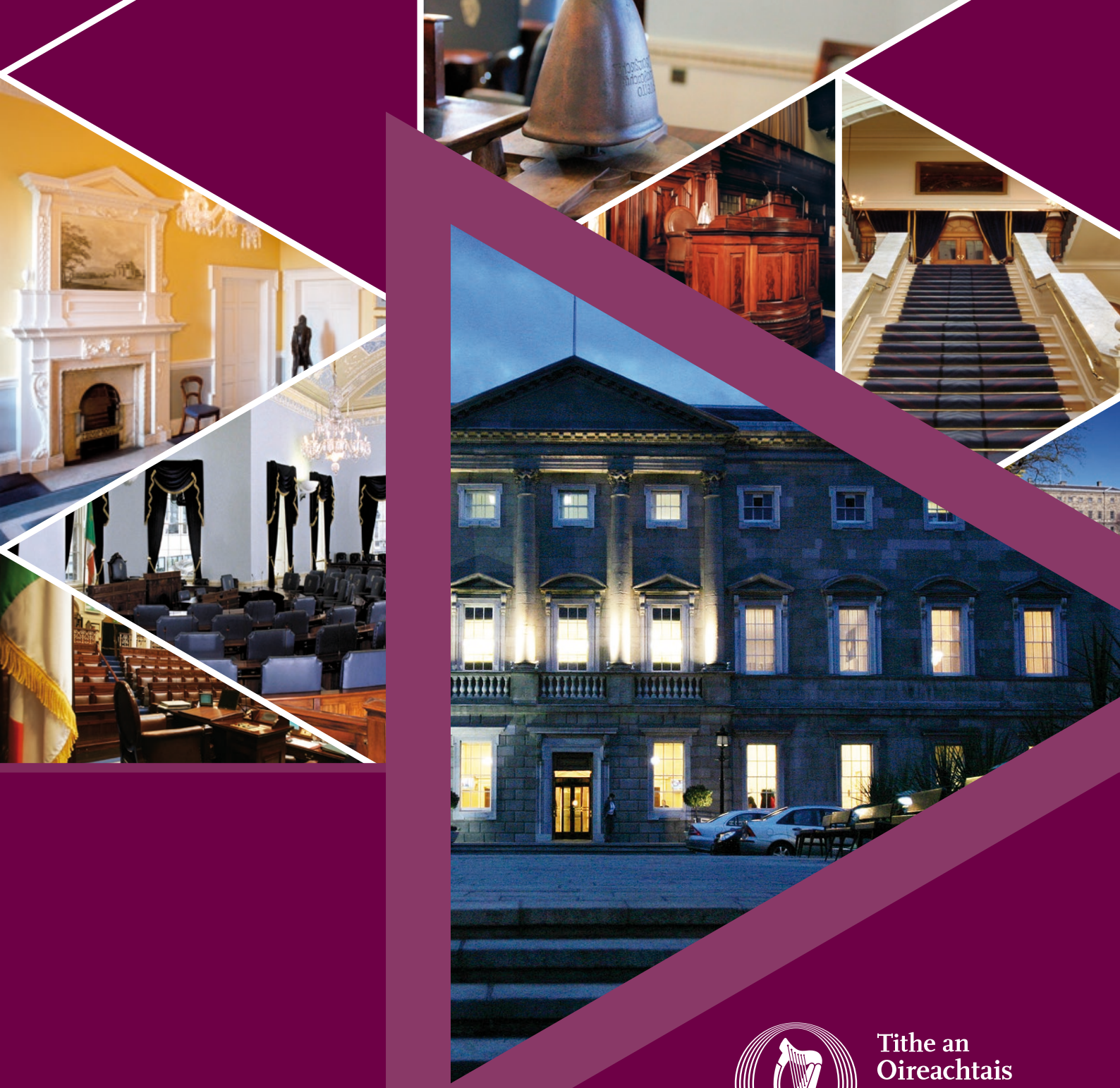

Tithe an Oireachtais
Houses of the Oireachtas

An Oifig Buiséid Pharlaiminteach
Parliamentary Budget Office

Summary and Analysis of the Stability Programme Update 2021

Publication 18 of 2021

Séanadh

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Key Messages

Economic Outlook

- In the short term, the Irish economic outlook is highly dependent on the evolution of the COVID-19 pandemic. The degree of uncertainty is still high and key risks primarily relate to the emergence of more contagious and vaccine-resistant variants, and to a slower than expected vaccination rollout, meaning that public health restrictions would be required for a longer period.
- The Irish economy has proved to be relatively resilient during the pandemic, largely due to the contribution of economic sectors dominated by foreign-owned multinationals (e.g. pharma and ICT). However, the domestic economy, and in particular consumer-facing sectors (e.g. accommodation and retail), have experienced a significant contraction in activity.
- Despite the high uncertainty, the economic outlook has improved as vaccination is underway and, while some non-tariff barriers will exist, an orderly end to the EU-UK transition period will mitigate some of the most negative consequences of the exit of the United Kingdom from the Single Market.
- Economic forecasts in the SPU 2021 assume that the key targets for the vaccination rollout are met, and vaccination will be effective, allowing for a gradual opening of the economy. GDP is forecast to increase by 4.5% in 2021 and 5% in 2022. The recovery will continue in 2023 to 2025. This economic outlook is reasonable and broadly consistent with PBO analysis. However, these forecasts are largely dependent on assumptions around the projected trajectory of COVID-19.
- The impact of the pandemic on the Irish labour market has been extensive, and has also highlighted the differential impact between high-tech sectors and labour-intensive domestic sectors. During the pandemic, employment losses were concentrated in domestic sectors and mostly affected younger cohorts. This raises the issue of how to address potential 'scarring' effects, which could lead to an increase in long-term unemployment.
- There are potential economic upsides, including for example the use of a larger proportion than the €2.25 billion of excess savings assumed in the SPU to fund consumption, that could accelerate the recovery. In addition, the fiscal stimuli adopted globally, particularly in the US and the EU, will likely have positive implications for Ireland, given the openness of the Irish economy.
- However, several macroeconomic challenges for fiscal policy remain ahead including climate change, ageing population, house supply shortages, the optimal management of structural transformations in the economy and the mitigation of 'scarring' effects on the labour force and in capital stock.

