Tithe an Oireachtais
Houses of the Oireachtas

An Oifig Buiséid Pharlaiminteach
Parliamentary Budget Office
Pre-Budget Commentary 2024

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Séanadh

Is í an Oifig Buiséid Pharlaiminteach (OBP) a d'ullmhaigh an doiciméad seo mar áis do Chomhaltaí Thithe an Oireachtais ina gcuid dualgas parlaiminteach. Ní bheartaítear é a bheith uileghabhálach ná críochnúil. 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.

Is de chineál ginearálta í an Fhaisnéis. Baineann éiginnteacht le ráitis réamhbhreathnaitheacha agus d'fhéadfadh go dtiocfaidh nithe suntasacha chun cinn mar thoradh ar an bhFaisnéis. Ní sholáthraítear ráiteas cinntitheach leis an bhFaisnéis i ndáil le haon saincheist ar leith nó i ndáil le himthoisc phearsanta. Ní comhairle atá san Fhaisnéis. Ní mór a dheimhniú duit féin go bhfuil an Fhaisnéis a sholáthraímidne, an Oifig Buiséid Pharlaiminteach agus Coimisiún an Oireachtais (lena n-áirítear seirbhísigh, gníomhairí agus conraitheoirí na hOifige agus an Choimisiúin) oiriúnach agus iontaofa. Ní ghlacaimid aon fhreagracht as cruinneas ná oiriúnacht, ná eile, na Faisnéise agus ní thugaimid aon ráthaíocht ná aon ghealltanas ná aon bharánta i leith an chéanna; ná go mbeidh ár leathanaigh ghréasáin nó an Fhaisnéis nó ábhar eile saor ó earráidí, saor ó víris nó saor ó shárú. Ní ghlacaimid aon dliteanas (lena n-áirítear i leith éilimh maoine intleachtúla) a eascróidh as aon ábhar tríú páirtí nó aon suíomh gréasáin tríú páirtí a gcuirfimid nasc ar fáil chuige nó dá ndéanfaimid tagairt. Ní ghlactar le haon dliteanas ar bith, a mhéid is mó a cheadaítear faoin dlí is infheidhme nó (i) as aon iontaoibh a chuirfear san Fhaisnéis nó san ábhar ar ár leathanaigh ghréasáin nó (ii) as aon chaillteanas nó damáiste a eascróidh as an úsáid a bhainfidh tú as na leathanaigh ghréasáin sin nó i dtaca leis an úsáid sin. Féach ár *bhFógra Séanta cuimsitheach anseo*. I gcás aon easaontacht a bheith idir an Séanádh seo agus ár bhFógra Séanta cuimsitheach, is ag an gceann deireanach a bheidh an forlámhas.

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Message from the PBO Director

Annette Connolly
Director of the Parliamentary Budget Office (PBO)

The PBO provides key economic, fiscal and budgetary intelligence to inform Members of the Oireachtas. As an independent specialist unit within the Houses of the Oireachtas Service, our primary objective in the following pre-budget analysis is to provide robust, objective contextual evidence to support Parliament in the ex-ante scrutiny of Budget 2024.

The headline budgetary position masks considerable vulnerabilities. It is clear that planning for major structural change is necessary to strengthen fiscal sustainability, maintain fiscal buffers, and build resilience to future challenges including intergenerational equity. To improve sustainability of public services, Budget 2024 will need to avoid building up permanent fiscal commitments on the basis of revenues that may prove transitory. Further, it is crucial that fiscal and monetary policy remain mutually reinforcing.

Budget 2024 is facing many counterbalancing demands. It will be our second cost-of-living budget. Inflation is still substantially above target, and the erosion of real incomes is putting households at risk of falling living standards. Likewise, there is considerable pressure on the public finances to maintain the existing level of public services in a rising cost environment. Based on a practical assessment of the extra resources (fiscal space) available, budget measures need to be efficiently targeted towards those most in need without fuelling domestic inflation in current circumstances. For instance, targeted reductions in end-user costs for public services such as transport, health, childcare and education would alleviate cost of living pressures with the least effects on inflation.

The underlying fundamentals of the economy are strong and the number of people in employment in Q2 2023 is up 3.5% compared to a year previous and the unemployment rate is below pre-pandemic levels. Modified domestic demand was down 0.3% year-on-year in Q2 but the first half of 2023 was better than the first half of 2022. So far, consumer spending has been better than expected and nominal tax receipts are up across the board. Wages are growing and remain in line with inflation, so far, but additional demands are on the way.

A spending package of €5.2 billion is proposed for Budget 2024 but this does not account for the rising costs of services delivery. As of end-August 2023, €541 million more had been spent (gross) than had been profiled. It was reasonable for the Government to breach the 5% Spending Rule during the exceptional social, health and economic conditions of the Covid Pandemic and in Budget 2023 due to the cost-of-living challenge. Likewise for Budget 2024, a fair share of the signalled above-trend core expenditure will be due to excess-inflation. Moreover, a transparent link needs to be identified in Government spending plans. In times of cost uncertainty, some restraint would help to put the public finances on a long-term sustainable path.

Capacity constraints are delaying the necessary delivery of infrastructural investment. There are further inflationary risks associated with capital spending during labour shortages. Census 2022 revealed some important insights into Ireland's population and housing landscape. The overall population increased by 8.2% since the previous census.[1]

A strategy of determined multi-annual fiscal planning rather than just focusing on the year ahead is warranted. A growing and ageing population will test our provision of public services. Climate change obligations require further investment. Macroeconomic forecasts seven years ahead to 2030, with budget forecasts only three years out, are insufficient for long-term fiscal planning. Even with the known complications of forecasting Irish macroeconomic variables, short projections cannot account for incredibly significant longer-term spending pressures.

The PBO welcomes the announcement that the Minister for Finance will bring forward proposals to Government to establish a long-term savings fund. The fund should be prepared to complement rather than substitute other efforts to meet public spending commitments. Putting excess corporation tax receipts aside for structural issues will help temper the procyclicality of future Government spending.

The PBO recognises the political pressures for tax cuts and additional spending. However, spending should be resourced sustainably and set to deliver the services that citizens need and that achieve maximum value for public money. The Spending Review process is vital to underpin this. For these reasons, using windfall receipts to fund current spending increases or permanent tax cuts may create problems in the future and limit our room to manoeuvre when needed.

[1] CSO (2023) Census of Population 2022 - Preliminary Results.

Summary

Economy

- Despite high inflation and the rise in interest rates, the Irish economy continues to grow but at a more gradual pace after a strong post-pandemic recovery.
- The Irish labour market was not badly scarred by the pandemic and there has been significant inward migration. There are now over 2.6 million people employed and unemployment is at its lowest rate for decades. There is limited scope for expansion in the labour force.
- Wholesale energy prices have receded somewhat from their peaks of last year, yet prices of goods and services continue to rise at above target inflation rates. Even excluding mortgage interest, headline inflation remains stubbornly high; the August HICP reading ticked up to 4.9% from 4.6% for July.[2]
- Cost of living pressures hurt low-income households most, since they typically spend a larger share of their income on energy and food.
- Electricity prices for homes and businesses are starting to be reduced due to recent falls in wholesale prices but they will remain elevated compared to 2021.
- There is a growing mismatch between demand and supply in the economy potentially triggering 'second-round' effects on cost inflation. There are significant capacity constraints in areas of labour, housing, construction, and key energy infrastructure.
- Consumer spending is close to its pre-pandemic trend despite the impacts of higher inflation over the past 18 months. Household spending continues to be supported by saving, the stock of which has not declined significantly, but the flow of new savings has returned to pre-pandemic rates.
- Business investment and construction activity are facing headwinds from higher interest rates and may continue to moderate depending on the rate of housing starts.
- The external economic situation is increasingly fragile and could adversely affect growth prospects as headwinds to both the multinational and domestic sectors here include global inflation, tighter financing conditions and geopolitical tensions.

[2] Annual inflation rate as per EU Harmonised Index of Consumer Prices - Ireland.

Fiscal

- The headline fiscal position is strong. This is mainly due to the surprisingly robust and ongoing issues around potentially unsustainable performance of the corporation tax yield.
- The risks underlying a reliance on an elevated corporation tax yield are well understood, with circa €12 billion in receipts potentially transitory in nature.
- Tax revenue growth has remained robust consistent with the strength of economic activity, including low unemployment rates.
- Non-corporation tax receipts and PRSI are up on last year due to the strong momentum in the domestic economy.
- Tax receipts are heavily dependent on a small number of multinational firms headquartered in Ireland. In particular, the corporation tax yield is extremely vulnerable to evolving geopolitical developments and to decisions made in other countries.
- The continued growth in tax revenue is projected to lead to only a slight increase in the budget surplus this year as strong spending is set to absorb most of the 2023 increase.
- Public debt in Ireland is reasonably high with significant fiscal challenges foreseen. Climate change mitigation, the digital transition and financing an ageing population will put significant pressure on public finances into the future.
- Age-related expenditure is projected to increase by over 3% of GNI* (modified Gross National Income) by 2030 and even further in the following decades.
- Climate action will lead to diminished excise revenues from fossil fuels and related activities and necessitate greater spending across a range of areas.

Public Spending

- In Budget 2024, it has been signalled that core spending will increase by €5.2 billion (6.1%) over 2023 levels. Depending on the measures announced on Budget Day, non-core (temporary) spending could decline to €4 billion for 2024.
- Funded from 'windfall' corporate tax receipts, windfall capital investment is commencing in 2024 (€0.25 billion), rising to €0.75 billion in 2025, to €1.25 billion in 2026.
- Increased 'core' spending of €5.2 billion is likely to be partially absorbed by rising costs of service delivery. Further, any potential public sector pay deal impacting on pay costs in 2024 would need to be funded from this sum.

- As of end-August 2023, €541 million more had been spent (gross) than profiled. If spending in 2023 remains above profile – the year-on-year increase in core spending (ongoing, recurring spending commitments) the quantum of increased core spending (€5.2 billion) may be significantly reduced to maintain the delivery of public services at their current levels.
- The PBO's *Pre-Budget 2024 Ready Reckoner* (September 2023) shows that a €1 increase to the rate of payment of the State Pension (Contributory and Non-Contributory) would cost €32.3 million.
- The PBO *Pre-Budget 2024: Selected Impacts on Households* (September 2023) shows a €10 increase to Child Benefit would cost €140 million, whereas an increase in payment rates of €10 for Qualified Children could cost €143 million but have significantly greater impact on households in the lower income deciles and particularly benefit lone parents.

Glossary

- **Allocated** and **unallocated** refers to whether or not the funds have been allocated to a specific Vote. Unallocated funds may be earmarked for specific purposes e.g., Ukraine Reserve, but are not allocated to specific Votes pending a determination of (i) whether they're required; and (ii) the area (Vote) in which they are required.
- **Core spending** refers to spending which maintains the Existing Level of Service (ELS) + new measures which expand the quantity or quality of public services on an ongoing basis e.g., recruitment of nurses, increased payment rates of social assistance schemes. Core spending on ELS and new measures in one year can be expected to form the base (ELS) in the subsequent year. **Non-core spending** therefore refers to once-off/temporary/short-term measures (usually in the form of a grant or payment) to respond to transient issues such as the Cost-of-Living pressures being experienced at present.
- **Existing level of service (ELS)** refers to the cost of maintaining the current level of service delivery. It is an approach similar, but distinct from, estimates of Stand-Still used by the Fiscal Council.[3]
- **Fiscal Space** is the amount of resources available for discretionary allocation in the Budget. These resources can be used to provide for once-off measures (non-core spending) or can be committed to ongoing liabilities (core spending) such as by increasing staffing in the public sector, increasing payment rates of various social welfare schemes etc.
- **Windfall** tax receipts refers to tax revenues that are potentially transitory in nature.[4]

[3] Irish Fiscal Advisory Council, *Fiscal Assessment Report* (May 2022) pp.59-60.
[4] Department of Finance, *Future-proofing the public finances – the next steps* (May 2023) p.1.

Strategic Issues for Budget 2024

With a very tight labour market and uneven and excess[5] corporation taxes boosting the Exchequer, there is a high risk of procyclical fiscal policy – that is, increasing spending and cutting taxes when the economy is already performing strongly. This would amplify demand in an economy already operating at capacity and risks leading to inflation being higher in Ireland for longer than would otherwise be the case. As such, further stimulation through a large budgetary package risks a destabilising effect fuelling more price increases. The consequences could mean cutting spending and increasing taxes during future periods of economic downturn.

