Stability Programme Update 2023

Introduction

The Government published the *Draft Stability Programme Update* 2023 (SPU) on the 18th of April. This is Ireland's national medium-term fiscal plan which sets out the macroeconomic and fiscal forecasts for the short and medium term. The macroeconomic forecasts underpinning the SPU were endorsed by the Fiscal Council on the 6th of April. The draft SPU will be submitted to the European Commission by the 30th of April in accordance with the requirements of the European Semester. The Parliamentary Budget Office (PBO) welcomes the inclusion in the SPU of forecasts out to 2030. While this reflects a move to align with the new EU fiscal rules requirements, the extension of the forecast horizon is more conducive to fiscal planning and can allow for a better understanding of medium-term trends and risks.

To support budgetary scrutiny by Members of the Houses of the Oireachtas, in this note, the PBO identifies key issues arising from the SPU. It also summarises some of the main aspects (economic, tax and spending forecasts) of the SPU 2023 and highlights key changes from the previous forecasts (i.e., those contained in Budget 2023).

Key Points

- The Irish economy continues to perform strongly driven by the multinational sector, with SPU forecasts indicating that the economy is set to expand significantly in the absence of future economic shocks. However, with employment levels evidently close to equilibrium/full employment, and the current inflationary pressures, particularly in relation to the increase in core inflation, the economy may be at risk of overheating.
- At the current juncture and noting that the main indicators of economic activity have all largely surpassed pre-pandemic levels, it is appropriate that fiscal policy transitions from broad-based support towards an increasing focus on temporary and targeted measures.
- Fiscal support to mitigate the impact of higher food and energy prices should become more focused on those most in need. Better targeting and a timely reduction in overall support would help to ensure fiscal sustainability, preserve incentives to lower energy use and improve energy efficiency, and limit additional demand stimulus at a time of persistent inflation.
- The SPU expects that inflation will fall to 2% over the forecasting horizon. The PBO notes that inflation is currently still at high levels considering that inflation in the reference period last year was already high. This and additional factors such as the tight labour market, supply constraints and geopolitical risks could imply that the current level of inflation might not be temporary.
- In terms of the labour market, the economy is approaching full employment. Higher participation rates and inward migration have boosted employment levels. However, skills shortages are apparent in certain sectors and are exacerbated by housing constraints. The SPU expected the unemployment rate to largely stay constant over the forecasting period.
- Ensuring the sustainability of the public finances has become more challenging due to the multiple impacts of the pandemic, the war in Ukraine, energy shocks, and increasing interest rates. The fiscal projections assume a reversion to the 5 per cent (net)expenditure growth rate. This is to be welcomed but there are risks surrounding the conditions under which it might be disregarded.
- Compared to Budget 2023, tax revenue in the current year is expected to be €1.9 billion higher at €88.9 billion. The large majority (84%) of this is driven by an upward revision to the expected level of Corporation Tax receipts.
- The increase in tax revenues will lead to a budget surplus from 2022 to 2026. In 2023, the government is expected to run a surplus of €10 billion. However, once these windfall corporation tax receipts are considered, the government will run an underlying budget deficit of €1.8 billion and won't return to a surplus until 2024.
- Compared to a counterfactual scenario where Corporation Tax (CT) receipts grow at the 2016-2019 average growth rate from 2020 onwards, the PBO estimate that from 2020 to 2026, on a cumulative basis, €22 billion in additional CT receipts would be raised. Overall, the multinational sector's activities have provided a very substantial boost to the Irish public finances, not only through CT receipts, but also benefitting other tax heads such as Income tax and VAT. This also highlights a critical concentration risk for the public finances and the economy more generally.

- As a result, saving windfall receipts and allocating public spending strategically, for example, by addressing key bottlenecks (i.e., housing, climate change, transport) while also implementing structural reforms (i.e., health) is a prudent strategy by government to help maintain competitiveness of the Irish economy.

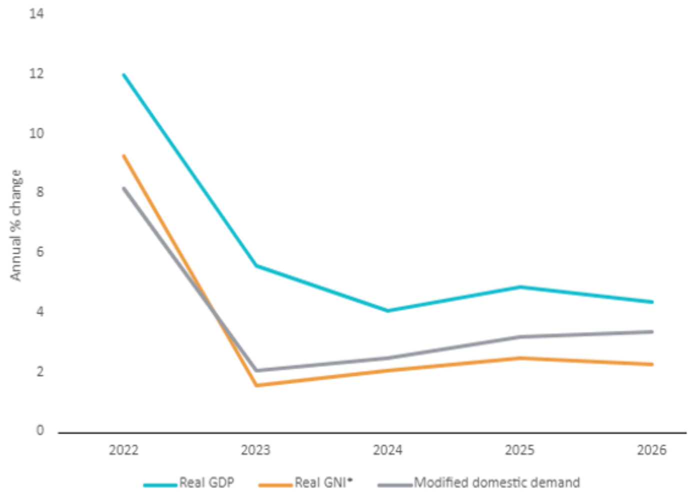
Overview of economic forecasts

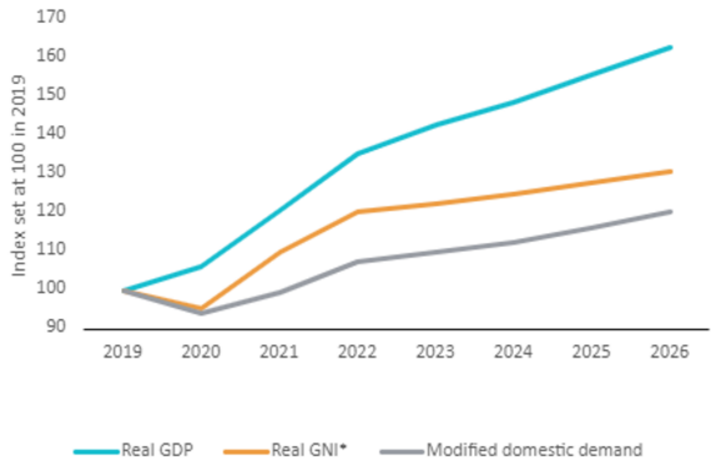
The SPU sets out the Department of Finance's updated macroeconomic forecasts. Overall, the Irish economy is performing strongly, and risks anticipated in Autumn last year have not materialised. Compared to expectations, supply chain bottlenecks have eased due to the full re-opening of the Chinese economy, and energy prices have reduced from 2022 peak levels following Russia's invasion of Ukraine. Ireland's main export markets have also avoided a recession, and fiscal stimuli worldwide by governments to cushion the impact of inflation has also boosted economic activity.

Figure 1a presents forecasts out to 2026 for GDP and measures of the Irish economy that better capture domestic activity – GNI* and Modified Domestic Demand. Real GDP forecasts were revised to 5.6% in 2023 (from 4.7% in Budget 2023) and to 4.1% in 2024 (from 3.3% in Autumn last year). As has often been the case in recent years, the largest contribution to this year's GDP growth is expected to come from the multinational sector (ICT and Pharma) through net exports. GDP growth is expected to remain high in the medium term, averaging 4.7% over 2025-2026.

Similarly, albeit lower, forecasts for growth of GNI* (1.6%) and Modified Domestic Demand (2.1%) for 2023 were also revised upwards. For 2023, there is an upward revision to Modified Domestic Demand (+0.9 percentage points), largely reflecting a higher forecast for consumer spending. Figure 1b shows that, the economic recovery post-pandemic has been substantial, with economic indicators vastly exceeding 2019 levels in real terms. In 2023, GDP is expected to be 43% above 2019 levels, GNI* 22% higher, and Modified Domestic Demand 10% higher.

Figure 1a - Forecasts for economic activity Figure 1b - post-pandemic recovery





Source: PBO based on SPU 2023 and CSO data. Forecasts from 2023 onwards based on SPU.

Looking at the underlying components of GDP:

- Forecasts for consumer spending were revised upwards to 3.9% in 2023 (compared to 1.8% in Autumn) and 3.8% in 2024. The primary reason for this is lower-than-expected inflation and increased earnings and employment.
- Government consumption is expected to increase by 0.5% in 2023 and 0.8% in 2024. For 2023, this is an upward revision of 2 percentage points compared to Budget 2023. However, in 2022 government consumption growth was lower than what had been forecast. Government consumption growth is forecast to increase in 2025 (2%) and 2026 (1.5%).
- Forecasts for Modified Investment[1] were revised downwards. Modified investment is expected to fall by -0.6% in 2023 due to base effects and record growth last year, particularly in machinery and equipment. It is forecast to increase by 1.2% in 2024. Investment in 2023 will be largely driven by the multinational sector (i.e., manufacturing facilities and data centres). Growth is forecast to remain high in both 2025 (3.7%) and 2026 (4.9%), with construction activity expected to pick up despite higher interest rates.
- Forecasts for Exports have been revised upwards and will be a key contributor to overall growth this year. Exports are expected to grow by 7.8% in 2023 and 4.9% in 2024. Over the medium term, exports are forecast to grow by 5.4% and 4.7% in 2025 and 2026. Uncertainty is higher, as the tech sector is experiencing challenges due to increasing interest rates.
- Modified Imports are forecast to grow by 6.8% in 2023 and 4.2% in 2024. These forecasts were revised upward (2.9 pp and 0.1 pp) compared to Budget 2023 forecasts in line with growth in Modified Final Demand.