Taxation

- €60.3 billion is expected in tax revenue for 2021, up 5.6% on 2020. Despite modelling a more benign economic scenario in the SPU, the Department's estimates of tax revenue for 2021 are level with those published alongside the Budget. A breakdown of the factors driving these estimates, with reference to each scenario analysed, would be welcome. For example, personal consumption (a key driver of VAT receipts) was originally expected to increase by 7% in 2021, but the SPU revises this figure down to 3.5%, although VAT receipts are now expected to be higher.
- A rebound in Income Tax and VAT is anticipated, with both expected to average 7% growth over 2022-2025. There are upside and downside risks to these estimates. A higher than expected proportion of the household savings stock could be spent (e.g. if incentive schemes are introduced), while capacity constraints could limit activity in the short-term. Potential scarring effects could slow the recovery in the labour market, and weigh on Income Tax receipts over the medium-term.
- It is notable that Corporation Tax is anticipated to grow by an average of 1.8% over 2022-2025, contrasting with average growth of 13% seen over 2015-2019. This reflects concerns around the impact of international tax reform. The SPU estimates that annual receipts could be €2 billion lower by 2025 as a result. The PBO would welcome a more detailed analysis by the Department on the potential ramifications of international tax reform for Ireland's corporate tax base.

Government Spending

- Voted spending in 2020 was €1.8 billion less than expected at Budget time contributing to a smaller than expected deficit.
- The SPU does not revise the projected 2021 level of voted spending (€87.8 billion) but indicates that all the contingency and recovery funds (€5.4 billion) not allocated in Budget 2021 will be spent.
- The SPU assumes that the Pandemic Unemployment Payment and the Employee Wage Subsidy Scheme (amongst others) are not extended past 30 June 2021. Given past experience they are likely to be extended in some form if restrictions remain in place. It is not clear that such an extension can be funded from the €87.8 billion spending level set in Budget 2021.
- The medium-term projections for spending in the SPU are based on 'core' (i.e. non-COVID-19 and non-Brexit related) spending growing at 3.5% per annum. This is a technical assumption and there is no in-depth analysis in the SPU of the cost to maintain public services at their current level, spending pressures or costing of new policies over the period.
- The Government is projecting that voted spending will be cumulatively €42.5 billion higher between 2020 to 2024 than what was set out in Budget 2020 (i.e. in October 2019 pre-pandemic). While much of this is pandemic related, annual spending is expected to be approximately permanently €3.5 billion higher by 2024 than previously.
- Voted expenditure grew at 5.3% per annum from 2015 to 2019 – this suggests that the 3.5% technical assumption is conservative. If the 5.3% trend rate had been used voted spending would be almost €15.5 billion above the SPU scenario over the 2022-2025 period.

Deficit and Debt

- The estimated deficit for 2021 has been revised down since the Budget, to €18.1 billion (an improvement of €2.4 billion). The deficit is expected to fall to €800 million by 2025 (or 0.3% of GNI*).
- Although alternative economic scenarios are modelled in the SPU, alternative estimates of the deficit have not been provided. As estimates in the SPU are prepared on a no-policy change basis, these deficit figures will likely change. It is likely that additional stimulus measures are introduced in the 2021 National Economic Plan for some sectors (e.g. hospitality). It is unclear if such stimulus can be accommodated within the current spending envelope. If not, the National Economic Plan should update both spending and deficit forecasts.
- The SPU estimates that the stock of government debt will increase by €20.7 billion in 2021, with a further increase of €8.1 billion for 2022. Government debt is expected to reach €262.9 billion by 2025. From a sustainability perspective, the debt-to-GNI* ratio is expected to fall over the forecast horizon, from 111.8% in 2021 to 100% in 2025. This additional debt, while significant, is sustainable at least in the medium-term, given strong growth prospects and accommodative debt financing conditions.

PBO Summary and Analysis of the Stability Programme Update 2021

Introduction

The Stability Programme Update (SPU) 2021 sets out Ireland's medium-term economic outlook and its fiscal plans. It presents the Department of Finance's updated economic and fiscal forecasts out to 2025.

The Autumn forecasts (published with the Budget) did not contain estimates beyond 2021, due to heightened uncertainty surrounding the epidemiological situation at that time. The estimates for 2022-2025 included in the SPU, are the first set of medium-term economic and fiscal forecasts published by the Department since the onset of the COVID-19 pandemic.

Forecasting is particularly challenging in the current environment. Owing to the significant uncertainty surrounding the COVID-19 pandemic and the implications for economic activity, estimates included in the SPU are framed in a scenario analysis – with detailed results for the baseline scenario presented. A similar approach was taken in Budget 2021 (October) and in last year's SPU.

The central or baseline scenario presented in Budget 2021, assumed a "disorderly" Brexit outcome. This did not come to pass, with the Trade and Co-operation Agreement between the EU and UK concluded at the end of 2020. Separately, it was also assumed that widespread vaccination against COVID-19 would not occur in 2021, with sporadic targeted lockdowns used to curb local spread of the virus.

In contrast, the baseline scenario modelled in SPU 2021 assumes that mass vaccination occurs throughout Q2, with 80% of adults receiving at least a single vaccine dose by the end of the quarter. It is assumed that this allows an easing of restrictions in the second half of the year (with minimal restrictions in place for 2022), facilitating a sustained recovery thereafter.

This briefing summarises and analyses for Members some of the main points of the SPU. It examines the economic forecasts and their implications for tax revenues over the medium term. In addition, it summarises and discusses the assumptions made on Government expenditure during the period. Finally, it examines the forecasts for the deficit and Government debt. The briefing is more in-depth than previous PBO briefings on the SPU reflecting that this will be the first time many new members will scrutinise a 'normal' Stability Programme Update.

Commentary on the SPU 2021's Economic Forecasts

The economy, especially the domestic side, has been impacted significantly by the COVID-19 virus and more contagious variants. Severe public health restrictions were re-imposed in January 2021 to control the virus. This had a negative impact on economic activity in the first quarter of this year, although not to the same extent as the first lockdown (as shown by the PBO Weekly Domestic Activity Tracker).[1]

On the positive side, vaccination is underway, and it is expected it will protect a large proportion of the Irish population from serious illness and death in the second part of this year. Furthermore, while some non-tariff barriers will exist, the EU-UK Trade and Co-operation Agreement and an orderly end to the EU-UK transition period will mitigate some of the most negative consequences of the exit of the United Kingdom from the Single Market.

The trajectory of the Irish economy, particularly in the short term, is contingent on exogenous (outside the economy) factors. Major risks are related to the emergence of more contagious and vaccine-resistant variants, and to a slower than expected vaccination rollout, leading to an extension of public health restrictions.

The main assumption underpinning the forecasts in the SPU 2021 is that the key targets for the vaccination rollout are met, and vaccination will be effective, allowing for a gradual opening of the economy, which will gain momentum from the second half of this year. Under this set of assumptions, **GDP** is forecast to increase by 4.5% in 2021 and 5% in 2022. The recovery will continue from 2023 to 2025, with a negative output gap[2] closing over the forecasting period (meaning that the extent of spare capacity in the economy will be reduced).