The PBO recognises the political pressures for additional spending. However, these should be resourced sustainably and set to achieve maximum value for public money. Linking expenditure to Irish-specific trends in economic growth is a useful anchor yet the National Spending Rule intended to limit net spending growth to 5% each year is not being adhered to, mainly because it is not a permanent policy measure.[6] On top of that, the EU fiscal rules are currently not binding as these have been paused since the pandemic.

Fiscal sustainability takes account of capacity constraints which are fuelling price pressures and addressing these through appropriate investment in structural reforms. Capacity constraints are delaying necessary infrastructural investment. Price and wage increases cannot be avoided if the labour market is exceptionally tight. Under these circumstances, the planned cost of public spending could be under-estimated and ultimately provide less than expected value for public money – less outputs costs more. For *Budget 2024,* the link between the signalled above-trend core expenditure and excess-inflation has yet to be clearly set out. Government spending plans on this basis lack transparency and discipline.

An ageing population, increasing health and social care costs, and the costs associated with responding to climate change limits the fiscal space before any new policies are costed and implemented. These factors increase the Stand-Still cost of current service provision. According to the Irish Fiscal Advisory Council (Fiscal Council), public expenditure will be €7-€8 billion higher, per annum, to account for this natural attrition. Without

[5] The Irish Fiscal Advisory Council proposes that "excess" corporation tax refers to the share of annual corporation taxes that cannot be explained by the performance of the domestic economy (Fiscal Assessment Report, May 2022, Box G).
[6] The 5% rule was derived by DPER to be close enough to the 10-year average of potential real GDP growth plus inflation - the idea is for primary spending to grow in line with the sustainable growth of the economy.

offsetting tax increases or compensating limits on spending in other areas, there could be too much reliance on uncertain revenues to meet the difference between permanent expansions and maintaining existing policies. In addition, the Government has yet to conclude the latest public sector pay negotiations which, if agreed, will also be drawn from funds allocated to maintain existing levels of public services. Pressures in infrastructure, climate and health need long-term planning and multi-year funding.

Economic Risks

The outlook for economic growth and inflation remains highly uncertain – these could go either way. There continues to be a divergence between prospects facing foreign-owned multinational enterprises (MNE)[7] and other domestic-dominated sectors of the economy.[8]

Growth is slowing in many of our key export markets. We cannot depend on ever-increasing tax receipts from our multinationals derived from worldwide activities, as these could vary substantially depending on global economic conditions. Particular downside risks to growth include supply chain disruptions[9] from Russia's unjustified war in Ukraine, weaker growth in China or an increase in broader geopolitical tensions. Global trade fragmentation weighs hard on a small open economy such as Ireland. Growth could be slower if the effects of global monetary policy are more forceful, and the world economy weakens in the process. Conversely Irish growth could be higher if our strong labour market means that households and businesses remain confident and spend more.

It is noteworthy that central banks in the UK and US as well as the ECB have adopted a data-dependent approach for monetary policy decisions. This allows them to keep their options open about whether or not rate increases need to be paused. Upside risks to inflation include potential renewed upward pressures on the costs of housing and food. Adverse weather conditions may push food prices. European Central Bank (ECB) efforts may take longer to bring inflation back to target. In contrast, weaker demand would lead to lower price pressures. Inflation would come down faster if declining energy prices and lower food price increases were to pass through more quickly and thoroughly to the prices of other goods and services.

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[7] The main sectors dominated by MNEs in Ireland include Pharma and Chemical production, Computer, electronic and optical device manufacturing, MedTech and Information & Communications, including software publishing.
[8] Modified domestic demand (MDD) was up only 0.1% in Q1 2023 over Q4 2022.
[9] Federal Reserve Bank of New York, 'Global Supply Chain Pressure Index (GSCPI)' (2023).

Budgetary Context

Table 1 summarises the key projections relating to 2023 and 2024 which set the context for Budget 2024. Spending is projected to undergo significant growth in 2024, with core spending (recurring/permanent spending commitments) increasing substantially, offset to some extent by a reduction in levels of spending on non-core spending (temporary or one-off measures). Tax receipts are forecast to experience robust growth with the caveat that Ireland's tax base is heavily reliant on Corporation Tax receipts which may be windfall in nature (transitory and unreliable). These forecasts of spending and revenue sit within a context of projected economic growth and easing inflation (down from 8.1% in 2022).

Table 1: Headline Projections 2023-2024

	2023	2024
Expenditure Ceiling (€ billion)	€91.1	€95.5
Core	€85.9	€91.2
Non-Core Spending	€5.2	€4.0
Windfall Capital Investment		€0.25
Tax Receipts (€ billion)	€88.9	€94.4
Real GNI* Growth forecast (%)	1.6%	2.1%
HICP forecast	4.9%	2.5%

Source: Department of Finance, *Stability Programme Update* (April 2023); and the Department of Finance and the Department of Public Expenditure, NDP Delivery and Reform, *Summer Economic Statement* (July 2023) p.xi.
Note: The Expenditure Ceiling includes spending of the Social Insurance Fund and the National Training Fund; however, the income to these funds is not reflected in forecast tax receipts.

The Fiscal Position ahead of Budget 2024

The *Summer Economic Statement* (SES) indicated that the Government had revised its spending plans set out in April's *Stability Programme Update* (SPU). These plans hint at higher spending increases and more permanent tax cuts than previously envisaged. Core net spending could be €4.1 billion higher by 2026 compared with previous government plans.[10] Without specifics (to be announced on Budget Day and the Finance Bill), the Government has indicated additional tax cuts of €0.6 billion annually to 2026. Government plans point to a permanent increase in current spending of €1 billion per year. Annual capital spending could also be increased – termed "windfall capital investment" – such that the additional outlay is €1.1 billion higher in the next 3 years. Together, these fiscal plans are expansionary and such a fiscal stance in a strong growth economy is

[10] Irish Fiscal Advisory Council, Pre-Budget 2024 Statement (September 2023).

pro-cyclical. It comes at a time when price pressures are high, increasing risks for fiscal sustainability.

Issues and trade-offs

The SES informs us that the Government intends not to rely on temporary measures in *Budget 2024*, as in *Budget 2023* to get around the National Spending rule. Without the requirements of the EU fiscal rules (currently because they are suspended and in future because of the use of Irish GDP as the standard metric[11]), Ireland must return to applying an appropriate and credible fiscal framework, such as the National Spending rule, to sustainably manage the public finances.

In public accounting terms, additional capital spending was presented as "windfall capital investment" in the pre-Budget SES not counting towards core spending. Spending overruns will push spending up further than projected – there is no explicit mention of how these will be handled in the SES plans. Costs related to long-term structural developments including demographic change and climate protection have yet to be specified by the Department of Finance or Public Expenditure, NDP Delivery and Reform and don't appear to be reflected in the pre-Budget projections.

The PBO welcomes the announcement that the Minister for Finance will bring forward proposals to Government to establish a long-term savings fund to complement rather than substitute other reforms needed to meet its public spending commitments. Putting excess corporation tax receipts aside for long term structural issues will temper the procyclicality of future Government spending.[12] It will reduce the need for tax increases in hard times ahead and could be available for acute pension shortfalls. In the interim, €2.25 billion of windfall receipts will be utilised to support additional infrastructural projects over the period 2024 to 2026. This should be done in line with the National Development Plan which provides a framework to plan for longer term capital needs. Appropriate capital

[11] Ireland's GDP figure inflates our economic performance and national income and is principally distorted by the presence of more than 1,500 multinationals, among them most of the world's top tech and pharma firms. Ireland is also the world's top hub for aviation leasing. A large part of GDP does not accrue to Irish residents. Using GDP in the Irish context can mislead comparative analyses of debt, carbon intensity and inequality for example.

[12] Excess corporation tax receipts, those beyond which can be justified by domestic activity, are now contributing in excess of 40% of the corporate tax take representing at least 4% of GNI*. The risk of these diminishing or reversing is compounded when just three corporate groups make up to one-third of these receipts (Cronin, 2023).

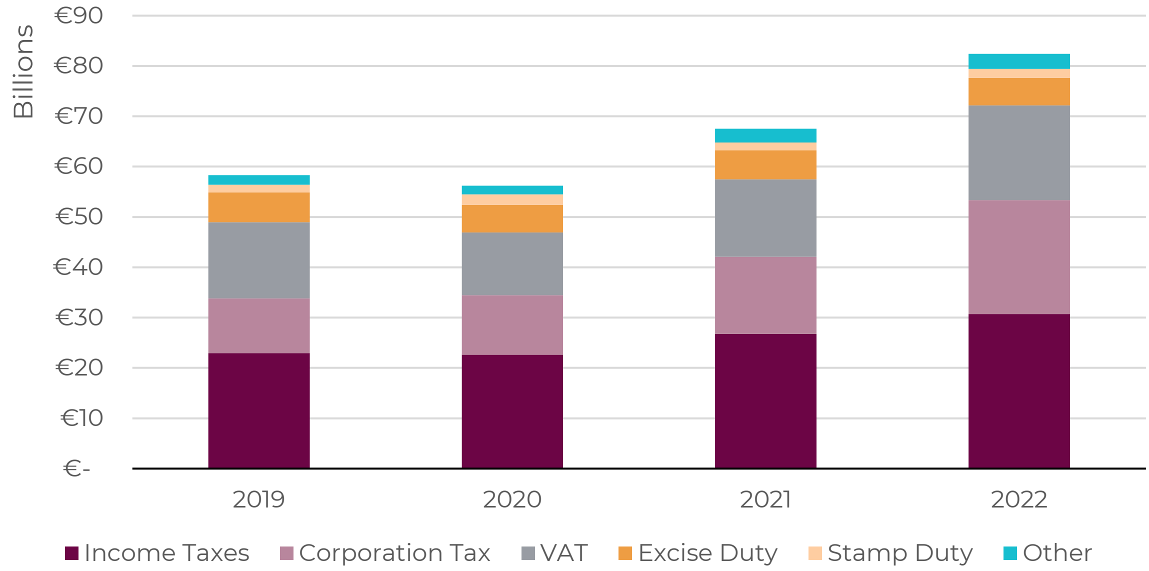
investment now can also serve to 'future-proof' reductions in public spending which may be forced during less favourable economic periods.[13]

Taxation

The Stability Programme Update 2023 (*SPU 2023*) estimated that Exchequer tax revenue for 2023 would be €88.9 billion.[14] By end-August 2023, cumulative tax receipts stood at €53.1 billion which was €3.3 billion higher than the same period in 2023.[15]

In recent years, the Irish Exchequer has experienced a significant increase in tax revenues. The Exchequer collected a total of €58.31 billion in tax revenue in 2019, rising to €82.42 billion in 2022, an increase of **€24.1 billion or 41.3% in just three years**. Almost half of the growth in tax receipts for this period was due to Corporation Tax (48.8%), followed by Income taxes (32%) and VAT (15%). It is important to caveat, these figures are correct at the time of publication and may be revised on budget day.

Figure 1: Composition of Exchequer Revenue 2019-2022



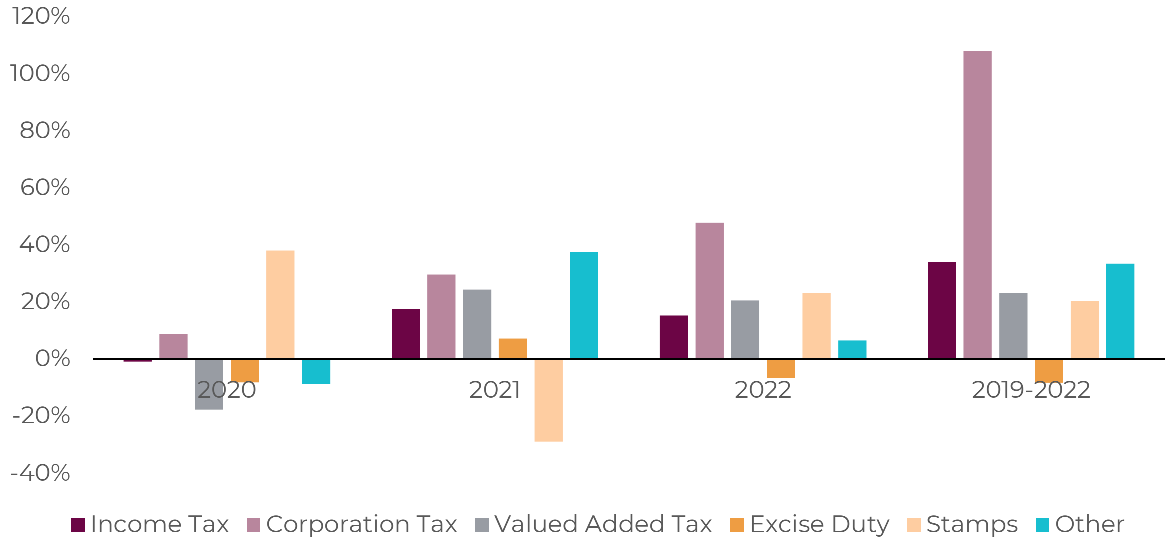
Source: Office of The Revenue Commissioners, Annual reports 2019 to 2022.