In terms of external economic developments, relative to the Government's autumn forecast, forecasts have been revised upwards for 2023 for Euro-area (0.8% from 0.3%) and US growth (1.6% from 0.5%). For the UK, short-term growth forecasts have been revised downward (-0.3% from 0%). Oil price projections are lower than Budget 2023 forecasts (€80.2 vs €89 for 2023). Gas price projections are significantly lower compared to Budget 2023 forecasts.

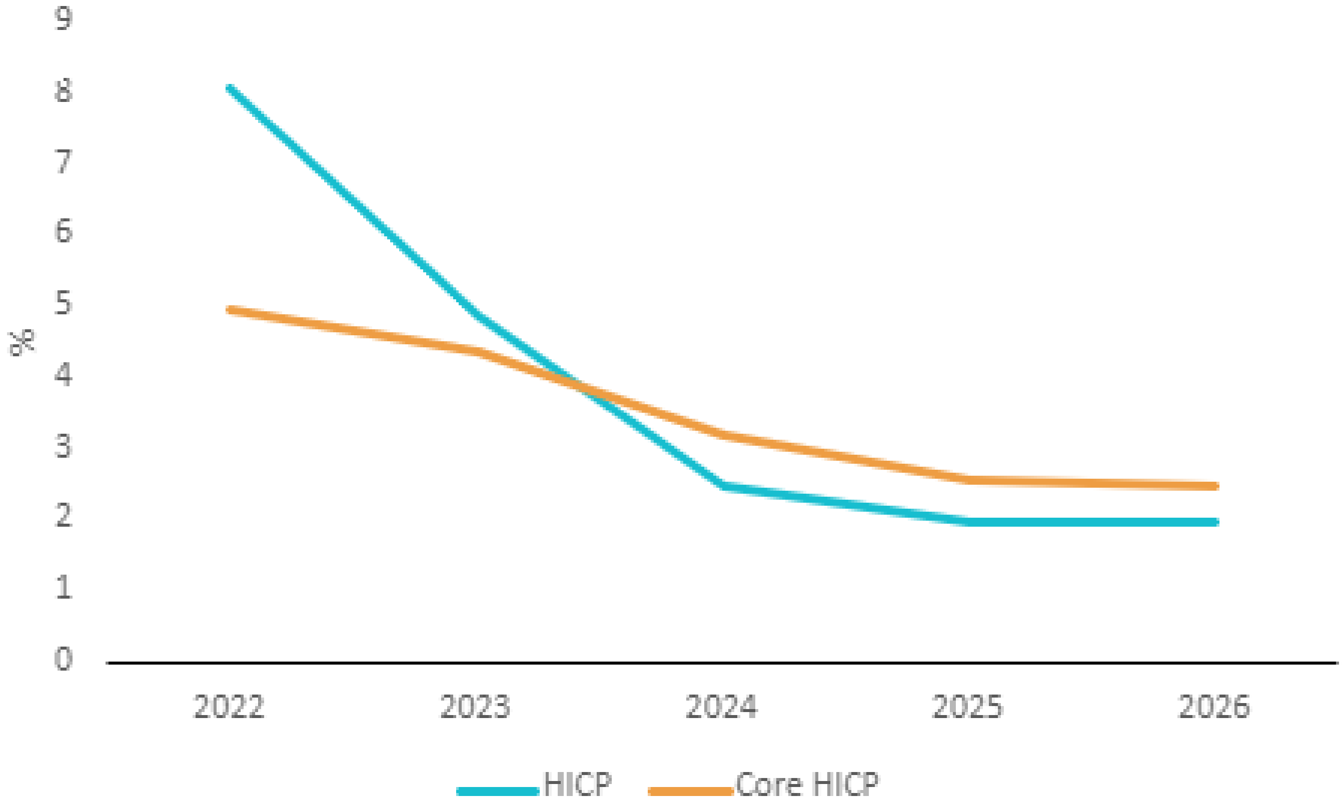
Headline inflation in the euro area has been falling in recent months due to downward base effects (having high inflation in the reference period last year), and an easing of energy commodity prices. However, core inflation (which excludes energy and unprocessed food) continues to increase. [2]Irish inflation has been reducing in recent months but is still well above the European Central Bank's 2% target. As of March 2023, the HICP (harmonised index of consumer prices) inflation rate stands at 7%, down from an annual increase of 8.1% in February 2023[3] While energy prices have fallen remarkably from peaks levels, particularly for gas, inflation has increased for non-energy products. The rise in core inflation is largely explained by spill-over effects from energy prices, strong economic growth (low unemployment and high spending), and a mismatch between supply and high demand.

The SPU expects that headline inflation (as measured by the HICP) will fall in 2023 to 4.9% (vs. 7.1% in Budget 2023) and will grow at 2% by 2025. Core inflation, forecasted at 4.4% in 2023, will also fall to 2.6% growth by 2025. However, it also notes that further volatility in energy prices, and the current tight labour market, could prolong the original high inflation caused by the supply shock.

The PBO notes that inflation is currently still at high levels considering that inflation in the reference period last year was already high. This implies that the current inflation might not be temporary and it might persistently increase the price level in addition to the one-off shock-driven increase.

1 Modified Investment excludes investment in aircraft for leasing and investment in R&D from abroad, same for Modified Imports
2 PBO Economic Update- 2023 Q1 | Flourish
3 Consumer Price Index March 2023 - CSO - Central Statistics Office.

Figure 2 - Inflation forecasts

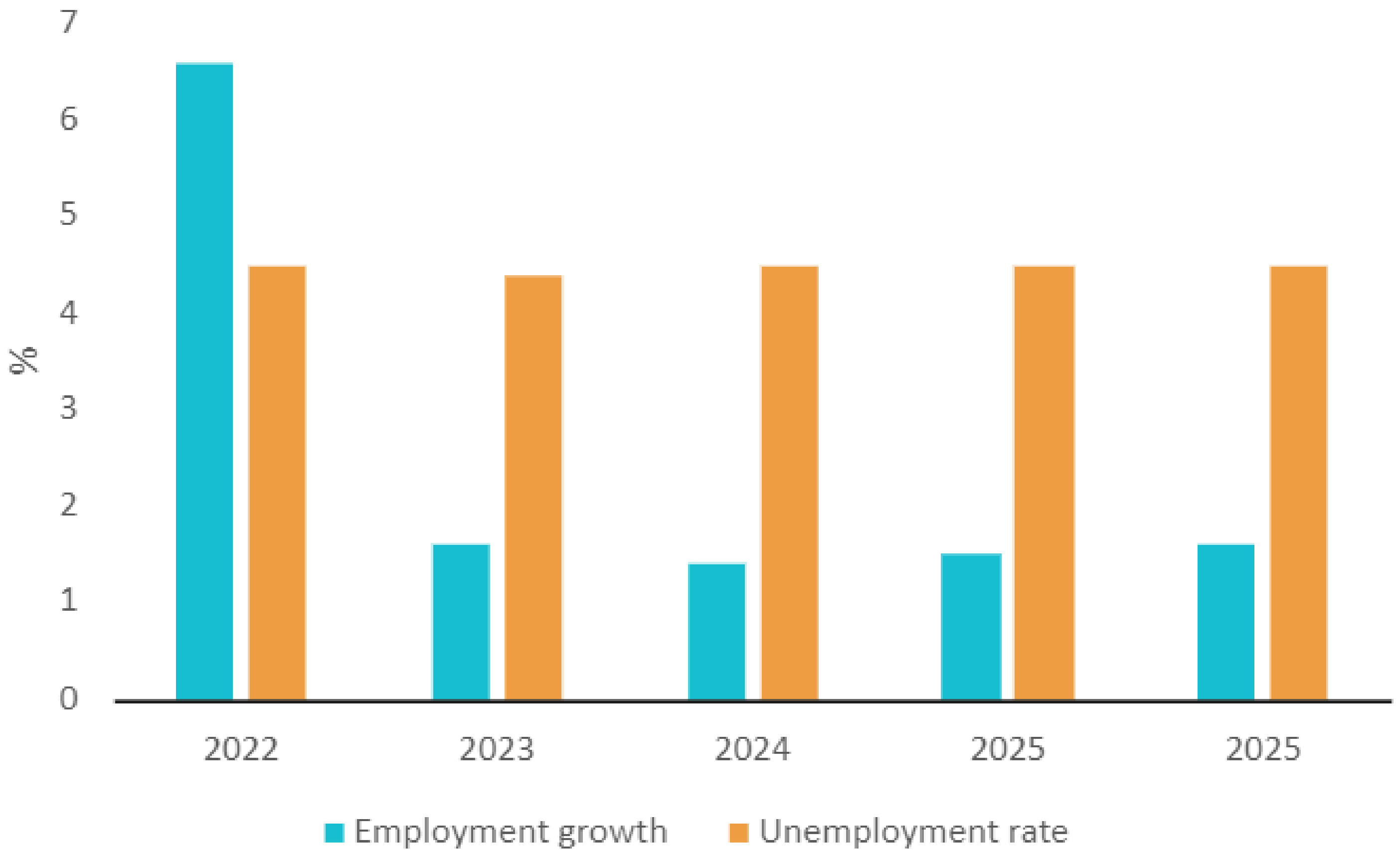


Source: SPU 2023.