Components of Economic Activity

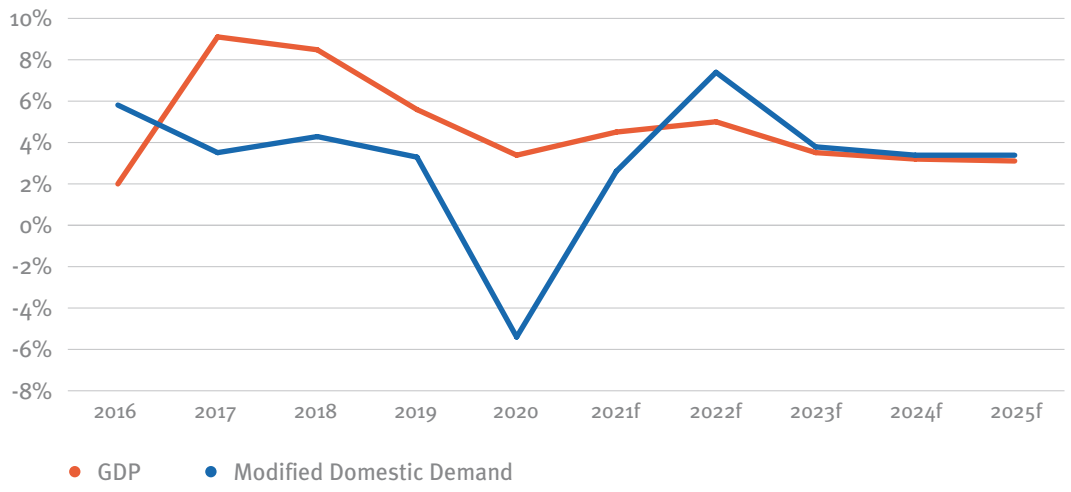
Modified Domestic Demand is forecast to increase 2.6% in 2021. As MDD is a measure of the domestic economy, the growth is less than GDP due to the gradual easing of restrictions, which have a bigger impact on the domestic economy. Modified Domestic Demand is expected to grow by 7.4% in 2022 and reflects the scale of the rebound in the domestic economy as the pandemic crisis eases and public health restrictions are fully removed. Between the years 2023 to 2025, Modified Domestic Demand is expected to increase on average by 3.5% each year.

On the **components of GDP**, **personal consumption** was greatly affected by public health restrictions in 2020, in particular social consumption (e.g. hospitality expenditure). A modest rebound is projected for 2021 (3.5%), as restrictions are expected to be eased gradually. By 2022, all restrictions are assumed to be removed and thus a strong recovery is expected (10.4%).

1 The PBO Weekly Domestic Activity Tracker is available on the *Parliamentary Budget Office's data visualisation and analysis webpage*.

2 A measure of how the economy is preforming against its potential. A negative output gap means there is scope to increase economic growth without causing inflationary pressures.

Figure 1: GDP and MDD growth (annual % changes in real terms)



Source: CSO 2016-2020 and Department of Finance SPU 2021 for 2021-2025, f indicates a forecast.

There has been a rise in online spending, as consumers have changed their behaviour in response to the restrictions, especially for consumption of durable goods. This may have significant implications for 'bricks and mortar' retail businesses in the future.

Another issue for consumption is the substantial rise in **savings**. The SPU estimates that excess household deposits, i.e. generated by the pandemic, were around €11.5 billion in February 2021. This is calculated in respect of an assumed 'normal' level of savings, benchmarked to the average growth rate in household savings over 2015-2019. Furthermore, it is assumed that around €2.25 billion of excess savings will be used to fund personal consumption, especially social consumption, as part of the rebound of consumption in late 2021 and 2022. While savings are likely concentrated in high-income households (who would have a lower marginal propensity to consume) it is also possible that the level of pent-up demand is higher than assumed which would mean that the boost to consumption could be higher than expected.

Government consumption, which increased by 9.8% in 2020 in response to the pandemic, is forecast to grow by 2% in 2021 and is only expected to increase by 0.1% next year, due to ending of exceptional spending on pandemic related goods and services.

Modified Investment (investment excluding aircraft leasing and imported intellectual property) is forecast to increase slightly by 0.9% in 2021 due to the uncertain environment. As restrictions in Ireland and across the world are eased, it is expected that companies will resume investment, with Investment forecast to grow by 6.7% in 2022 and 7.6% in 2023.

Exports are expected to expand, with a projected growth rate of 6.0% in 2021 and 5.9% in 2022. Export growth is concentrated in sectors dominated by multi-national companies, including the IT sector and the pharmaceutical sector. Exports have significantly contributed to economic growth in 2020 and Ireland was the only EU country that recorded GDP growth in 2020. An increase in **modified imports** of 6.5% is projected for 2021 and 7.9% for 2022.

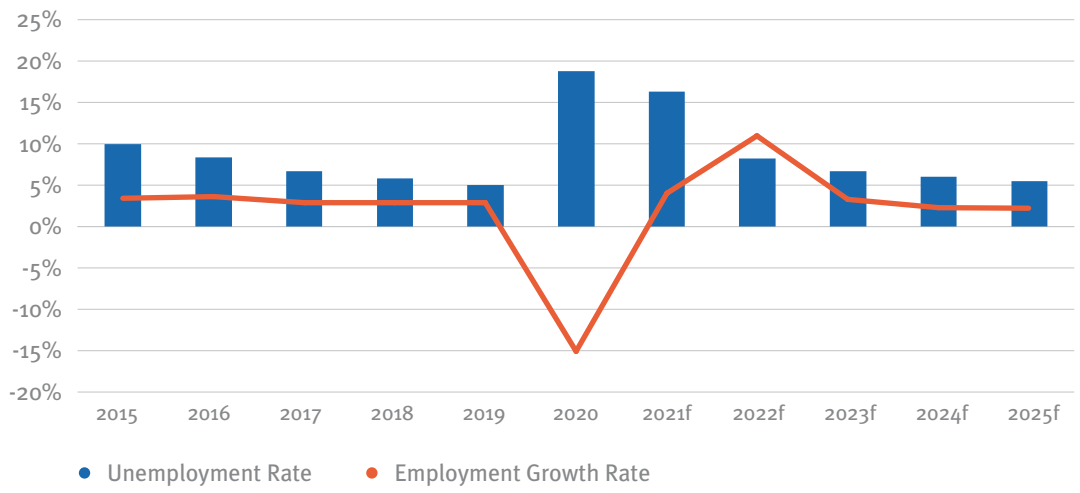
Overall, the Irish economy has proved to be relatively resilient during the pandemic, largely due to the contribution of activities and economic sectors dominated by foreign-owned multinationals (e.g. pharma and ICT). However, the domestic economy, and in particular consumer-facing sectors (e.g. accommodation, hospitality and retail) have experienced a significant contraction in activity. This further reinforces Ireland's dual economy and these divergent sectoral developments explain Ireland's 'unusual' economic performance last year compared to other countries.

