Irish Fiscal Advisory Council

Long-term Sustainability Report

Fiscal challenges and risks 2025-2050

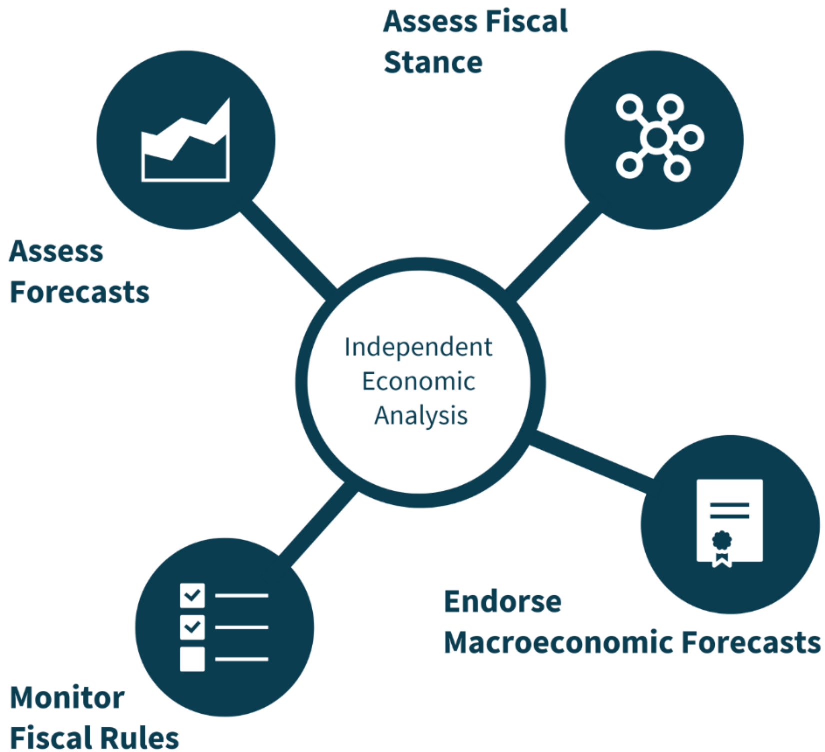
14 July 2020

Brief Background to the Long-term Sustainability Report

- The Fiscal Council is an official independent body with a mandate to assess the public finances

- This first *Long-Term Sustainability Report* (*LTSR*) looks at challenges and risks to the public finances 2025 to 2050

- This analysis feeds into the Council's assessment of the fiscal stance

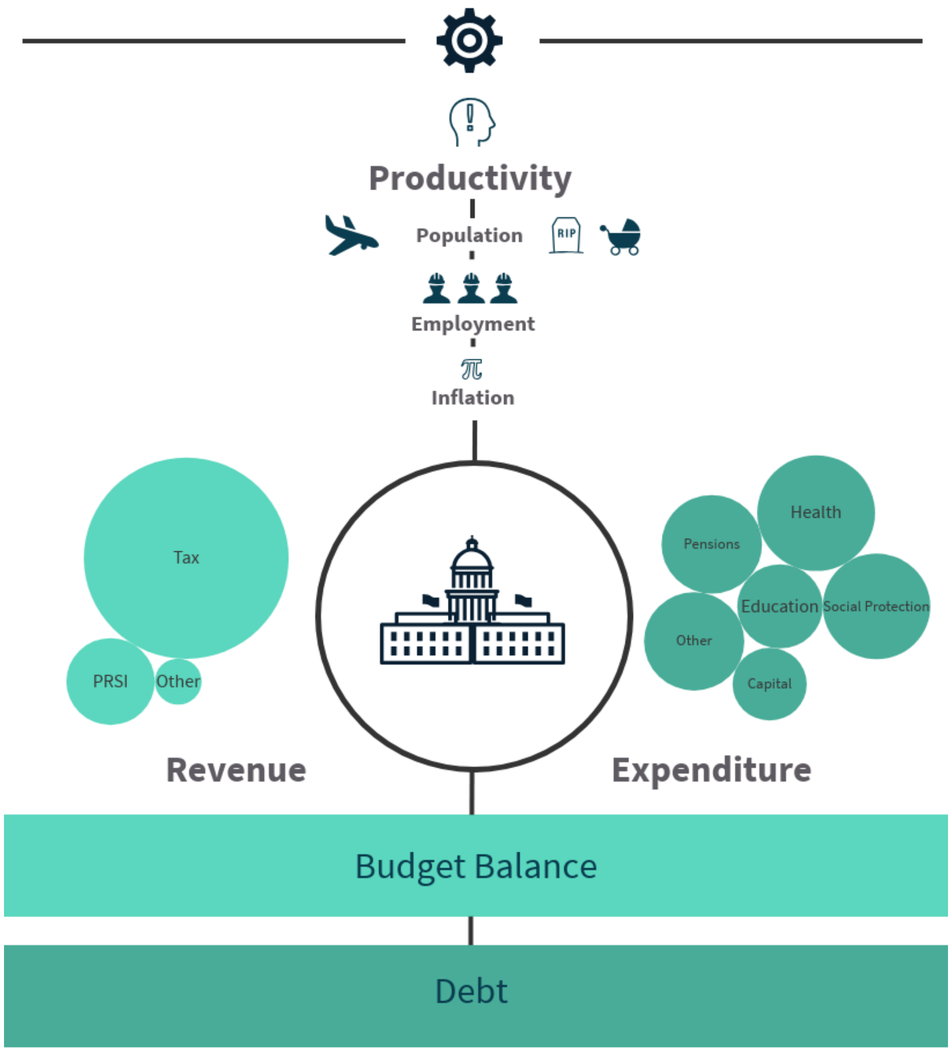


Key messages

The LTSR looks at the Budget situation beyond 2025

- Growth may slow, the number of older people will increase fast
- Under current policies, spending growth would outstrip revenue
  - Pension and health costs will rise
  - A large deficit would build up, particularly from 2040
  - Without policy action, debt would fall more slowly to around 90% GNI* and then begin to rise sharply to reach 110% GNI* by 2050
- For fiscal sustainability, tax and spending will need adjust over time
  - Allowing the pension age to follow rising life expectancy would help
  - Taking appropriate actions promptly would be less costly
- There is substantial uncertainty, particularly around COVID-19, interest rates, climate change, corporation tax and health costs

LTSR Framework



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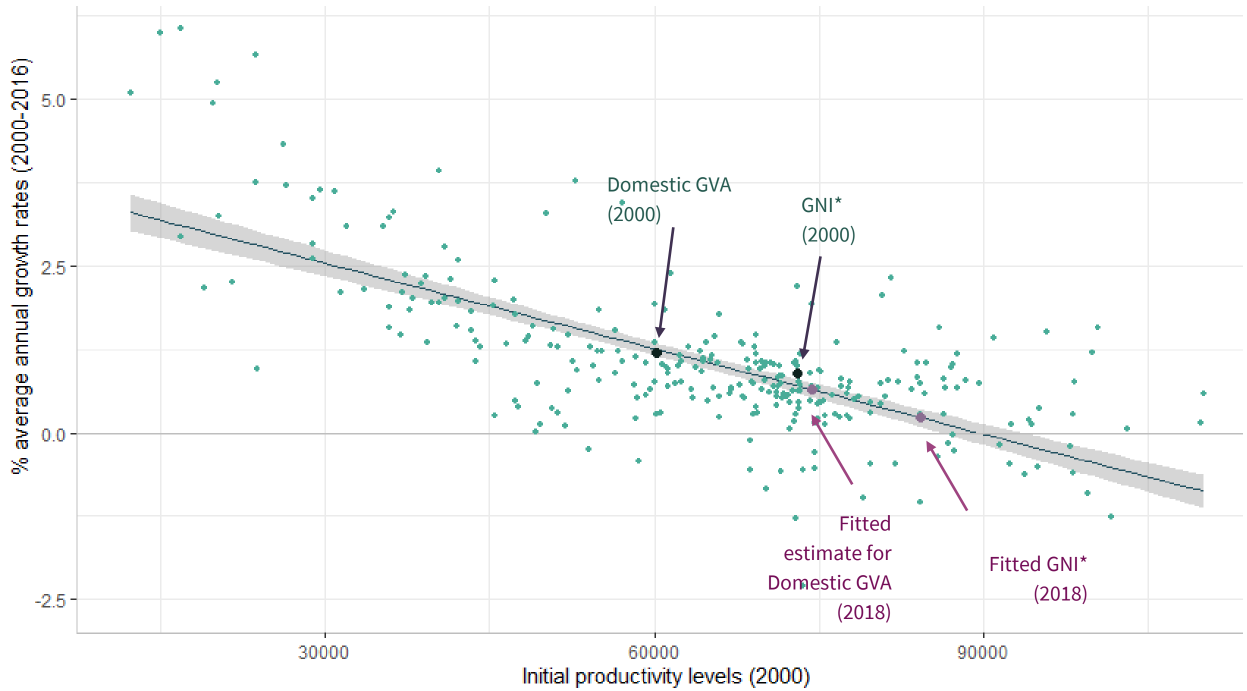
Productivity growth is projected to slow

Regions with higher productivity levels tend to grow more slowly

Regional labour productivity growth



Sources: OECD (Regional Database); and Fiscal Council workings.