In terms of labour market developments, the economy is approaching full employment, with the unemployment rate standing at 4.3% in March 2023.[4] Higher participation rates and inward migration have boosted employment levels. However, skills shortages are apparent in certain sectors (e.g., science and engineering, health and skilled crafts) and are exacerbated by housing constraints, that inhibit labour mobility. While overall employment reached a record high in the fourth quarter of 2022 (2.6 million), the number of people employed in certain sectors fell compared to the previous year (e.g., ICT). In addition, the low unemployment rate and tight labour market has meant that workers from abroad are needed to fill vacancies.[5] A tight labour market and capacity constraints also means upward pressure on prices and wages. Overall, the SPU forecasts the unemployment rate to stay at 4.5% over the medium term. Employment growth is expected to average 1.5% each year out to 2026.

4 Monthly Unemployment March 2023 - CSO - Central Statistics Office
5 PBO Economic Update- 2023 Q1 | Flourish

Figure 3 - Labour market forecasts



Source: SPU 2023.

Geopolitical Risks Here to Stay

This Stability Programme Update notes that, despite an improved outlook for the Irish economy, *"uncertainty remains high, and any escalation of geopolitical tensions could derail the global economy once again"* (p.8). The PBO noted in its Budget 2023 report that geopolitical tension was one of the risks to the Irish economy. Seven months onward, the same point remains valid. The regional security situation in Europe, and its implications for the European economy, remain uncertain. The War in Ukraine is still going on, while Finland and Sweden decided to apply for NATO membership (Finland formally joined the NATO on 4th April 2023).

At a wider level, the politico-economic rivalry between the United States and China has shown little sign of de-escalation, while the European Union seems to be divided over how to approach China.[6] It has also been reported that US companies are becoming more concerned with the risk of worsening China-US relations.[7] As the Irish economy is exposed to the US economy through the significant presence of American multinational companies (e.g., strong corporate tax receipts), the risk to US companies implies a risk to the Irish economy and public finances as well. In addition, if geopolitical constraints make it difficult for Irish businesses to trade with China, it will directly affect the Irish economy, as Ireland has been increasingly trading with China recently. [8]

Ireland is a heavily trade-dependent economy (the trade-to-GDP ratio being 237% in 2022 [9]). Therefore, geopolitical constraints and incidents are a significant risk. The PBO would welcome detailed sensitivity analysis on the implications of geopolitical constraints and incidents for the Irish economy and public finances.

6 Jennifer Rankin, "Macron sparks anger by saying Europe should not be 'vassal' in US-China clash," Guardian, 10 April 2023.
7 Oliver Telling, Martin Stabe, Chan Ho-him, and Andrew Edgecliffe-Johnson, "China's ports dominance undermines western aims to loosen trade ties," Financial Times, 3 April 2022.
8 Parliamentary Budget Office, Ireland's Economic Relations with China: A Statistical Overview, Publication 25 of 2022, 25 October 2022.
9 Calculated as (Exports + Imports) / GDP by the PBO using the CSO data: Central Statistics Office, "ISQ01: Quarterly Current Account," 4 April 2023Central Statistics Office, "ISQ01: Quarterly Current Account," 4 April 2023.

Box 1: Real Change in Incomes by Group, 2022 – 2023

Department of Finance central estimate inflation figures for 2022 and 2023 (8.1% for 2022 and forecast 4.9% for 2023), combined with wage growth figures of 4.2% for 2022 and 5.6% (forecast) for 2023, indicate a significant loss of purchasing power in 2022, but with a slight rebound in 2023 as real incomes are set to increase. However, the real change in incomes over 2022 and 2023 vary substantially across different groups.

Table 1 below shows the indicative numbers in each group analysed, combined with nominal increases in income in 2022 and 2023 it also shows the cumulative nominal change over the period, in addition to the cumulative real change over the period, based on all 3 Department of Finance inflation forecasts.

Table 1: Real Change in Income, by Group, 2022-2023, by Department of Finance Inflation Scenarios

Group	2021/2022 Numbers	2022 Nominal Increase	2023 Nominal Increase	2022-2023 Cumulative Nominal Increase	Cumulative Real Change 2022-2023: Low 2023 Inflation Scenario	Cumulative Real Change 2022-2023: Central 2023 Inflation Scenario	Cumulative Real Change 2022-2023: High 2023 Inflation Scenario
Welfare Recipients (numbers end 2021):							
State Pension Contributory	468,761	2.0%	4.7%	6.8%	-5.4%	-5.8%	-6.6%
State Pension Non-Contributory	95,004	2.1%	5.0%	7.2%	-5.1%	-5.5%	-6.3%
Widow/er's or Surviving Civil Partner's Contributory Pension	123,988	2.4%	5.6%	8.2%	-4.2%	-4.6%	-5.5%
Jobseekers Allowance	125,290	2.5%	5.8%	8.4%	-4.0%	-4.4%	-5.3%
Disability Allowance	155,181	2.5%	5.8%	8.4%	-4.0%	-4.4%	-5.3%
Carer's Allowance	90,899	2.3%	5.4%	7.8%	-4.6%	-5.0%	-5.8%
Total number in employment (numbers Q4 2022)	2,574,500	4.2%	5.6%	10.0%	-2.6%	-3.0%	-3.8%
Public Servants (numbers Q4 2021)	365,893	5.1%	3.5%	8.8%	-3.6%	-4.1%	-4.9%

Source: PBO analysis of Department of Social Protection, CSO, Department of Public Expenditure, NDP Delivery and Reform, and Department of Finance data.

Notes:

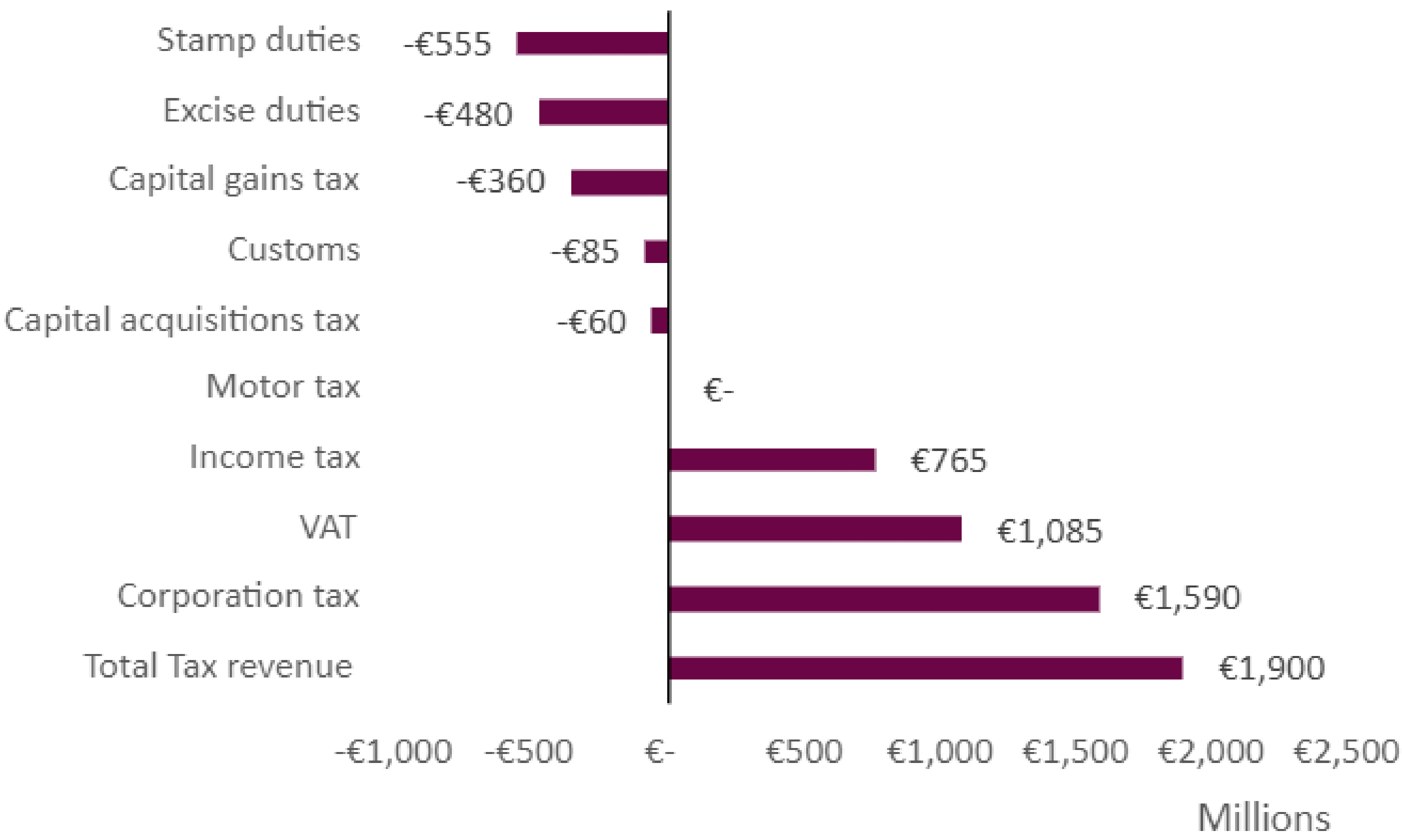
1. Group membership is not mutually exclusive, e.g. Public Servants are part of the total in employment group and a minority of these welfare recipients may also be in employment.
2. Not all welfare recipients are shown, only the largest groups (excluding Child Benefit recipients). These six welfare recipient groups account for over 1m persons – circa 41% of the total number in employment.
3. Wage growth and inflation figures/forecasts are from the Department of Finance. Public Servant pay growth figures are based on the 2022 and 2023 agreed pay increases.
4. The main/most common rate is used for the six welfare payments, e.g. the full State Pension.
5. One-off lump sums are not included in the welfare income changes as these payments are temporary in nature and do not impact lost purchasing power into 2023 and 2024.

As can be seen in Table 1, overall and based on the central inflation forecast, those in employment will have incurred a 3% decrease in real income over the 2022-2023 period, by the end of this year. In comparison, those on the Contributory State Pension will have incurred a 5.8% real fall in income over the same period, as welfare rate increases are less than average wage growth.

Overview of Tax revenue

Tax receipts have performed strongly in the first three months of 2023 compared to 2022. The Irish Exchequer has collected €19.7 billion in taxes in Q1 2023 compared to €17.2 billion in Q1 2022. Corporation Tax contributed €2.6 billion in tax receipts in March 2023, outperforming March 2022 levels (€1.6 billion) by approximately €1 billion. Income tax receipts in March 2023 were ahead of March 2022 income tax receipts by approximately €200 million. The Irish Exchequer collected €2.7 billion in tax receipts from VAT in March 2023, compared to €2.5 billion in March 2022.[10]

Figure 4 - changes to tax forecasts in 2023

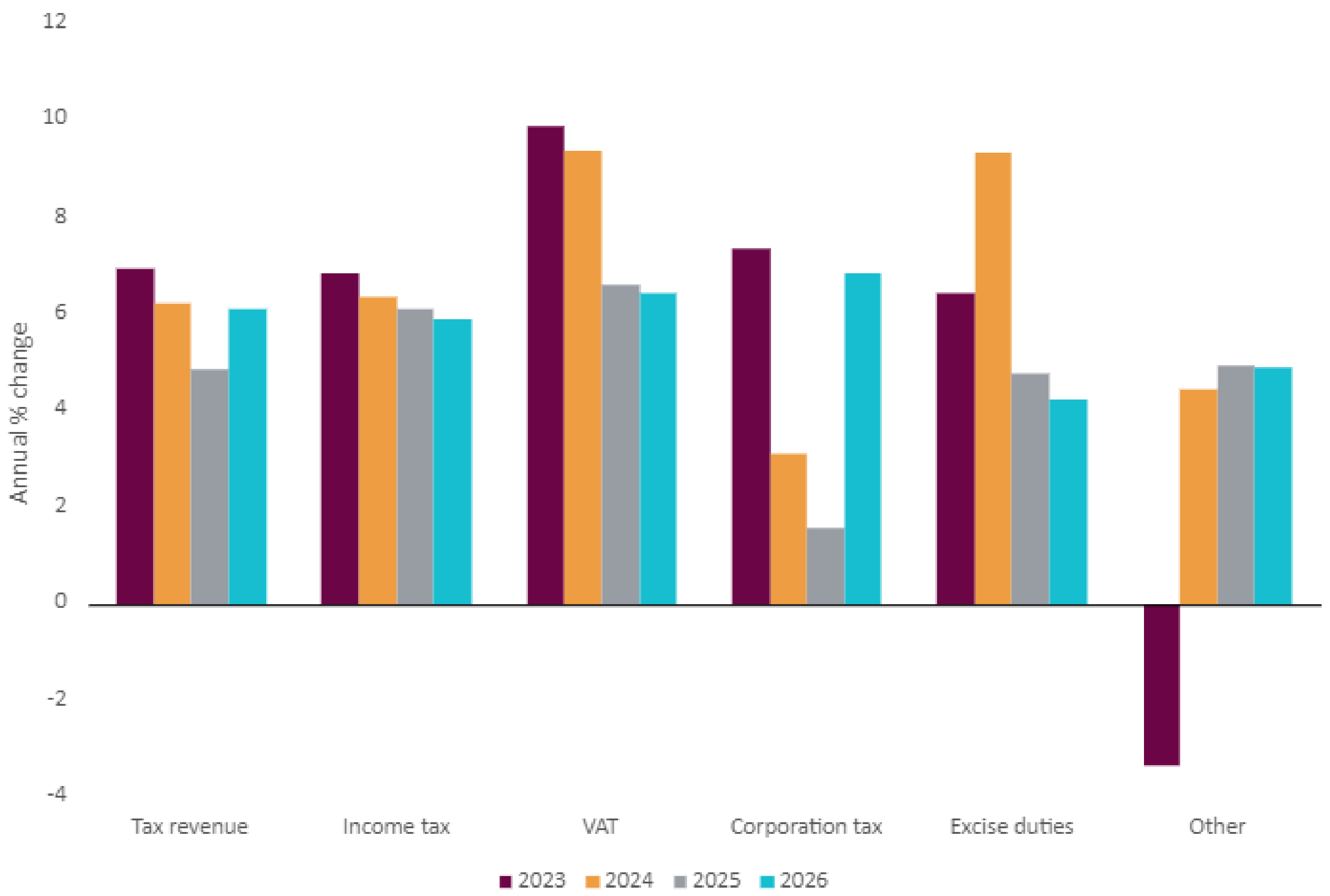


Source: PBO based on SPU 2023.

Relative to Budget 2023, tax revenue in the current year is expected to be €1.9 billion higher at €88.9 billion. The large majority (84%) of this is driven by an upward revision to the expected level of Corporation Tax receipts, by €1.6 billion, with a further €1.1 billion expected in VAT and €0.8 billion in Income Tax. The large upward revision to corporation tax was largely driven by a strong previous year's outturn – the 'starting point' effect. Tax forecasts were revised down notably for stamp duties, capital gain tax, and excise (due to the impact of policy changes on last year's outturn, i.e., the extension of reduced excise duties on fuel).