The economic outlook for the future, as outlined in the SPU, is reasonable and broadly consistent with the PBO's baseline economic scenario presented in a recent analytical note,[3] which examines the issue of public debt sustainability. However, it must be noted that forecasts are largely dependent of assumptions around the projected trajectory of COVID-19.

Labour Market

The labour market was largely impacted by the COVID-19 pandemic with the COVID-19 adjusted unemployment rate (the unemployment rate including Pandemic Unemployment Payments (PUP) recipients) standing at 24.2% in March 2021 (CSO). According to the SPU forecasts, the COVID-19 adjusted **unemployment rate** will average 16.3% in 2021. The rate is expected to fall to 8.2% next year and will continue to decrease gradually in the subsequent years. The unemployment rate will still be higher compared to pre-pandemic years (i.e. less than 5% in 2019). During the pandemic, employment losses were concentrated in labour-intensive sectors and mostly affected younger cohorts.

Figure 2: Unemployment rate (%) and Employment growth (y-on-y % change)



Source: CSO out to 2020 and Department of Finance SPU for 2021-2025, f indicates a forecast.

The **employment growth rate** is forecast to be 4% in 2021 and more dramatically 11% in 2022, reflecting the end of public health restrictions for consumer-facing businesses. A major issue is that of the potential **'scarring' or permanent effects**, which could lead to an increase in long-term unemployment.

3 PBO Publication 16 of 2021, "*The PBO analytical model for public debt sustainability analysis*".

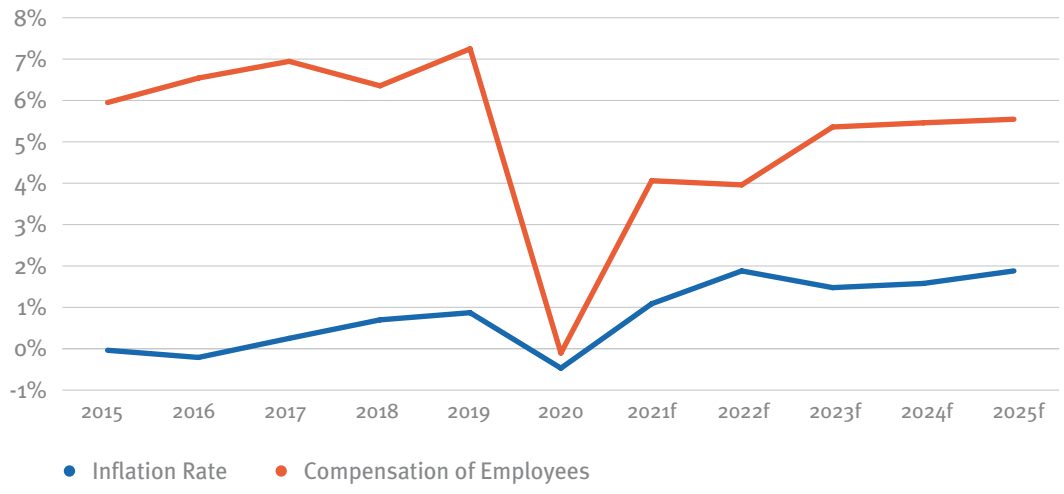
Until now, the focus on Government policy has been providing income supports to people who lost their jobs (i.e. PUP) and maintaining links to employment (through wage subsidy schemes). These schemes have been largely effective in achieving their goals in a period of emergency. Once the main pandemic restrictions cease and the temporary supports are withdrawn, the focus should shift to the support of viable businesses, facilitation of reallocation of economic activities, absorption of innovation by firms, and training and re-skilling of workers. As a result of the pandemic, there might be several structural changes to the economy, in terms of consumer preferences, businesses, production processes, changes in value chains and more widespread adoption of digital technologies. These changes will impact the labour market both positively and negatively.

While overall the labour market has suffered extensively from the COVID-19 pandemic, compensation of employees (i.e. the national wage bill) decreased by only 0.1% in 2020. This can be attributed to the effect of wage subsidies provided by Government and substantial wage increases in some sectors that have been less exposed to the pandemic, such as ICT. As a result of projected economic recovery, compensation of employees is expected to grow by 4.1% in 2021 and 4% in 2022. This is a lower growth rate than in the pre-pandemic era (2015-2019, see below Figure 3). This could be due to the expectation that employment growth will be mainly in relatively low paid sectors.

Inflation

Core HICP inflation (excluding the most volatile components) was -0.5% in 2020, due to the pandemic and is similar to other euro area economies. As the economy recovers, inflation is expected increase to 1.1% in 2021 and 1.9% in 2022, a much higher figure than in the pre-pandemic era. In addition to the release of pent-up demand, temporary factors such as higher oil prices and the end of the VAT Standard rate cut are expected to contribute to this inflation rate.

Figure 3: Inflation rate (HCPI) and Wage Bill (annual % change)



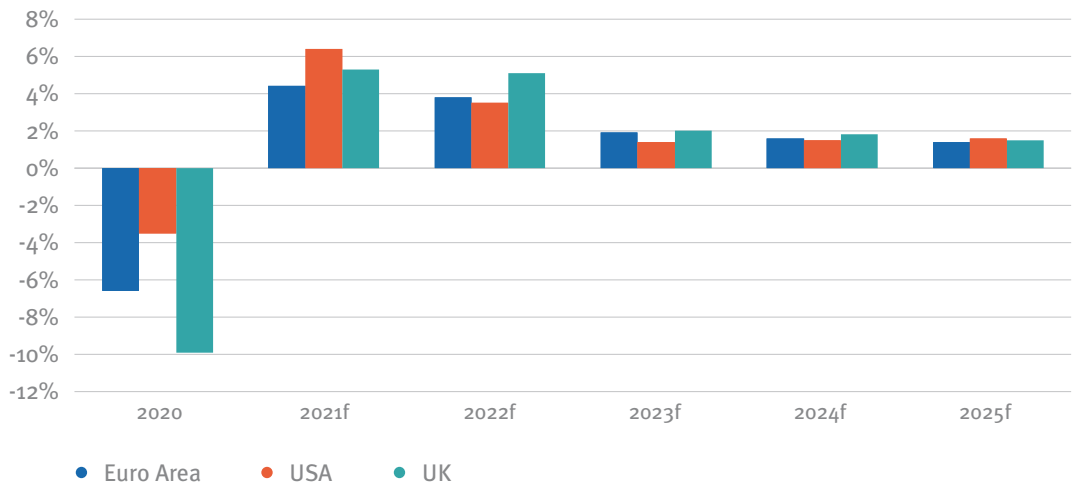
Source: CSO out to 2020 and Department of Finance SPU for 2021-2025, f indicates a forecast.

Global Economic Outlook

The global economic outlook has improved with the global deployment of COVID-19 vaccines and the expansive fiscal policies in major economies, including the Next Generation EU Instrument in the EU and the American Rescue Plan Act in the United States. As Ireland is a very open economy, fiscal stimuli in these two key markets will have positive implications.

