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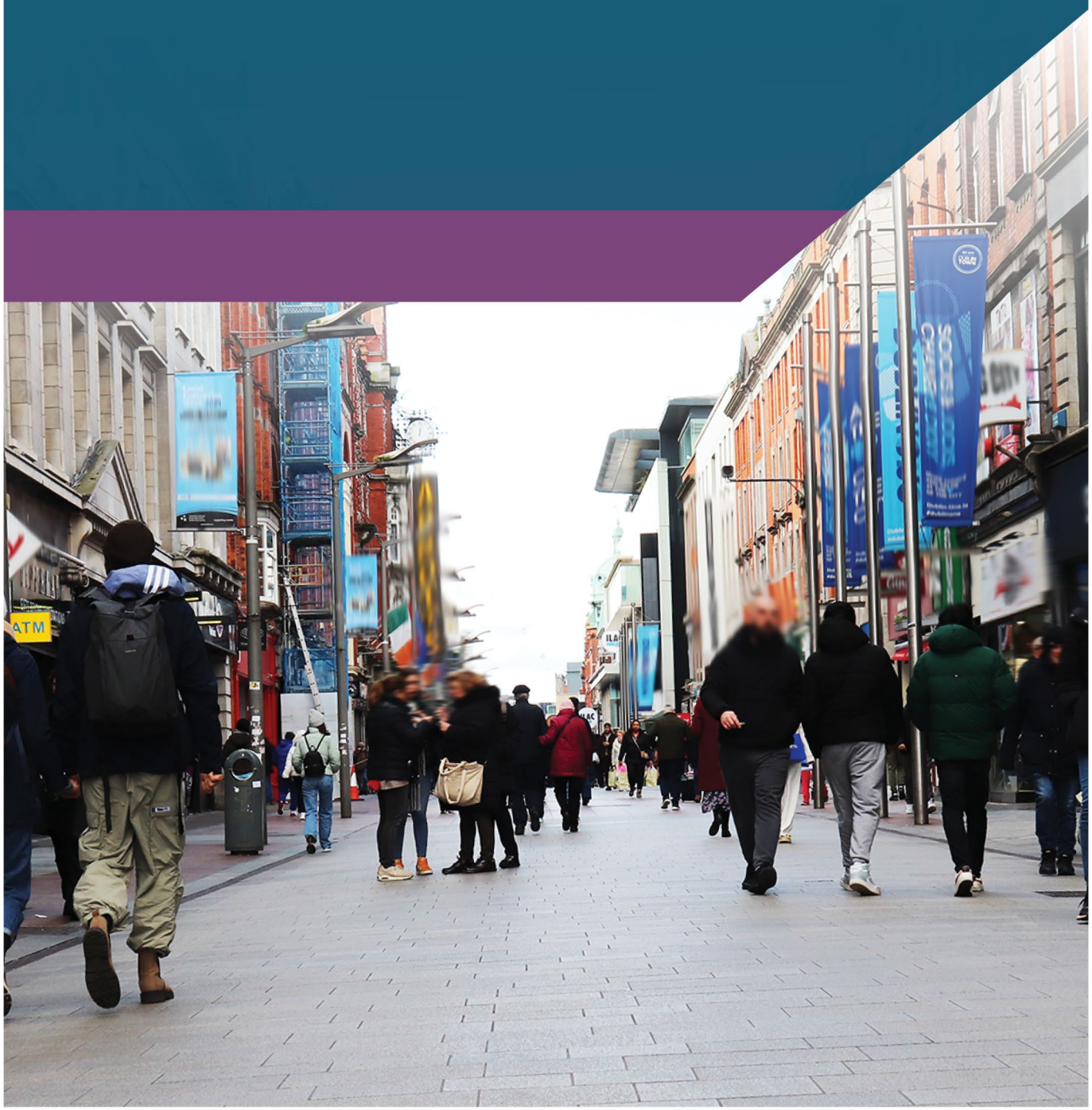

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Managing Risks and Building Resilience in the Public Finances

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Abstract

Strong economic growth and exceptional corporation tax receipts have benefitted the public finances over the last decade but these benign conditions are threatened. Risks to the public finances and the economy from Ireland's reliance on multinational firms have risen given recent developments in the US and the more disruptive international economic environment. A loss of corporation tax – most notably, of the windfall receipts of recent years – along with weaker economic growth and lower multinational investment would result in a deficit in the public finances of over 4 per cent of national income by 2030, in the absence of corrective action. To improve long-term growth and the resilience of the economy, increases in public investment that address current infrastructure gaps are needed. These should be implemented in a way that is consistent with long-run economic and fiscal sustainability. With current full-employment conditions and in the absence of offsetting revenue-raising measures, further large increases in public investment on top of existing plans could aggravate overheating pressures. If economic activity slows markedly, then increases in public investment could be accommodated with lower inflationary risks and would help to support demand. Implementing measures to broaden the tax base would improve the resilience of the public finances should CT revenue decline. Moreover, it would help to ensure that growing public expenditure needs from an ageing population, to fund new infrastructure and to meet emission reduction targets can be sustainably met.

[1] Irish Economic Analysis Division. We would like to thank David Cronin, Robert Kelly, Fergal McCann, Martin O'Brien, and Gerard O'Reilly (Central Bank) and David Purdue and Amélie Maddock (NTMA) for comments. The views expressed in this Article are those of the authors and do not necessarily reflect those of the Central Bank of Ireland or the European System of Central Banks.

1. Introduction

Over recent years, the public finances have benefitted significantly from the growth in economic activity and employment. From 2021 to 2024, annual average growth in national income (GNI*) measured just over 7 per cent in real terms with employment growth averaging 4.9 per cent. This pace of expansion – well above long-run historic averages – boosted tax receipts, which also benefitted from the exceptional growth in corporation tax observed since 2015. Together, this resulted in Exchequer tax revenue increasing by 42 per cent since the end of 2021, averaging growth of over 14 per cent per annum.[2] Government expenditure has also increased rapidly in recent years reflecting a combination of large rises in recurring day-to-day (current) spending, government investment and repeated cost-of-living measures up to Budget 2025, having initially been introduced as a temporary intervention in 2021. Excluding these temporary expenditures, we estimate that net gross voted Exchequer spending grew by 37 per cent (or €28 billion) since the end of 2021. This was significantly in excess of the 16 per cent (or €12 billion) increase in expenditure that would have occurred had the 5 per cent net spending rule announced in 2021 been complied with.

The magnitude of the increase in government revenue – turbocharged by corporation tax – meant that even with the substantial rise in government spending and some tax cuts, the headline budget balance has run large surpluses in recent years. In addition, the Government established the Future Ireland Fund (FIF) and the Infrastructure, Climate and Nature Fund (ICNF) in 2024, with the overall balance in both funds standing at €10 billion at the end of 2024. However, there are signs that this benign combination of factors – namely, a rapidly growing economy and exceptional CT receipts – which enabled these favourable developments to occur - could be threatened in the coming years. The projections for economic activity in *Quarterly Bulletin 2 2025* have been revised down reflecting the impact of new tariffs and the related increase in economic uncertainty observed over recent months. On its own, slower economic growth through these channels results in a less favourable projection for the public finances. Moreover, while CT receipts could increase further in the short term, there are risks to the sustainability of the current high levels of corporation tax revenue over the medium term from a range of sources, including from possible reductions in MNE profitability in Ireland and changes in US tax or broader economic policy.

[2] This excludes the temporary impact of the EU Court of Justice state aid case ruling on Exchequer tax receipts in 2024.

Against this backdrop, the analysis in this *Article* outlines the exposure of the public finances to a loss of corporation tax and other risks to the government revenue base. While corporation tax risks have been documented extensively, the analysis points to a broader vulnerability in the tax base arising from the heavy concentration of income tax among the top 10 per cent of earners and the narrowness of the VAT base in Ireland. In the event of a loss of all current estimated excess corporation tax by 2030, the budget balance would deteriorate from a surplus of 2.3 per cent of GNI* to a deficit of around 2 per cent. In a scenario where the loss of excess corporation tax was accompanied by weaker economic activity (as in the *adverse* scenario from *Quarterly Bulletin 2* 2025) along with a reduction in MNE investment in Ireland, the deficit would increase further to over 4 per cent.

Public investment has an important role to play in improving competitiveness and boosting sustainable growth. A notable development over the past 10 years has been the scale of increase in public capital spending which has tripled in nominal terms, despite falling short of initial targets in some years. Such investment is needed to address infrastructure gaps in housing, energy, water, waste water and transport. Yet, a combination of shortfalls in nominal spending, higher inflation than initially expected at the outset of the plans and continued strong economic growth mean that real investment and the level of the real public capital stock relative to the size of the economy (GNI*) have remained broadly flat since 2021. Delays in the planning and building of construction projects are currently reducing the quantity of public infrastructure being delivered. During a period when public investment is being increased substantially, it is important that policy measures are taken to minimise planning and building delays. This would increase the amount of real infrastructure delivered for a given nominal rise in spending, guard against inflationary pressures and help to crowd in additional private sector investment.

Two specific areas that require significant increases in public investment in the years ahead are housing and decarbonisation. Our analysis shows that further increases in capital spending must be managed carefully to avoid adverse macroeconomic and fiscal outcomes. If the economy and labour market remain close to capacity as at present, new revenue raising measures would help to reduce the risk of higher public spending damaging competitiveness and crowding out activity in other parts of the economy. If economic growth slows materially (for example, as in the *QB2 adverse* scenario) and some excess capacity emerges, then higher investment could be absorbed with a lower risk of crowding out.

Beyond short-run demand management considerations, the medium-term resilience of the public finances points to a need to broaden the tax base to increase government revenue as a share of national income so as to address known emerging funding needs and to mitigate the reliance on CT receipts. It is estimated that government expenditure will need to rise by 6½ percentage points of national income (GNI*) between 2025 and 2050 to fund higher age-related spending and the additional public investment required to meet housing and net zero targets. In nominal terms, total spending needs would increase by €265bn by 2050. Broadening the tax base over the coming years would help to ensure that additional known expenditure needs can be met sustainably even if corporation tax was to decline significantly.

The remainder of this *Article* is structured as follows. Section 2 assesses MNE-related tax revenue risks and characteristics of the income tax and VAT bases in Ireland – together these three tax headings currently account for two-thirds of overall government revenue. Scenario analysis is included to show the estimated impact on the public finances from a loss of CT and a wider downturn in MNE activity. Section 3 focusses on public investment and in particular on energy and housing – two areas where significant additional investment is needed over the coming years. The analysis demonstrates how the impact on the economy of additional public investment is influenced by prevailing cyclical conditions, i.e. whether the economy is operating at full employment or below. The scenario analysis also illustrates the differential effect of higher public investment on the economy when the expenditure is funded by borrowing and when taxes are raised to do so. This section also illustrates the impact of planning and building delays in reducing the potential gains from higher public investment. Section 4 examines the increases in public expenditure that will be required over the coming years to meet the needs of an ageing population and other long-term pressures. The analysis shows that the government's long-term saving fund (the Future Ireland Fund) will contribute to partly funding this additional expenditure, but higher government revenue will be needed. Section 5 concludes.

