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€10bn budget surplus now expected in Ireland

The Irish government is the enviable position of having what may be described as "an embarrassment of riches" in its public finances thanks to ongoing outperformance of tax revenues. It will be politically difficult not to spend it.

Tax revenues boom on back of stronger economy and corporation taxes

The latest Stability Programme Update published last evening shows that a general government surplus of €10bn is now in prospect for 2023, up from its previous estimate of €6.2bn. This equates to 3.5% of GNI* and would the best fiscal position in the euro area yet again this year. Large budget surpluses are also in prospect up to 2026 (5.4% of GNI* in 2w024). Debt is expected to fall to 79% of GNI* at end-2023 and 75% at end-2024. All of the upward revision to the estimated surplus is due to higher tax revenues, stemming from two sources. Firstly, tax buoyancy is higher on the back of upgraded forecasts for economic growth. Its estimate for Modified Domestic Demand (MDD) has been upgraded to 2.1% for 2023 (up 0.9%), with 2.5% pencilled in for 2024. This is consistent with the better performance and stronger international environment since the start of the year. The second driver of the higher tax estimate is profitability and thus corporate tax revenue at multinationals based in Ireland. Corporate tax receipts are now expected to grow to €24.1bn this year, representing a record 27% of total tax revenues. This is €1.6bn higher than was anticipated at the time of Budget 2023 last September.

Corporation taxes could rise even further in the short-term

Sensibly, the Irish government recognises the important role that booming corporation tax receipts are playing here, and also their vulnerability. "Excess" receipts are calculated at €12bn this year, but it is possible that these receipts may grow further in the short-term. It is likely that Pillar II of the OECD global tax changes will be introduced first. This will result in the corporation tax rate paid by large companies rising to 15%, increasing the concentration in corporate tax receipts even further. It is expected that this will kick in in 2024. Pillar I, which reallocates a certain proportion of profits by large companies to other jurisdictions, will result in a net loss for the Irish exchequer but will not be introduced until a later date.

Urge to use windfall gains obvious ahead of general election

Ireland has long recognised the vulnerability of these tax receipts given their dependence on a relatively smaller number of very large companies. In 2022, it is estimated that 60% of corporate tax revenues came from ten companies, with 30% from as little as two. It has set up a rainy day fund (National Reserve Fund), which has already been seeded with €6bn. On the spending side, core expenditure is expected to grow by 7.4% in 2023. This is slightly above the 5% rate that would be in line with the Irish economy's growth potential, but can be explained by a number of measures such as dealing with the Ukrainian refugee crisis and some cost of living policy measures. Core expenditure growth is expected to revert to the 5% target in the 2024-2026 period. Given that the government now well into the second half of its term, following through on this pledge will be a real test of its resolve to maintain spending prudence. Introducing a more formalised, rule-based approach to diverting the additional "excess" corporation tax in the rainy-day fund would reduce the likelihood of using the extra monies for potential electoral benefit. This is easier for an economist to say than a politician to do.

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