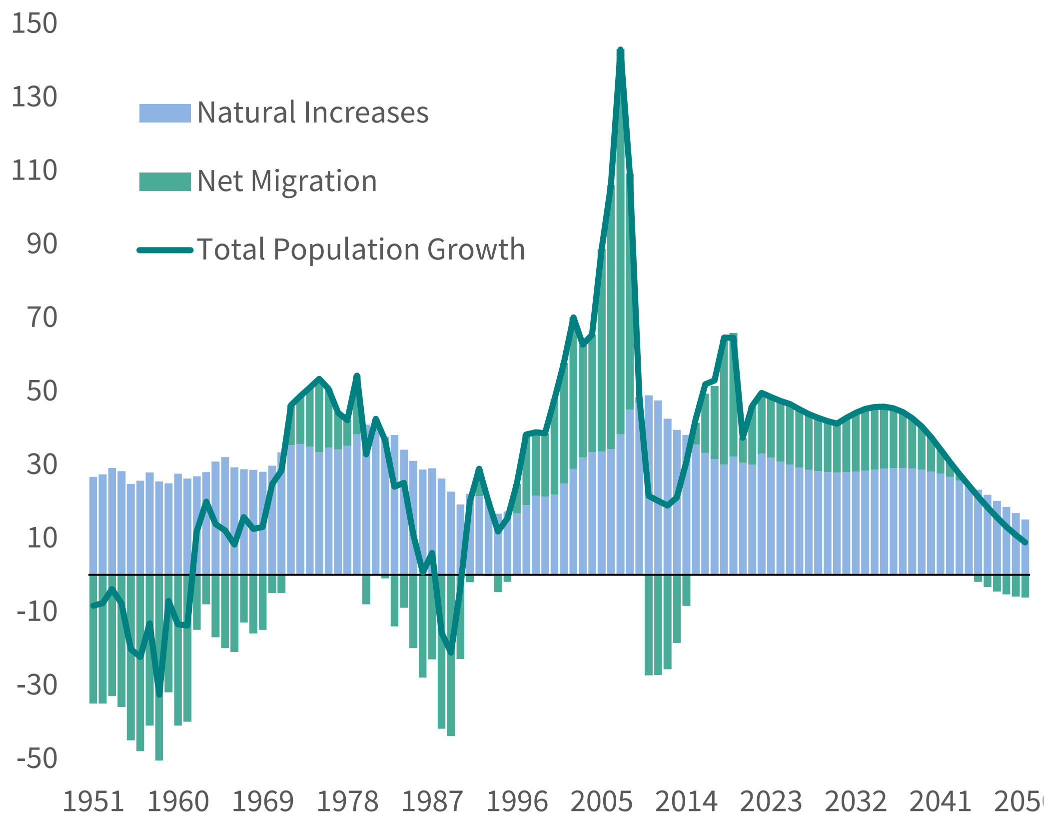
- Ireland's productivity level is already high in GNI* terms
- Irish and international trends point to slower growth

Population ageing is driven by many factors

- Rising life expectancy
- Bigger cohorts in retirement
- Stable fertility
- Migration will help to mitigate ageing pressures

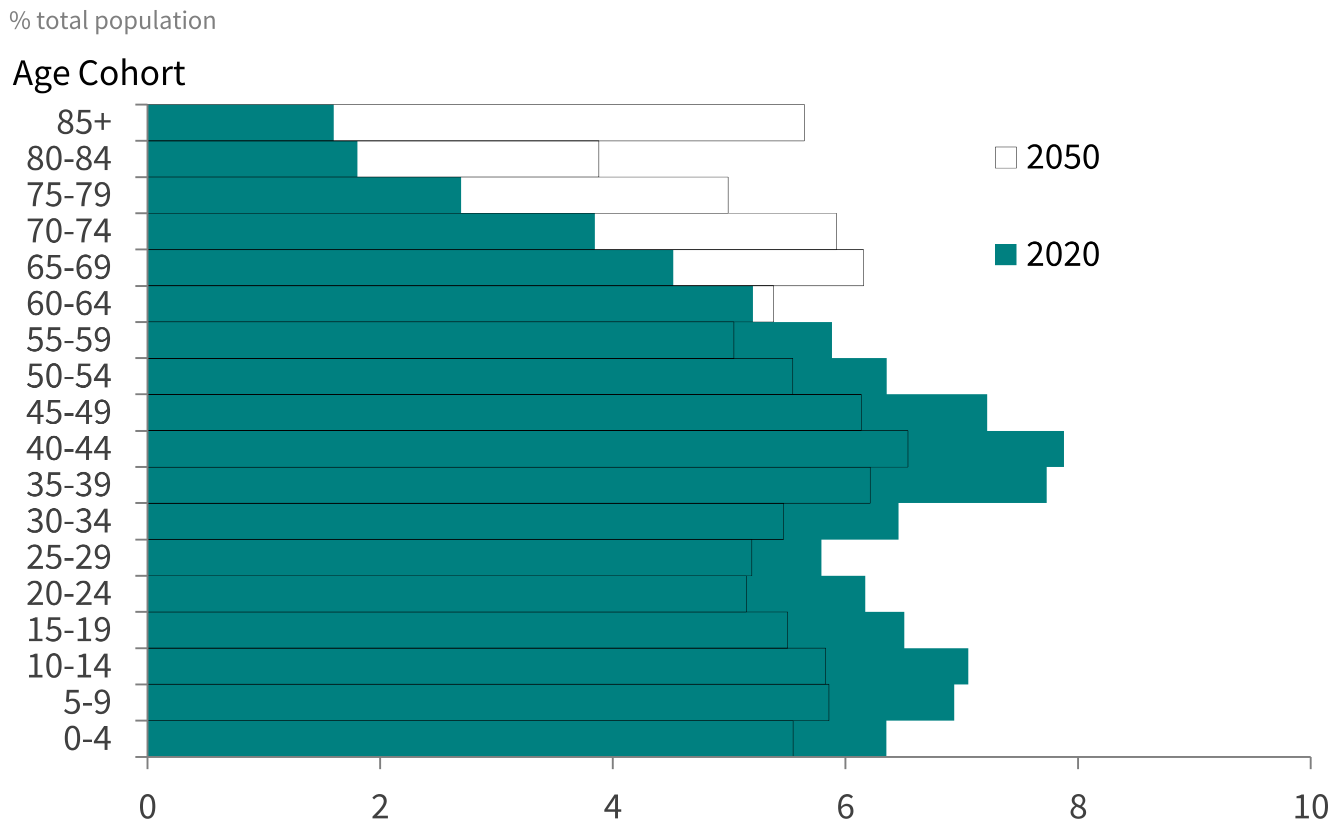
Population trends over time

Thousands annually



Sources: CSO; Osés Arranz (2019); and Fiscal Council projections.

The population will age significantly



- The share of over-65s in the population will increase to 27%
- Life expectancy at 65 will rise from 85 to almost 90 by 2050
- More people will be reaching retirement age

Ireland’s ageing is relatively rapid

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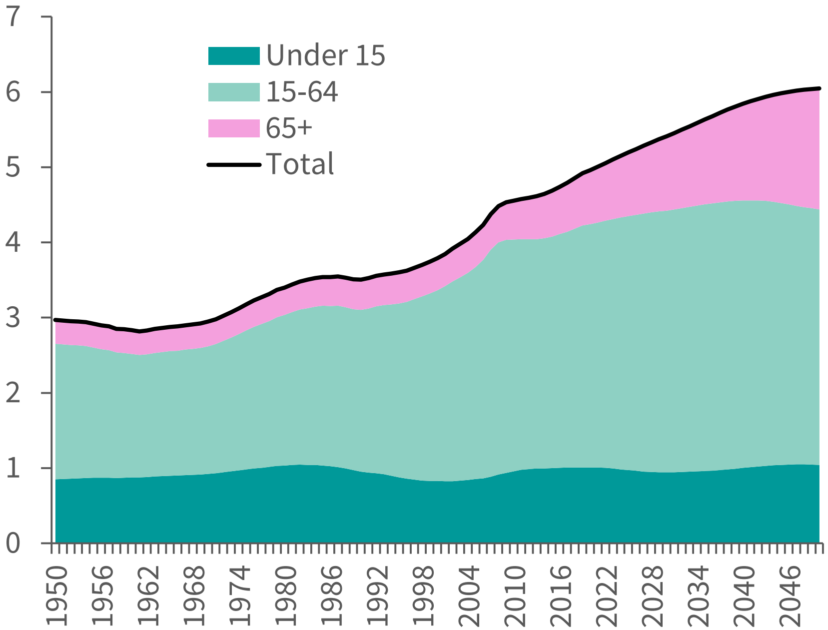
The share of older cohorts in the population will increase significantly

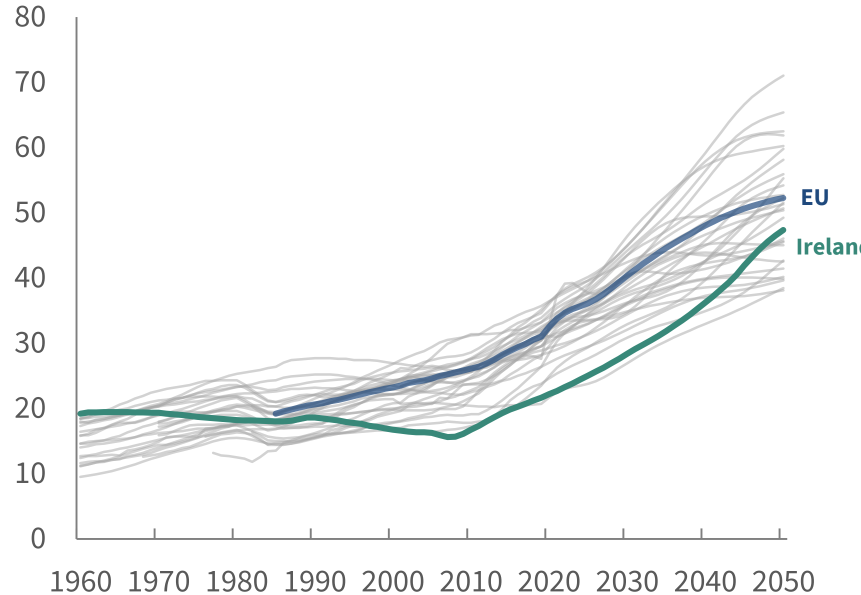
Population by broad age group in million



Sources: CSO; and Fiscal Council projections.

Old-age dependency ratios in Ireland and Europe

Ages 65+ as % of population aged 15–64



Sources: Fiscal Council projections; Eurostat; and Ageing Working Group projections.