The long-term sustainability of the State's tax revenue is essential to fund public services. Relying on volatile tax heads to fund increased levels of core spending risks inflating public spending and restricting the ability of the State to react to economic downturns other than by reducing the scope or quality of public services. The PBO previously highlighted the

[13] Bedogni J, and Fitzgerald K, *Revenue volatility and the role of the Rainy-Day Fund: Potential mechanisms for identifying and setting aside excess receipts* (Parliamentary Budget Office Working Paper Series, April 2020) p.7.
[14] Department of Finance, *Stability Programme Update April 2023*.
[15] Department of Finance, *Fiscal Monitor* (September 2023).

strong links between different tax categories,[16] with the most volatile tax categories experiencing the highest growth rates. As a result, there should be greater consideration of revenue growth and volatility in the design of tax policies.

Figure 2: Percentage Changes in Tax Revenues 2019-2022 (Annual)



Source: PBO based on Department of Finance, 'Databank' (Accessed 18 September 2023).

From 2019 to 2022, Corporation Tax was the main driver of revenue growth, increasing from €10.89 billion in 2019 to €22.64 billion (27% total tax revenues). It overtook Value Added Tax (VAT) in 2022 as the second largest revenue source, further increasing the State's reliance on Corporation Tax. Income taxes, the largest source of revenue for the Irish Exchequer, have been a more stable source of revenue while revenue collected from Stamp Duty and Excise Duties have fluctuated over time. Capital Gains Tax (CGT) also doubled from 1% of total tax revenues in 2013 to 2.1% in 2022.[17]

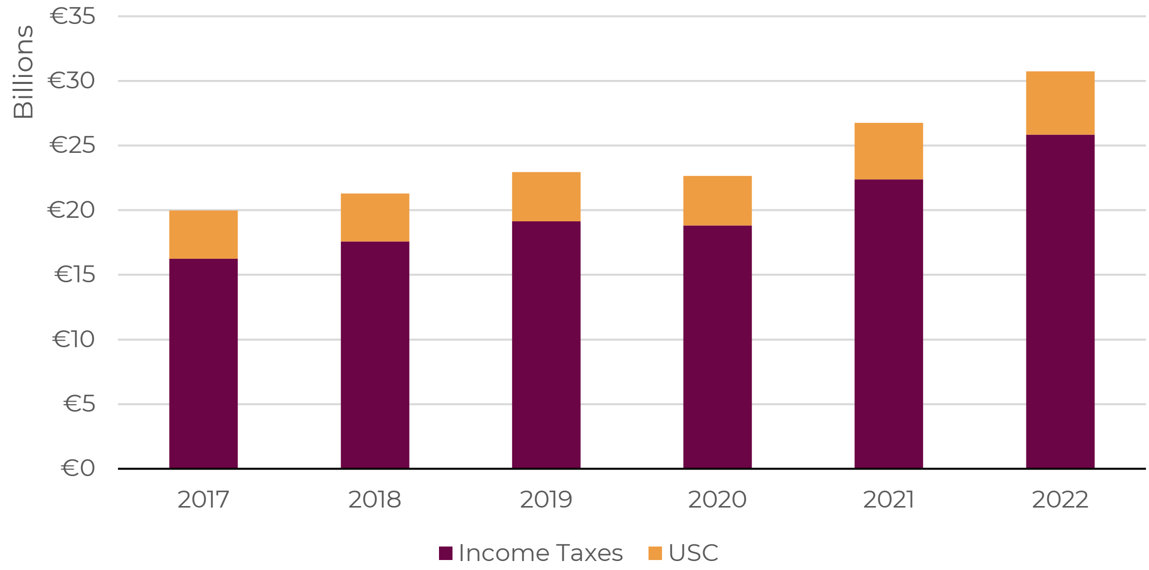
Income Taxes

The SPU 2023 notes the Irish Exchequer collected €30.7 billion in net receipts in 2022 from income taxes (including the Universal Social Charge (USC)).[18] This represents a year-on-year increase of approximately €4.1 billion or 15.2% compared to the €26.7 billion collected in 2021.[19] The USC contributes a significant share of income taxes. In 2022, a total of €30.73 billion was collected in income taxes of which €4.89 billion came from the USC – equivalent to 15.9% of tax revenues collected in that year.

[16] Parliamentary Budget Office, An Application of Portfolio Theory to Tax Revenue Volatility (2019).
[17] Capital Gains Tax (CGT) increased from €369 million in 2013 to €1,747 million in 2022.
[18] Department of Finance, Stability Programme Update (April 2023).
[19] Department of Finance, Stability Programme Update (April 2022).

On a cumulative basis for the first eight months of 2023, the Irish Exchequer has collected €20.74 billion in tax receipts from income taxes (including USC), up approximately €1.6 billion on the €19.16 billion collected in the first eight months of 2023.

Figure 3: Composition of Income Taxes and the Universal Social Charge ('USC') 2017-2022



Source: Office of The Revenue Commissioners, Annual reports 2017 to 2022.

Corporation Tax

At end-August, cumulative Corporation Tax receipts for the first eight months of 2023 were €12.66 billion, €0.68 billion higher than the same period last year.

Corporation Tax raised €22.64 billion for the Irish Exchequer in 2022. To put this figure in context, this was enough to fund the 2022 gross spending of:

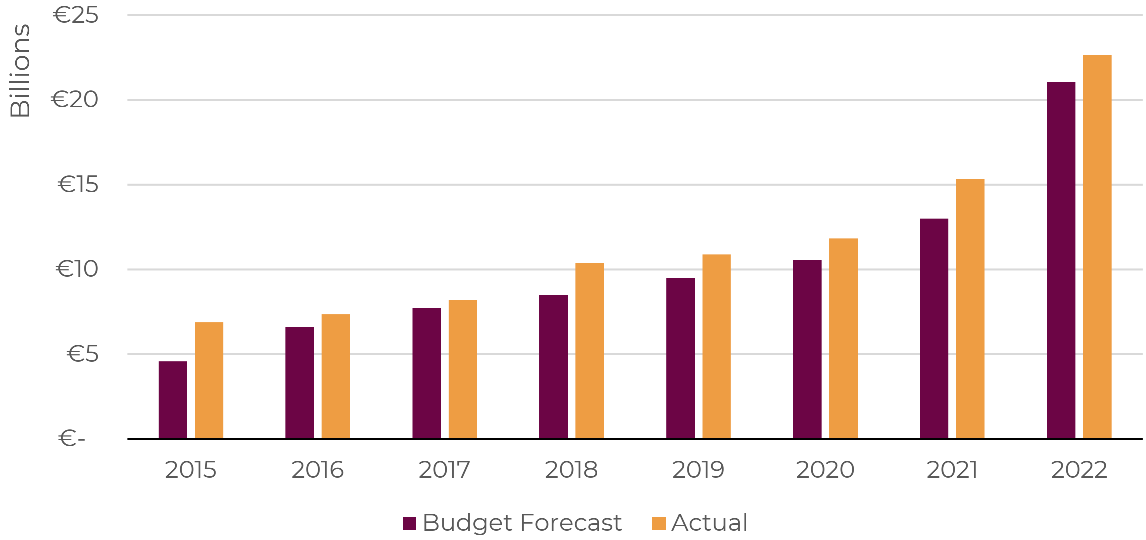
- Education Budget - (€9.77 billion),
- Housing, Local Government and Heritage - (€5.36 billion),
- Transport - (€3.36 billion),
- Further and Higher Education, Research Innovation and Science - (€3.25 billion), and
- Still have a balance of €0.51 billion left over.

In 2022, foreign owned multinationals accounted for 86.5% of Corporation Tax revenues, accounting for €19.58 billion. This means almost one quarter of total tax revenues collected in 2022 were from Corporation Tax paid by foreign owned multinationals. The Irish Exchequer has never been more reliant on these foreign owned companies for tax revenues.

The SPU 2023 forecasts revenues for the years ahead; it estimates total Corporation Tax for the period 2023-2026 will reach €102 billion.

Historically, corporation tax receipts have exceeded budget day forecasts each year from 2015 to 2022 inclusive. Figure 4 illustrates that from 2015 to 2022, corporation tax receipts exceeded the Budget forecast in the budget for that year. It also illustrates the forecast corporation tax receipts for the period 2023 to 2025 based on *Budget 2023: Economic & Fiscal Outlook*.

Figure 4: Performance of Corporation Tax Revenues Compared to Budget Day Forecasts



Source: PBO based on Department of Finance, *Economic and Fiscal Outlook* (various), and Department of Finance, 'Databank' (Accessed 23 August 2023).

Corporation Tax is expected to increase to 15% from January 2024, subject to upcoming legislation. This is taking place following an OECD agreement in 2019 to set a minimum corporation tax rate for firms with a turnover of €750 million or more *per annum*. This new rate will be implemented through the existing 12.5% rate and a 2.5% Qualified Domestic Minimum Top-Up Tax. Where firms have a turnover below this amount, they will only be subject to the 12.5% corporation tax rate.

The Government's Debt Warehousing Scheme (DWS) was introduced in 2021 during the Covid-19 pandemic to assist businesses experiencing cashflow or trading issues. It enabled firms to defer certain tax liabilities until they were in a financial position to address the debt but was extended in 2022 and 2023. The Scheme now has a deadline of 1st May 2024 for businesses to repay their warehoused debts in full or to agree a phased payment of debts to the Revenue Commissioners, with interest of 3% throughout 2023.

The PBO previously highlighted the issue of concentration risk amongst corporation tax receipts, and the challenges this poses.[20] In 2022, over €13 billion in corporation tax was concentrated in 10 companies, meaning 16%

[20] Parliamentary Budget Office, Pre-Budget 2023 PBO Commentary (September 2022).

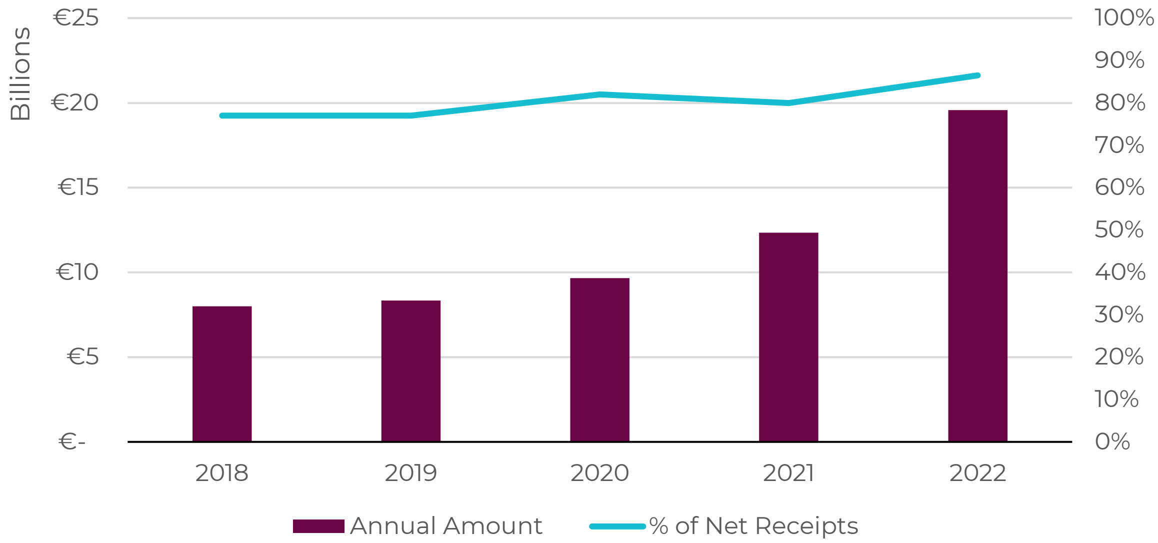
of the State's total tax revenue in 2022 came from just 10 companies. The Department of Finance estimated €4 to €6 billion of the Corporation Tax receipts collected in 2021 were potentially at risk of being once-off.[21] Reliance on funding from these potentially unsustainable tax revenues should not be used to fund current Government spending but instead saved for future use or infrastructural project investments.