2. Corporation tax and MNE-related revenue risks

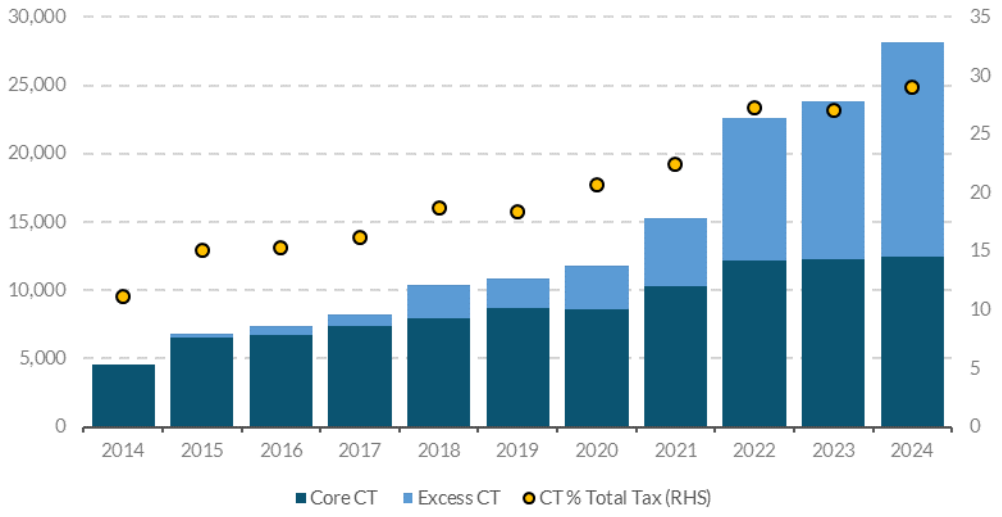
2.1. Risks to Corporation Tax

Government tax revenue has increased rapidly in the post Covid-19 period. Excluding the temporary impact of the CJEU ruling, general government revenue increased by an average of 12 per cent per annum between 2022 and

2024.[3] This compares to a long run average growth rate of just over 7 per cent and is double the average rate of increase in the euro area over the same period. Revenue growth in Ireland has been driven by the strong performance of direct taxes in recent years, in particular CT receipts. This tax head has grown from 11 per cent of total tax receipts in 2014 to around 30 per cent in 2024, driving 40 per cent of the total increase in tax revenue growth over this period (Figure 1).

CT has risen substantially to account for one-third of tax revenue in 2024

Figure 1: CT and estimated excess CT, € millions and % of overall revenue



Source: Department of Finance Databank and authors' calculations

Note: Core CT is an estimate of corporation tax receipts that are directly linked to activity in the Irish economy. Excess CT is an estimate of corporation tax receipts that are disconnected from activity in the Irish economy. Temporary receipts from the Apple state aid case are not included in the Figure.

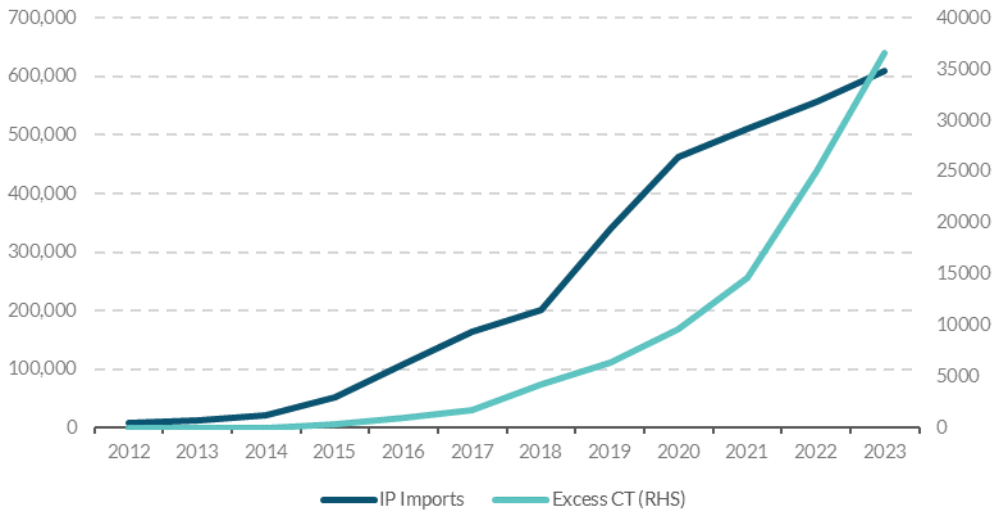
Concerns about the increased importance of CT to the State's revenue base are well established. One is that a very high proportion of the CT receipts that the State collects appears to be disconnected from actual economic activity in Ireland. We refer to these receipts, which could be particularly vulnerable to reversal and external shocks, as 'excess' CT. Estimating the size of excess CT is subject to significant uncertainty and a number of different methodologies can be used. Reflecting this, the Central Bank of Ireland uses a range of approaches

[3] When we refer to revenue in the remainder of the Article it is excluding the temporary impact of the CJEU ruling.

to estimate the portion of CT receipts that might be less sustainable over the medium to long term.[4] These estimates show that a significant - and growing - share of CT receipts cannot be explained by developments in the underlying economy or are out of line with historical and international norms. Notably, there is a strong correlation between imports of Intellectual Property (IP) assets and cumulative excess CT flows (Figure 2). This highlights the role that the onshoring of Intellectual Property (IP) by foreign multinational enterprises in Ireland (MNEs), which accelerated notably from 2018 onwards, has played in generating CT receipts. When excess CT receipts are excluded from the general government balance (GGB), it has remained in deficit in recent years and is expected to continue to do so over the medium term. This highlights the key role that these receipts have played in returning the GGB to surplus following the financial crisis.

Excess CT receipts have increased alongside intellectual property imports

Figure 2: Cumulative Excess CT and IP imports, € millions



Source: CSO and authors' calculations

Note: The Figure shows cumulative IP imports and excess CT receipts from 2012. Excess CT is an estimate of corporation tax receipts that are disconnected from activity in the Irish economy.

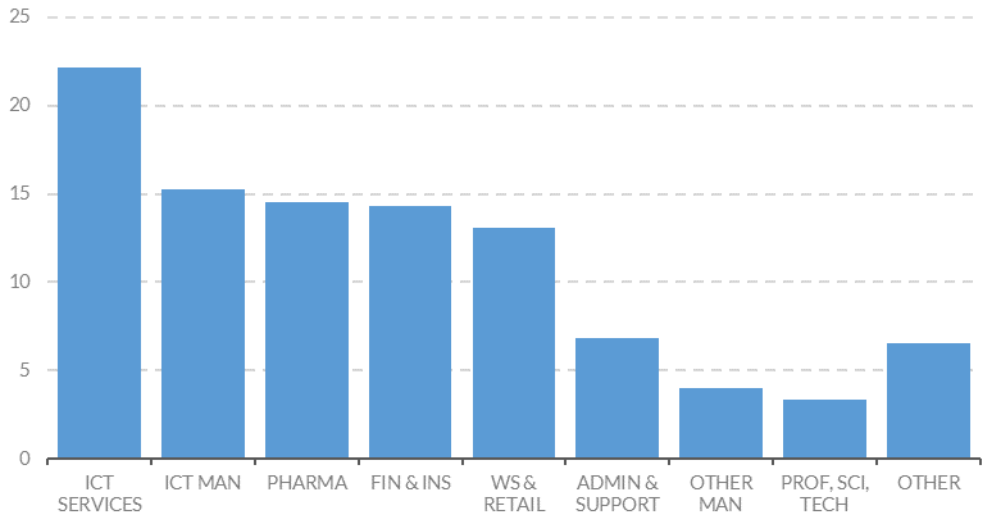
The second concern about the growing importance of CT receipts relates to the exceptionally narrow nature of this tax base. Data from Revenue show that 10 companies were responsible for 57 per cent of all CT receipts in 2024 (or 11 per cent of total government revenue). Other estimates suggests the base is

[4] These approaches are discussed in more detail in Conefrey et al (2023).

even narrower with just three corporate groups responsible for 38 per cent of all CT receipts in 2023 (Cronin, 2023). The narrowness also relates to the sectors that generate Irish CT revenue. Two sectors – Information and Communication Technology (ICT) and Pharmaceuticals – were responsible for just over half of all CT revenue in 2024 up from around 35 per cent in 2019 (Figure 3). This shows that the Irish public finances are highly exposed to the decisions of a very small number of firms and developments in a limited number of sectors.

ICT and Pharmaceutical firms pay over half of Ireland's CT

Figure 3: CT receipts by sector in 2024, per cent of total



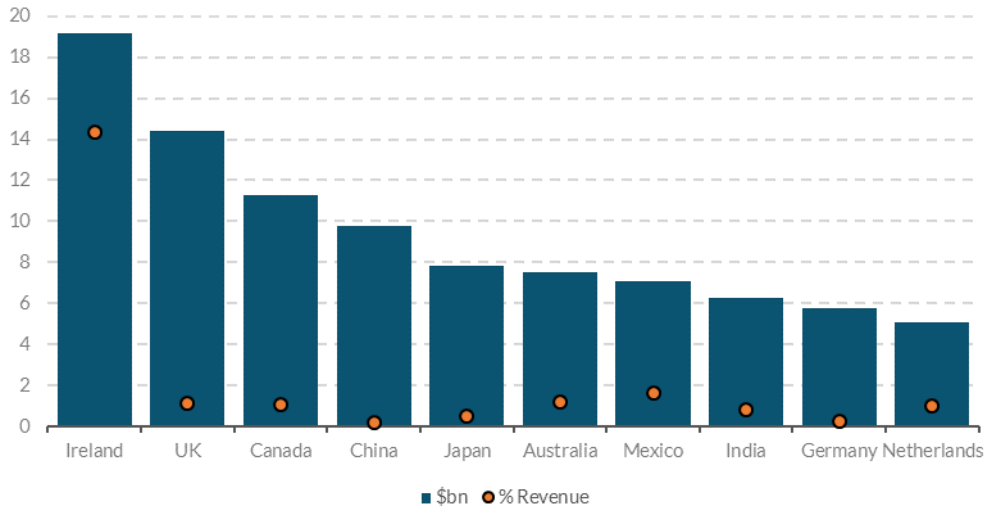
Source: Revenue

Note: MAN – Manufacturing, FIN & INS – Financial and Insurance Activities, WS & RETAIL – Wholesale and Retail Trade, PROF SCI TECH – Professional, Scientific and Technical Activities. Sectors included under the 'OTHER' heading are Construction, Mining and Quarrying, Real Estate, Accommodation and Food, Transportation and Storage, Other Sectors and Agriculture, Forestry and Fishing.