10 PBO Fiscal Monitor March 23 | Flourish.

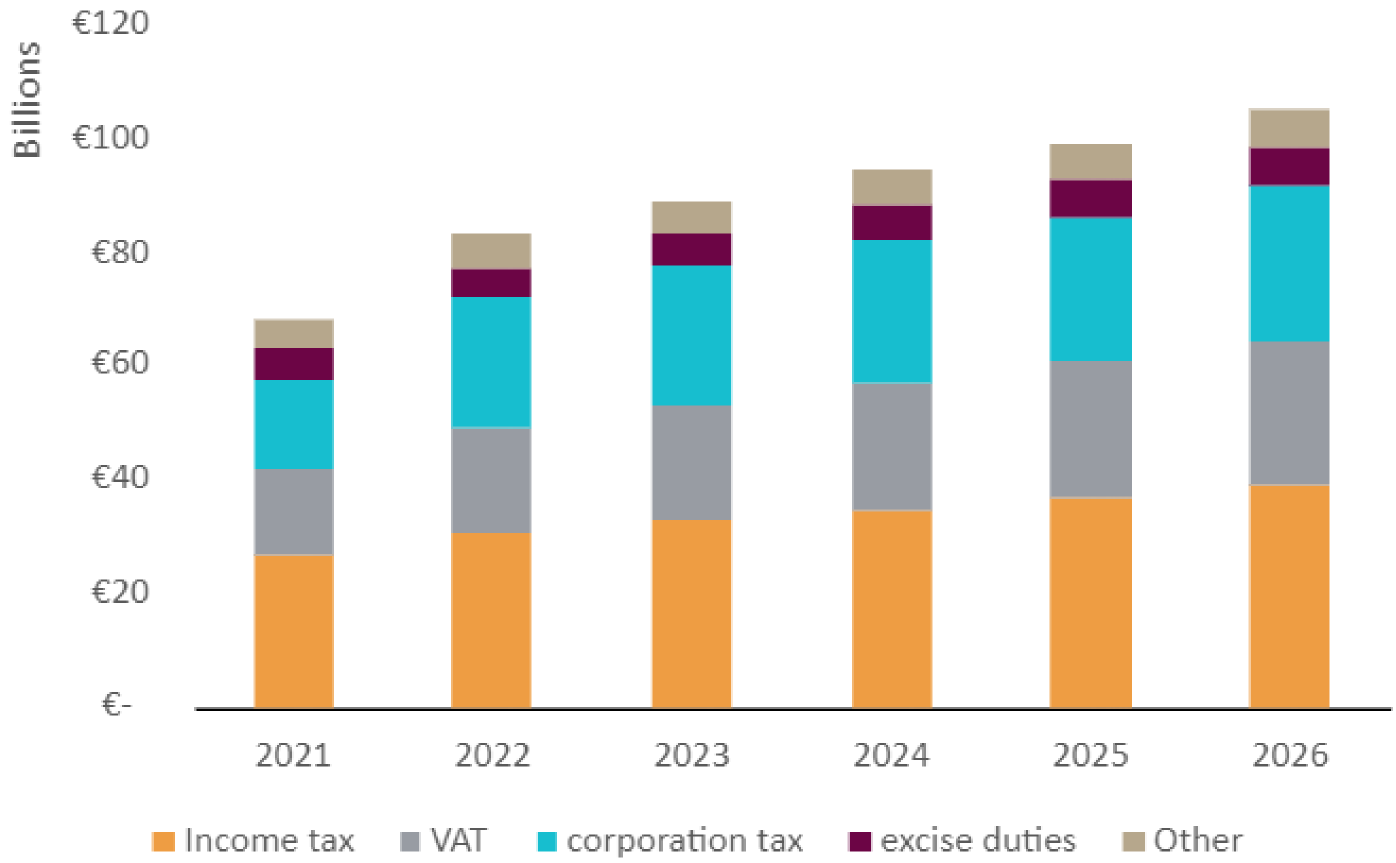
Figure 5 - forecast growth in tax revenue



Source: PBO based on SPU 2023.

In terms of forecasted growth rates, tax revenue is forecast to increase by 7% in 2023, driven by better-than-expected economic activity. Tax revenue growth will average 5% over 2025-2026, largely in line with growth forecasts. Income tax, forecast at €32.8 billion in 2023 and €34.9 billion in 2024 will experience a similar growth pattern. VAT is forecast to grow by 10% and 9% in 2023 (to €20.4 billion) and 2024 (€22.4 billion), driven by upwards revisions to consumer spending and strong performance last year (which offset the government's VAT reductions). Corporation tax (CT) receipts are forecast to increase by 7% to €24.3 billion in 2023, making up 27% of the tax base. Growth in CT is expected to reduce in 2024 (3% to €25.1 billion) and 2025 (2%) before increasing by 7% in 2026. Windfall corporation tax receipts are estimated at almost €12 billion in 2023 and 2024, almost 50% of the CT intake. The estimated impact of BEPS on CT receipts is now expected to materialise from 2025 onwards - €2 billion loss relative to baseline. This estimate has not been revised since 2020.

Figure 6 - Tax revenue forecasts

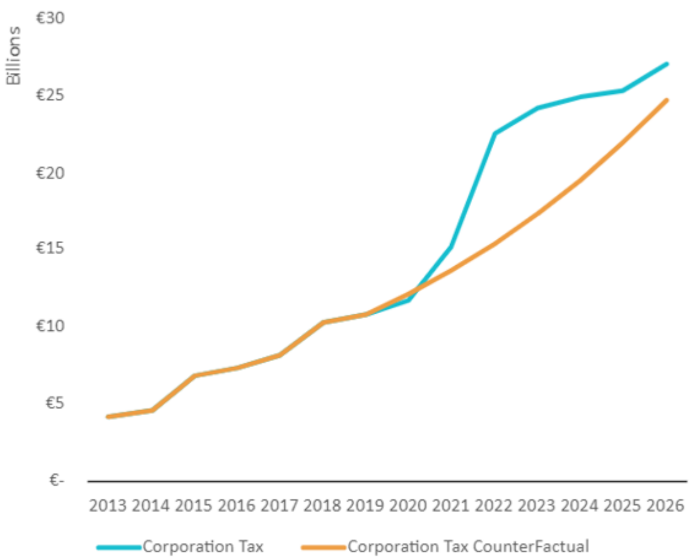


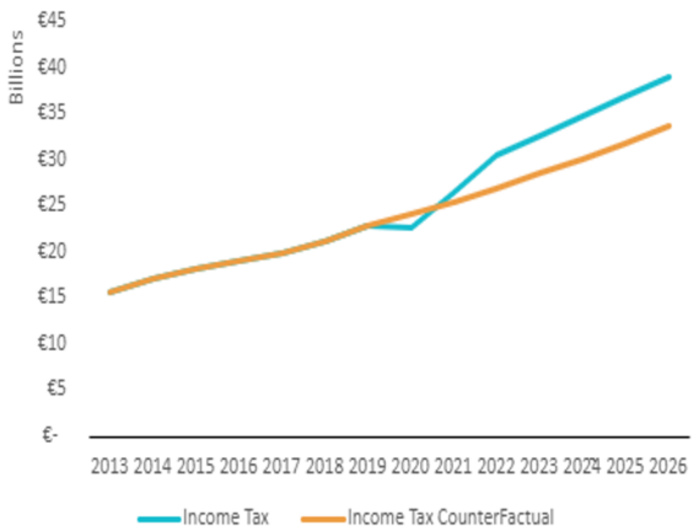
Source: SPU 2023.

As shown in Figure 7a and 7b, there has been a level shift in tax revenue post-pandemic. The figures compare actual CT and Income Tax receipts to the counterfactual receipts that would have materialised if these receipts grew by the average annual growth rate from 2016-2019 from 2020 onwards. From 2020 to 2026 (7 years), on a cumulatively basis, €22 billion in additional Income tax receipts will be collected compared to their counterfactual. Part of the rise in recent years is due to bracket creep, with rising wages leading to people paying a higher proportion of their income at the higher marginal tax rate leading to higher overall average tax rates. The SPU also notes that some of the increase is due to tax warehousing during the pandemic, with business paying these back over the course of future tax years. It may be worth noting that the income tax base may not be permanently as large as observed recently. Fiscal prudence in not committing these receipts to permanent current expenditure would be wise.

From 2020 to 2026, CT will be €26 billion higher than the counterfactual scenario. Overall, multinational sector's activities have provided a very substantial boost to the Irish public finances, not only through CT receipts, but also benefitting other tax heads such as Income tax and VAT. This also highlights a critical concentration risk for the public finances and the economy more generally. As a result, savings windfall receipts and allocating public spending strategically, for example addressing key bottlenecks (i.e., housing, climate change, transport) while also implementing structural reforms (i.e., health) is a prudent strategy by government to help maintain competitiveness of the Irish economy.