Foreign Ownership Risk

The PBO notes that Corporation Tax receipts are dependent on foreign-owned multinationals who account for €19.6 billion, or 86.5% of total net corporate tax receipts in 2022. This means corporation tax from foreign firms represent one in four euros of total tax revenue collected in 2022.

Net receipts from the foreign owned multinational sector have increased significantly in recent years, effectively doubling since 2020 and tripling since 2017. The Irish Exchequer collected €19.6 billion in net Corporation Tax receipts from the foreign owned multinational sector in 2022, up from €12.34 billion in 2021 and €9.66 billion in 2020.

Figure 5: Corporation Tax from Foreign Owned Multinational 2017-2022



Source: The Revenue Commissioners, *Corporation Tax Payments and Returns* (various).

VAT

In 2022 the Irish Exchequer received €18.8 billion from Value Added Tax (VAT).[22] This is an increase of €3.4 billion (22%) on 2021.[23] Forecast VAT receipts for 2023 of €20.4 billion reflect an annual increase of just under

[21] Department of Finance, *De-Risking The Public Finances – Assessing Corporation Tax Receipts* (September 2022).
[22] Department of Finance, *Estimates of Receipts and Expenditure for year ending 31st December 2023* (September 2022) p.3.
[23] Revenue Commissioners, *Annual Report 2022* (April 2023).

10%.[24] By end August 2023, VAT receipts amounted to €13.5 billion, an increase of over €1.3 billion compared to the same period in 2022.[25]

Economy-wide inflation has increased the price of goods and services which are associated with VAT receipts. As the price of purchasing goods and services increases, the percentage recouped through VAT will increase accordingly, thereby providing higher VAT receipts to the Exchequer.

At present, certain sectors are availing of time limited rates of reduced VAT introduced in response to cost-of-living challenges. A 9% VAT rate applied to gas and electricity is due to expire 31st October 2023.[26] Since 2020, the reduced VAT rate for the hospitality and tourism sector has cost the Exchequer around €1.2 billion in lost revenue.[27]

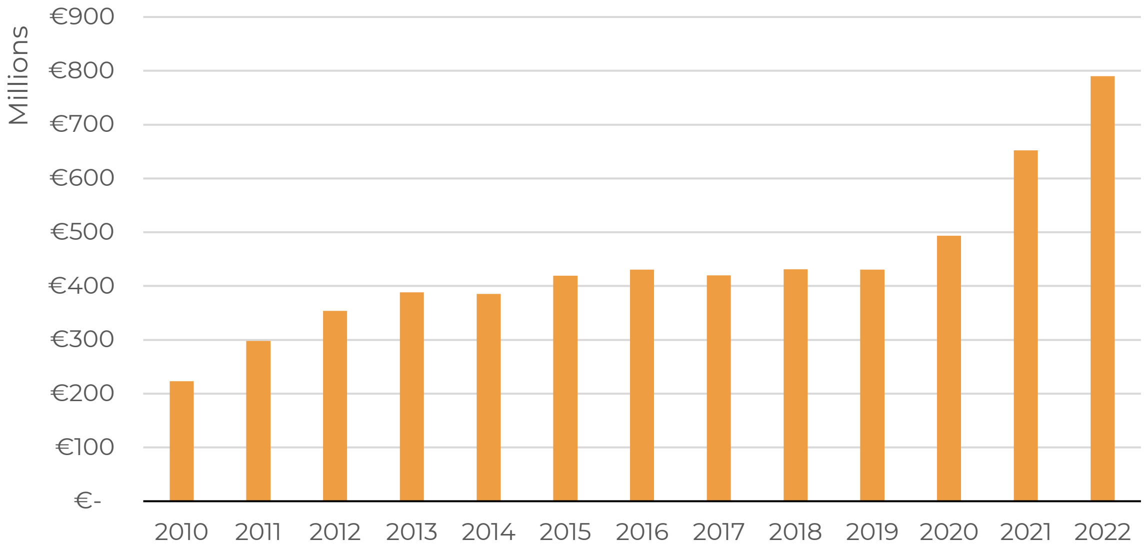
Carbon Tax

A carbon tax was introduced in Ireland in 2009 on a phased basis.[28] Initially the tax applied to motor fuels at a rate of €15 per tonne of CO_2 emitted. The Government has committed to increasing the Carbon Tax to €100 per tonne by 2030. This was legislated for in the *Finance Act 2020* and does not require annual changes in the Finance Bill to give effect to these measures. The Carbon Tax raised €223 million in tax revenue for the Irish Exchequer in 2010 and this has risen steadily in recent years to €789.75 million in 2022.[29]

The current rate of Carbon Tax is €48.50 per tonne of carbon dioxide emitted.

[24] Department of Finance, *Stability Programme Update* (April 2023) p.27.
[25] Department of Finance, *Fiscal Monitor* (September 2023) p.14.
[26] The 9% VAT rate for the hospitality and tourism expired 31st August 2023.
[27] Department of Finance, *Value Added Tax: Tax Strategy Group - 23/08* (July 2023) p.9.
[28] Parliamentary Budget Office (2021), *Publication 36 of 2021*.
[29] Revenue Commissioners, *Annual Report 2022*.

Figure 6: Carbon Tax Yield 2010-2022



Sources: Revenue Commissioners, *Excise receipts by commodity* (2023).

In 2022, Carbon Tax revenues amounted to ~€790 million, primarily sourced from auto diesel (48%), marked oil gas (13%), and natural gas (12%).[30]

Excise Duties

Excise duties were the fourth largest source of tax revenue for the Irish Exchequer in 2022, contributing €5.83 billion.[31] This was around the same level of tax receipts raised as in 2021.[32] The SPU 2023 projected receipts of around €5.8 billion for 2023,[33] By year to end-August 2023, Excise Duty raised €3.58 billion in tax receipts, slightly higher than the level raised for the same period the previous year, at €3.57 billion. In 2022, the Government announced a temporary reduction in Excise Duty on the price per litre of fossil fuels to assist the public by stabilising prices following rapid price increases.[34] This measure reduced the potential tax intake, with the accrued cost of this measure estimated at €383 million.[35]

Capital Taxes and Duties

Capital Gains Tax (CGT) has traditionally been a relatively volatile source of revenue compared to other tax sources and is sensitive to changes in the wider economic and fiscal cycle.[36] It raised €1.75 billion in 2022, up from

[30] Department of Finance, *Tax Strategy Group - Climate Action and Tax July 2023*.
[31] Department of Finance, *Estimates of Receipts and Expenditure for year ending 31st December 2023* (September 2022) p.3.
[32] Parliamentary Budget Office, *Pre-Budget 2023 PBO Commentary* (September 2022) p.12.
[33] Department of Finance, *Stability Programme Update* (April 2023) p.33.
[34] Department of Finance, *Climate Action and Tax: Tax Strategy Group - 23/07* (July 2023) p.7.
[35] Houses of the Oireachtas, Dáil Debate, Financial Resolution No.3: Value Added Tax (February 2023).
[36] Parliamentary Budget Office, *Pre-Budget 2023 PBO Commentary* (September 2022) p.12.

€1.64 billion in 2021,[37] with the SPU 2023 forecasting tax receipts of around €1.81 billion for 2023.[38] In the year to end-August 2023, CGT receipts stood at €410 million, down from €577 million for the same period in 2022.[39]

Capital Acquisitions Tax (CAT) raised €605 million in 2022, up approximately 4% on the €581 million received by the Exchequer in 2021.[40] SPU 2023 forecasts total receipts of €615 million from CAT in 2023.[41] In the year to end-August 2023, CAT receipts stood at €181 million, down €5 million compared to the same period in 2022.[42]

Stamp Duty raised €1.82 billion for the Irish Exchequer in 2022, an additional 23% from the €1.48 billion raised in 2021.[43] The projected take In the SPU was revised downwards by 21.5% to €1.6 billion.[44] In line with this, the year to end-August 2023 Stamp Duty tax receipts were down €336 million compared with the corresponding period in 2022.[45] However, it is noted the 'comparison is skewed by a number of once off payments, once off repayments, and policy measures such as changes to institutions subject to the bank levy'.[46]

Net tax receipts from customs duties amounted to €636 million in 2022, up from €526 million in 2021.[47] 2023 Customs Duties receipts are forecast at €560 million.[48] In the year to end-August 2023, Customs Duty receipts stood at €360 million, down €36 million from the same period in 2022.

Vacant Homes Tax

The first chargeable period for Vacant Homes Tax (VHT) is 1 November 2022 to 31 October 2023. The VHT is set to be charged at three times the base Local Property Tax (LPT) rate.[49] It applies to properties in use for less than 30 days in the 12-month chargeable period unless one of a range of exemptions apply. The potential revenue raised by this tax is likely to be relatively insignificant and the tax may cost more to administer than it will raise in revenue. However, the tax is also intended to have a behavioural impact as one of its core objectives. The tax may bring properties into use or to disposal, increasing the supply of properties to the housing market.

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[37] Department of Finance, 'Databank'.
[38] Department of Finance, *Stability Programme Update* (April 2023) p.33.
[39] Department of Finance, *Fiscal Monitor* (September 2023) p.15.
[40] Department of Finance, 'Databank'.
[41] Department of Finance, *Stability Programme Update* (April 2023) p.33.
[42] Department of Finance, *Fiscal Monitor* (September 2023) p.15.
[43] Department of Finance, 'Databank'.
[44] Department of Finance, *Stability Programme Update* (April 2023) p.33.
[45] Department of Finance, *Fiscal Monitor* (September 2023) p.15.
[46] Department of Finance, *Fiscal Monitor* (June 2023) p.4.
[47] Department of Finance, 'Databank'.
[48] Department of Finance, *Stability Programme Update* (April 2023) p.33.
[49] Revenue Commissioners, 'Vacant Homes Tax (VHT)' (Accessed 12 September 2023).

Further where an exemption does not apply, many vacant properties may need significant refurbishment or be located in areas of low housing demand. It remains to be seen if this tax measure will have an impact on increasing the supply of housing units to the market.

Tax Expenditures

Tax Expenditures are defined by the OECD and Department of Finance as the transfer of public resources through the reduction in "tax obligations with respect to a benchmark tax rather than by direct expenditure" or the "provision of tax legislation that reduces or postpones revenue for a comparatively narrow population of taxpayers relative to the tax base".[50] They are policy instruments used to promote specific social or economic policies and are closely related to direct spending programmes. Some examples include reliefs, credits or allowances on pension contributions, research and development, medical insurance and employers' contribution to approved superannuation schemes. In 2022, there were an estimated 188 tax expenditures in place.[51] Budget 2023 documents outlined that in 2022 the cost of revenue forgone by the Exchequer amounted to €7.7 billion, down from €8.2 billion for 2021.[52]

Possible Budget Changes

Budget 2024 may include a range of changes to the present tax measures. These span across a range of areas and sectors, with some possible budget measures listed below.

Table 2: Possible Tax Measure considerations for Budget 2024

Category	Details
Income tax Income Tax Thresholds	**Indexing income tax** thresholds to account for inflation. Income tax bands determine the point an individual or couple pays the higher rate of income tax. Bracket creep in times of inflation and rising nominal incomes could have drawn more taxpayers into the higher tax bracket. Indexing income tax thresholds corrects for this. These changes to income tax would follow on from similar changes in Budget 2023.
USC Reductions	Possible **cuts to Universal Social Charge (USC)** which was introduced in 2011, may see USC levy reduced from 4.5% to 4% on incomes over €22,920 is expected to cost €220 million. The 2% rate on incomes is likely to remain unchanged.
VAT Rate	**The VAT rate for the hospitality and tourism sector, and electricity and energy** from 9% to 13.5% expired end-August 2023 and may be reinstated. A stronger case exists for extending the reduced VAT rate for **electricity and energy** due to expire end October 2023.
Corporation Tax	**Increasing Corporation Tax to 15%**, following the OECD 2019 agreement, is likely to take place from the 1st January 2023 for firms with turnover greater than €750 million, subject to legislation forthcoming. Firms below this turnover will retain the 12.5% rate.