Data published by the Internal Revenue Service (IRS) confirms that the Irish tax base is particularly exposed to changes in US economic policy and the decisions of US MNEs. The data shows that, at $19.2bn, Ireland received more CT from US-owned firms than any other country in the 2022 US tax year (July 2022 to June 2023) in nominal terms, and this represented a significantly higher proportion of overall government revenue in Ireland than in any of the other largest recipients (Figure 4). Using the same IRS data, US MNE's are estimated to have been responsible for three-quarters of all CT received by the Irish Exchequer in the 2022 US tax year, up from 50 per cent in the twelve months to June 2017 (Figure 5) (Cronin, 2025).

Ireland's CT base is notably more reliant on US MNEs compared with other countries

Figure 4: CT paid by US MNEs in 2022 US tax year– Top 10 recipients, € billions and per cent of total tax revenue, %

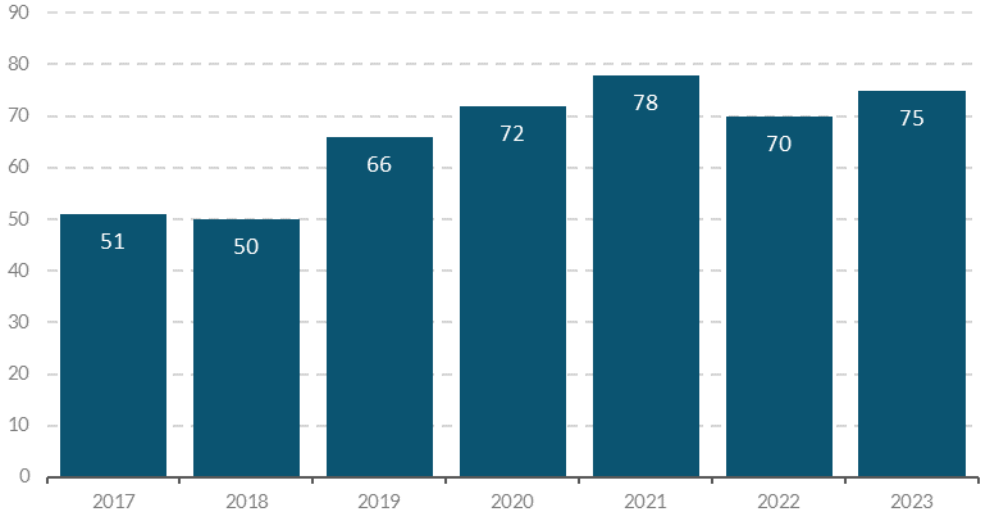


Source: Internal Revenue Service and IMF WEO Databank

Note: The Figure shows the ten countries that received the highest amount of corporation tax from large US multinational enterprises in the 2022 US tax year (July 2022 to June 2023).

US MNEs contribute three-quarters of all CT in Ireland

Figure 5: Share of Ireland's CT receipts paid by US MNEs, %



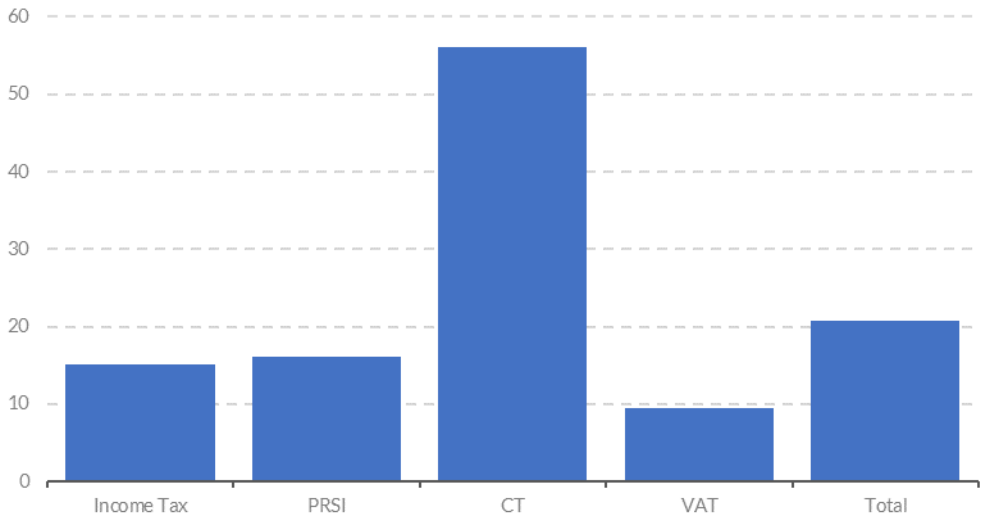
Source: Cronin (2025)

Note: 2017 refers to the 12-month period from July 2016 to June 2017, with each year following suit.

The contribution of foreign-owned MNEs to the Irish public finances is, of course, not limited to CT. Focusing on the manufacturing and ICT sectors – in which there is a particularly large presence of US MNEs - data produced by Revenue highlights the risks to the broader tax base (Figure 6). While foreign-owned MNEs in these sectors were responsible for more than half of all CT receipts in 2023, they also employed around 10 per cent of the workforce and contributed 15 per cent of income tax, USC and PRSI combined. In total, foreign- owned MNEs in the manufacturing and ICT sectors generated at least €22.8bn – or 20 per cent - of all tax and PRSI received by the State in 2023. This emphasises that risks to government revenue are not confined to CT with vulnerability also arising owing to the relative narrowness of the income tax and VAT bases in Ireland (discussed in more detail in Box A).

The manufacturing and ICT sectors account for a fifth of Ireland's total tax revenue

Figure 6: Share of total government revenue (tax and PRSI) paid by Manufacturing and ICT sectors in 2023, %



Source: Revenue and CSO

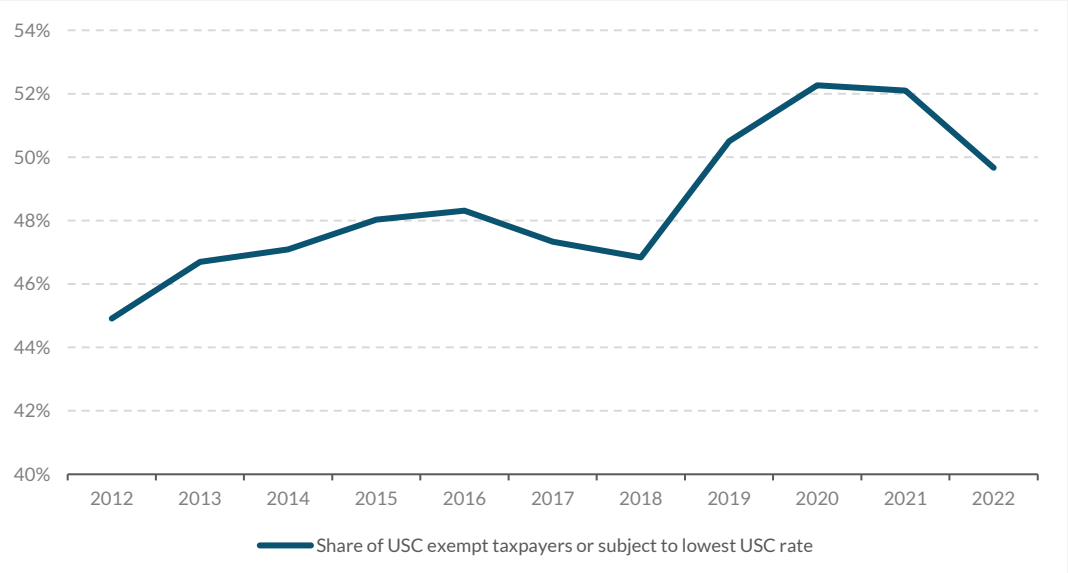
Note: The Revenue data covers €92.9bn – or 85 per cent - of the total €109.9bn in tax and PRSI collected by the State in 2023. Data is not available for other taxes paid by foreign MNEs, such as excise duty, stamp duty, customs, capital gains and capital acquisition tax. Accordingly, the figure of 20 per cent represents a lower-bound estimate of the proportion of overall tax revenue paid by foreign MNEs in the manufacturing and ICT sectors in 2023.

Box A: Personal Income Tax and VAT Bases: Dimensions of Concentration and Narrowness

The personal income tax system in Ireland is one of the most progressive in the European Union: The Gini coefficient of disposable income in 2022 is 21 per cent lower than the Gini coefficient of gross income (income before taxes but after transfers). In comparison, income inequality in the EU for the same year declined by 11 per cent on average once personal income taxes (PIT) are taken into account.[5] As is well documented, however, this large redistributive capacity stems from a narrow tax base (e.g., Irish Tax Institute). Specifically, 8.5 per cent of the highest-income taxpayers in Ireland account for 56 per cent of aggregate PIT revenue (income tax and USC) collected in 2022.[6] In contrast, the bottom 50 per cent contribute 2.6 per cent of revenue.[7]

Increase in the share of taxpayers subject to lowest USC rate or fully exempt

Figure A.1: Share of taxpayers subject to lowest USC rate or exempt, %



The Universal Social Charge introduced in 2011 to replace several levies broadened the tax base somewhat, but with time, the share of fully exempt

[5] Author's calculations based on the OECD's Income Distribution Database. This is a persistent feature of Irish direct taxation relative to the EU: In 2010, direct taxes reduced income inequality by 19.2% in Ireland compared to 10.5% in the EU.
[6] Taxpayers with gross income of 100,000 or higher in 2022.
[7] See https://www.revenue.ie/en/corporate/information-about-revenue/statistics/personal-taxes/income-tax-tables/distributions.aspx

taxpayers and those subject to the lowest USC rate has increased steadily (Figure A.1). In addition, throughout the period 2011 to 2022, the lowest USC rate declined by 2 percentage points (p.p.) and an intermediate rate of 5.5 per cent was added in 2016. These developments resulted in a 4.8 p.p. decline in the share of USC liability borne by the bottom 50 per cent of taxpayers in 2022 relative to 2012, bringing the redistributive power of the PIT system back to its 2010 level.[8]

The present levels of concentration of the tax base leave Ireland's overall tax revenue exposed to domestic and foreign shocks: if high-income taxpayers are mostly prevalent in a few sectors, vulnerabilities arise with respect to sector-specific performance. Similarly, global developments such as the current US trade policy can have major repercussions if a majority of high-earners are employed by foreign multinationals. Importantly, even relatively small employment losses can cause large fiscal disruptions if they disproportionately affect high-income earners. A loss of 1,000 jobs from the gross income range €100,000-€150,000 (or 0.6 per cent of taxpayers positioned in this income band), for example, would result in about 0.11 per cent decline in overall PIT receipts. Crucially, an economic downturn affecting MNEs could contemporaneously bring down both corporate and personal income tax receipts, the two most important sources of government revenue in Ireland. It is therefore important to study the characteristics of high-earners as well as identify opportunities for raising more revenue from consumption-based taxes, which are less sensitive to economic fluctuations.