Figure 7a - actual CT ve pre-pandemic trend Figure 7b - actual IT vs pre-pandemic trend



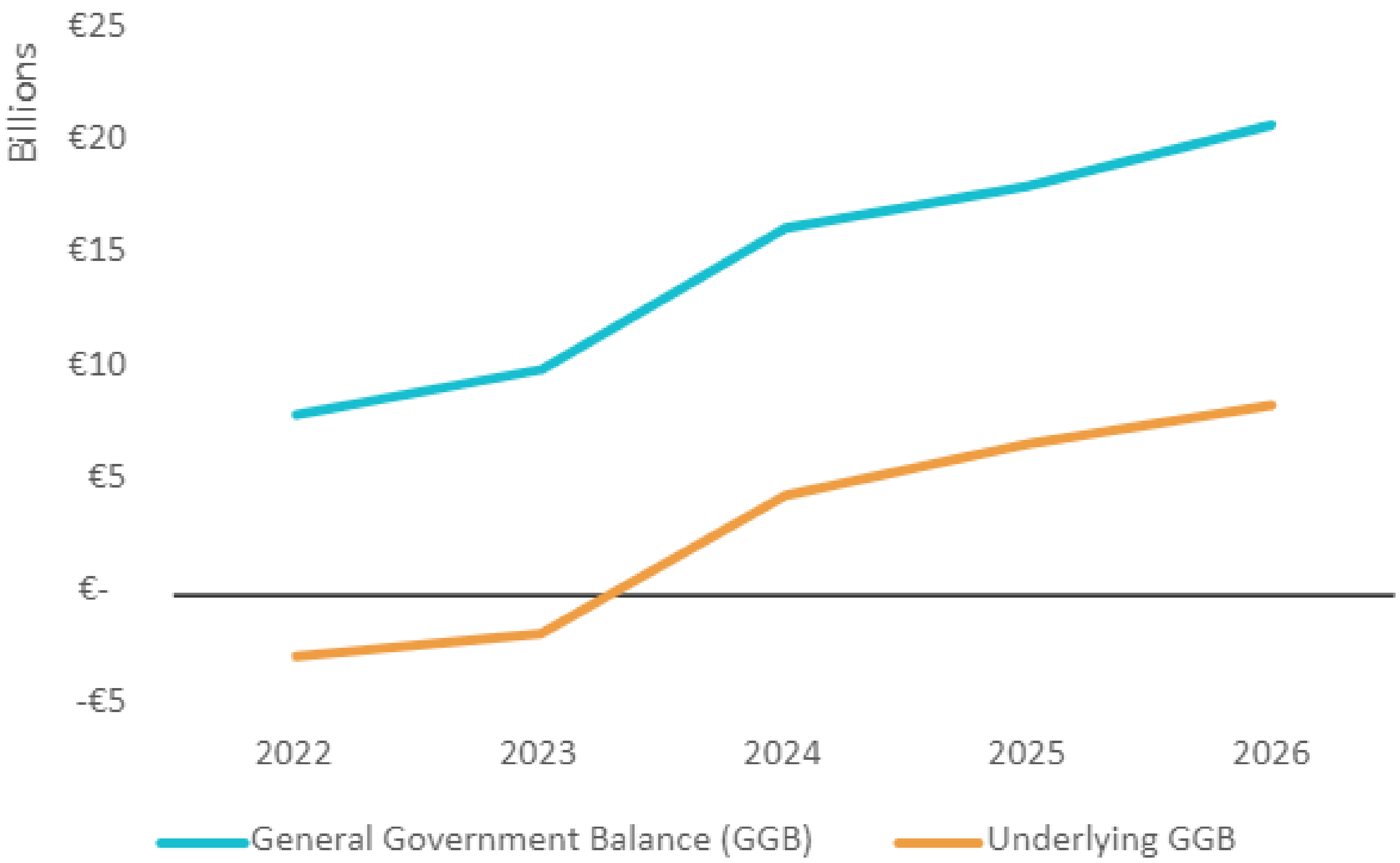


Source: PBO calculations based on DFIN data.

General Government Balance, Debt and Fiscal Stance

The increase in tax revenues will lead to a budget surplus from 2022 to 2026. It primarily reflects stronger than expected tax receipts, particularly from ‘excess’ corporation tax. In 2023, the government is expected to run a surplus of €10 billion. However, once these windfall corporation tax receipts are excluded, the government will run an underlying budget deficit of €1.8 billion and won’t return to a surplus until 2024.

Figure 8 - General Government Balance



Source: SPU 2023. The underlying budget balance excludes estimated windfall corporation tax receipts.

The Debt to GNI* ratio is also expected to fall over the forecast horizon from 78.8% in 2023 to 65.4% in 2026. The fall in the ratio will be mostly driven by strong growth in GNI* as opposed to paying down debt. Borrowing costs have been rising since the beginning of 2022. This won't significantly impact servicing the Irish Government debt as a significant proportion is locked in at fixed rates. However, borrowing costs will rise in the second half of this decade if borrowing costs are still high when the debt matures.

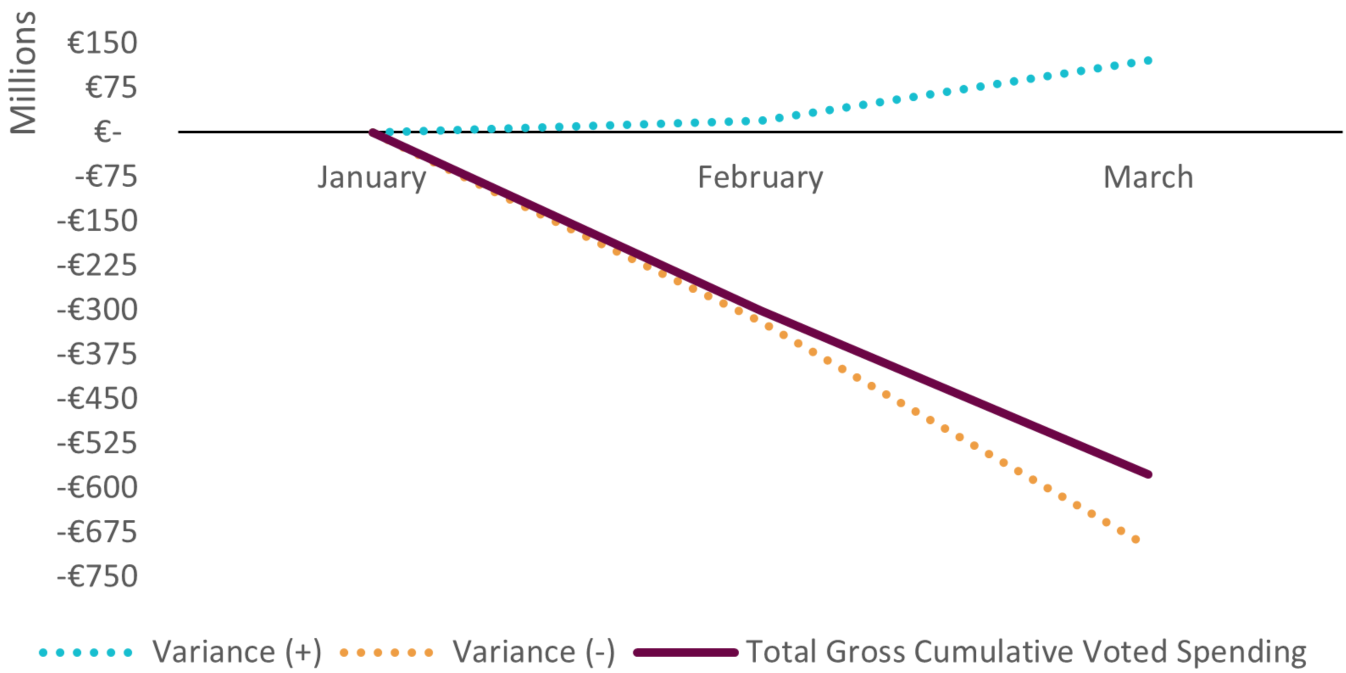
The fiscal stance, which indicates the short-term impact of fiscal policy on the economy, is set to remain supportive, as measured by the negative change in the Structural Primary Balance in 2022/2023 (-0.6 pp). The output gap is estimated to be positive (1.4% in 2023). There is a risk that a policy-driven increase in real demand would add further price pressures (i.e., further inflation) and push the positive output gap larger relative to the current baseline forecasts. This could risk amplifying another set of economic imbalances, namely supply-side constraints and labour market tightness. The government should therefore aim to stick to its 5% spending rule and stay within it in 2023.

Spending (2023-2026)

Introduction

Before commenting on spending in the short to medium term it is important to provide some context by way of reviewing recent developments in spending. Figure 9 shows gross government spending in the period 2019 to 2023.[11] Gross Government spending is a means to describe the cost of delivering public services, it includes the money allocated by Dáil Éireann, and money it allows bodies to retain from their income to offset their costs. It also includes the spending of the Social Insurance Fund (SIF) and the National Training Fund (NTF)[12]

Figure 9: Gross Government Spending (including SIF & NTF). 2019-2023



Source: PBO based on DPER Databank (accessed 18 April 2023).