[50] Department of Finance, *Report on Tax Expenditures 2022* (September 2022) p.9.
[51] Department of Finance, *Report on Tax Expenditures 2022* (September 2022) p.6.
[52] Ibid. p.9.

Vacant Home Tax	Potential **Vacant Home Tax Increases** may be considered as part of Budget 2024, to change behaviour on housing which is not currently in use and may increase the available supply of housing.
Carbon Tax	**Carbon Tax increases**, legislated for under the Finance Act 2020, of €7.50 per tonne of carbon (CO_2) emitted will be included in Budget 2024. These see the price of carbon increasing to €56 per tonne, with the intention to increase the cost annually by €7.50 per tonne of CO_2 by 2030.
Renter's Credit	A **renter's credit** of €500 per annum was introduced in Budget 2023 and could also be claimed retrospectively for 2022. It is possible this may be modified following a low take up of by renters, which resulted in the measure not costing as much as initially envisioned. It is possible there may be increases or changes to the eligibility criteria to claim the credit, that could ensure it is easier for tenants to apply and landlords to meet the necessary registration conditions.

Public Spending

Fiscal Position

Decisions about changes to the public services provided by the State are announced on Budget day, and subsequently provided for through the Estimates process.[53] At Budget time, Ministers announce spending allocations both for new measures and for existing services.

A detailed snapshot of Vote Groups is set out separately in PBO, *Pre-Budget 2024: Spending Issues* (2023).

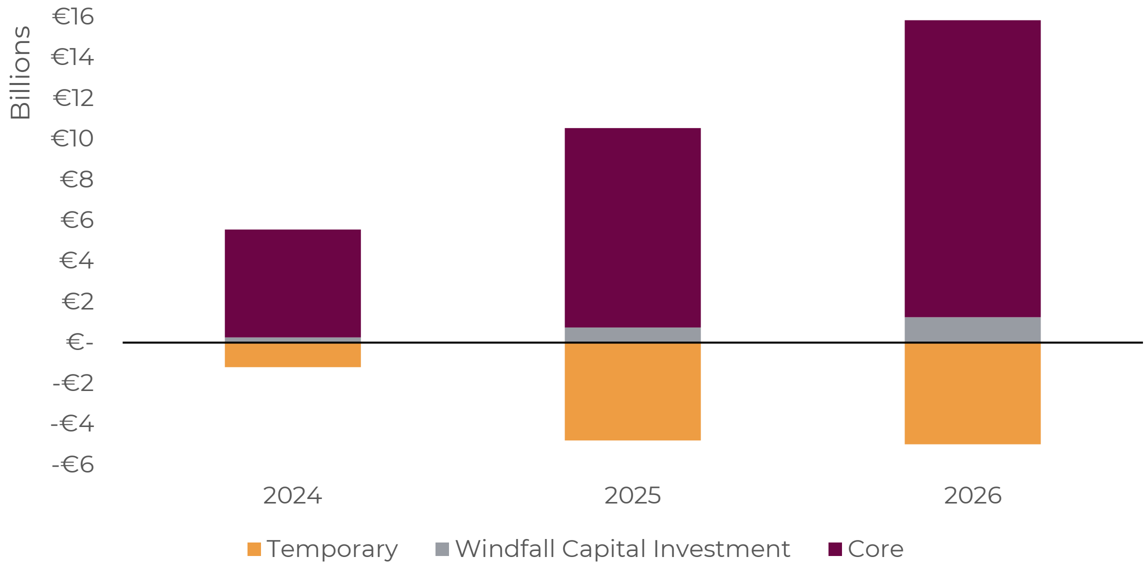
Budgetary Context

The *Summer Economic Statement* (July 2023) outlined the broad direction of Budget 2024. This includes:

- An expenditure package of €5.2 billion. This is €1 billion more than previously planned.[54]
- Windfall corporation tax receipts to provide for additional capital spending of €2.25 billion for the period 2024-2026.[55]
- €4 billion of non-core spending is also being provided for "humanitarian supports for refugees arriving from Ukraine and more limited Covid-19 provision in respect of potential continued requirements."[56]
- Figure 7 shows that non-core spending is set to decrease in 2024 by ~€1.2 billion compared to 2023 levels. Non-core spending on the Ukraine humanitarian contingency is set to increase by ~€0.5 billion.[57]
- While the levels of non-core spending have been declining, it is not entirely clear this has been the result of spending reductions on these measures or if this spend has simply been recategorized and absorbed within core spending in some areas.[58]

[53] PBO, *The Role of the Oireachtas in the Provision of Public Services* (2020).
[54] PBO based on Department of Finance and the Department of Public Expenditure, NDP Delivery and Reform, *Summer Economic Statement* (July 2023) p.x.
[55] Ibid.
[56] Ibid.
[57] PBO based on Department of Finance and the Department of Public Expenditure, NDP Delivery and Reform, *Summer Economic Statement* (July 2023) p.24.
[58] See for example, Parliamentary Budget Office, Health Spending in Ireland 2015 – 2023 (August 2023) p.3.

Figure 7: Budgetary Strategy (Spending): Change from 2023



Source: PBO based on Department of Finance and the Department of Public Expenditure, NDP Delivery and Reform, *Summer Economic Statement* (July 2023) p.xi.

Spending Pressures in 2024

Spending increases are primarily for core spending (permanent or recurring spending), with an additional €5.3 billion for 2024.

- Supplementary Estimates in 2023 may be indicative of spending levels for 2024. Of particular note is the potential for a significant supplementary estimate for Health. If this arises, it suggests that a significant portion of the additional €5.2 billion may be required to maintain the Health budget.
- As discussed in 2023 Spending (p.24), many Votes were unable to spend their allocations in 2022 and 2023. The Comptroller and Auditor General's Appropriation Accounts for 2022 will, when published, indicate the extent of funds which were unspent and ultimately returned to the Exchequer for 2022. Thus, while headline allocations may continue to grow in 2024, Votes may not necessarily have the ability to spend these allocations.
- The current public sector pay agreement is set to expire at end 2023. In 2023, €24 billion (26.7%) of gross spending is on public sector pay. The implementation of a successor public sector pay agreement, even of modest increases, would have a significant impact on the overall public sector pay bill; however, some commentators have pointed to a likelihood of larger increases in public sector pay.[59]

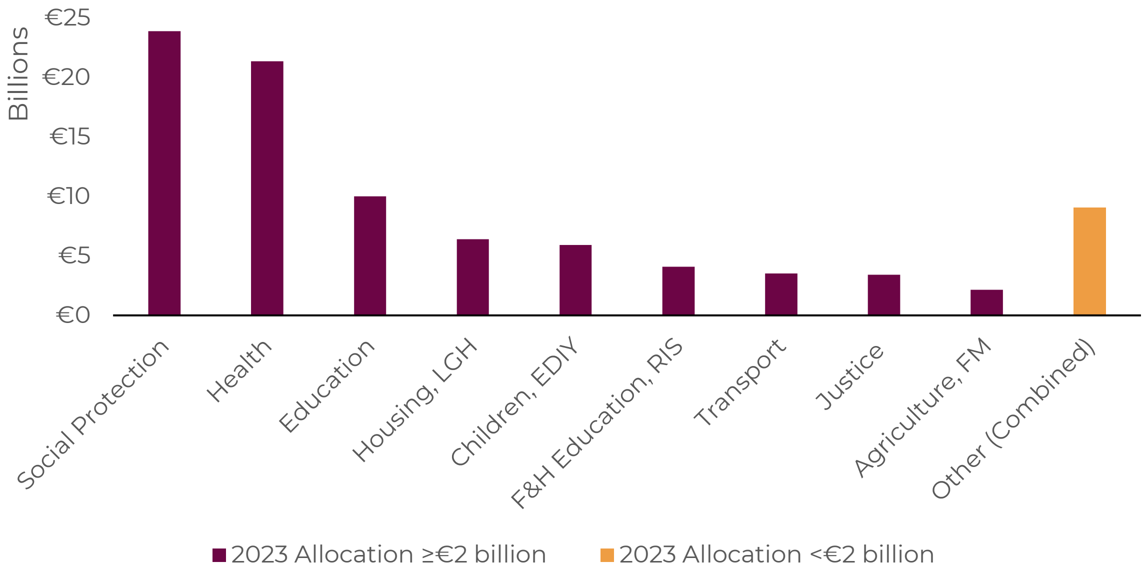
[59] John Fitzgerald, 'Workers will have to be paid more to sustain public services' *The Irish Times* (Dublin, 25 August 2023).

2023 Spending

The *Revised Estimates for Public Services 2023* (December 2022) provided for €91.1 billion gross spending in 2023, of which some €5.2 billion was set aside for temporary non-core funding.[60] This non-core funding was set aside to provide for the Government's response to temporary external challenges, such as the provision of Covid-19 related supports, humanitarian supports for Ukrainian refugees, and the Brexit Adjustment Reserve (BAR).[61] The balance, almost €89.8. billion was allocated to programmes across 18 Vote groups, which consist of a total of 45 Votes.[62]

Figure 8 illustrates the 9 Vote Groups with gross allocations exceeding €2 billion for 2023. It also shows the combined value of all other Groups whose individual allocations were less than €2 billion as 'Other (Combined)'. Gross spending allocations are highly concentrated in a small number of Vote Groups. The gross allocation to Social Protection, Health, and Education represents 61.5% of the gross allocation for 2023.

Figure 8: Vote Group Allocations in 2023



Source: PBO based on Department of Public Expenditure, NDP Delivery and Reform, 'Databank' (Accessed 15 September 2023).

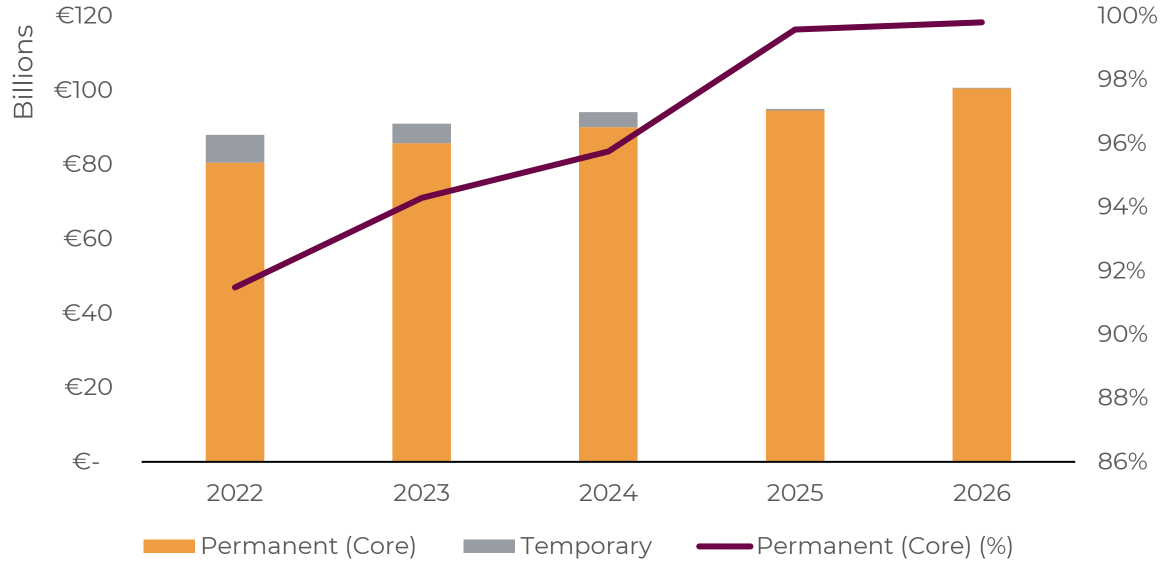
Figure 9 illustrates the Expenditure Ceiling for the period 2023 to 2026. Most significantly, spending is anticipated to grow within this timeframe from €91 billion to €100 billion (an increase of 10.7%); however, this growth is concentrated within core (permanent or recurring) spending (+€14.7

[60] Non-core expenditure provides flexibility to react to new challenges and allows for temporary supports to be removed if they are no longer required.
[61] Department of Public Expenditure, NDP Delivery and Reform, *Mid-Year Expenditure Report 2023 (2023).*
[62] This spending also includes spending of two funds, the Social Insurance Fund (SIF) and the National Training Fund (NTF).

billion / 17.1%), with temporary (non-core) spending declining significantly (-€5 billion / 96.2%).[63]

Non-core spending has, in recent years, been primary associated with Brexit and Covid. However, as Covid supports have wound down, "*new challenges emerged requiring a significant government response. Increased prices and the war in Ukraine have seen additional areas where government has provided substantial supports throughout 2022 and 2023*".[64]

Figure 9: Composition of Expenditure Ceiling 2023 to 2026



Source: PBO based on Department of Finance; Department of Public Expenditure, NDP Delivery and Reform, *Summer Economic Statement 2023* (July 2023).