Column (1) in Table A.1 lists the top four sectors by share of employees earning more than €100,000 a year, i.e. employees in the top 8.5 per cent of earners mentioned above. Four sectors stand out with a particularly high concentration of high-earning individuals — Information and communication; Industry; Financial, insurance and real estate activities; and Professional, scientific and technical activities. In total, they account for 73 per cent of all high earners. Column (2) shows that these 4 sectors further account for close to 50 per cent of total employment by foreign multinationals in Ireland in 2022. The personal income tax base is therefore narrow not only in terms of the income segments contributing to it, but also in terms of its sectoral and firm-type composition leaving Ireland's PIT revenue stream exposed to similar shocks as its corporate income tax base. Broadening the PIT base to

[8] See https://www.revenue.ie/en/corporate/information-about-revenue/statistics/personal-taxes/income-tax-tables/distributions.aspx. PIT Tax bands and credits are not indexed to inflation in Ireland. The adjustments in these over time almost fully match inflation , while changes in the tax code affecting the USC more than offset the effect of inflation.

include more workers in different sectors and across a greater breadth of the income distribution would increase the resilience of this major revenue stream through risk diversification.

Table A.1 – Top four sectors – by share of employees earning more than €100,000 a year

	(1) Sector's share of all workers earning over €100,000, %	(2) Sector's share of total employment in foreign multinationals, %
Information and communication (J)	29.5	11.1
Industry (B to E)	17	16.0 (Manufacturing C)
Financial, insurance and real estate activities (K,L)	13.8	16.8
Professional, scientific and technical activities (M)	12.2	5.5

Note to Table A.1: A total of 127,120 employees across all sectors in Ireland earn €100,000 or more in 2022. The shares in Column (1) are calculated based on this number. A total of 992,023 employees in Ireland in 2022 were employed by foreign multinationals. The shares in column (2) are based on this number.

The Value-added Tax (VAT) Base in Ireland

When it comes to consumption taxes, Ireland collected the lowest fraction of VAT in total revenue from all EU countries in 2022. This ranking is not significantly distorted due to disproportionately large corporation tax (CT) revenue collections relative to other countries: for the same year, VAT revenue in Ireland as a share of GNI* (GNI for other EU countries) was the third lowest in the EU.[9] To understand this current position better, it is worthwhile exploring how well Ireland is leveraging its VAT system to generate revenue from consumption over time.

Figure A.2 plots the C-Efficiency ratio for Ireland vis-à-vis the EU-27 average. The C-Efficiency coefficient is the share of actual VAT revenue receipts from potential revenue collected if total final consumption were taxed at a single VAT rate (no policy gap) and if non-compliance and fraud were absent (no compliance gap).[10] Thus, a C-Efficiency lower than 100 per cent would capture both the effect of reduced rates, exemptions, and other legislative instruments narrowing the consumption tax base, and behavioral

[9] Source: Eurostat.
[10] The exact formula is: Vat revenue/(total final consumption—vat revenue)*standard VAT rate.

responses by economic agents that are non-compliant with the VAT law. The C-Efficiency of VAT in Ireland in 2023 was 0.48, i.e. an estimated 52 per cent of the theoretical potential VAT revenue is not collected.[11] Prior to the global financial crisis, Ireland's C-efficiency was significantly higher than the EU average, but declined by relatively more after 2008 and has stayed at this considerably lower level up to 2023 (Figure A.2). This development is mainly due to a combination of changes in the composition of consumption and further narrowing of the VAT base by the introduction of an additional reduced rate for hospitality, and is not related to compliance.

Post-2008 consumption recovered mainly from expenditure on Housing, water, electricity, gas and other fuels, Health, Transport, and Restaurants and hotels—consumption categories with large prevalence of reduced VAT taxation or exemptions, while standard-rated categories such as Furnishings, household equipment and household maintenance exhibit a pronounced decline in line with the collapse – and subsequent muted recovery – of the construction sector in Ireland.[12] The widespread application of reduced and zero rates to a variety of goods and services has been highlighted as the key factor behind the relatively narrow consumption tax base in Ireland by the Commission on Taxation and Welfare and more recently also by the OECD.[13, 14]

This analysis suggests that there is scope for base broadening in both the consumption and the personal income tax bases. Such broadening could finance, for example, increased capital expenditure in a budget-neutral

[11] In the context of Ireland, it is important to decompose the C-efficiency ratio into a policy and compliance gap in order to target base broadening accordingly and swiftly if required by policymakers.

[12] Comparing two years with very similar levels of total consumption (2007 and 2015), the share of consumption expenditure for health from total consumption has increased by 61 % in 2015 relative to 2007, by 30% for education, by 17% for housing, water, electricity, gas and other fuels, and by 14% for restaurants and hotels. Consumption in these sectors is to a very large extent subject to reduced or zero VAT rates. In contrast, the share of consumption expenditure for consumption categories mainly taxed at the standard VAT rate has declined: by 31% for Furnishings, household equipment and routine household maintenance, by 13% for clothing and footwear, by 11% for alcoholic beverages, tobacco and narcotics, etc. In addition, in 2011 a new reduced rate of 9% was introduced for the tourism and hospitality sector. See also the discussion on revenue developments after the Global Financial Crisis by Addison-Smyth, Diarmaid, and Kieran McQuinn. "Quantifying Revenue Windfalls from the Irish Housing Market." *Economic & Social Review* 41.2 (2010).

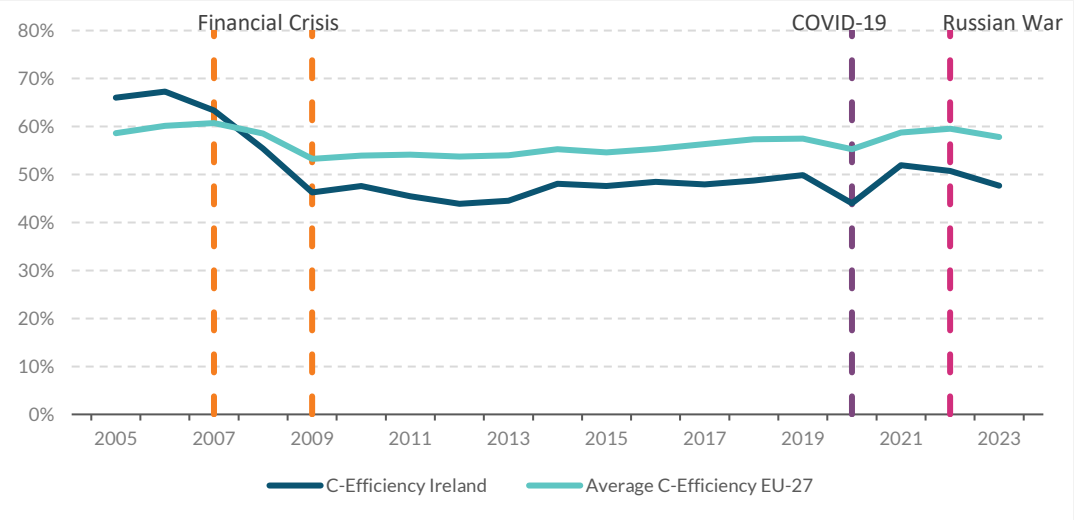
[13] Commission on Taxation and Welfare, Foundations for the Future: Report of the Commission on Taxation and Welfare, 2022. https://assets.gov.ie/static/documents/foundations-for-the-future-report-of-the-commission-on-taxation-and-welfare.pdf

[14] OECD (2025), OECD Economic Surveys: Ireland 2025, OECD Publishing, Paris, https://doi.org/10.1787/9a368560-en.

manner or reduce concentration-related vulnerabilities in tax revenues. Whatever the objective, decisions on broadening the tax base should be accompanied by a careful assessment of the distributional consequences of changes in VAT's reduced and/or standard rates or PIT rates/brackets to ensure that any revenue changes are also welfare-enhancing.

Consumption tax base in Ireland narrower than EU average

Figure A.2: Comparison of C-Efficiency Ratio (IE vs EU-27 Average)



2.2. Scenario analysis – weaker economic growth with a loss of excess CT and lower MNE investment

Concerns about the reliance of the Irish public finances on CT receipts have been widely reported in recent years, but risks to this source of revenue appear to have become more acute since the beginning of the year. These reflect changes in US economic policy, most notably the introduction of tariffs on the import of goods to the US. Alongside the imposition of tariffs, other changes in US economic or fiscal policy could affect CT revenue in Ireland through a number of channels, ultimately related to the relative rate of return US MNEs generate from their Irish-resident operations. Those channels are:

- **Trade channel:** the imposition of tariffs is likely to reduce trade flows between Ireland and the US. This lower level of activity would reduce MNE profits and CT payments.
- **Supply chains:** the supply chains of multinational firms are in many cases complex and interconnected. Large shift in trade policy in the direction of greater fragmentation could lead to disruption to these supply chains with negative implications for firms' costs and profitability.

- **FDI and Production channel:** if tariffs are maintained over time, this could act as a disincentive for US firms to locate production in Ireland, leading to a reduced inflow of multinational investment. Additional changes made to the US tax code or industrial policy to further incentivise relocation of production could strengthen this channel further. Changes such as these could also lead to a reversal of the strong IP inflows to Ireland that have occurred in recent years and that have underpinned the growth in excess or windfall corporation tax revenue.[15]

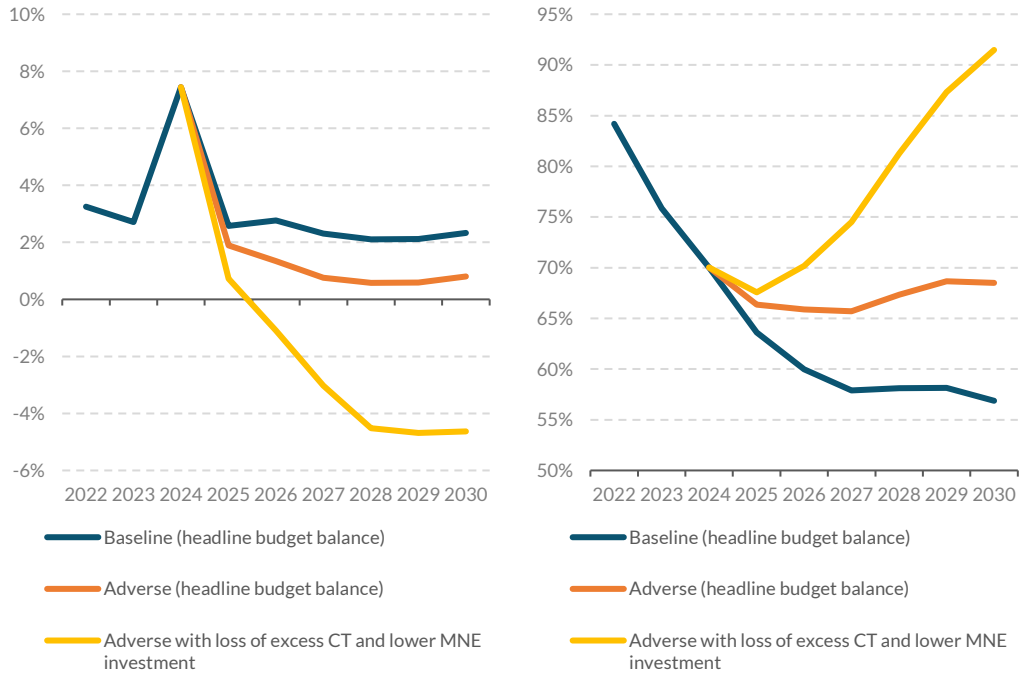
To assess the risks to the fiscal position over a longer period taking account of CT and wider MNE-related risks, we extend the baseline fiscal projections presented in Central Bank of Ireland *Quarterly Bulletin 2* out to 2030. In this extended baseline the headline GGB is expected to stabilise at a surplus of just over 2 per cent of GNI* from 2027 onwards, with the general government debt (GGD) ratio falling below 60 per cent of GNI*.[16] Given the changing geopolitical landscape, excess CT receipts are assumed to peak at €17.3bn (5 per cent of GNI*) in 2026, when they are boosted by the introduction of BEPS Pillar II, and to remain at that level out to 2030.