- By 2035, Ireland will be like today’s EU average
- Within a generation, Ireland’s population will be more elderly than any EU country is today

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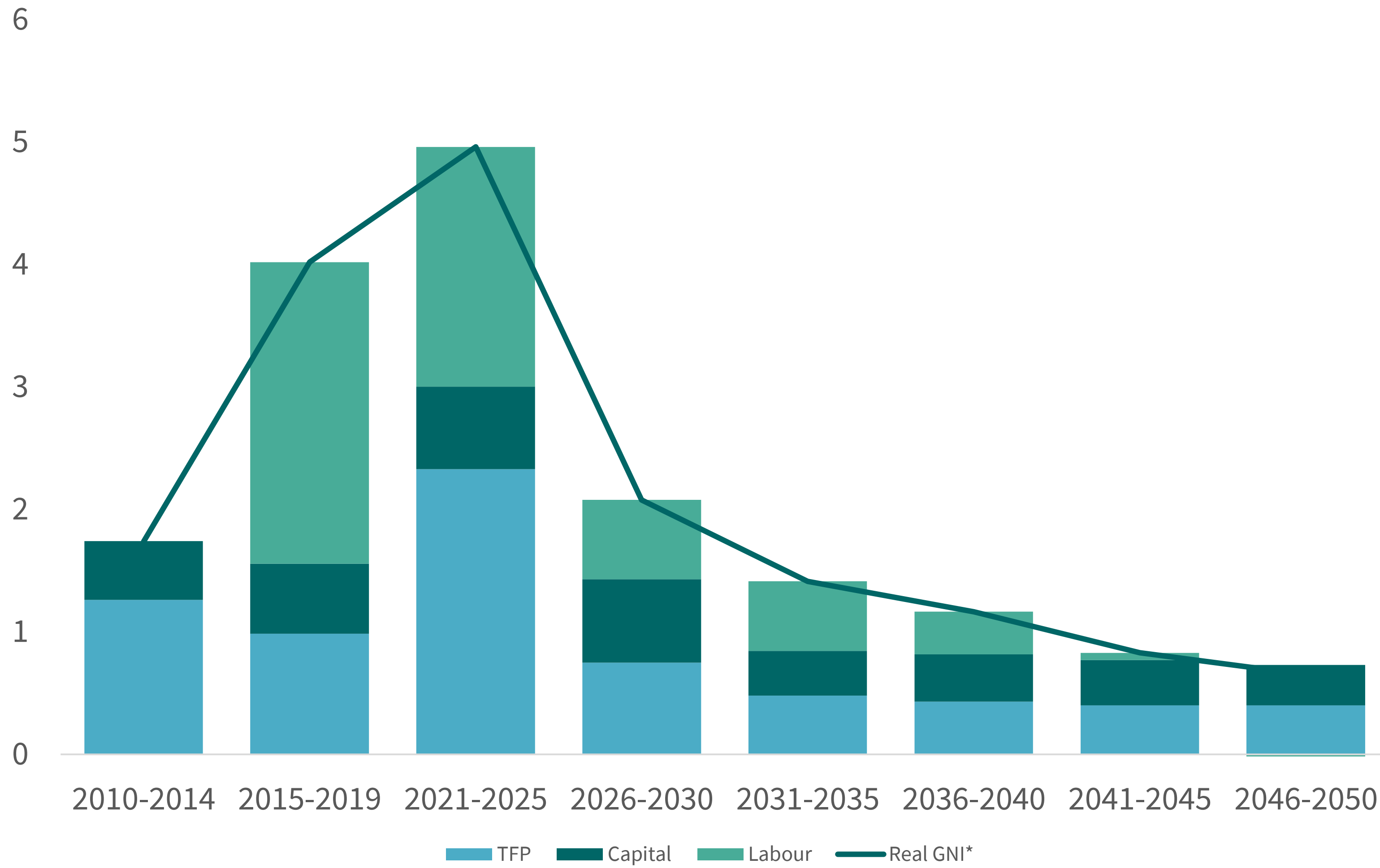
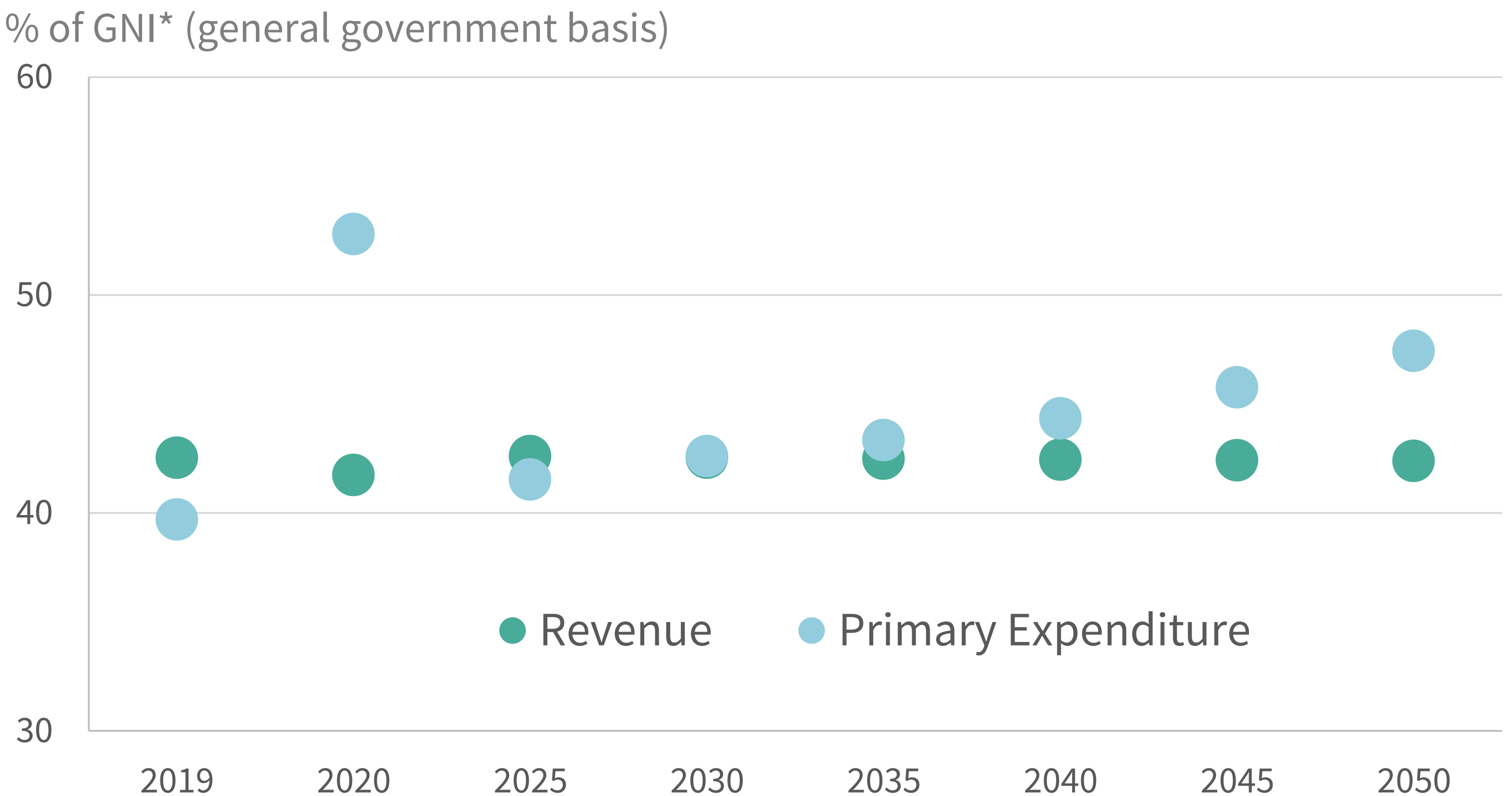
Growth is expected to slow

Real GNI* growth

% change year-on-year



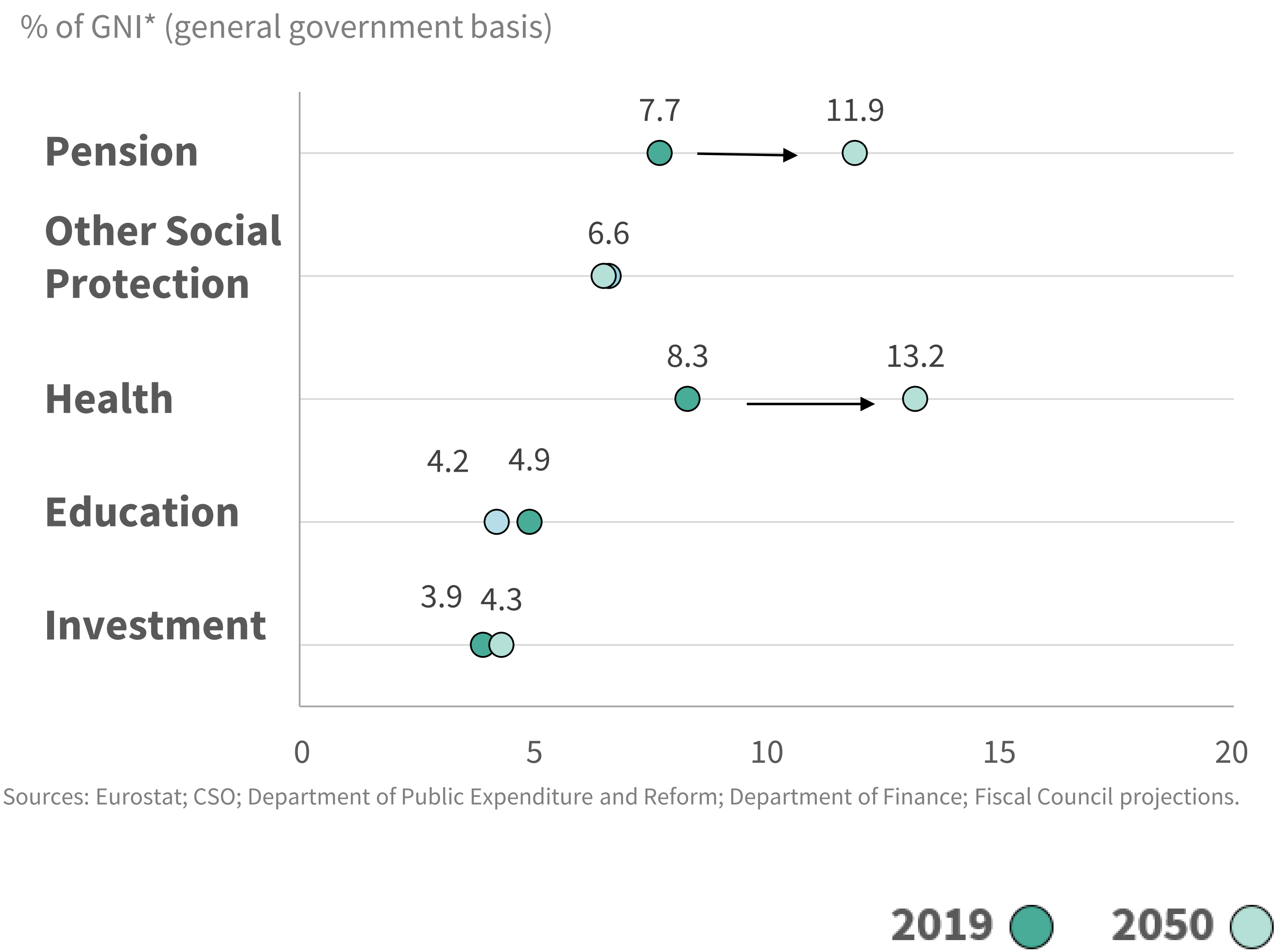
Under current policies, spending growth would outstrip revenue



Sources: Eurostat; CSO; Department of Finance; and Fiscal Council projections.

- Most revenue and spending items grow in line with the economy
- But some key items like pensions and health grow faster

Pension and health costs will rise



Sources: Eurostat; CSO; Department of Public Expenditure and Reform; Department of Finance; Fiscal Council projections.