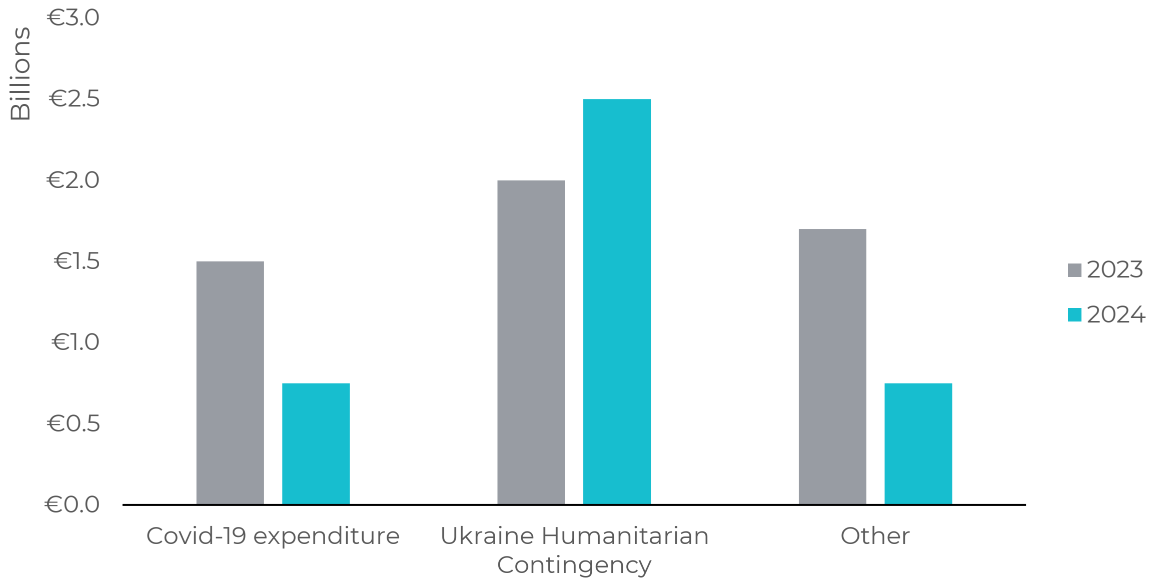
The temporary spending reflects the non-core supports (up to €5.2 billion) that have been put in place in the first half of 2023. Allocations of this funding have been made to a number of Departments totalling €4.1 billion with the remainder (€1.1 billion) of non-core funding held in reserve. Figure 10 outlines the breakdown of the temporary spending such as Covid-19 expenditure, Ukraine Humanitarian Contingency and other.[65] In 2023, almost 40% of funding allocated relates to the Ukraine Fund, followed by Covid-19 allocations at just over 30%.

Figure 10 illustrates the non-core spending allocation in 2023 and 2024 with a provision of €4 billion being made available as part of the expenditure strategy for 2024. This €4 billion provision in 2024 includes

[63] Department of Finance; Department of Public Expenditure, NDP Delivery and Reform, *Summer Economic Statement 2023* (2023).
[64] Department of Public Expenditure, NDP Delivery and Reform, *Mid-Year Expenditure Report 2023* (2023) p.16.
[65] Includes Temporary Business Energy Support Scheme (TBESS), Brexit Adjustment Reserve and The National Recovery and Resilience Plan.

€2.5 billion for the Ukraine humanitarian supports (+€500 million/25% over 2023) and €0.75 billion for Covid-related spending (-€750 million/50% over 2023).[66]

Figure 10: Breakdown of non-core spending allocation for years 2023 & 2024



Source: PBO based on Department of Finance; Department of Public Expenditure, NDP Delivery and Reform, *Summer Economic Statement 2023* (July 2023).

The *Mid-Year Expenditure Report 2023* outlines the breakdown of the cost-of-living measures for 2023, with €3.1 billion in cost-of-living measures as part of the Budget 2023 in addition to the €1.3 billion in the Spring/Summer cost-of-living package, bringing the total to €4.4 billion. The €4.4 billion of cost-of-living measures are categorised as:[67]

- Taxation (38%),
- Income Supports (25%),
- Energy (24%),
- Family/Child (4%),
- Health (2%), and
- Other (7%).

[66] Department of Finance; Department of Public Expenditure, NDP Delivery and Reform, *Summer Economic Statement 2023* (2023) p.24.
[67] Department of Public Expenditure, NDP Delivery and Reform, *Mid-Year Expenditure Report 2023* (2023) p.19.

Variance in Gross Spending (end-August 2023)

Variance is the difference between what spending was projected to be at a point in time and the actual spend at that time. **Monitoring variance is important as it can help identify Vote Groups in which Supplementary Estimates may arise, either to reallocate available monies (savings) or to seek additional funding where it has insufficient resources for the current year.**[68] Variance is important to analyse under two primary measures.

I. Total variance looks at how accurate forecast levels of spending are. It measures the degree of variance by Vote Group and totals these measures – it does not set savings against overspending. This measure reflects how accurately levels of spending have been forecast and can indicate the general quality of profiling. This measure can indicate that Supplementary Estimates will be required to redistribute resources or to allocate additional resources.

II. Total Gross Cumulative Voted Spending measures the variance by Vote Groups and offsets overspending against under profile spending. This results in a netting-off effect which shows, on aggregate, how close projected levels of spending are to profile across all Vote Groups. This obscures the individual performance of Vote Groups. Low cumulative variance suggests that the overall level of resourcing is adequate – but cannot indicate if those resources have been allocated appropriately across Vote Groups.

As of end-August, total gross cumulative spending reached €56,388 million, €541 million (1%) more than profiled. A small number of Vote Groups have, as of end August, spent more than had been profiled (€1,650 million); however, this 'overspend' was offset by below profile spending in other Vote Groups (-€1,111 million). Overall (total) capital variance at end-August 2023 was -€586 million (see Figure 13, p.30). Capital variance tends to decline at year-end, meaning the off-setting effect of 'underspends' in capital are generally exaggerated at earlier stages of the year.

Figure 11 illustrates total variance of gross spending at end-August 2023 compared to end-August 2022 for all Vote groups where variance was greater than €50 million at end-August 2023.[69] All Vote groups, in which

[68] Over or under profile spending must be treated with caution. Spending over profile can reflect that additional public services were delivered or that the cost of services was higher than anticipated. Likewise, under profile spending is not necessarily a saving (public services costing less than forecast) but could also reflect under-delivery.
[69] Variance at end-August 2023 that is greater than €50 million in both under profile spending and over profile spending.

gross variance was less than €50 million, are illustrated separately in Figure 12.

Figure 11: Variance (in Gross spending) at end-August 2023 compared to end-August 2022

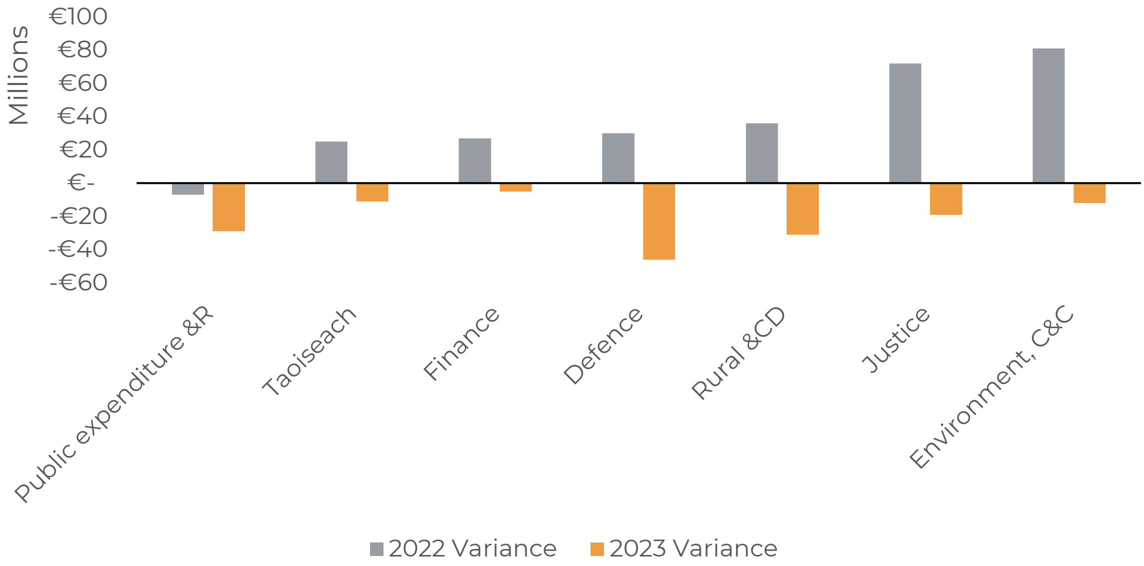
Source: PBO based on Department of Finance, Fiscal Monitor (August 2022 and August 2023).

Variance as set out in Figure 11 continues some trends identified and explained in the Mid-Year Expenditure Report 2023.[70] The Department of Children, Equality, Disability, Integration and Youth had the highest variance (overspend on profile) at end-August (€704 million/17.9%), which reflects the spending associated with the "*humanitarian responses for Ukrainian refugees and other International Protection Seekers*".[71]

Figure 12 illustrates that Vote Groups with variance less than €50 million as of August 2023. As can be seen in Figure 11, at end-August 2023 each of these Vote Groups spent less than profiled. At an aggregate level, the underspend of these Vote Groups totalled €153 million.

[70] Department of Public Expenditure, NDP Delivery and Reform, *Mid-Year Expenditure Report 2023* (2023) pp.6-13.
[71] Ibid. p.9.

Figure 12: Variance at end-August 2023 compared to end-August 2022 (in Vote Groups where variance was <€50 million)



Source: PBO based on Department of Finance, Fiscal Monitor (August 2022 and August 2023).

Capital Variance

Figure 13 illustrates within-year variance in capital spending. Consistently capital spending tends to display negative variance (actual spending being lower than profiled).

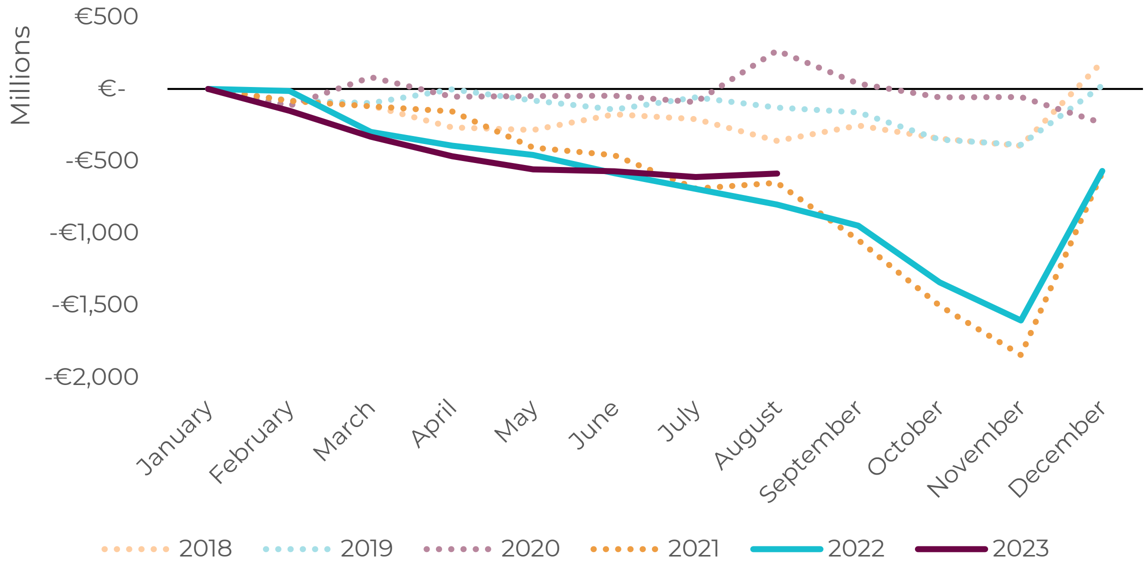
Figure 13 illustrates that variance in capital spending has been significant in recent years, this is at least partly attributable to the impact of crises on capital spending in-year and the knock-on effect of this into subsequent years arising from capital carryover (the application of deferred surrender). The distortive effect of capital carryover has been explained by the PBO previously.[72]

Understanding variance is important as it can be a useful predictor of whether:

- Sufficient cumulative resources have been allocated, and
- Those resources are allocated appropriately across Vote Groups.