An *adverse* scenario is presented in *Quarterly Bulletin 2 2025* showing the possible path of economic activity based on higher tariffs, more prolonged uncertainty and tighter financial conditions than the assumptions underpinning the *baseline* forecast. In the *adverse* scenario, MDD grows at an annual average rate of 1.2 per cent from 2025 to 2027, slower than the 2.1 per cent annual average growth in the baseline. The weaker pace of economic growth in the *adverse* scenario would feed through to tax revenue which would grow more slowly than in the *baseline*, while government expenditure would increase relative to the baseline reflecting the higher unemployment rate. As a result, the headline general government surplus in the *adverse* scenario would fall to below 1 per cent in 2027, compared to a projected surplus of 2.3 per cent in the *baseline*.

[15] In the event of a reversal of IP, depending on the nature of the transactions and precise accounting treatment by statistical authorities, there could be a large impact on measured GDP and the capital stock, while it is likely that GNI* would be less affected.
[16] For the period 2028 to 2030 revenue growth is driven by longer term macroeconomic assumptions outlined in Conefrey et al (2024), while expenditure reflects internal estimates of 'stand still' spending. Stand still spending is government expenditure required to maintain existing levels of public services given demographic changes, price developments and previously announced policy measures (primarily the National Development Plan). For public debt projections, it is assumed that the deficit-debt adjustment (DDA) evolves in line with the Department of Finance's Budget 2025 projections.

Subdued economic growth with a loss of excess CT and weaker MNE activity would result in a large budget deficit

Figure 7 – GGB and GGD following loss of excess CT and lower MNE investment (per cent of GNI*)



Source: own estimates.

Note: The *baseline* refers to the projection for the headline General Government (GG) balance in *QB2* 2025. The *adverse* represents the path for the headline GG balance consistent with the *adverse* scenario in *QB2*. The *adverse with loss of excess CT and lower MNE investment* shows the estimated GG balance if these additional negative shocks are layered on top of the *QB2 adverse* scenario.

The underlying GGB – which excludes excess CT – has recorded persistent deficits in recent years and, as noted, there are particular concerns over the long-term sustainability of revenue from this source. A loss of excess CT may not materialise in isolation but could occur alongside reduced activity by multinational firms in Ireland. To illustrate the potential impact if this risk materialised, we consider a scenario where a four-year loss in excess CT occurs alongside a decline in physical investment by foreign-owned multinationals in Ireland. We implement this scenario as a 20 per cent reduction in tradable sector investment and a corresponding loss of export market share.[17] The scenario can be interpreted as estimating the impact of a

[17] Modified M&E investment jumped by 35 per cent in 2022 driven by higher activity by MNEs in Ireland and investment has remained elevated at close to its 2022 level up to 2024. The

reduced flow of new inward investment by MNEs in Ireland, rather than a reduction in the existing capital stock. These additional negative shocks to excess CT and MNE investment are layered on top of the *adverse* scenario in *QB 2*. This could be considered a somewhat extreme scenario as it incorporates a loss of all excess CT by 2030 along with weaker economic activity, but it is illustrative of a key vulnerability for Ireland relating to the future path of the foreign-owned capital stock. This scenario would result in a budget deficit of over 4 per cent by 2030 and the debt ratio as a share of GNI* would rise sharply to 90 per cent (Figure 7). It is important to note that this exercise assumes that no corrective action is taken to mitigate the loss of excess CT and other tax revenue which occurs in this scenario. It also assumes that the Government continue to make contributions to the long-term savings funds and to increase cash balances in net terms from 2026 onwards, as outlined in Budget 2025. In reality, the Government might choose to utilise funds in the Infrastructure, Climate and Nature Fund should an adverse scenario occur.

3. Public Investment

The current environment presents a balancing act for budgetary policy. The economic and fiscal outlook is clouded by uncertainty and, as illustrated by the scenarios in the previous section, there are considerable downside risks. At the same time, a key current public policy priority is the need for higher public investment to close infrastructure gaps, improve competitiveness and to boost the economy's long-term potential growth. This section describes recent changes in the level of nominal and real public investment and the capital stock. Scenario analysis is used to illustrate the trade offs faced by the government in delivering large increases in public investment while at the same time ensuring that economic growth and the public finances remain on a sustainable path.

3.1. Recent developments in nominal and real public investment

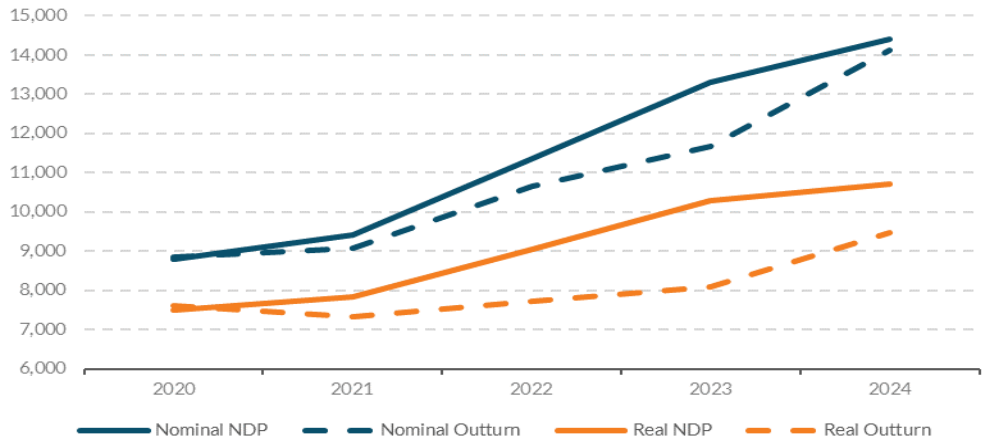
Following a period of stagnation in the years following the financial crisis, nominal capital spending has more than tripled over the past decade, underpinned by the National Development Plan (NDP). The NDP, updated in 2021, set out an investment package worth €165bn alongside a ten year plan to reach public investment levels of 5.4 per cent of GNI* by 2024, with that

MNE investment scenario is consistent with a reduced flow of MNE activity such that the level of modified M&E investment returns to its pre-2022 trend.

level then broadly maintained to 2030.[18] In nominal terms, spending levels are close to the original NDP ceilings as public investment rose by around €2.5bn in 2024 – or more than 20 per cent – to total €14.1bn (Figure 8). However, accounting for inflation, real investment shows a larger gap against expectations around the time of the NDP publication. For example, in 2024, real investment amounted to €9.5bn against an expected €10.7bn when Budget 2022 projections are adjusted to take account of inflation.

Nominal investment spending has grown significantly but the increase in real terms has lagged NDP projections

Figure 8: Government investment outturn v NDP, € millions



Source: CSO, Budget 2022, NDP and authors' calculations

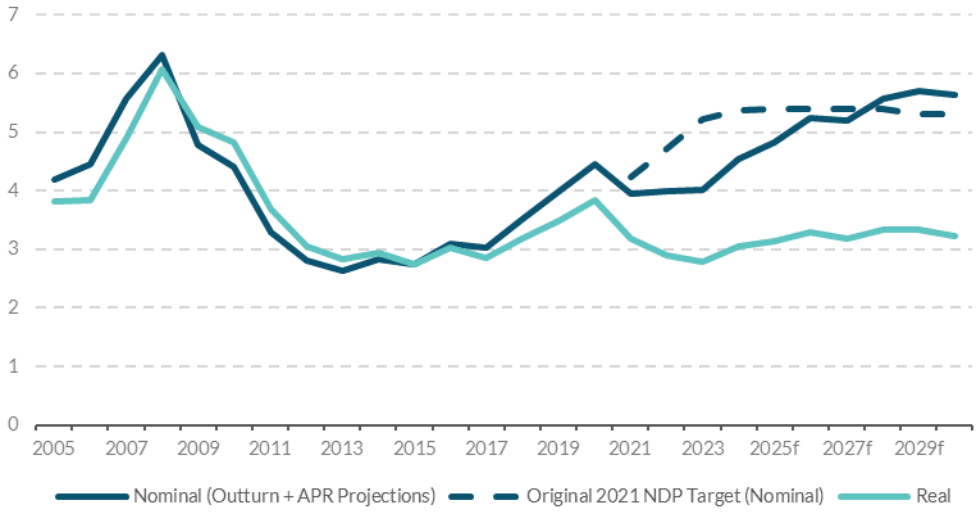
Note: NDP data reflects Budget 2022 forecasts, with the real series deflated using QB4 2021 deflator for modified investment. Outturn data reflects CSO actuals, with the real series deflated using the QB1 2025 deflator for modified investment.

Nominal investment expressed as a share of GNI* in 2024 also fell short of expectations at the time of the NDP, at 4.6 per cent with the equivalent figure for real investment standing at 3.1 per cent in 2024 (Figure 9). This difference highlights the extent to which strong growth in economic activity (GNI*) and higher inflation than envisaged at the time of the NDP in 2021 has resulted in the level of real investment as a share of national income rising only gradually, despite a large rise in nominal expenditure.

[18] The NDP forecasts Exchequer investment to reach 5.1 per cent of GNI* in 2024, with this level broadly maintained to 2030. To derive investment in general government terms, we use the Budget 2022 government investment projections as a proxy for the NDP targets in general government terms. Budget 2022 was published after the revised NDP and so we assume the public investment projections are consistent. The same approach was followed by Conroy, Casey and Jordan-Doak (2021).

High inflation has dampened real investment levels

Figure 9: Gross fixed capital formation as a share of GNI*, %



Source: CSO, Budget 2022, NDP and authors' calculations

Note: Data until 2024 is outturn data on general government (GG) gross fixed capital formation. Values from 2025-2030 reflect Department of Finance projections in the Annual Progress Report 2025 (extended for the period 2027 to 2030 using the forecast growth rates in Budget 2025). The original target NDP path (dashed line) was derived using Budget 2022 forecasts for GG gross fixed capital formation and GNI* for 2021 to 2025. Then, 2026 to 2030 is obtained by applying the year-to-year change in the NDP published ratio for Exchequer funding of capital expenditure as a share of GNI*.