Pensions costs will rise due to ageing

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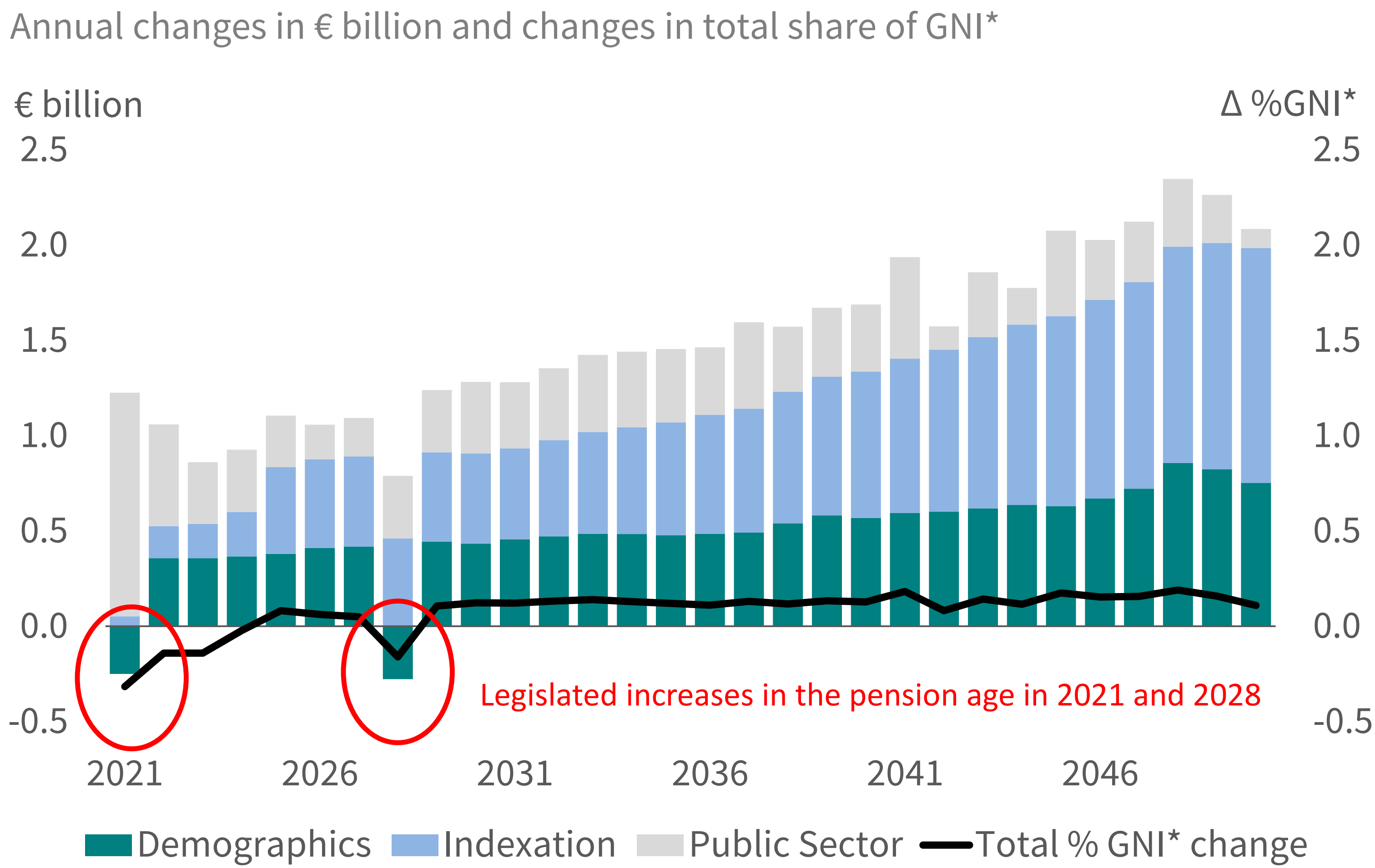

Sources: Department of Public Expenditure and Reform; and Fiscal Council projections.
Note: Changes in spending as a share of GNI* depend on the relative pace of growth in spending and GNI*. Demographic increases are based on y-o-y changes in claimants and avg. pension payments in (t-1). Public sector pension estimates from 2021-2050 are official estimates consistent with the *Ageing Report 2018* (European Commission, 2018). The 2021 increase is a break in time series, since 2020 public sector pensions are taken from the Revised Estimates, 2020.

Health costs will rise with higher demand

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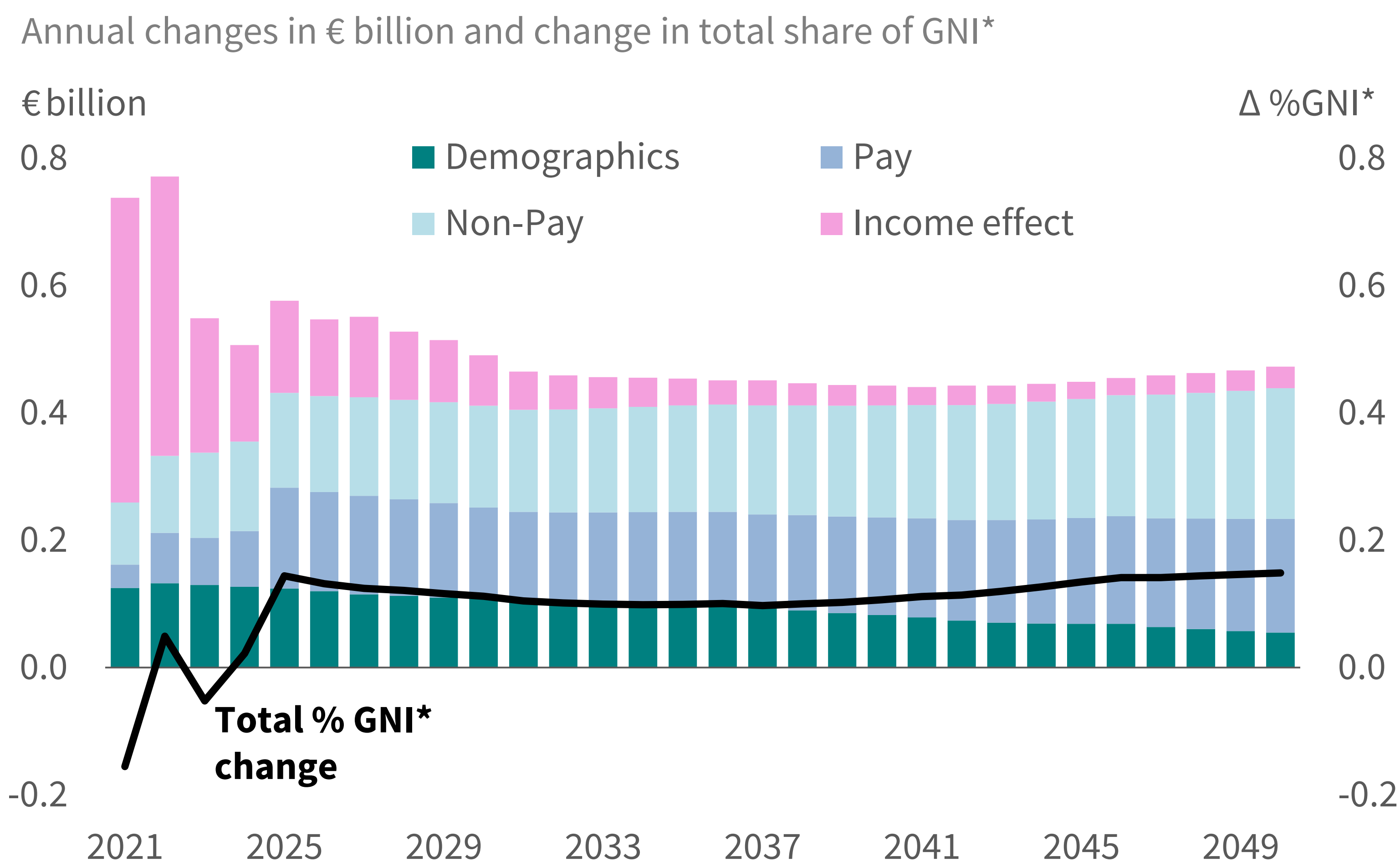
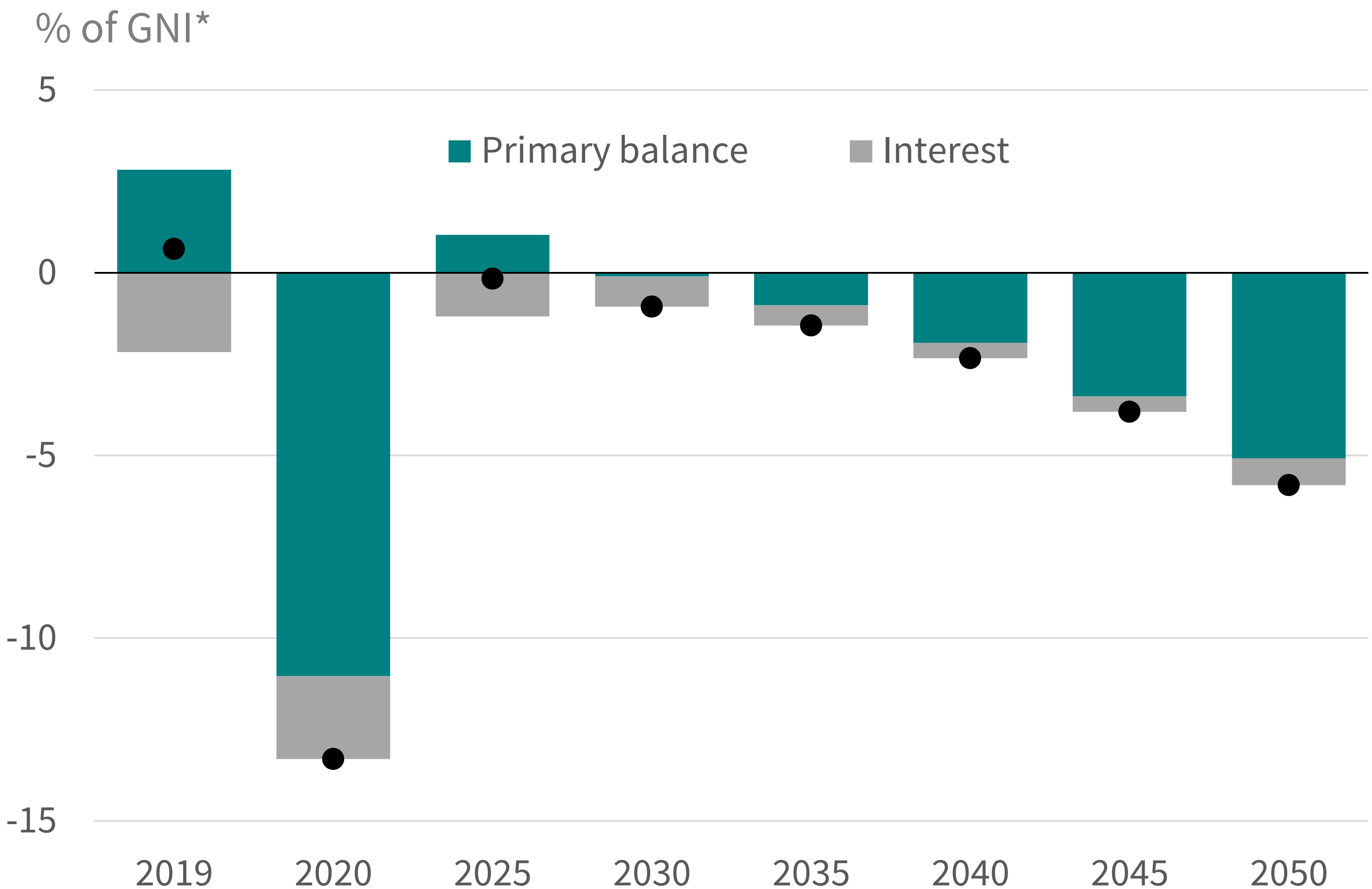