[72] PBO, *Capital Carryover (Deferred Surrender) 2022* (2022).

Figure 13: Gross Capital Variance (2018 to 2023)



Source: PBO based on *Fiscal Monitors* (2018-2023 series).

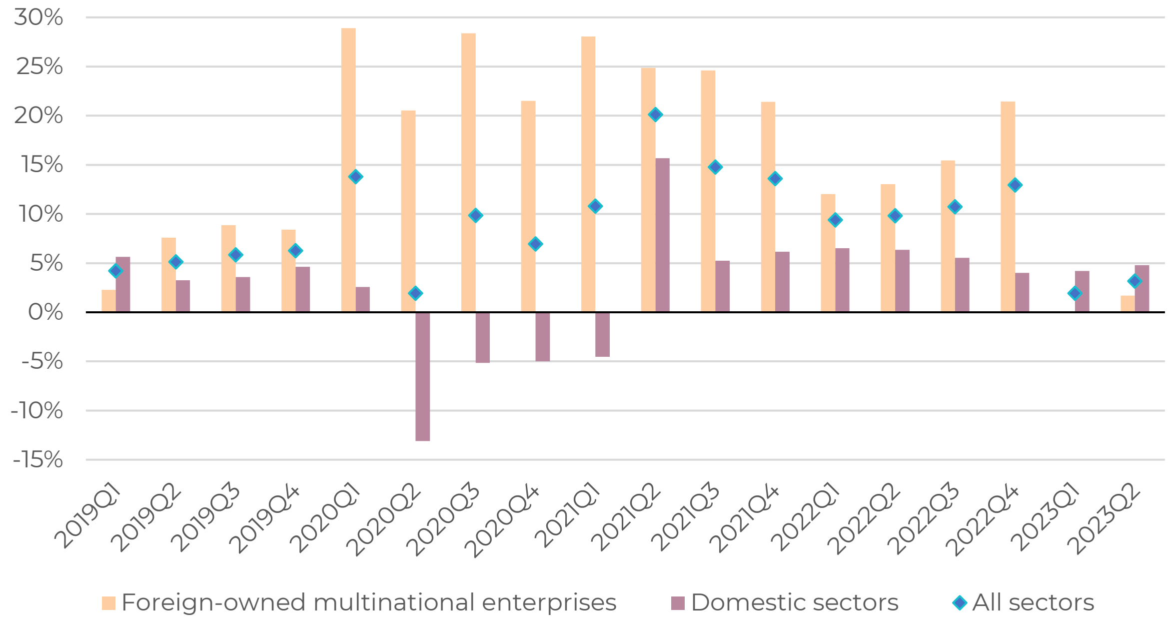
It is not yet clear if variance in capital spending will revert to pre-pandemic patterns or if high levels of negative variance will arise through Q4 of 2023, necessitating significant levels of capital carryover into 2024. Should this arise, it may be indicative of capacity constraints in relation to the delivery of capital projects i.e., the ability of various sectors to deliver capital projects may be constrained by factors such as labour, rather than by affordability.

Macroeconomic Assessment

National Income

Last year the Irish economy grew very strongly by 6.7% in GNI*[73] terms (9.4% GDP) but the pace of growth had begun to slow by the end of the year. Into 2023, multinational export-led output dropped back significantly in the first quarter having grown at double-digits since 2020. It will be important over the coming quarters to monitor whether this was a once-off occurrence or the start of a cyclical downturn. At the same time, domestic-oriented sectors maintained steady growth (Figure 14).

Figure 14: Annualised growth in Foreign and Domestic GVA



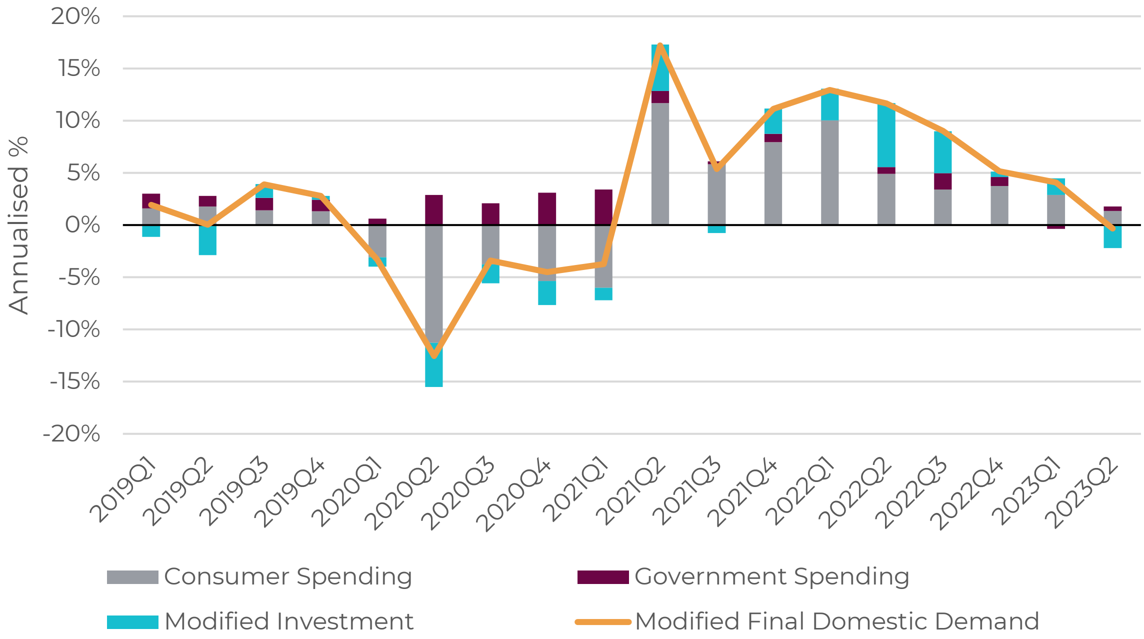
Source: PBO calculations based on CSO National Accounts, Q2 2023.

Budget 2024 will have particular influence on the elements of modified final domestic demand, which increased by 1.0% in Q2 over Q1 but fell by 0.3% from a year previous. The annual change in personal spending on goods and services just about held positive but there was contraction in domestically generated investment both of which are a key measures of domestic economic activity.[74] Large savings accumulated during and after the pandemic, rapidly rising employment, and government support to address the cost-of-living crisis continued to support household spending.

[73] The gap between GDP and GNI* is growing every year and has raised questions about which measure to use for economic growth. Modified Gross National Income (GNI*) excludes distorting effects (e.g. depreciation on intellectual property (IP) and aircraft leasing).
[74] CSO (2023) Quarterly National Accounts and International Accounts Q2 2023, released 1 September 2023.

Figure 15 below shows that consumer spending and investment in the domestic economy continued to shrink into 2023.[75] Government spending has moderated compared to what was required in Q1 2022 when some elements of pandemic-related government spending were still in place.

Figure 15: Contribution to Modified Final Domestic Demand (Annualised)



Source: CSO Quarterly National Accounts Q2 2023.

Since the last Budget, certain sectors focused on the domestic market experienced continued output growth with Finance & Insurance expanding most (8.1% in the half year to July 2023) with a strong (7.6%) performance also from Agriculture and, Distribution, Transport and Hotels and Restaurants compared with the equivalent six-month period of 2022. Of concern and related to capacity constraints, contractions were recorded in H1 2023 in Industry (1.2%), Arts & Entertainment (4.5%), and in Construction (0.2%).[76]

The Consumer Price Index (CPI) shows that prices for consumer goods and services in August 2023 increased by 6.3% on average when compared with August 2022. This was up from 5.8% in the 12 months to July 2023. Prices have been rising on an annual basis since April 2021, with annual inflation of 5% or more recorded in each month since October 2021.[77]

[75] CSO (2023) Quarterly National Accounts, Quarter 1 2023 Final.
[76] CSO (2023) Quarterly National Accounts Quarter 2, Press Statement.
[77] The most significant rises in the year were seen in Housing, Water, Electricity, Gas & Other Fuels which was up 17.3% and Recreation & Culture, which was up by 12.9%. Increased electricity (+25.1%) and gas (+36.6%) costs, along with higher mortgage interest

Inflation

Inflation in Ireland,[78] and most of the EU,[79] has been high since Q2 2022 and remains above the 2% ECB inflation target. More broadly, the cost of housing, rent and energy was the major contributor to the rise in the overall cost of living. Specific to the CPI measure of Irish inflation, there was a decline in the cost of energy and a 51.3% rise in mortgage interest in the 12 months to August 2023.[80]

Disposable incomes are holding up well.[81] Household income has been rising faster than consumption, and the household sector as a whole is better off, even as some households have been particularly affected by higher prices for basic goods and services and increases in tracker rate and (partial passthrough to) variable mortgage rates. As well as paying more for the same services, people consumed more goods and services (higher volumes), particularly in supermarkets, the hospitality sector and on cars. On the income side, wages and salaries out-paced inflation, so that in real terms, Gross Disposable Income was up.

Many households have reduced their pace of saving and latest data show that the seasonally adjusted rate of new saving normalised back to 12% in Q2 2023 from 28% in early 2021.[82] Inflation-adjusted total disposable income (TDI) rose 1.2% in Q2 of 2023. While 1.2% is a relatively small increase, incomes are out-pacing significant price rises and the growth in the quarter comes after several quarters of smaller rises all above pre-pandemic levels.[83]

Interest rates

After over a decade of very accommodative monetary policies, many with negative interest rates, inflation is driving central banks around the world to tighten monetary conditions (with exceptions such as Japan and China). A stable monetary environment is necessary for householders to feel secure in their consumption and saving decisions, while corporates can concentrate on their investment decisions and generate profits for their shareholders. Governments can decide to sustainably spend public money to fund services and support the economy without substantial cost

repayments (+51.3%) are reflected in the yearly growth of Housing, Water, Electricity, Gas & Other Fuels. The annual change in Recreation & Culture costs reflects a rise in prices in package holidays (+57.9%) and pets & related products & services (+13.0%) compared with August 2022. Education (-6.3%) and Transport (-2.0%) were the only divisions to show a decrease when compared with August 2022.

[78] CSO - Consumer Price Index July 2023.

[79] Eurostat - HICP.

[80] CSO (2023) Consumer Price Index, August 2023.

[81] CSO (2023) *Quarterly National Accounts, Quarter 1 2023* Final.