Nominal government investment growth is projected to remain very strong in the coming years, increasing by an average of 14 per cent per annum in 2025 and 2026.[19] As a result, nominal investment levels as a share of GNI* are projected to exceed the NDP capital ceilings from 2028, while the share of government spending allocated to capital investment is projected to reach 14 per cent by 2030, up from 9 per cent at the beginning of this decade. Despite these large nominal increases, in real terms, government investment is projected to stabilise at around 3.5 per cent of GNI* over the next five years cent (Figure 9 above). This is below its long run average of 3.8 per cent.

Therefore, while spending levels exceed their previous peak 2008 level in real terms in 2025, investment deficits may remain for two key reasons. Firstly, given the past under-investment (particularly during the Economic Adjustment Programme over 2010 to 2014), a sustained period of higher investment is

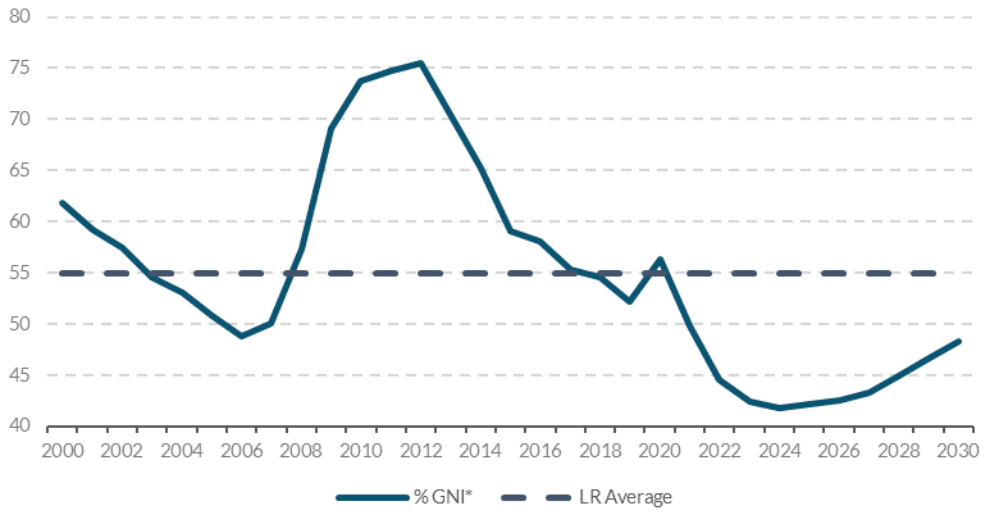
[19] We have incorporated the latest information published by the Government in the May 2025 Annual Progress Report. This only included GGB projections for the period 2025 to 2026. For later years we incorporate the forecast growth rates published in Budget 2025.

likely required to make up for the foregone past investment. Secondly, the economy is larger than projected at the time of NDP publication. In 2024, GNI* is estimated to have exceeded Budget 2022 projections by 15 per cent. Therefore, the original investment targets in the NDP may not fully reflect the investment needs of Ireland's larger economy today.

Nevertheless, the significant increases in government investment planned over the coming years are expected to support a recovery in the public capital stock. We follow the approach of Hickey et al. (2018) and use adjusted non-financial assets (NFA) of the government as a proxy for the public capital stock after removing the impact of valuation changes. This is a useful approach as valuation changes are not informative when it comes to determining the impact that the public capital stock has on future growth. It also takes account of the depreciation of capital assets. The adjusted NFA has grown significantly since 2018, with further increases anticipated out to 2030 (averaging 7.4 per cent per annum). However, as a share of GNI*, the public capital stock in 2024 was at a low level by historical comparison and is expected to remain below its long-run average at the end of the decade (Figure 10).

The public capital stock is expected to rise but to remain below its long-run average

Figure 10: Adjusted non-financial assets as a share of GNI*, %



Source: Authors' calculations

Note: Adjusted NFA is used as a proxy for the public capital stock. We take the part of general government net worth that is related to non-financial assets in 2000 as the base. This is subsequently adjusted for the change in net worth due to the net acquisition of non-financial assets in each year. This removes the impact of valuation and other changes resulting in an estimate of the capital stock that is more closely aligned with the assets that can be used to support production in the economy.

3.2. Increasing public investment: macroeconomic and fiscal considerations

Two of the most urgent areas that require additional investment are housing and decarbonisation. In terms of the former, Central Bank analysis published in 2024 computed the additional number of housing units that would be needed each year above the number delivered in 2023 to meet the structural demand for housing arising from demographics and trends in headship rates.[20] In particular, an additional 19,000 units would be needed each year to enable convergence to UK headship rates by 2050.

In terms of climate targets, statutory obligations commit the state to reducing Irish greenhouse gas emissions by 51 per cent by 2030 (relative to 2018) and to achieving climate neutrality by 2050 (NCAP, 2024). Moreover, CCAC (2024) recommends a set of five-year carbon budgets over the transition period that is consistent with achieving these targets. Decarbonising Ireland's energy system will require a significant increase in investment, which will have both a public and private component. Using estimates from Daly et al (2024), together with imputations for investment in the energy grid and transport infrastructure, McInerney and FitzGerald (2024) project that limiting emissions to within the carbon budget recommended by CCAC would require additional investment of close to 55 billion euro (in 2020 prices), 20 per cent of which would be financed by the State.[21]

Figure 11 illustrates the potential path of additional public investment in housing and climate-related measures that would be required to meet the Government's targets in these areas over the next decade. The path of additional investment in housing is consistent with Irish headship rates converging on UK rates by 2050 and assumes a 50 percent private-public financing mix (Central Bank, 2024). In this scenario, public investment in housing would need to rise by approximately €1.8 billion per annum, in nominal terms, which would support the construction of around 10,000 additional new housing units each year over the period.

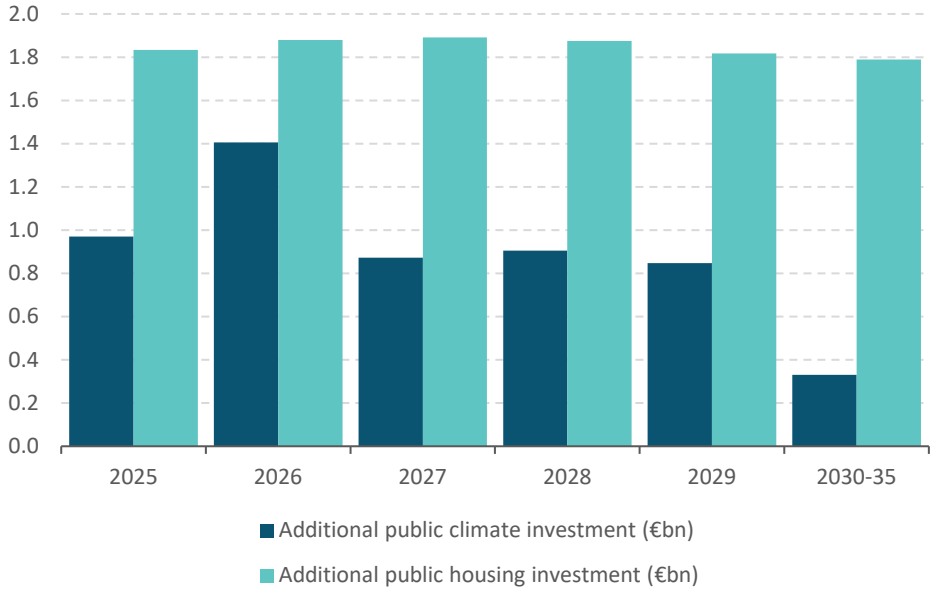
Figure 11 also highlights how the profile of additional investment in decarbonisation is heavily front loaded over the next five to six years. In particular, over 90 percent of the *public* share of the investment needed to meet Ireland's emission reduction targets is required to be spent by 2030.

[20] Headship rates show the proportion of a population that is the head of a household.
[21] The 'additional' investment computed in those projections is relative to that projected under the EPA's "with existing measures (WEM)" scenario, as simulated by the TIM model of the Irish energy system (Daly et al, 2024).

This investment is mainly aimed at reducing energy demand through retrofitting, at upgrading and expanding the energy grid, and at developing transport infrastructure.

Higher public investment required to meet climate and housing targets over the next decade

Figure 11: Estimated additional public investment needed to meet housing and climate targets, € billions



Source: Conefrey et al (2024) and McInerney and FitzGerald (2024)

We now use the Central Bank's semi-structural model of the Irish economy to examine the macro-fiscal impact of increasing public investment under alternative assumptions about the degree of excess capacity in the economy and the choice policy instruments used to finance the additional investment.

3.2.1 Impact of public investment with and without capacity constraints

At present, there is significant uncertainty over the pace of economic growth in the coming years, as discussed in *Quarterly Bulletin 2*. Reflecting this, we first consider a scenario in which the required increase in investment takes place when the supply of labour is relatively elastic so that the economy can more easily accommodate the rise in aggregate demand without significant upward pressure on prices (*without capacity constraints*). We compare the outcomes under this scenario to the case where labour supply is tighter and capacity constraints are more binding in the short run (*with capacity constraints*). In both cases, it is assumed that the government finances the additional spending using the proceeds of the Apple State Aid Case (€14.1

billion) with the remainder from issuing debt. These forms of financing will have the most expansionary fiscal and macroeconomic impact in the short run. This is because in both instances – funded by borrowing and funded by windfall tax revenue – there is an injection of money into the economy without any offsetting withdrawals elsewhere in the budget. In the next section, we examine the effect of the additional investment if taxes are raised to fund the balance of the investment spending rather than issuing debt.

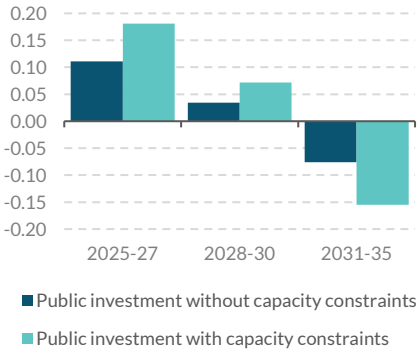
The results highlight how there is quite a high degree of state-dependence in the impact of the additional public investment (Figure 12). Consumer prices rise considerably more in the short and medium term when the economy is assumed to be at full employment than when there is some spare capacity (Figure 12a). The tight labour market raises the bargaining power of workers, which leads to strong real wage growth over that period, thus boosting real incomes (Figure 12b). However, higher inflation and the orientation of demand towards the domestic economy causes a real exchange rate appreciation, which reduces Ireland's competitiveness abroad. This is reflected in the significant fall in the output of the traded sector over the scenario horizon in the scenario *with capacity constraints* (Figure 12c).

In the short term, overall output is slightly higher in the scenario *with capacity constraints* as high consumption growth supported by the increase in real wages raises demand along with the investment stimulus (Figure 12d). Over the longer term, the imbalances created by the larger increase in prices (compared to the case without capacity constraints) puts downward pressure on inflation and leads to more muted growth in real incomes. The imbalances created by the reorientation of the economy away from external demand cause a further drop in the output of the traded sector (Figure 12c). Overall, in the long run *with capacity constraints* aggregate production is lower than when there is some spare capacity due to a combination of factors including the fall in real incomes reducing consumption growth and the decline in net exports due to the deterioration in competiveness (Figure 12d).