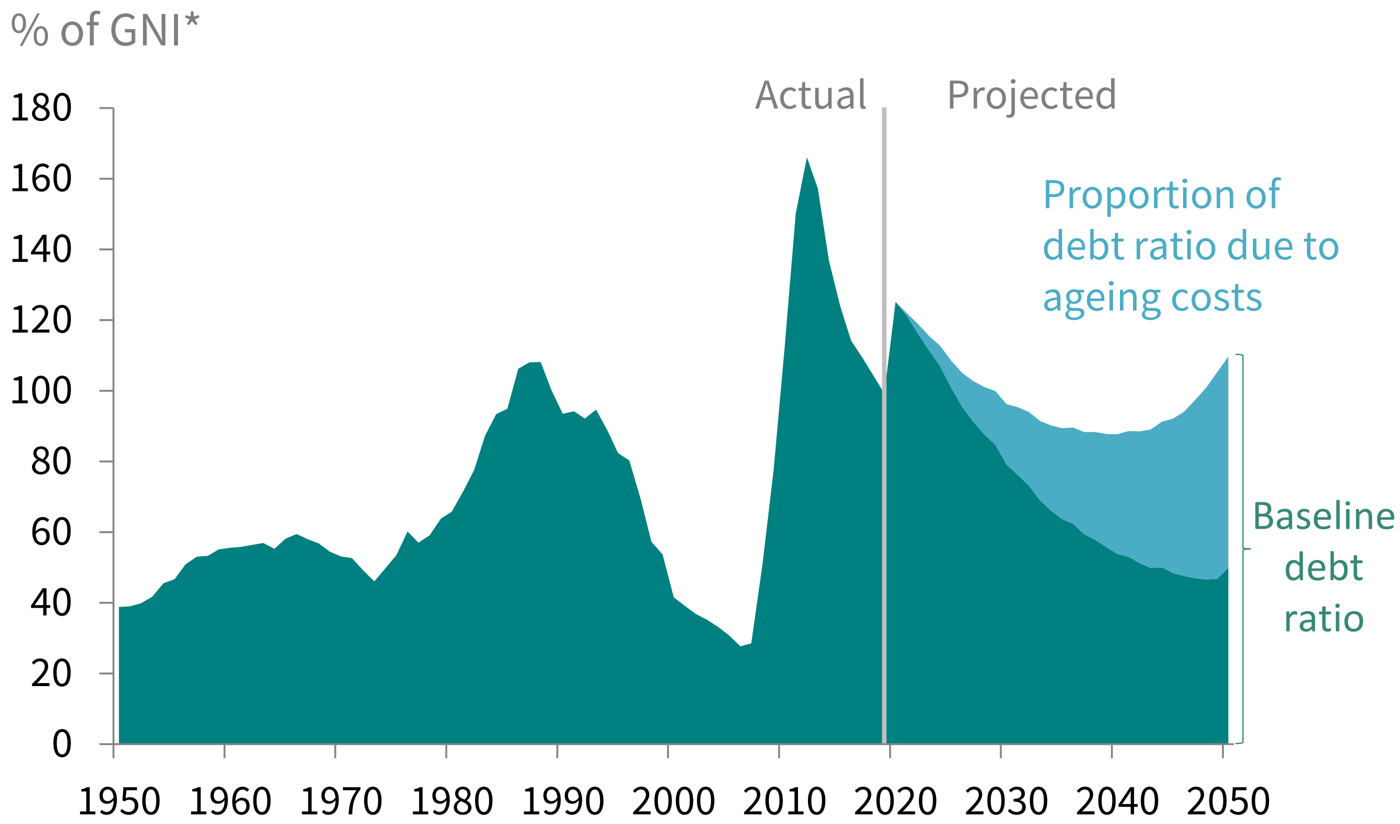
Sources: Department of Public Expenditure and Reform; and Fiscal Council workings.
Note: Healthcare spending includes spending on long-term care. Changes in spending as a share of GNI* depend on the relative pace of growth in spending and GNI*. Demographic costs are based on constant last observed costs per age group. In the longer run, some of the demographic effect is taken up by price effects due to this lack of chain-linking.

A large deficit would build up, particularly from 2040



Sources: CSO; Department of Finance; and Fiscal Council calculations.

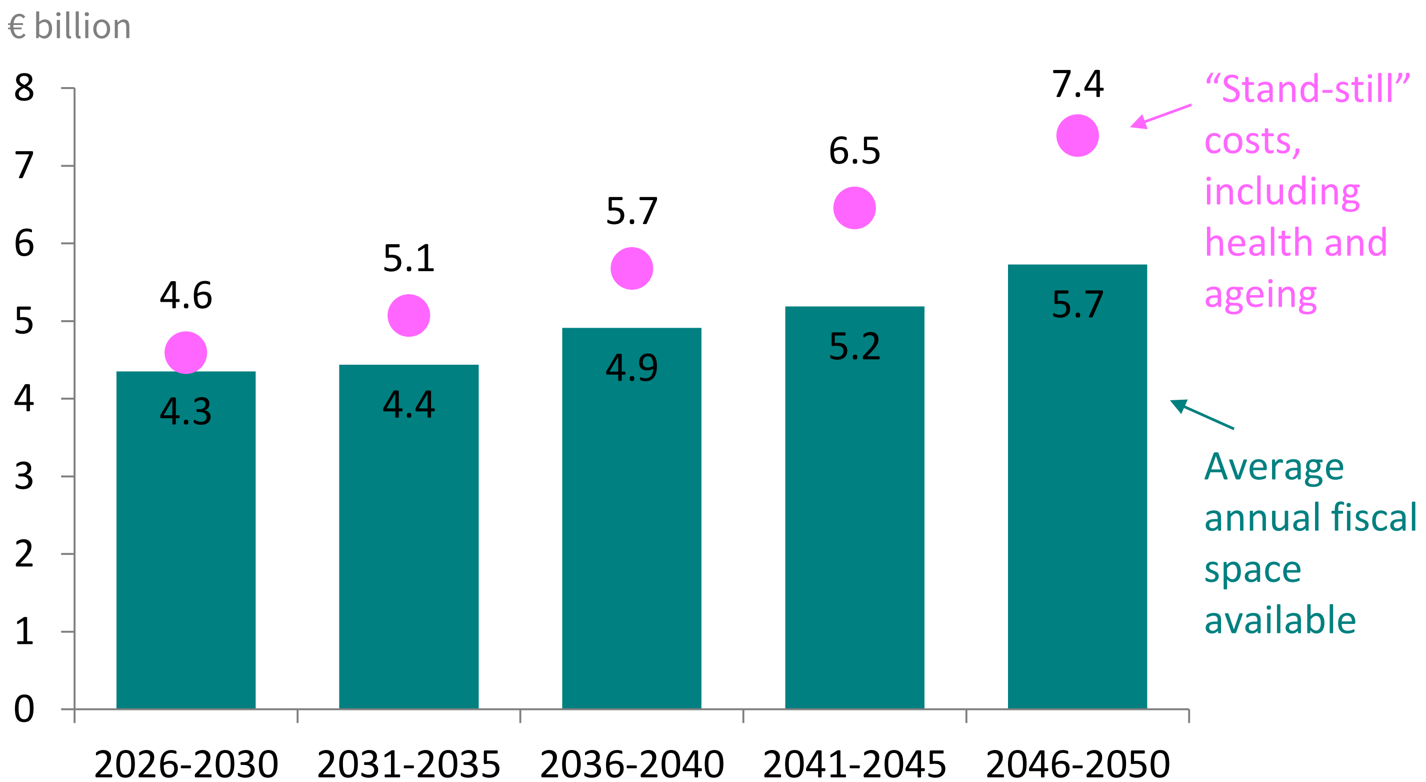
Debt would fall more slowly to around 90% GNI* and then begin to rise sharply after 2040



Sources: CSO; Department of Finance; and Fiscal Council calculations.