According to IMF forecasts (see Figure 4), the US and UK economies are expected to experience strong recovery in 2021 due to the quick deployment of COVID-19 vaccines. The UK economy should benefit from the Trade and Co-operation Agreement with the EU and the ending of uncertainty about their trading relationship. The Eurozone economy will have weaker economic recovery in 2021, however it should see stronger growth in 2022 with the expected completion of vaccine deployment and easing of restrictions.

Figure 4: Real GDP forecast – Ireland's key trading partners

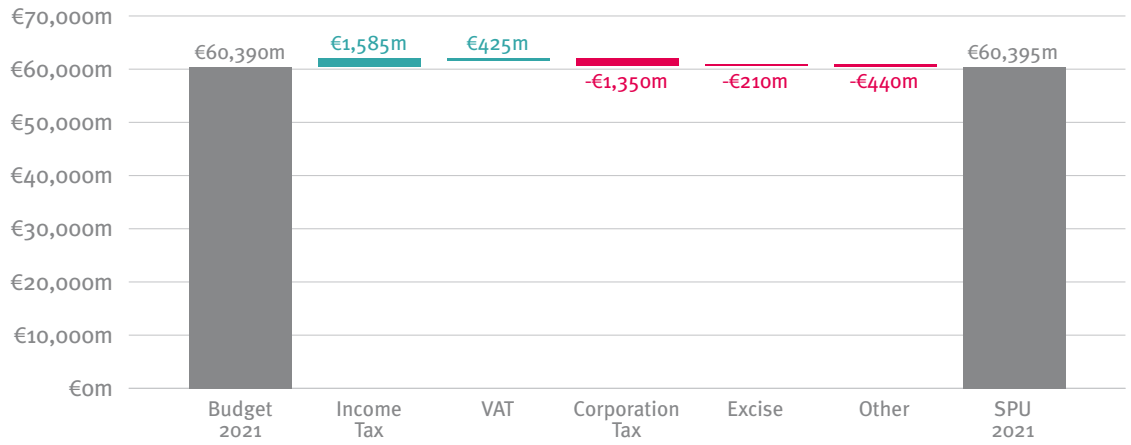


Source: IMF, f indicates a forecast.

Developments in Tax Revenue

Figure 5 compares tax revenue estimates for this year, from the SPU and Budget 2021. As shown, despite significant differences in the two scenarios on which these estimates are based, there is an insignificant impact on the expected level of tax revenue. Under the SPU's central scenario, €60.3 billion is expected for the year (just €5 million above the Budget estimate).

Figure 5: Tax revenue for 2021: SPU 2021 versus Budget 2021



Source: Stability Programme Update 2021 (Department of Finance); Budget 2021 – Economic and Fiscal Outlook (Department of Finance).

Among the individual taxes, Income Tax has been revised up by 7% (€1.6 billion), VAT has been revised up by 3% (despite the downward revision in personal consumption of 3.5 percentage points), while Corporation Tax has been revised down by 10% (€1.35 billion). Overall, tax revenue for 2021 is estimated to be up 5.6% on 2020.

Figure 6a shows the SPU estimates of tax revenue over the forecast horizon (out to 2025), while Figure 6b highlights the dynamics of individual tax heads over this time. Figure 6b also highlights the severe impact of COVID-19 on VAT receipts in 2020, and the relative resilience of receipts from Income Tax and Corporation Tax, which has been well documented.

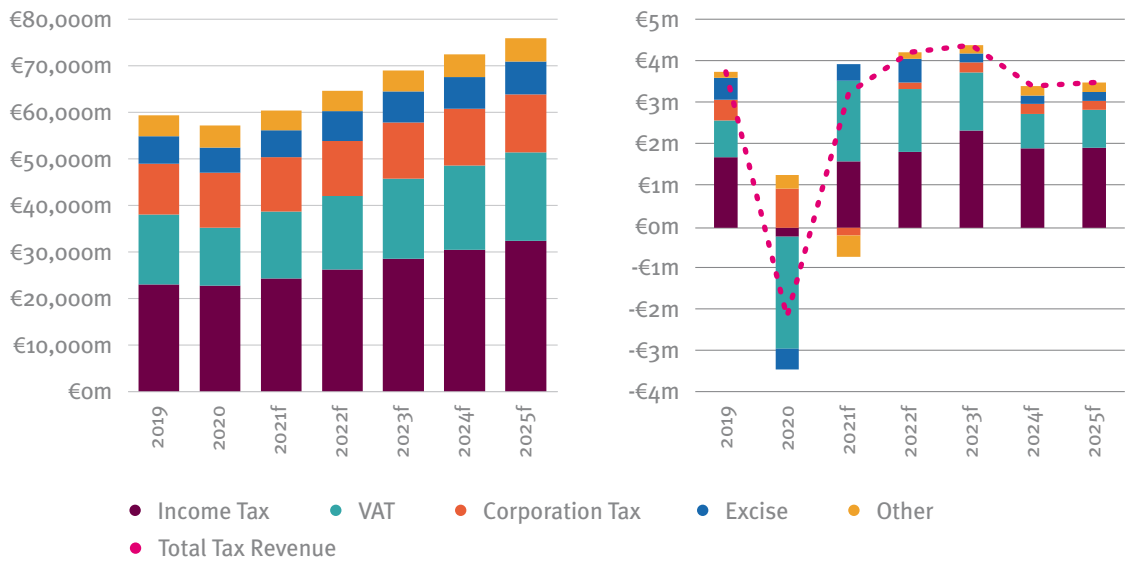
As shown, the bulk of revenue growth over the next five years is expected to be driven by a rebound in Income Tax and VAT receipts – both are expected to average 7% annual growth over 2022-2025.

The recovery in VAT will depend on the extent to which the substantial stock of household savings is unwound as the economy begins to reopen. The Department estimates that 20% of these savings will be consumed from Q3 2021 throughout 2022 (with 40% expected to be "re-saved").[4]

4 This appears to be a conservative estimate, but reflects the fact that much of these savings are among high-income households with a lower marginal propensity to consume i.e. they spend a lower proportion of additional income versus poorer households.

Capacity constraints in the short-term, as the economy begins to re-open, could limit the speed or extent to which these excess savings are spent. Conversely, the actual level consumed could exceed the 20% estimated by the Department, particularly if incentives are put in place to encourage consumption (e.g. extensions to the Stay and Spend Scheme or similar measures).

Figure 6a: Tax revenue 2019-2025; & Figure 6b: Changes in revenue by tax head 2019-2025



Source: Stability Programme Update 2021 (Department of Finance); Department of Finance Databank.
f indicates a forecast.