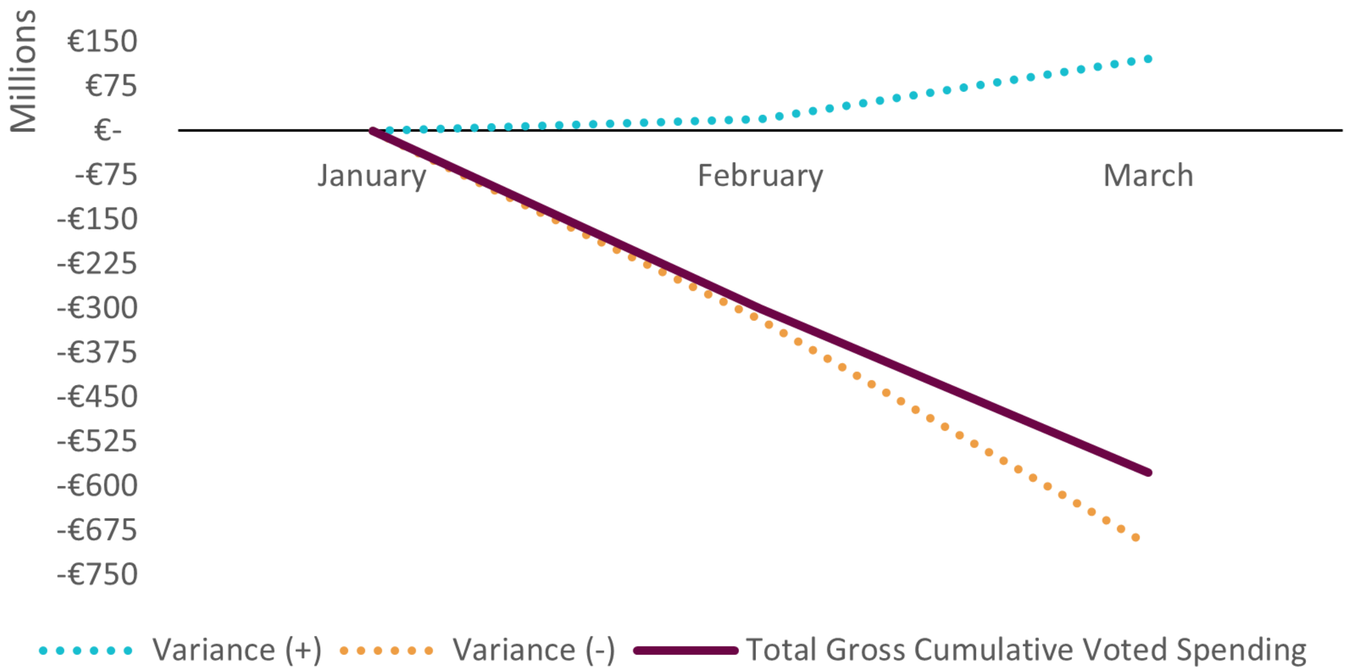
Gross government spending rose considerably in 2020 in response to the pandemic. As pandemic related spending has eased, other pressures have emerged, specifically spending associated with the Russian invasion of Ukraine and measures introduced to mitigate the cost-of-living pressures facing citizens. Government spending (see Figure 9) is projected to rise to almost €90 billion in 2023 (a 2% increase); however, this doesn't reflect the full amount of Government spending provided for in 2023. Specifically, the *Revised Estimates for Public Services 2023* (December 2022), which provided for additional 'unallocated' spending to an overall level of €91.1 billion (a 3.4% increase on the provisional spending in 2022).

Short Term (2023 spending)

Variance, a measure of the difference between spending and profiled spending (the estimated spending to have taken place at a point in time), is shown for Q1 2023 in Figure 10. Overall, while some spending is above profile (higher than estimated), the net position is €577 million below profile (lower spending than estimated). This is approximately 2.8% below the profiled level of gross government spending for Q1 (€20,387 million). Even so, this is €923 million more in spending compared to Q1 2022. [13]

[11] Spending figures for 2019 to 2021 are final. 2022 figures are provisional. 2023 figures reflect the allocations to Votes for 2023, actual spending may deviate significantly from these figures.
[12] Government Expenditure (Spending) is defined in the Ministers and Secretaries (Amendment) Act 2013.
[13] Department of Finance, Fiscal Monitor: March 2023 (04 April 2023).

Figure 10: Variance in Q1 2023



Source: PBO based on PBO based on Department of Finance, *Fiscal Monitor* (January, February, and March).

Table 2: REV Estimates and Expenditure Ceiling Composition 2023

Revised Estimates 2023	Millions
Current Expenditure	€77,795
Capital Expenditure	€12,070
Total Expenditure	**€89,865**
Core Unallocated Expenditure	€112
Non-Core Unallocated Expenditure	€1,123
Total Gross Expenditure	**€91,100**

Source: PBO Based on *Revised Estimates for Public Services 2023* (December 2022).

The composition of the Expenditure Ceiling for 2023 is set out in Table 2. Since the publication of the *Revised Estimates for Public Services* in December 2022, a Further Revised Estimate for Public Services was introduced, allocating a further €30 million in capital spending to Vote 42 Rural and Community Development, specifically for a new subhead in Programme B – Community Development, specifically 'B14 Ukraine Supports - Community Fund'. This has reduced the unallocated funds by €30 million (from €1,235 million to €1,205 million) while simultaneously increasing the allocated capital spending from €12,070 million to €12,100 million.[14]

[14] See PBO, Revised Estimates for Public Services 2023(20 February 2023) p.2.

Medium Term (2023-2026 spending)

The Draft SPU uses a technical assumption to project 'core' spending for 2023 to 2026. The SPU estimates a growth rate in core expenditure of 7.4% for 2023. Then, it assumes that core expenditure will grow by 5% annually over 2024-2026.

Table 3: Technical Assumptions on Expenditure

	2022	2023	2024	2025	2026
Voted Expenditure	**88.8**	**91.1**	**90.9**	**95.1**	**99.7**
Core Expenditure	80.0	85.9	90.2	94.7	99.5
Non-Core Expenditure	8.8	5.2	0.7	0.4	0.2
Percentage (%) Change Core Expenditure	-	7.4	5.0	5.0	5.0

Source: SPU

Note: Except where otherwise indicated, figures are measured in €billions

The technical assumption relates only to core spending. This means that, core spending is projected to increase by €19.5 billion (19.6%) from 2022 to 2026 but Voted expenditure is only projected to increase by €10.9 billion (10.9%). In last year's analysis, the PBO noted the limited forecasting on non-core expenditure and suggested having a 'placeholder' figure should be included to account for the potential ongoing costs in some areas, particularly around support for refugees from the Ukraine war. In this year's SPU the cost forecasting associated with assisting those fleeing the war in Ukraine are only made for 2023. The SPU (p.36) justifies this forecast on the basis that ongoing supports would be subject to a Government decision. The PBO's view is that this suggests the forecast levels of non-core spending are conservative, potentially understating the cost and duration of these supports into the future.

Some aspects of the PBO's commentary in the Summary and Analysis of the Stability Programme Update 2022 (April 2022) remain applicable in relation to the Draft SPU for 2023. The Draft SPU's technical spending scenario lacks detail. While in the 2022 SPU, there was a limited incorporation of measures relating to the Ukraine crisis (in 2023 only), this has been removed for 2023. There is no indication of what spending is needed to 'stand still' i.e. to maintain public services at their current level and thus identify what funds are available to invest in new policies. There is also little analysis of medium-term spending pressures or costing of new policies. Without such analysis the spending figures lack credibility.