- This would leave the debt/GNI* ratio at a vulnerable and unsustainable level

Cost pressures would more than use available fiscal space each year from 2025



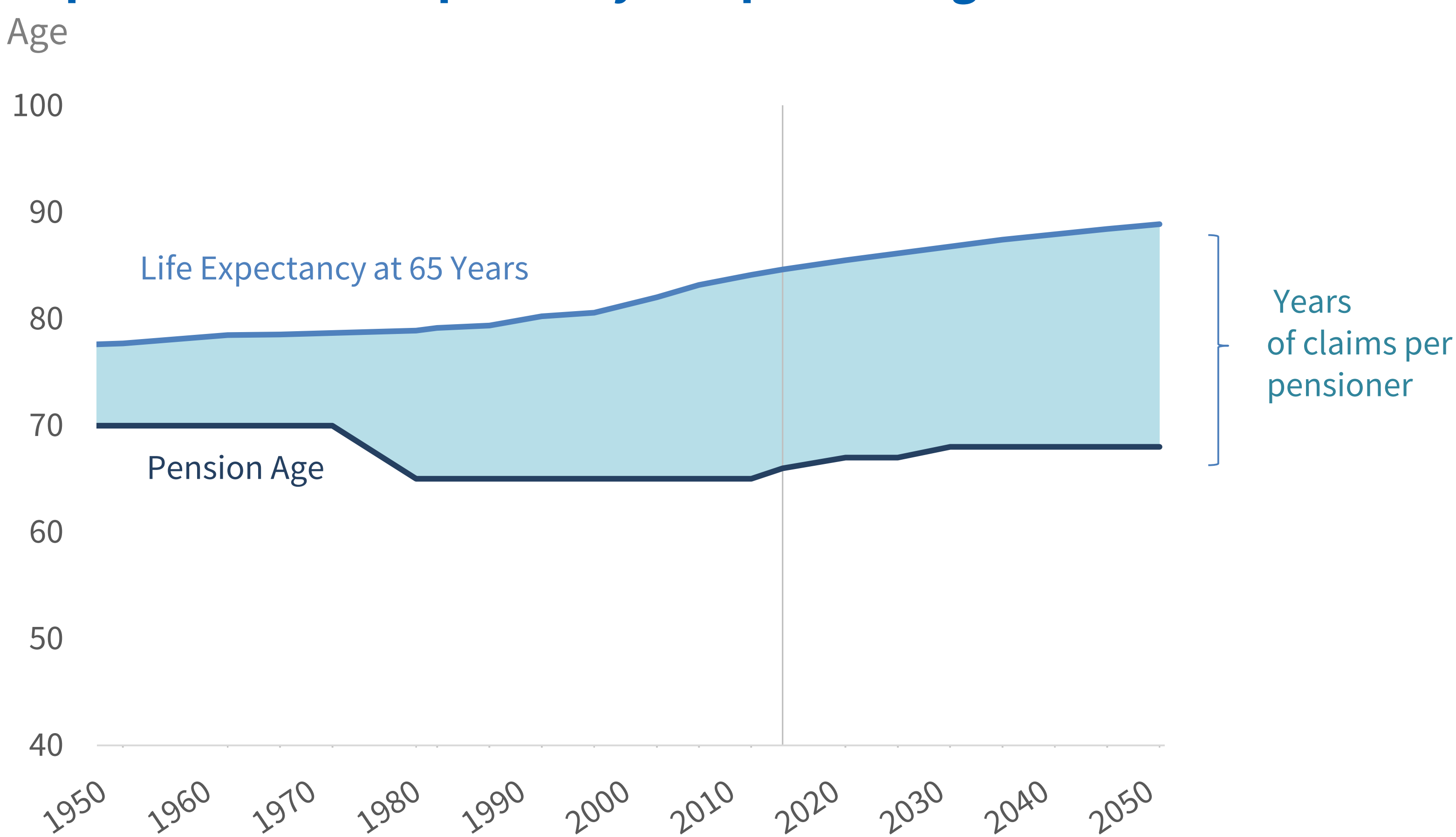
Source: Fiscal Council Workings.
Note: The "Stand-Still" basis is where today's level of public services and benefits are maintained in real terms over the long term (allowing for price and wage increases and demographic pressures). It is assumed potential growth equals actual growth over the long term. This means that the fiscal space available for each year is determined by the previous year's corrected expenditure aggregate multiplied by the current year's nominal growth rate.

Policy Strategies to Meet Future Needs Sustainably

- Increase taxes or adjust other areas of spending
- Make changes within the pension system:
  - Raise the retirement age
  - Raise contribution rates
  - Reduce benefits or coverage

Allowing the pension age to follow rising life expectancy would improve sustainability

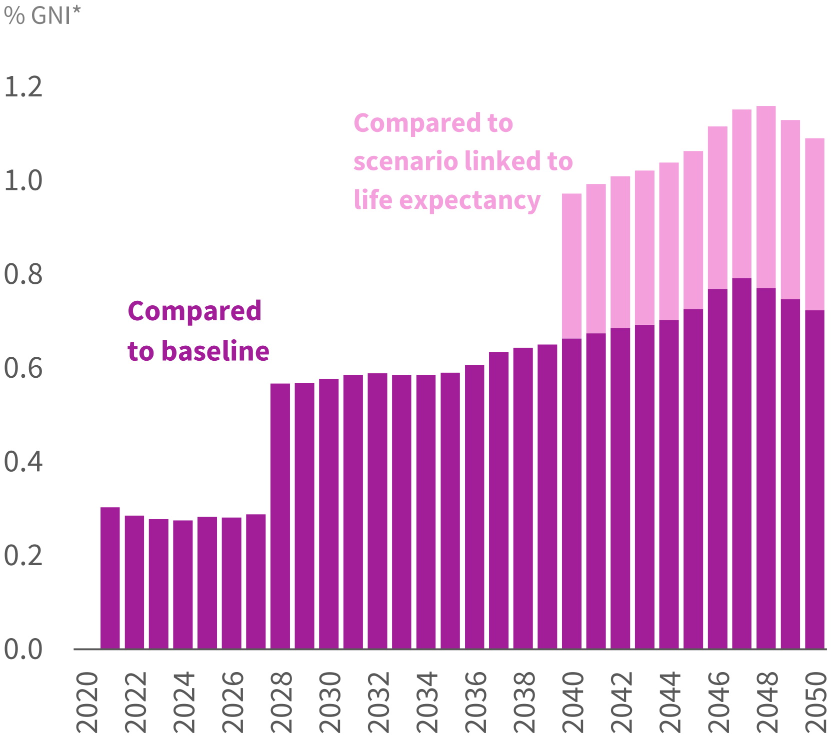
Gap between life expectancy and pension age has widened



Sources: CSO; Government of Ireland; and Fiscal Council workings.
Note: The baseline assumed includes two legislated adjustments to the pension age: in 2021 and in 2028.

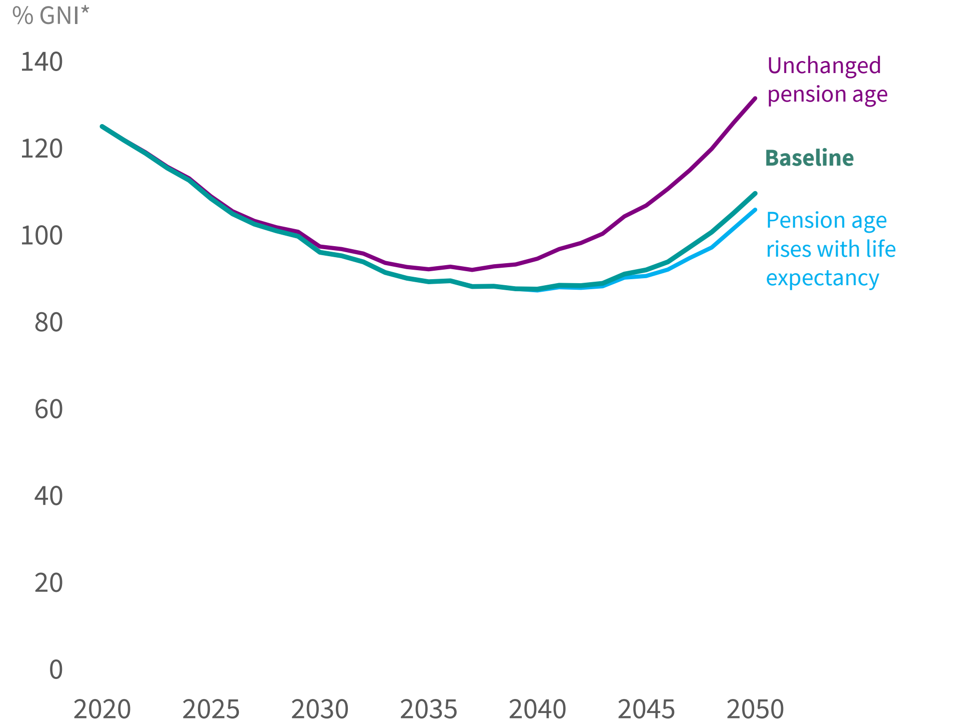
Implementing already legislated pension age rises and allowing future increases would help

Additional costs in a scenario where the pension age is unchanged



Sources: Fiscal Council projections.
Notes: Unchanged pension age refers to the pension age staying at the 2020 age of 66. In the baseline, the pension age rises from 66 to 67 in 2021 and to 68 in 2028. The link to life expectancy assumes another rise to 69 in 2040. The costs include differences related to spending on state pensions and other old age supports. These are adjusted for associated changes to working-age supports.

Additional costs in a scenario where the pension age is unchanged

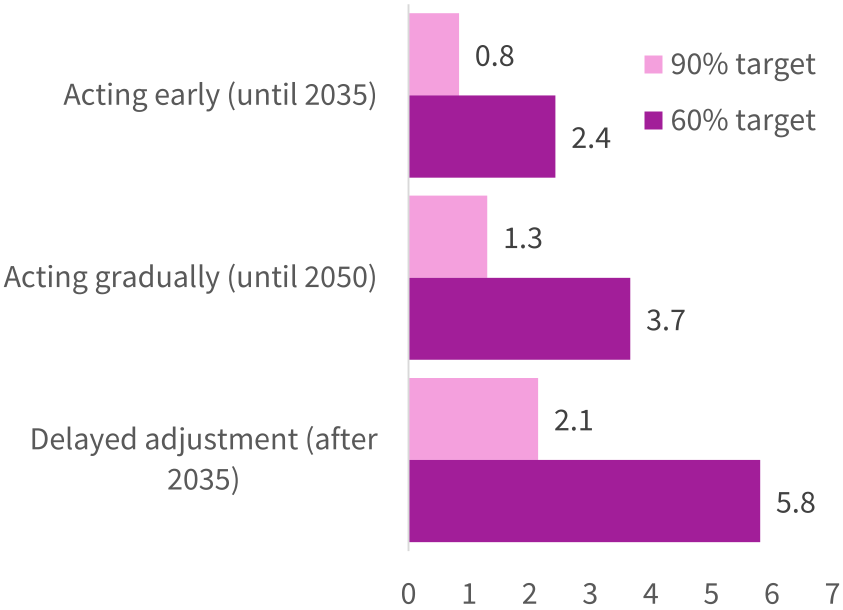


Sources: CSO; Department of Public Expenditure and Reform; Department of Finance; and Fiscal Council projections.
Note: The debt-ratio scenarios assume a pension age that rises to 67 in 2021 and then to 68 in 2028 in the baseline scenario, compared to a constant pension age of 66 (upper range) and pension age dynamically changing with projected life expectancy (lower range).