The rebound in Income Tax receipts will be driven largely by employment gains in labour intensive sectors that have been effectively closed since the pandemic began (i.e. retail and hospitality). However, as has been well documented, these sectors contribute relatively less in Income Tax revenue compared to other sectors (which largely explains the resilience of this tax head throughout the pandemic). In addition, potential labour market scarring could slow the recovery in employment over time, and weigh on potential Income Tax receipts.

It is notable that Corporation Tax is anticipated to grow by only 5% over the 2020-2025 period, contrasting with the sizable growth seen in this revenue stream since 2015 (growth averaged 13% per annum over 2015-2019). This reflects concerns around the impact of international tax reform for Irish corporate tax receipts (the SPU estimates that annual receipts could be €2 billion lower by 2025 as a result).

While the Department has modelled alternative scenarios in the SPU (with less benign epidemiological conditions), tax revenue forecasts (or other fiscal forecasts) for these scenarios have not been provided.

Spending

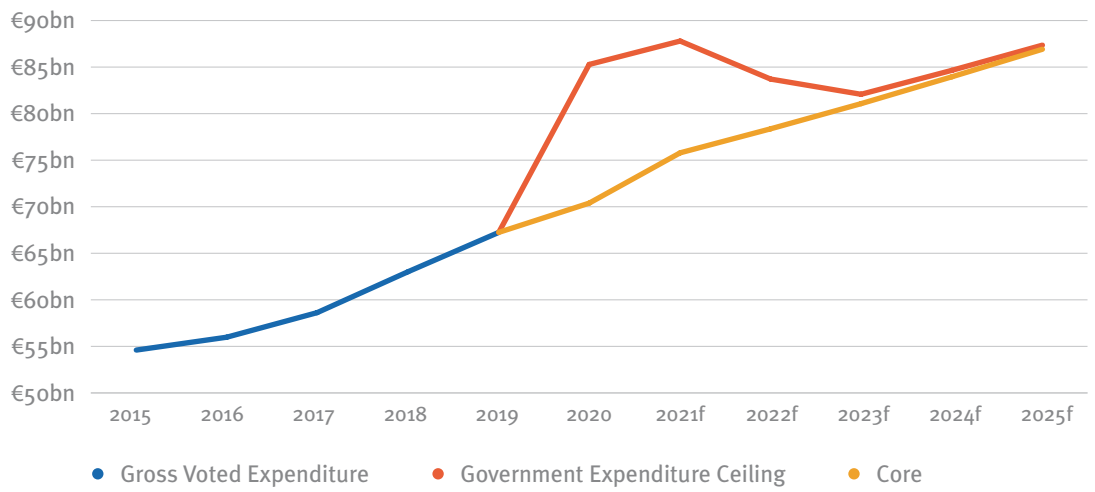
Context

Total Gross Voted expenditure of €85.3 billion for 2020 was €17.9 billion (26.5%) higher than in 2019. It was €14.9 billion higher than the original pre-COVID planned spending of €70.4 billion. The increase was mainly due to COVID-related income and business supports provided by Government to mitigate the effects of the restrictions.

At Budget time (October 2020) Gross Voted expenditure was expected to be €87.1 billion. Actual spending was €1.8 billion below that estimate which contributed to a lower budget deficit than expected.

Figure 7 charts Gross Voted expenditure over the period 2015-2025 based on the SPU projections. By 2025, Gross Voted expenditure is expected to reach almost €87 billion from approximately €55 billion in 2015. The chart also shows from 2020 'core' spending, the Government's measure of non-COVID and non-Brexit related spending, is estimated to grow by an average of 3.5% between 2022 and 2025 or €2.6 to €2.9 billion per annum.

Figure 7: Gross Voted Spending 2015-2025 (€ billion)



Source: 2015-2019 Department of Public Expenditure Databank, 2020-2025 Department of Finance (2021) Stability Programme Update 2021. f indicates forecast.

Short Term – 2021 Spending

In Budget 2021 the Government set a limit to voted spending (Government Expenditure Ceiling) of €87.8 billion. Included in this figure was €5.4 billion in non-allocated funds set aside as part of a Recovery Fund and as a contingency. The SPU does not revise the projected 2021 level of voted spending, but indicates that all the contingency and recovery funds will be spent.

There are clear pressures on spending due to the extended restrictions during the first half of 2021. The extension of Pandemic Unemployment Payments, Employee Wage Subsidy Scheme payments and other subsides to businesses, was projected to cost €3.3 billion in Q2 alone.

The SPU assumes that, in line with announced Government policy, the PUP and EWSS will end on 30 June. Given the current context, extensions to these and other schemes (e.g. the Commercial Rates wavier, COVID-19 Restrictions Support Scheme, etc.) are likely. Such extensions into Q3 will likely exhaust the €5.4 billion reserve, some of which would also have been used to cover COVID-19 related costs in Q1. There will be areas where money allocated may not be spent due to restrictions, which could be used to off-set COVID-19 related spending. However, the longer restrictions endure into Q3 and Q4, the more likely that voted expenditure will exceed the €87.8 billion ceiling set in Budget 2021.

As the PBO has pointed out[5] there will be a need for either new Revised Estimates or Supplementary Estimates across a range of Votes and in particular, Social Protection, to allocate the Contingency and Recovery Fund monies.

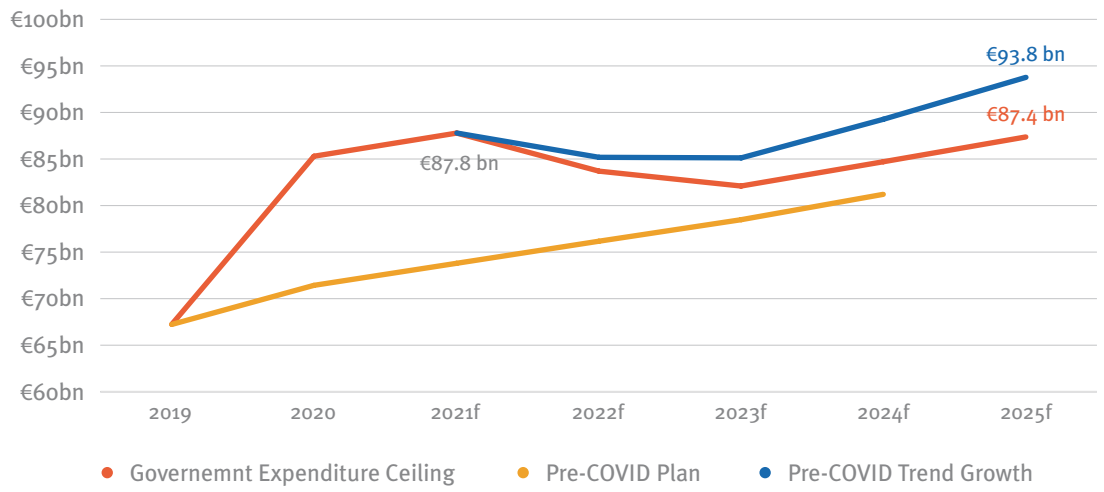
Medium Term – 2022-2025

The SPU uses a technical assumption to project 'core' spending for 2022 to 2025. It assumes a growth rate of expenditure of approximately 3.5%. This is higher than similar technical assumptions on spending growth used in previous SPU's. However, it could still be considered conservative. Voted spending between 2015 and 2019 grew at 5.3% per annum, an order of magnitude above the 2021 SPU's assumptions. That rate was during a high growth period where spending pressures from unemployment were falling so underlying spending growth was even higher.