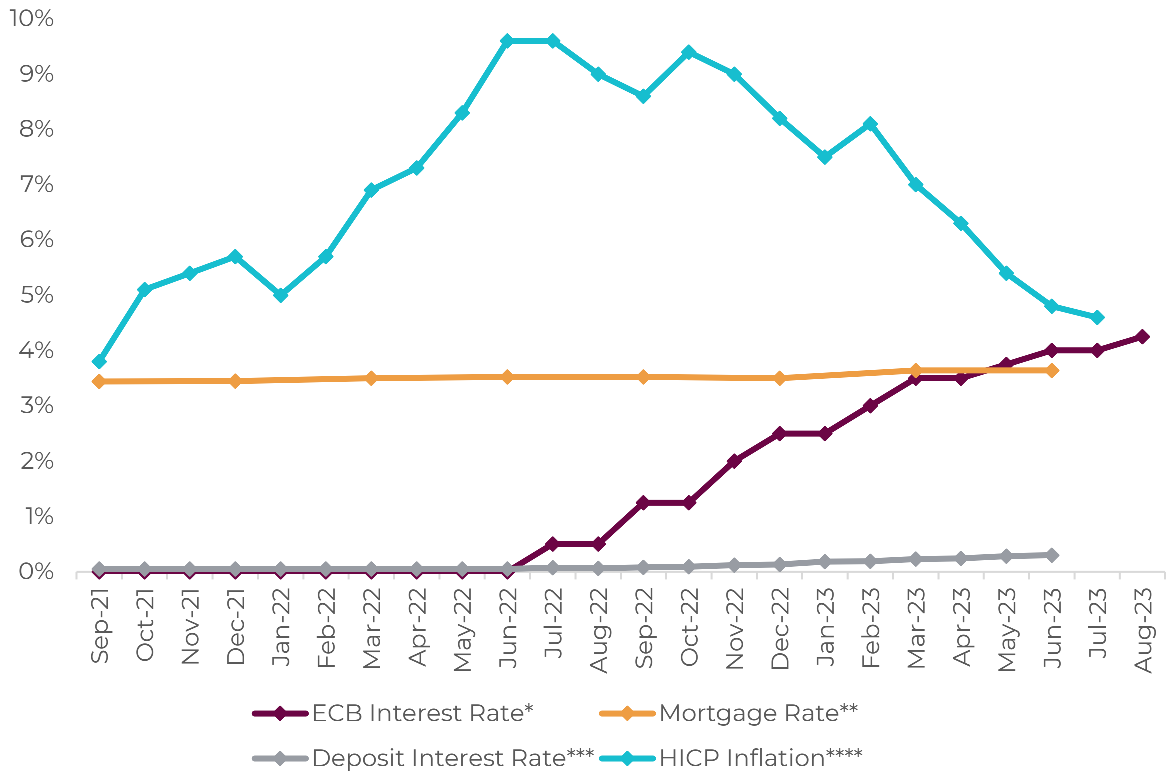
[82] CSO (2023) Household Saving Q2 2023 - CSO - Central Statistics Office.

[83] CSO (2023) Household Saving Q2 2023, 7 September release.

uncertainty. The ECB, which must balance the divergent needs of the economies of the entire euro area, is currently in the process of raising interest rates to combat economy-wide inflation. Higher interest rates will dampen demand and tighter financing conditions will curb investment.

As shown in Figure 16, both variable-rate mortgages and deposit interest rates for the Irish banks have been increased at a slower extent than the ECB rate increases.[84] At July 2023, the average standard variable mortgage rate was 4.18% and the weighted average interest rate on new household deposits with agreed maturity was just 1.89% in July.[85]

Figure 16: Comparison of interest rates with Irish inflation rate



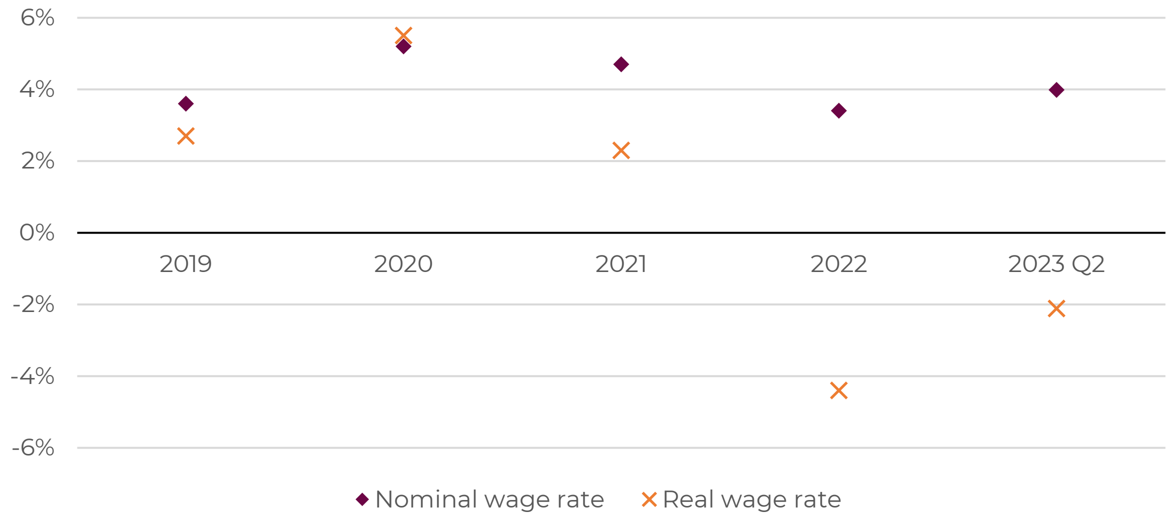
Source: * ECB Fixed Rate Tender - ECB.
** Ireland, Principal Dwelling Houses, Floating Rate, Standard or LTV variable, Outstanding Amounts - CBI.
*** Ireland, Households, Redeemable at notice, Rates – Central Bank of Ireland .
**** Irish HICP Inflation (Annual Rate of Change) - Eurostat.

Figure 17 shows nominal wage compared to real wage rate growth from 2019 to Q2 2023. Real wage rate growth refers to the increase in wages adjusted for inflation and gives an indication of changes in purchasing power. As the inflation rate climbed in 2021, the growth in real wages kept

[84] New deposits are benefitting most with rates on term deposits more reactive to official rates since February 2023. That said, deposits with an agreed maturity (on which deposit interest is paid) represent a very small share of total deposits.
[85] By contractual design, tracker mortgage interest rates change directly in response to the ECB policy rate. There have been no new tracker mortgages issued since 2008.

pace with the rate of inflation.[86] Through 2022, real wage growth turned negative especially around the time the rate of inflation reached a 30-year high mid-year. The divergence in real wages from nominal wages has adverse consequences for real disposable incomes meaning decreased purchasing power due to the higher cost of living. When inflation is high, there is an escalating risk of an economic downturn which in turn will affect perceptions around job security and future growth. Some commentators have suggested Ireland could be at risk of a wage price spiral due to second-round effects from inflation-adjusted wage increases in a very tight labour market. In 2022, the minimum wage increased by 2.95% and wages nationally increased by 3.4%. Average weekly earnings rose by 4.3% to €909.77 in the second quarter of 2023 up from €871.93 the same time last year. Average hourly earnings grew by 5.1% from April to June but average weekly paid hours were down slightly.

Figure 17: Inflation vs Growth in Real Wage Rate



Source: PBO based on CSO, 'EHQ03: Average Earnings, Hours Worked, Employment and Labour Costs' and 'CPM01: Consumer Price Index'.

Labour market

At end-August 2023, there are 2.6 million people employed in the Irish economy. The employment rate for persons aged 15-64 years in Q2 2023 was 74.2%, the highest recorded since the series began in 1998. The parallel unemployment rate for the entire labour force was down to 4.4% in Q2 2023.[87] The participation and employment rates for females were also at

[86] Those earning the minimum wage were slightly worse off, as their real wages fell 1.4% in 2021.

[87] According to the CSO, the number of persons aged 15-74 years who were unemployed increased by 1,300 (1.1%) to 121,200 in the year to Q2 2023, using standard International Labour Organisation (ILO) criteria. The unadjusted unemployment rate for persons aged 15-74 years decreased from 4.5% to 4.4% over the year to Q2 2023. Labour Force Survey, Quarter 2, August 2023

record high rates. An estimated fifth of those in employment worked part-time but only 1 in 4 of those in part-time employment were classified as 'underemployed' (i.e. they would like to work more hours for more pay) – an indication of significant disincentives to full-time employment for part-time workers.

The Industrial Development Authority (IDA) indicated that in the first half of the year it had attracted 135 fresh investments into Ireland, potentially adding a further 12,000 jobs, down on the 18,000 jobs in 2022's exceptionally buoyant figures, but a return to pre-pandemic levels.[88]

Trade

Net exports of goods and services fell by 14.4% in Q2 2023 or by €7 billion compared with the previous quarter showing a slowing in Ireland's main export markets. In the most recent international accounts, the current account of the Balance of Payments recorded a surplus of €15.8 billion in flows with the rest of the world in Q2 2023, an improvement of €2.0 billion compared with the surplus of €13.8 billion in Q2 2022. The merchandise balance dis-improved by €9.5 billion in Q2 2023 compared with the same quarter in 2022 while the services balance improved by €6.2 billion. Net outflows of multinational profits were €24.4 billion in the quarter, a fall of €5.2 billion on Q2 2022 levels. In the globalised sectors, there was a mixed picture for the first half of the year. Expansion continued in the Information & Communication sector, which was up by 8.4% in H1 2023 compared with H1 2022, while the Industry sector fell by 1.2% over the same period.

Growth outlook

The near-term economic outlook will remain muted with the Department of Finance forecasting that real GNI* growth will be only 1.6% in 2023, before rebounding somewhat to 2.1% next year and 2.5% in 2025.[89] The first half of 2023 has shown a global slowdown and trade fragmentation affecting exports. This has led to uncertainty around the contribution of net exports and foreign-owned multi-national enterprises to Irish GDP and future corporation tax receipts. As a leading indicator for domestic consumption, sales in volume terms has not yet slipped back despite consumer sentiment falling to its weakest level in four months.[90] Industrial output is also likely to be held down by weaker external demand. Output from services is likely to remain most resilient albeit with slowing momentum. Continuing declines in input cost inflation will be necessary to support the forecasted growth.

[88] IDA Ireland announces 2023 mid-year results | IDA Ireland
[89] Department of Finance (2023) Stability Programme Update, April 2023, p5.
[90] The Credit Union Consumer Sentiment Index in Ireland fell to 62.2 in August 2023 from 64.5 in July.

Table 3: Latest Government Projections

	2022	2023	2024	2025
Department of Finance SPU April 2023				
Real GNI* growth (%)	9.3	1.6	2.1	2.5
HICP	8.1	4.9	2.5	2.0
Budgetary Forecasts (Summer Economic Statement) July 2023				
€ billion				
Balance	8.0	10.0	11.7	16.3
One offs and windfall CT	3.5	6.6	11.3	9.9
Balance excl. one offs and windfall CT	5.5	3.4	0.4	5.2
*% GNI**				
Balance	3.0	3.5	3.9	5.2
One-offs & windfall CT	1.0	2.3	3.8	3.5
Balance excl. One offs and windfall CT	2.0	1.2	0.1	1.7
Net debt ratio (% GNI*)	68.7	64.7		

Source: CSO, Department of Finance forecasts and Irish Fiscal Advisory Council.

Turning to supply conditions, the labour market is expected to remain robust especially in the services sector. The tech sector – measured in CSO data as Information and Communications – has gone through a difficult period but overall employment rates are holding and participation has increased.[91] The rapid expansion in employment may plateau with the number of people at work having reached 2.6 million in Q2 2023.[92] However, there is some weakness appearing in employment in younger age groups, particularly those under 25.[93] Due to increased labour costs and rising interest rates tightening financial conditions, business sentiment indicators are currently more negative than they were 12 months ago.

Rather than any shortfall in demand, capacity constraints are now a major obstacle to growth. There is evidence of a mismatch between labour demand and supply with both the vacancy rates and indicators of labour demand rising in sectors such as public administration and health. Further, the lack of sufficient housing supply is a bottleneck as well as the energy infrastructure. Infrastructural investment may not be proceeding as necessary due to a shortage of construction workers. Without structural changes easing these key supply constraints, rent and wage pressures could intensify and become long-lasting.

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[91] Participation in the labour market has increased significantly since the pandemic, helped in part by remote working. The rapid rise in the cost of living could also be a factor (Irish Fiscal Advisory Council, Pre-Budget 2024 Statement).

[92] Employment - CSO - Central Statistics Office.

[93] The youth unemployment rate was revised up to 10.7% in July from a rate of 10.5% in June.

The latest ECB poll of consumers[94] revealed that expectations for price growth across the 20-nation eurozone is dropping but headline inflation remains above the 2% goal and the cost of living is still high at present.[95] Wage demands and profit margins continue to be the main drivers. Renewed pressure on transport and energy prices will bring wider measures of inflation into focus. Further, mortgage interest payments, not included in the EU's harmonised index of consumer prices, have been pushing up the CSO's consumer price index for Ireland.[96] Bottlenecks and pressures in housing and infrastructure due to the economy operating at full capacity could continue to generate domestic inflation at a greater pace than in Europe.

[94] ECB (2023) Consumer Expectations Survey, August 2023.
[95] CSO (2023) *Consumer Price Index*, July 2023.
[96] More than a percentage point now separates Ireland's consumer price index (CPI), which showed inflation at 5.8pc in July, from Eurostat's harmonised index of consumer prices (HICP) for Ireland, which came in at 4.9%.

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