Earlier action and more prudent policies would ease future adjustment

If fiscal adjustments are chosen, swifter action will cost less

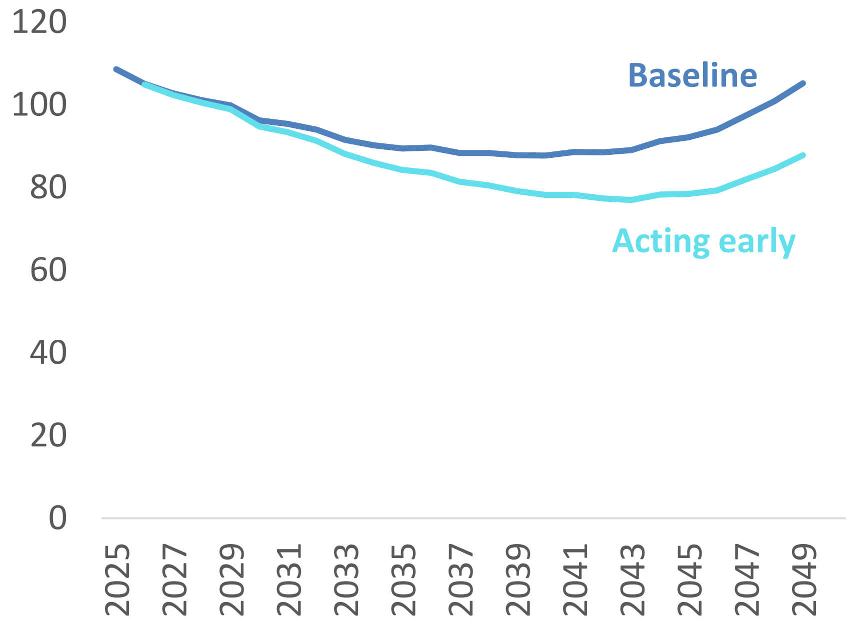
Fiscal adjustment required after 2025 to stabilise debt by 2050, cumulative % of GNI*



Source: Fiscal Council calculations.
Note: These adjustments are relative to a "stand-still" approach—where spending rises with demographic and price pressures—but the adjustments could also partly be achieved by growing spending at a slower pace than the economy expands at.

Path of the debt ratio under alternative adjustment scenarios

% of GNI*

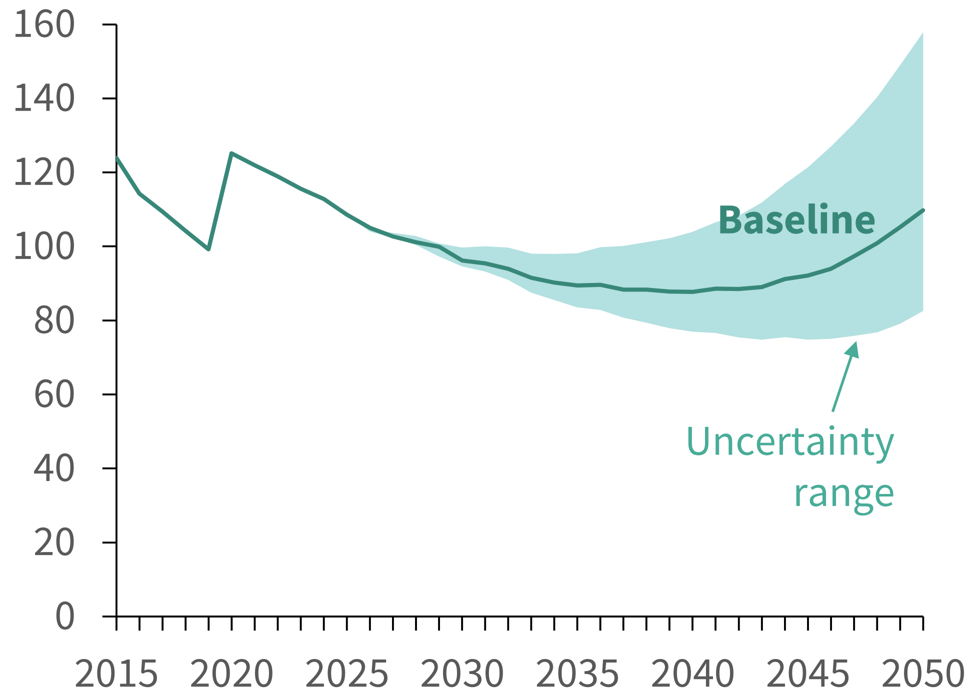


Source: Fiscal Council calculations.
Note: These adjustments are relative to a "stand-still" approach—where spending rises with demographic and price pressures—but the adjustments could also partly be achieved by growing spending at a slower pace than the economy expands at.

Uncertainty around long-term projections is high

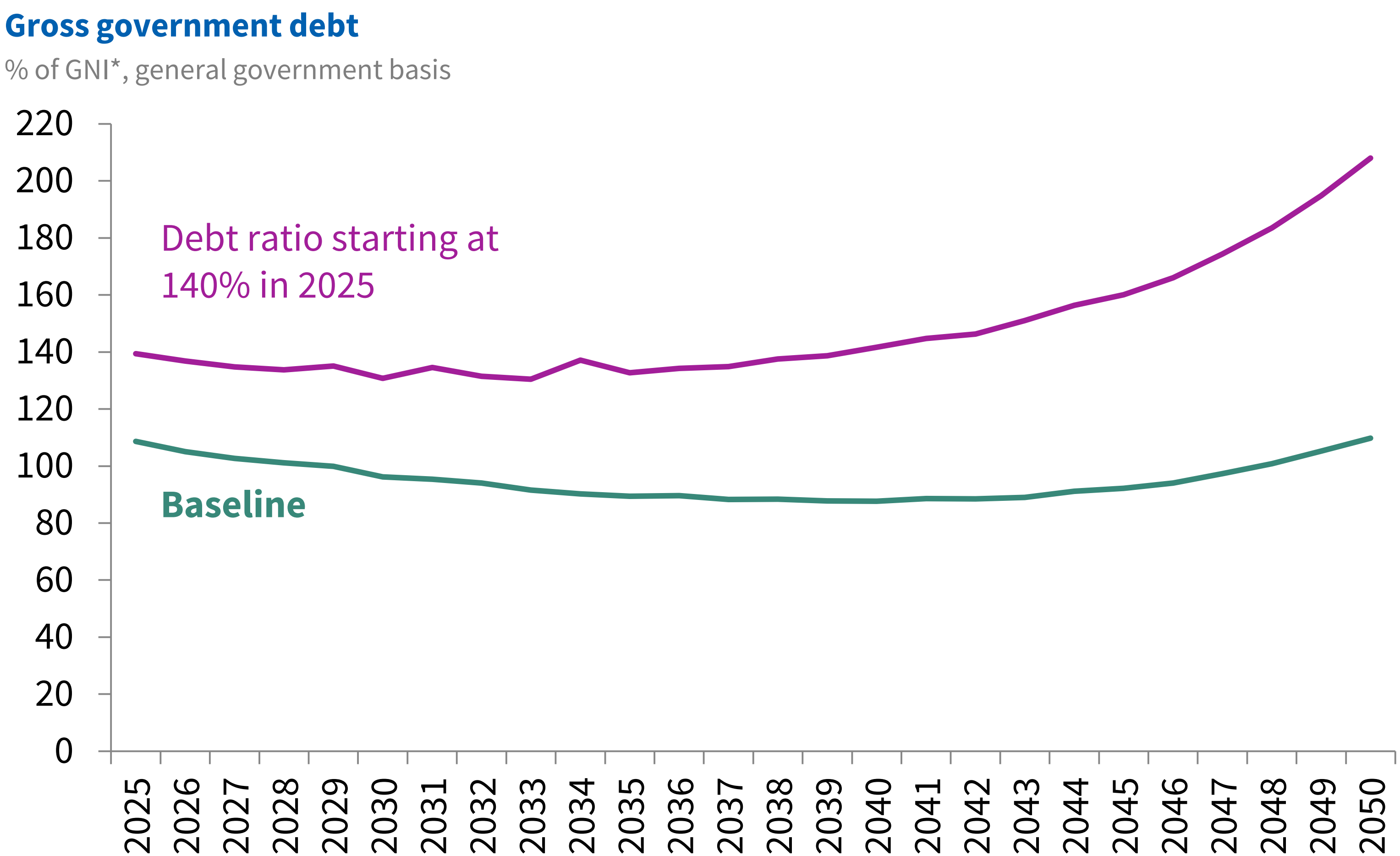
- Many uncertainties about the future
- 5 key risks:
  – COVID-19 risks
  – Reduction in CT
  – Climate change costs
  – Health care costs
  – Interest rates

General government gross debt as a % of GNI*



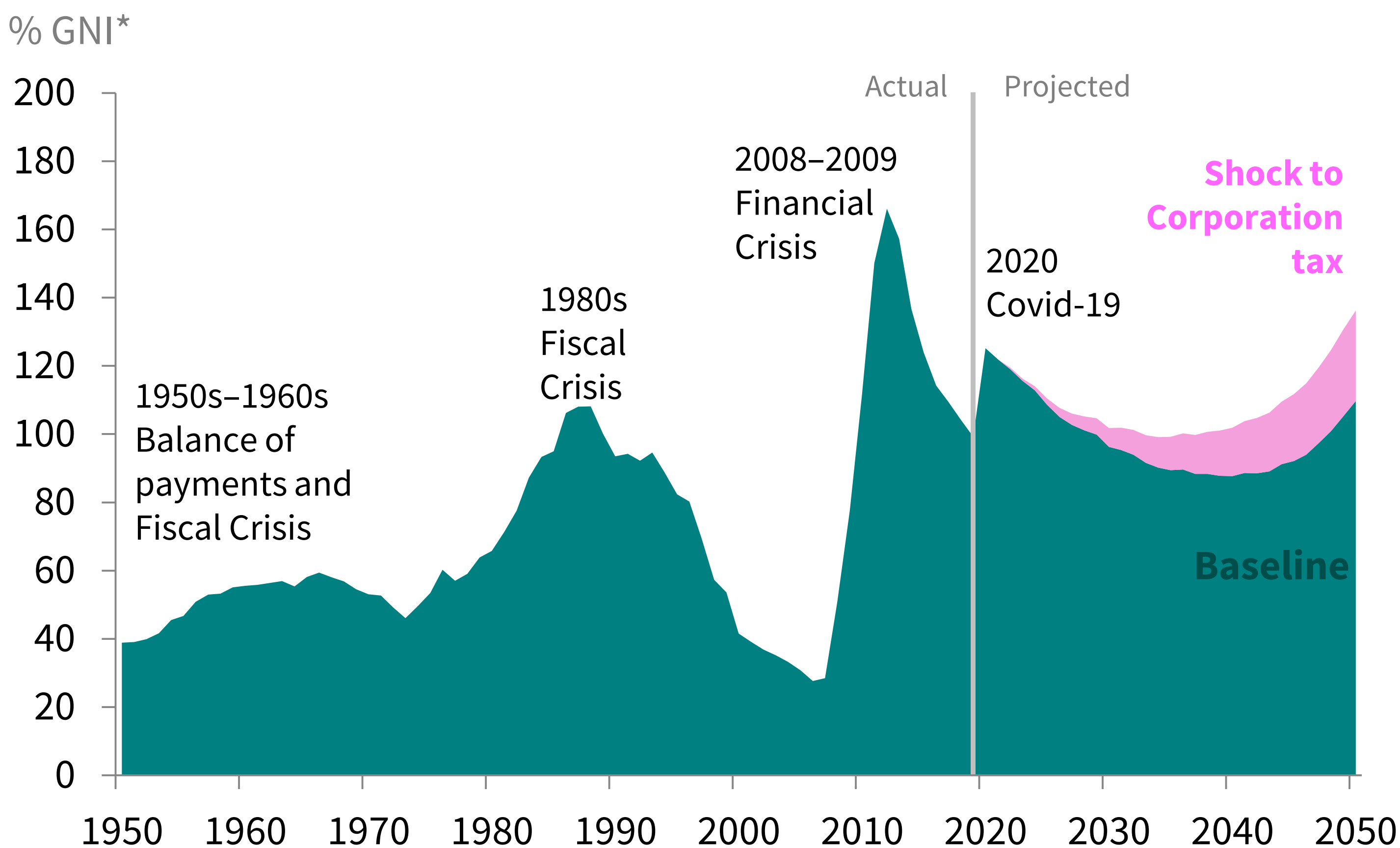
Sources: CSO; Department of Finance; and Fiscal Council projections.
Note: The uncertainty range is based on alternative assumptions for TFP growth over the long run of +/- 0.5 percentage points. This roughly corresponds to the middle two-thirds of the range of potential outcomes estimated under various approaches. The range also includes participation rates +/- 5 percentage points (ages 20–64) and the higher/lower migration consistent with growth.