Figure 8 shows the SPU's technical expenditure ceiling compared to the pre-COVID-19 plan (as set out in Budget 2020). The pandemic and other Government decisions seem to have led to both a temporary and permanent increase in spending. In both 2023 and 2024 when pandemic related spending has effectively ended spending is expected to be €3.5 billion higher than what was set out in Budget 2020. Overall, from 2020 to 2024, the Government is projecting that voted spending will be cumulatively €42.5 billion higher than what was set out in Budget 2020.

5 PBO (2021) *Economic and Fiscal Commentary – Spring 2021*.

Figure 8: Gross Voted Spending 2019-2025 (€ billion) alternative scenarios



Source: Department of Finance (2021) Stability Programme Update 2021, Government of Ireland (2019) Budget 2020: Economic and Fiscal Outlook and PBO calculations. f indicates forecast.

Figure 8 also shows a scenario where 'core' spending grows by 5.3% per annum (the pre-COVID-19 trend) from 2022 rather than the 3.5%. This is for illustrative purposes only but shows that if spending did revert to trend, overall voted spending would reach almost €94 billion in 2025. It would add 1.4 percentage points of GDP to the deficit that year (other things being equal) and would represent almost €15.5 billion in spending (and debt) above the SPU scenario over the 2022-2025 period.

The SPU outlines significant temporary or non-core expenditure in 2022, with some in 2023 onwards but much less significant. The COVID-19 related spending in 2022 is estimated to be €2.5 billion and provision is made for additional payments for higher levels of unemployment (€1.5 billion) reported as 'automatic stabilisers'. Provision for an increased level of unemployment payments is made for 2023 to 2025 albeit at a declining level as the economy is expected to recover.

In addition, the EU Funds that Ireland will be able to draw from are considered non-core. This includes €1.1 billion from the Brexit Adjustment Reserve in 2022 and €800 million from the Recovery and Resilience Fund over 2022 to 2024. As such funds are likely to be added to Capital expenditure (and are considered additional rather than paying for existing planned spending), they could be considered a modest stimulus, especially in 2022. With the Contingency and Recovery Funds been used to ameliorate issues arising from the restrictions, no provision for stimulus (if required) seems to have been made for 2021.

The SPU's technical spending scenario masks the lack of detail on the spending side. This is unsatisfactory and goes against the spirit of the spending reforms in recent years including the introduction of Ministerial Expenditure Ceilings and the Spending Review. There is no indication of what spending is needed to 'stand still' i.e. maintain public services at their current level and thus what funds are available for new policies. There is little analysis of medium-term spending pressures or costing of new policies. Without such analysis the spending figures lack a degree of credibility. More detail on Capital spending will be included in the Review of the National Development Plan.

The difference in 2021 between overall Exchequer spending at €95.3 billion (excluding transactions with no General Government impact) and General Government Spending at €108.6 billion is puzzling. While local authority spending makes up some of the difference it cannot account for a majority. An explanation of the 'walk' between Exchequer spending and General Government Spending, similar to the 'walk' reported between the Exchequer Balance and the General Government Balance would be useful.

The high and medium likelihood spending risks identified in the SPU include pandemic-related budgetary pressures, the aging population, EU budget contributions, litigation risk and climate change and renewable energy targets.

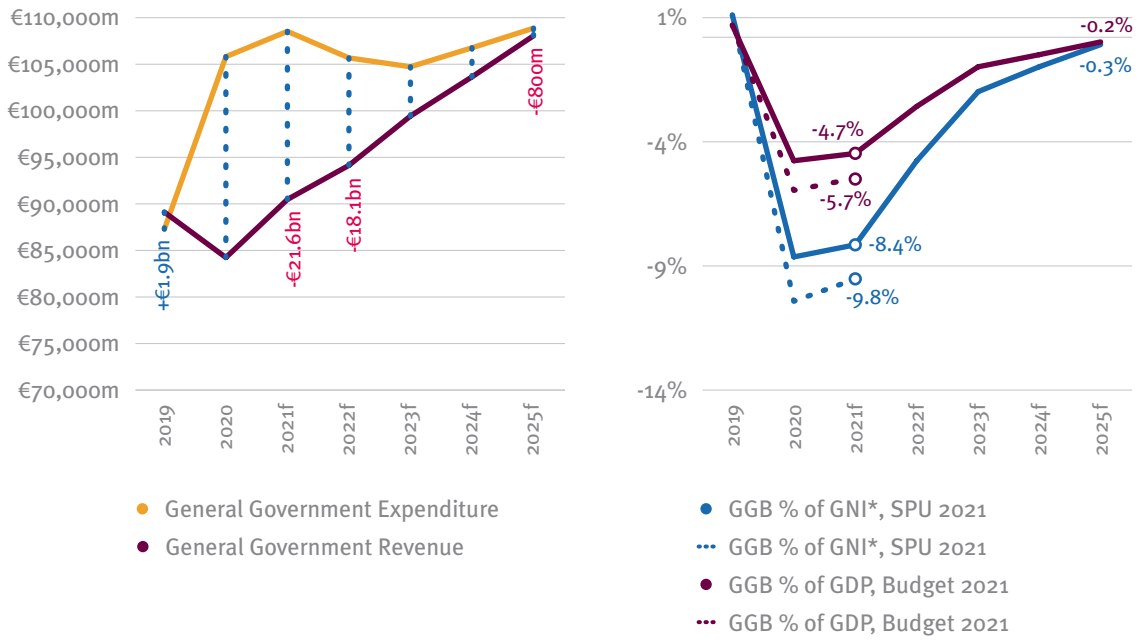
The SPU outlines the longer-term spending pressures from ageing. In 2030 age-related expenditure is expected to be 3.3% of GNI higher than in 2019, and 8.1% higher by 2050. The latter figure is equivalent in 2020 to the additional spending on COVID-19. Policies to mitigate the increase in spending such as changing the age people can claim retirement benefits would ameliorate the increase, but it is likely that additional permanent increases in revenue will also be needed in order to sustainably meet the challenge.