Macroeconomic effects of higher public investment affected by prevailing cyclical conditions

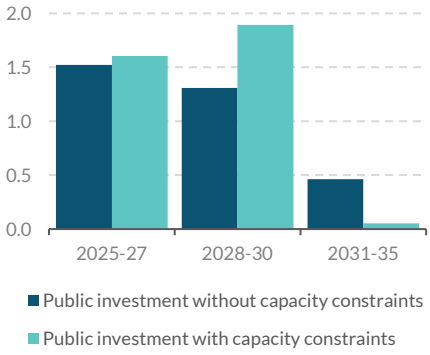
Inflation

Figure 12a
per cent deviation from baseline



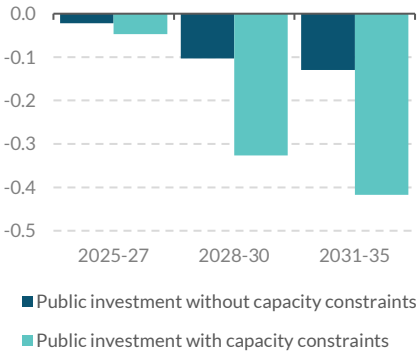
Real Income

Figure 12b
per cent deviation from baseline



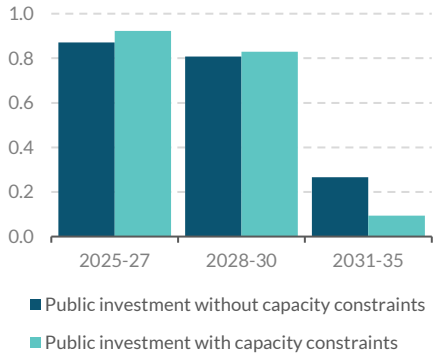
Traded Sector Output

Figure 12c
per cent deviation from baseline



Total Output

Figure 12d
per cent deviation from baseline



Source: Authors' calculations

3.2.2 Impact with capacity constraints and alternative modes of financing

The scenarios discussed above assumed that the additional government investment was financed using a combination of the windfall Apple State Aid receipts and debt. This assumption generates a more expansionary macro-fiscal impact than if this spending were funding by different combinations of lower spending in other areas or higher taxes. We now examine how this impact varies according to alternative assumptions about the mode of financing.

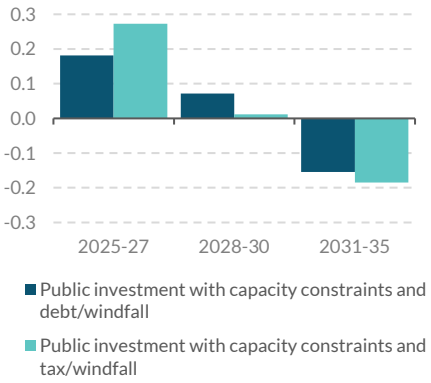
We continue to assume that the Government allocates all of the €14.1 billion received from Apple State Aid case to financing additional investment over the next decade but that the outstanding investment not covered by this windfall is now funded through a combination of higher indirect (VAT) and personal taxes. We note that this particular parameterisation of the funding mix is a technical assumption that simplifies the calibration of the exercise. In

reality, the appropriate mix is a policy choice that would seek to balance equity and efficiency trade-offs and may comprise different configurations of revenue-raising and spending-reducing measures. It should also be noted that raising distortionary taxes, such as those on labour, likely has a greater contractionary effect on economic activity than if 'flat' (lump-sum) or consumption tax rates were increased instead.

With full-employment conditions, raising tax revenue can ease overheating pressures when public investment is increasing

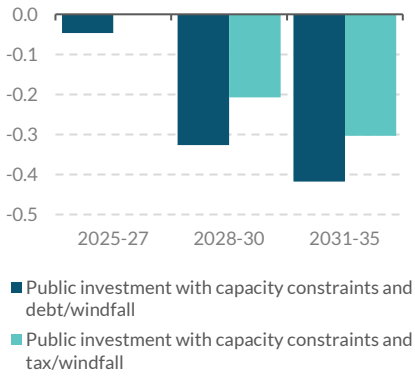
Inflation

Figure 13a
per cent deviation from baseline



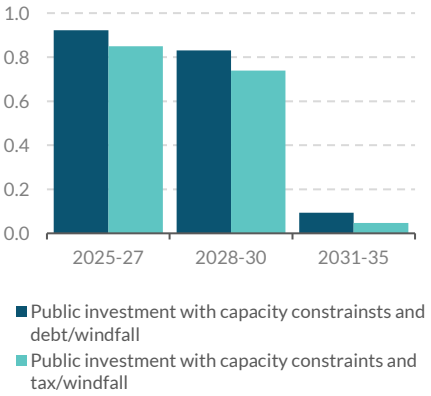
Traded Sector Output

Figure 13b
per cent deviation from baseline



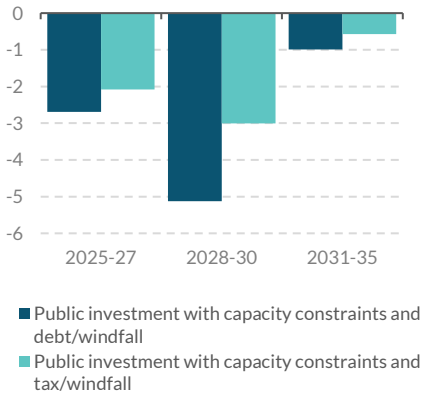
Total Output

Figure 13c
per cent deviation from baseline



Public Debt Ratio

Figure 13d
per cent deviation from baseline



Source: Authors' calculations

Figures 13a through 13d compares the impact of the investment shock on a capacity-constrained economy when the investment is financed by debt and when it is financed by a combination of windfall receipts and higher taxes. Inflation rises more in the short run in the tax/windfall case than when investment is financed by debt due to the direct impact of higher VAT rates

on the level of consumer prices. However, inflation is lower in the former case over the medium to long term as the increase in taxes lowers real disposable incomes and dampens domestic demand. This reduces labour demand and leads to more muted wage growth in response to the investment stimulus, which contributes to lower inflationary pressures.

All else being equal, the damping effect of the tax increases on inflation and domestic demand results in a smaller appreciation of the real exchange rate and thus to a smaller loss in competitiveness against Ireland's trading partners, compared to the scenario where the investment is funded by the windfall and debt. Figure 13b shows that the fall in the output of traded sector is about one-third smaller in the medium to long run relative to the case in which additional investment is windfall and debt-financed. Thus, while the overall macroeconomic impact in terms of total output in the scenarios is quite similar, the composition of the increase in output is different, with debt-financed investment resulting in higher domestic demand but lower external demand. Finally, on the fiscal side, financing the required increase in investment through windfall receipts and higher taxes has a similar impact on the debt ratio over the longer terms to the case where a combination of debt and windfall receipts is used. Thus, while the level of debt is lower in the former, the level of output is also lower so that the difference in the debt ratio is relatively small. We note however, that if the scenario horizon were marginally extended, the debt ratio in the scenario with tax-financed investment would be lower than in the scenario with debt financing.

This scenario highlights how, in the context of injecting an investment stimulus into an economy with capacity constraints, different configurations of the policy mix can used to dampen demand and manage potential overheating pressures. Accordingly, the appropriate calibration of policy levers could concurrently facilitate convergence towards housing and decarbonisation targets, mitigate short- to medium term competitiveness concerns and improve the long-run sustainability of the public finances.

Box B: Delivery of public investment in the presence of planning and construction delays

The delivery of public investment in Ireland is frequently subject to delays related to planning or construction, but most often the delay is due to a combination of both factors. There are several examples of large-scale public investment projects in Ireland that have been planned and announced, but then delayed. These often relate to the provision of public utilities such as water, transportation or health care. These are public goods and therefore have a positive externality for the provision of private goods as well as potential wider benefits for society.

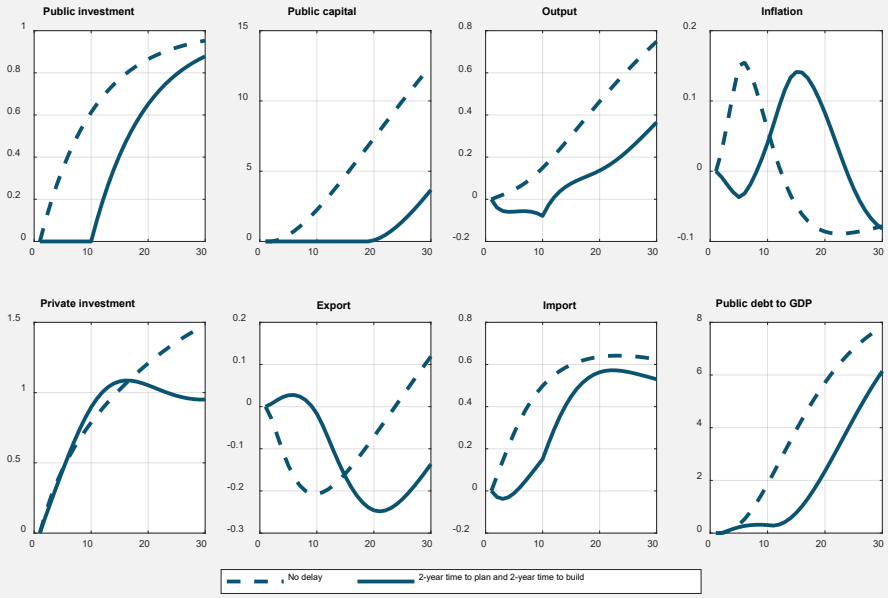
We use the Central Bank's DSGE model of the Irish economy to analyse the economic effect of construction and planning delays. In particular, we simulate a gradual, but permanent, increase in public investment of 1 p.p. of overall output (Figure B.1).[22] An increase without delays (dashed line) leads to an immediate increase in public capital, output, and private investment. There is a temporary and mild increase in inflation, which is caused by the demand stimulus from higher public investment, but this effect is overcome by the beneficial effect of higher public capital in about three years, which reduces inflation and is fostering the increase in exports. In contrast, a combined 2-year delay in planning and construction (full line) delays the increase in output by more than four years and causes fluctuations in inflation, which decreases in the short run and increases further out in the future (Figure B.1). The latter causes a worsening of competitiveness in the future, leading to a stronger and more persistent fall in exports and an increase in imports, thus worsening the external balance further out in the future. The delay leads to a mild contraction in short-run output and a lower and delayed increase in private investment.

In summary, delays during the planning and construction phases of investment projects are commonplace in Ireland. Reducing these delays and improving efficiency in the delivery of capital projects would ensure that the benefits of higher public investment accrue sooner and have a larger overall positive impact on the economy.