Following substantial increases in Corporation Tax since 2020, and in recognition of potential vulnerabilities to this revenue source, Budget 2022 and 2023 transferred €6 billion of the budget surplus to the National Reserve Fund (NRF). As this has now reached the funds savings limit, no further transfers are planned for 2024 to 2026. Work is ongoing for a longer-term reserve fund to address challenges which will arise over the decade. [15]

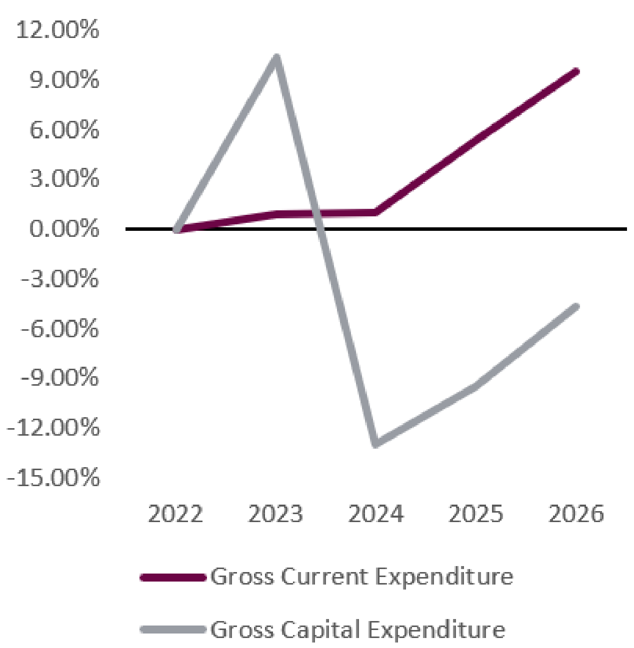
Forecast Developments in Spending

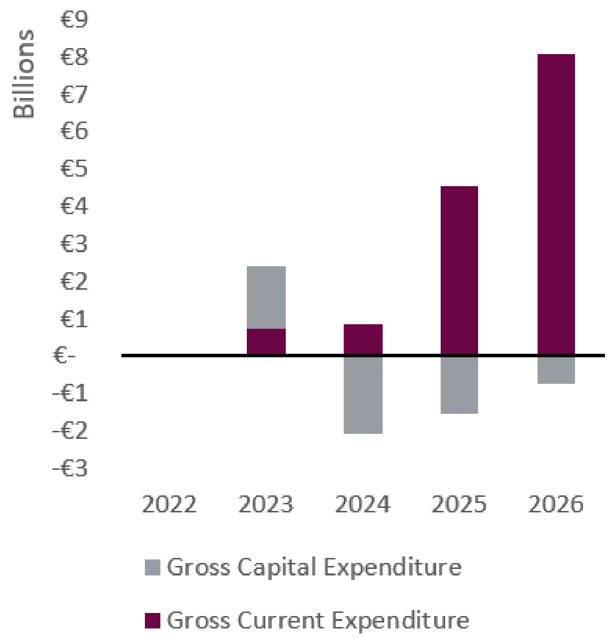
The *Draft Stability Programme Update* (Draft SPU) (2023, p.33) sets out budgetary projections for the period 2022 to 2026. Below, we show how gross current and capital spending is projected to develop over this window relative to the 2022 baseline.

Immediately in 2023 there is a significant increase in gross capital spending (+€1.7 billion / 10.3%); however, over the period forecast capital spending will generally remain below 2022 levels. Current spending will instead remain relatively static in the short-term but significant increases are forecast in 2025 (€4.6 billion / 5.3%) and 2026 (+€8.1 billion / 9.5%).

[15] gov.ie - Ministers McGrath and Donohoe publish Stability Programme Update 2023 (www.gov.ie)

Figure 11: Forecast Current and Capital Spending (2022 baseline, % change). Figure 12: Forecast Current and Capital Spending (2022 baseline, € change)



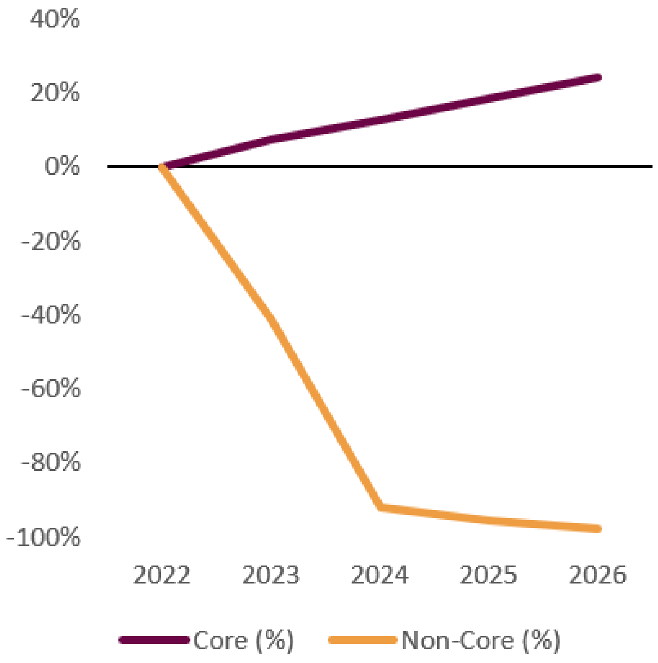


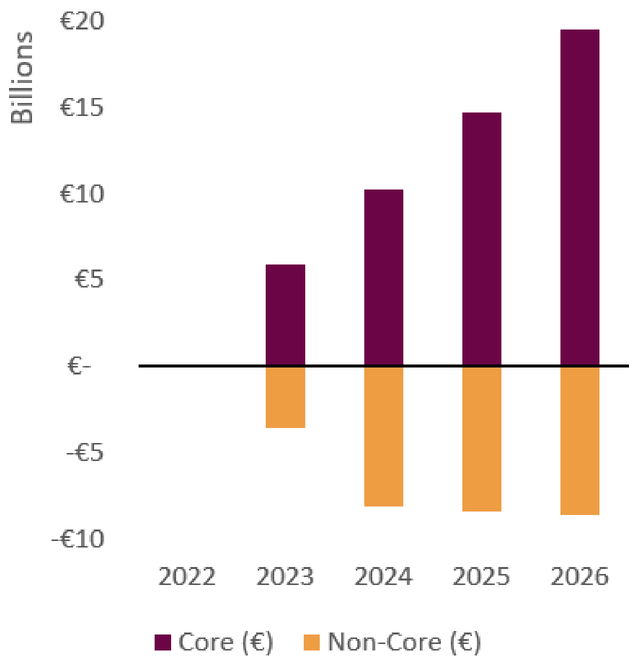
Source: PBO based on Department of Finance, *Draft Stability Programme Update* (18 April 2023) p.33.

The relatively stable level of current spending in the short term (to end 2024) reflects the incorporation of non-core spending (for temporary or one-off measures) in recent years into the base.[16] This is shown in Figure 13 and Figure 14, which show that non-core spending is projected to rapidly decline in the short term, falling by €8.1 billion (92%) by 2024 when compared with 2022 levels. While overall levels of gross capital spending will decline by 2026 to €14,380 million compared to 2022 levels of €16,115 million, this is a result of a significant reduction in non-core capital spending over the same time period (-€4,195 million / -81%).Overall, core spending is forecast to increase by €19.5 billion (24.4%) in 2026 when compared to 2022 levels.

[16] Department of Finance, *Draft Stability Programme Update*(18 April 2023) p.6.

Figure 13: Forecast Core & Non-Core Spending (2022 baseline, % change) Figure 14: Forecast Core & Non-Core Spending (2022 baseline, € change)





Source: PBO based on Department of Finance, *Draft Stability Programme Update*(18 April 2023) p.30.

Implications of the Russian Invasion of Ukraine

Health, Housing, Education, Social Protection

The key issues in determining the cost implications of the war in Ukraine on domestic spending are:

- how soon the conflict will draw to a close,
- the extent to which people want/are able to return to Ukraine, and
- whether or not their return is feasible pending post-war reconstruction.

The volume of refugees which Ireland may ultimately support is unlikely to be known for some time yet, with significant numbers requiring support since the war began.[17] Yet the longer the war in Ukraine continues the more likely it is that the number of refugees will increase alongside increased barriers to a safe return to Ukraine, due to widespread damage and destruction in essential infrastructure (housing, education, health etc.). The volume of refugees and the length of time they are resident in Ireland will have a significant impact on determining the overall level of costs.[18] The prudent approach would be to estimate a high level of refugees remaining in Ireland for a considerable period of time, which would allow an estimate of higher cost thresholds.

17 Nearly 80,000 refugees and asylum seekers now in State accommodation | Newstalk
18 Currently, up to €2 billion is allocated for providing humanitarian assistance to refugees from Ukraine.

In the interim, funding is required to ensure the provision of additional housing (an area already under significant and continuous pressure),[19] additional educational capacity,[20] social protection supports,[21] among others. While some refugees will be able to participate in the labour market and may make valuable contributions to the economy and society, many refugees will be children, elderly, and frequently lone parents.[22] The capacity of these people to contribute to the labour market is likely to vary between individuals depending on a range of factors and circumstances.

PBO@oireachtas.ie *www.oireachtas.ie/pbo* April 26, 2023

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19 Housing Ireland trends in spending and outputs of social and state supported housing
20 This will impact across all levels of education but may be most pronounced in primary and secondary education. The challenges faced may be exacerbated by the spatial distribution of refugees. If reliance is placed on the use of holiday homes to house refugees, then it may be necessary to increase resourcing (funding and staffing) to schools in more rural and depopulated locations.
21 Government looks at cutting some of its financial support for Ukrainian refugees | Business Post
22 Many women and children flee invasion, men told to stay (rte.ie)