General Government Balance and the Debt Burden

Figure 9a and Figure 9b illustrate developments in the General Government Balance (GGB) out to 2025, as estimated in the SPU. Estimates of the deficit for 2020, relative to national income (GDP and GNI*), have been revised since the Budget (by 1 and 1.4 percentage points respectively).

The SPU estimates a deficit for 2021 of €18.1 billion, while €20.5 billion was originally estimated in Budget 2021 (albeit under a more negative scenario; General Government Expenditure has been revised down by 0.6% while General Government Revenue has been revised up by 2.1%). The deficit is expected to narrow sharply over the forecast horizon.

Figure 9a: GGE & GGR 2019-2025F; & Figure 9b: GGB 2019-2025F, SPU versus Budget 2021



Source: Stability Programme Update 2021 (Department of Finance); Budget 2021 – Economic & Fiscal Outlook (Department of Finance). f indicates a forecast.

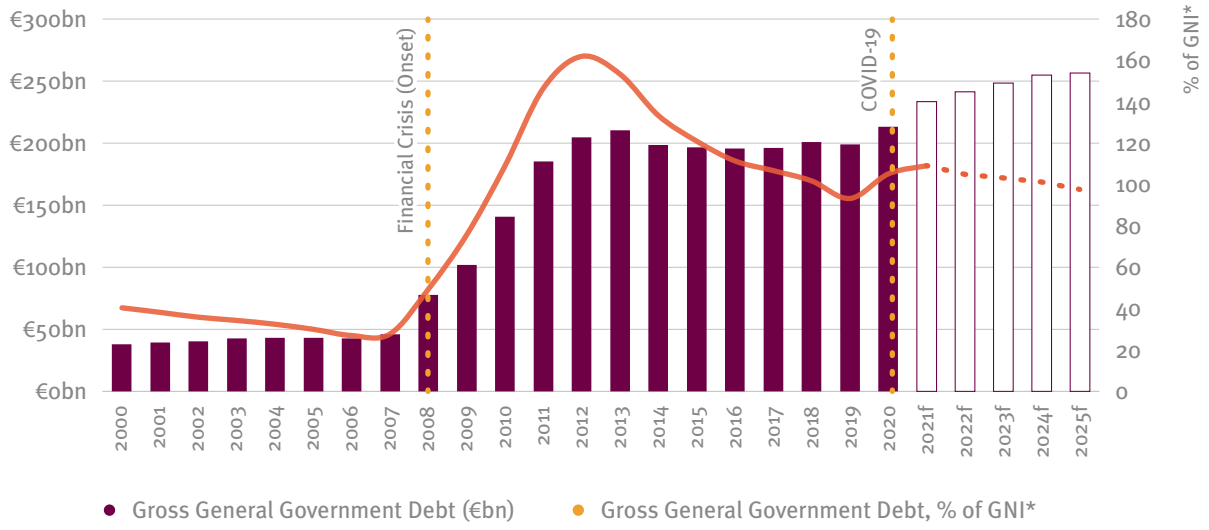
General Government Revenue (GGR) is anticipated to grow on average by 4.5% over 2022-2025, with a 7.4% increase expected for 2021. Reductions in General Government Expenditure (GGE) are expected for 2022 and 2023 (of 2.6% and 0.9% respectively), as temporary COVID-19 supports are unwound. The deficit is expected to fall to €800 million by 2025 (0.3% of GNI*).

These estimates are prepared by the Department of Finance on a "no-policy change" basis. This means that there is no account taken of possible stimulus measures which may be introduced to aid in the recovery post-COVID-19. In addition, additional supports may be required to mitigate or alleviate potential scarring effects arising from the pandemic. These measures could worsen the deficit in the short-term relative to baselines estimates. While a scenario analysis is included in the SPU, alternative estimates for GGR, GGE or the GGB are not provided.[6]

In addition, as discussed above, the technical assumption used by the Department in estimating spending growth over the forecast horizon may not be credible.

Under the baseline scenario, Ireland's GGD is expected to be 2.8% in 2022, below the 3% deficit threshold set under the EU fiscal rules. If achieved, this could mean that Ireland avoids an 'Excessive Deficit Procedure" when the temporary suspension of the EU rules ends. The SPU also provided estimates of Ireland's structural budget balance (a key variable under the EU fiscal rules) using the Department's preferred methodology for calculating potential output. In 2022 this is estimated to be a structural deficit of 1.9% (of potential GDP). EU rules usually have set this variable at a maximum of 0.5% of potential GDP. The SPU scenario has Ireland meeting this threshold in 2025.

Figure 10: Gross General Government Debt, 2000-2025



Source: Stability Programme Update 2021 (Department of Finance); CSO. f indicates a forecast.

The COVID-19 pandemic necessitated increased levels of public spending to deliver measures aimed at mitigating the impact of the virus against a backdrop of lower than expected tax revenues. As a result, 2020 saw a significant rise in the level of government debt, with the stock of debt expected to rise further out to 2025.

6 This represents a departure from the approach taken in Budget 2021, in which an estimate of the deficit under an alternative "downside" scenario was provided.

Notwithstanding the uncertainty around the actual level of the deficit for 2021 (as outlined above), the SPU estimates an increase of €20.7 billion for this year, with a further increase of €8.1 billion for 2022. The outstanding stock of debt is expected to reach €262.9 billion by 2025 (compared with €204.2 billion in 2019).

From a sustainability perspective, the debt-to-GNI* ratio (a key measure of sustainability) is expected to fall over the forecast horizon, from 111.8% in 2021 to 100% in 2025. A similar picture emerges when interest spending is assessed relative to revenue. As Figure 10 shows, despite a significantly higher stock of debt currently versus in the aftermath of the financial crisis, the picture in terms of sustainability (assessed via the debt-to-GNI* ratio), is very different.

This additional debt, while significant, is sustainable at least in the medium-term, given strong growth prospects and accommodative debt financing conditions. Despite the impact of the pandemic on public debt, borrowing costs have fallen significantly and are at their lowest level in a decade (supported largely by the European Central Bank's emergency bond-buying programme).

Debt sustainability is further aided by the long-term maturity profile of Irish debt and the substantial share of the debt that is held at fixed rates. This means that fiscal consolidation may not be required to ensure that the debt burden is on a sustainable path in the medium-term. However, as highlighted previously by the PBO, the winding down of temporary COVID-19 supports once the recovery sets in, and a prioritisation of growth enhancing measures, will be key in preserving the sustainability of the public finances in the long-term.[7] Even with the conclusion that the debt burden is currently sustainable, the high stock of debt may limit fiscal flexibility if another economic or fiscal risk which requires significant government borrowing materialises.

7 Findings from a previous PBO analytical note, show that the debt burden should be on a sustainable path over the next 10 years. See: Bedogni J., and K. Fitzgerald. 2021. "*The PBO analytical model for public debt sustainability analysis*", *Analytical Note*, Parliamentary Budget Office, 11 March 2021.

Notes

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