[22] In all cases we consider a debt-financed increase in public investment to avoid the confounding effects of financing with distortionary taxes.

Benefits of higher public investment enhanced when planning and construction delays are reduced

Figure B.1: effect of higher public investment, deviation from baseline, %



Notes: The lines are model-based responses to a gradual and permanent increase in public investment of 1 p.p. GDP. The units on the vertical axis are percent deviations from the baseline (except inflation, which is in p.p. deviations). The units on the horizontal axis are quarters.

4. Long-term expenditure pressures – implications for near-term policy

The Government created two new State savings funds in 2024 – the Infrastructure, Climate and Nature Fund (ICNF) and the Future Ireland Fund (FIF). The purpose of the ICNF is to ensure funding is available to support a continuance of capital spending in the event of a downturn, while also providing resources for designated environmental projects from 2026 onwards. Following an initial transfer of €2bn from the dissolution of the National Reserve Fund (NRF) last year it will be funded by an annual €2 billion transfer from 2025 to 2030, but withdrawals can begin in 2026.

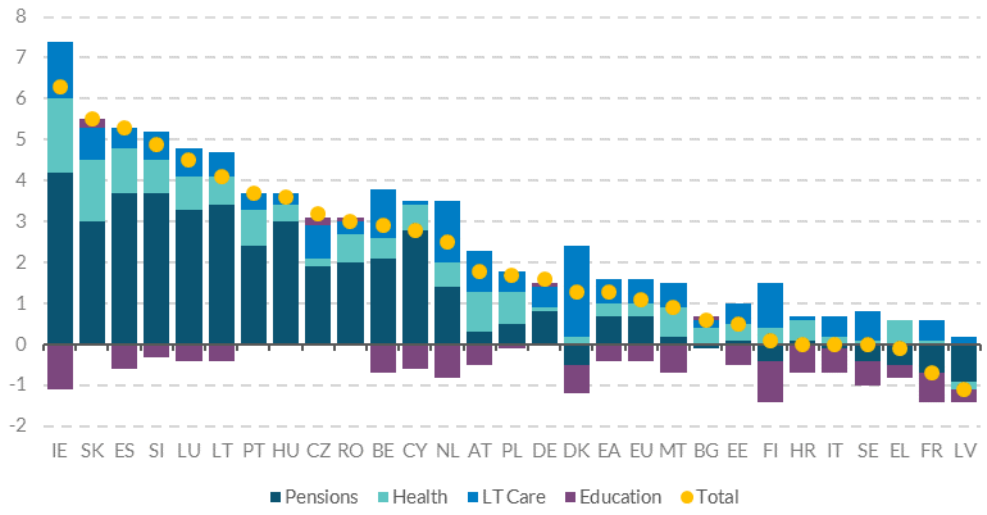
The FIF takes a longer-term perspective, having been established to help deal with future recognised expenditure pressures, most notably ageing, climate and digitalisation. An initial €4.3 billion was transferred to the FIF in September 2024 following the dissolution of the NRF and an additional €4.1 billion (0.8 per cent of GDP) was transferred in October 2024 bringing the overall balance in the fund to €8.4 billion at end 2024. Payments amounting to 0.8 per cent of GDP are scheduled to continue up to 2035. In the event of a

significant deterioration in the public finances, the Minister for Finance may seek to reduce the amount payable to the FIF in any given year. The Minister may also opt to increase the payment in a given year. As a long term savings fund, managed by the NTMA on a commercial basis, withdrawals are only possible from 2041 onwards. Estimates from the Department of Finance suggest that, based on assumptions for future GDP growth and the return earned on investments, the fund could grow to €100 billion by 2040.

The creation of the FIF recognises that Ireland will experience significant population ageing over the coming decades. While this is the case in most advanced economies, data from Eurostat shows Ireland will register one of the largest demographic shifts in the EU. In 2022 just 15 per cent of the Irish population were aged 65 or over, a figure that is projected to increase to 25.5 per cent in 2050. These changes in the demographic structure have major implications for the public finances.

Ireland will experience the largest increase in age-related spending in the EU between 2022 and 2050

Figure 14: Change in age related expenditure by component over 2022-2050, % of GDP



Source: European Commission 2024 Ageing Report.

Note: Irish figure is shown as a percentage of GNI*.

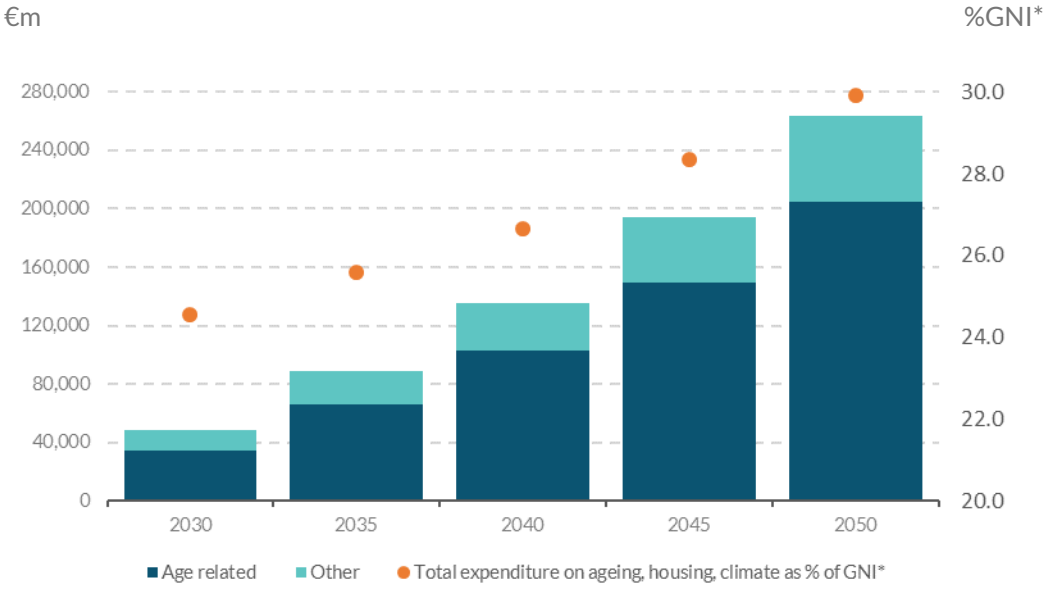
Age-related spending on areas such as pensions, healthcare and long-term care will record large increases, with a smaller proportion of the population to finance them. European Commission data suggests that Ireland will experience the largest increase in age-related spending in the EU between 2022 and 2050 - 6.4 percentage points of GNI* - led by developments in

pension expenditure (23.3 per cent to 29.6 per cent). This compares to an EU-wide increase of 1.1 per cent of GDP over the same period (Figure 14). In nominal terms this would result in a steady increase in age-related expenditure over the coming decades, from just below €80bn in 2025 to €284bn per annum in 2050. Taking the Department's estimate of a total potential FIF balance of €100 billion by 2040, an annual withdrawal of 3 per cent of the value of the fund per annum (in line with the rules of the FIF) would be sufficient to cover, on average, around one third of the estimated annual increases in ageing costs per annum from 2041.

As outlined in Section 3, additional expenditure will also be required over the coming years to meet housing and climate targets. When this expenditure is included along with higher age-related payments, total spending would rise by €265 billion by 2050 (Figure 15). In this case, annual withdrawals of 3 per cent from an assumed total FIF balance of €100 billion by 2040 would, on average, cover just under one-quarter of the total annual increase in expenditure related to ageing, climate and housing from 2041.

Expenditure on ageing, climate and housing projected to rise by €265 billion by 2050

Figure 15: Cumulative change in public expenditure related to ageing, climate and housing, from 2025 level



Source: Authors' calculations

Note: Bars show cumulative change in spending from 2025 level related to ageing, climate and housing. Circles show total level of expenditure on ageing, climate and housing as a percentage of GNI*.

These estimates show that the accumulated resources in the FIF are likely to be insufficient to pay for the additional long-term expenditure pressures on the public finances over the coming decades. This assumes that contributions to the FIF are maintained annually out to 2035 and that the fund earns a positive rate of return. In the event of a significant loss of corporation tax revenue, future contributions to the fund could be lower, reducing its size over the longer term. This would imply that the proportion of future expenditure increases linked to ageing and other pressures that could be covered by the fund would be further reduced, leaving an even larger gap between available revenue resources and estimated expenditure needs. While the existence of the Future Ireland Fund is welcome, this analysis indicates the need for additional revenue-raising measures to be introduced over the coming years so that the public finances can be maintained on a sustainable footing while government expenditure is rising.

5. Conclusions

Over the past decade, the public finances have benefited from the fast pace of growth in employment and economic activity at rates above historic norms and from surging corporation tax revenues. This pushed the headline budgetary position into surplus despite a large increase in government expenditure. Recent developments negatively affecting international trade and the broader global economy have the potential to create a less benign environment for the Irish economy and public finances over the coming years, compared to the experience up to the end of 2024. In particular, risks to the fiscal position from a loss of CT and other MNE-dependent taxes have increased materially given recent international developments. While over the short term, it is possible that corporation tax revenues could rise further, concerns over the long-term sustainability of revenue from this source have not dissipated and the risk of a reversal remains. The analysis in this paper shows that in an adverse scenario assuming a loss of current excess CT, weaker economic growth and lower MNE investment, the budget would move into a persistent deficit position out to 2030.

If implemented effectively, increases in public investment can improve competitiveness and boost the potential growth rate of the economy in the face of the current challenging external environment. Higher investment is required to address infrastructure gaps across a range of areas as the level of the real public capital stock remains low. If economic growth slows materially (for example, as in the adverse scenario), then this investment could be absorbed with a lower risk of excess demand and inflationary pressures. If the

economy remains close to capacity, offsetting revenue raising measures would be required to create the necessary economic and fiscal space to facilitate the rise in capital spending sustainably. Reforms that reduce delays in the planning and building of infrastructure would help to ensure that the benefits of public investment for long-term growth are fully realised.

Outside demand-management considerations in the short term, additional revenue-raising measures are needed to safeguard fiscal sustainability over the longer term. Implementing measures to broaden the tax base would improve the resilience of the public finances to a loss of CT. Moreover, growing expenditure needs from an ageing population and to fund infrastructure in housing and the transition to net zero will amount to an additional 6.4 percentage points of national income per annum by 2050. Assuming annual instalments continue, resources from the FIF would help to partly cover the increase in expenditure but additional government revenue will be needed to keep the public finances on a sustainable path.

To ensure sustainability of the economy and public finances, budgetary policy faces a balancing act between (1) improving fiscal resilience and the capacity of the public finances to withstand future pressures and adverse risks and (2) macroeconomic stabilisation, i.e. policy should be countercyclical. These considerations sit alongside other objectives for fiscal policy including its role in sustainably increasing trend economic growth. Commitment to a credible and effective fiscal anchor (or rule) which links the growth in public expenditure to the underlying potential growth rate of the economy (net of tax changes) would help the government balance the competing demands on the public finances in the years ahead in the face of economic and fiscal challenges.

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