A higher level of debt GNI* post-Covid-19 would increase future challenges



Sources: CSO; and Fiscal Council calculations.

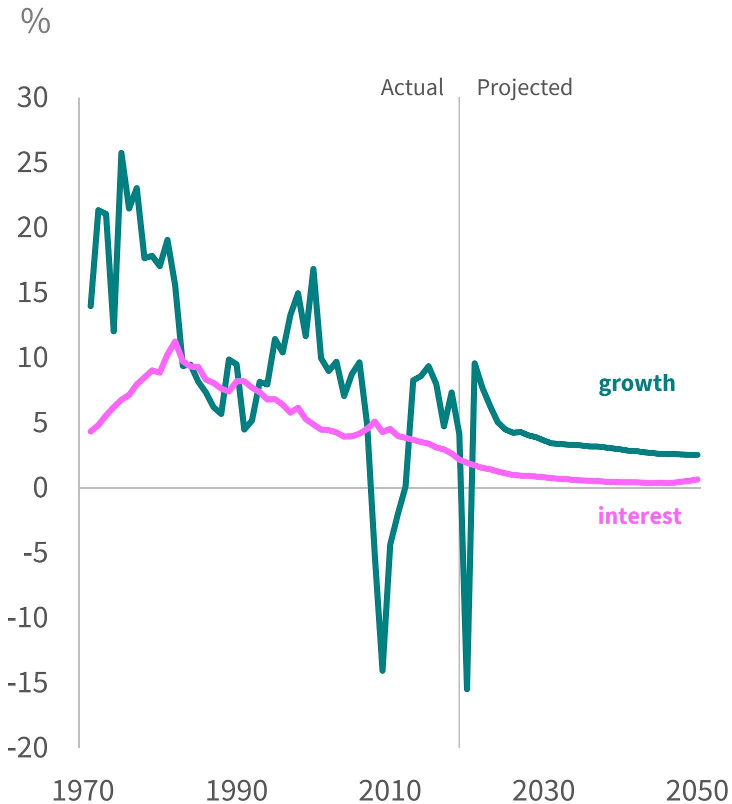
Further corporation tax falls would compound debt increases



Sources: CSO; FitzGerald and Kenny (2018); Department of Finance; and Fiscal Council projections.
Note: Graph shows gross debt. Modified GNI* is linked to GNI for the period 1970–1995 and to GNP for the period 1926–1969.

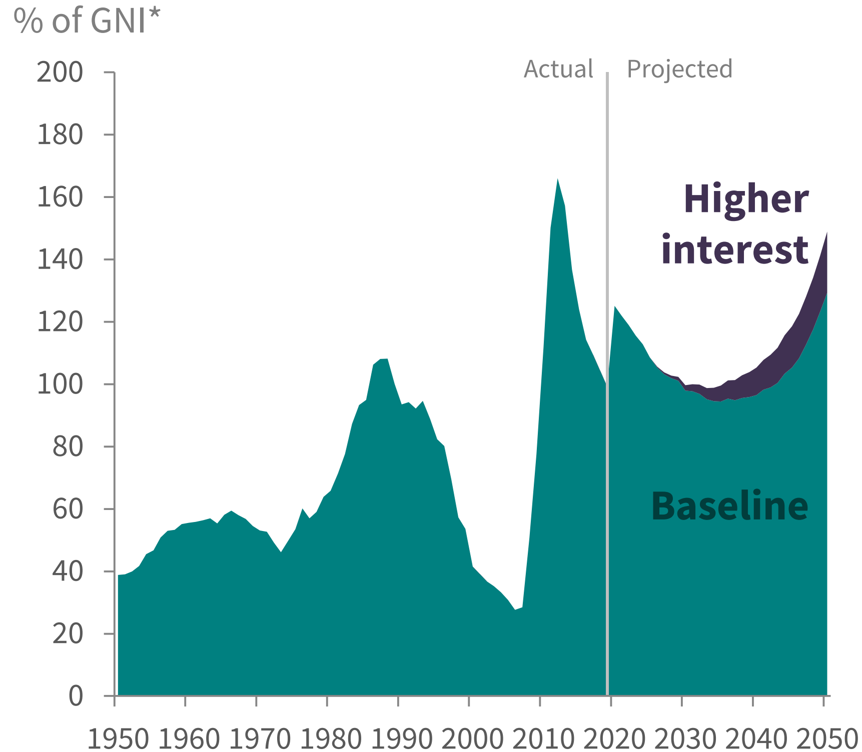
Debt dynamics are currently very supportive due to low interest rates, but this could change

The interest-growth differential is expected to be favourable



Sources: CSO; Fiscal Council calculations.

A percentage-point upward shift in the risk-free yield curve would increase Ireland's debt ratio

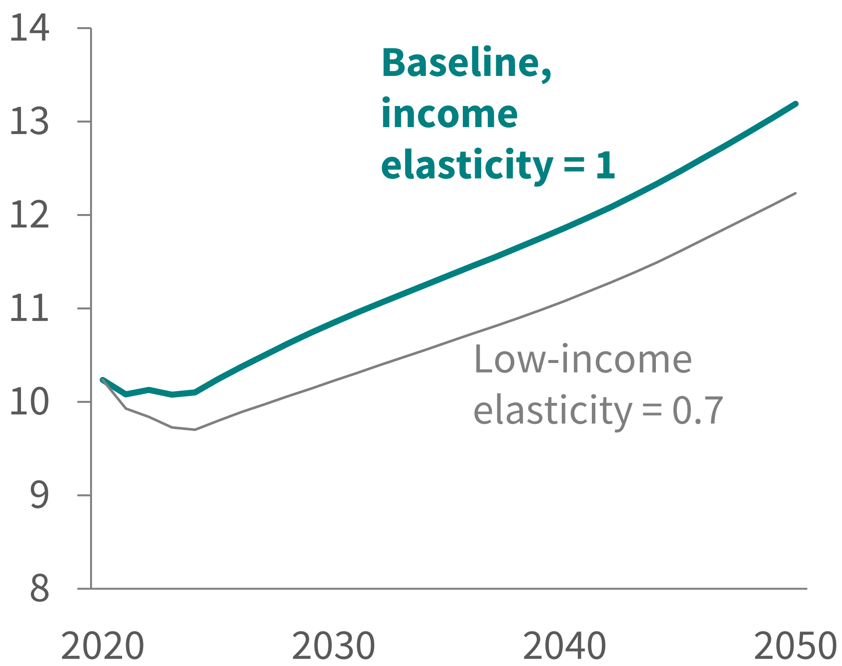


Sources: CSO; Fiscal Council calculations.

Health care costs are hard to predict; an unfunded Sláintecare would create risks

Alternative assumptions on how health demand increases with income

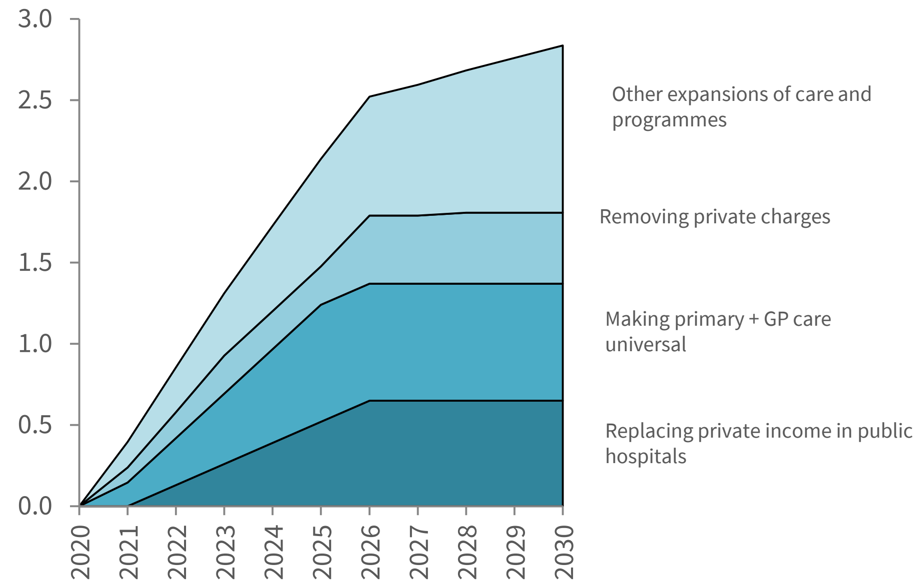
% GNI*



Sources: Fiscal Council calculations.

Assumed additional cost of Sláintecare relative to baseline

€ billion



Source: Committee on the Future of Healthcare (2017).
Note: We assume implementation begins in 2021. Additional annual spending is taken from Tables 8 and 9 of the *Sláintecare Report* (Committee on the Future of Healthcare, 2017).

Climate change and the carbon transition costs will need to be met at the same time

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Levels of greenhouse gas emissions

Mt CO_2eq

Source: Climate Action Plan 2019.

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