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Executive Summary

This is the second iteration of the Department's *Economic Insights* series this year. The document contains three notes covering a range of macroeconomic and fiscal issues. The first two notes examine developments in the Irish economy, namely the evolution of public healthcare spending and the degree of potential slack in the labour market. The final note discusses the increasing divergence in income per capita between the US and the euro area.

Public spending has substantially increased since the COVID-19 pandemic facilitated by strong economic growth and rising income and corporation tax revenues. While the Irish economy is relatively strong at present, there is considerable uncertainty regarding the future of the multilateral trading environment that has underpinned Ireland's rising living standards. In this context, the **first note** offers an examination of how one of the largest components of government expenditure growth, healthcare, has evolved over time and the implications of these developments for future funding requirements. The note highlights that Ireland already has high spending on health services, is likely to face a substantial rise in age-related healthcare costs, and has experienced a material decline in health service productivity in recent years. The note concludes that healthcare is set to consume a greater share of government resources in the future, with this necessitating either growth in the size of the State, a significant increase in productivity, or a change in the scope and type of healthcare services delivered through public funding.

The post-pandemic labour market recovery has been driven by an expansion of labour supply, by inward migration and increases in participation. However, labour supply growth from these sources is expected to moderate going forward. Against this backdrop, the **second note** examines the degree of slack in the labour market, focusing on the characteristics and preferences of those in employment, unemployment as well as those currently outside the labour force. While the analysis reveals some scope to increase hours worked among those in full-time employment and a non-negligible share of the inactive cohort that wishes to work, barriers to participation remain, particularly for those with health issues and caring responsibilities. While targeted efforts to remove such barriers would help increase participation, this additional labour supply will not be sufficient to meet future labour demand and underscores the role that both inward migration and productivity improvements will need to play to support employment and economic growth going forward.

A notable development in recent decades has been a growing difference in income per capita between the US and the euro area. The **third note** examines the source of this divergence, showing that it has been driven almost entirely by differences in multifactor productivity (MFP) growth. The impact of this has been partially offset by an increase in the share of the euro area population in employment, which has converged to the US level in the post-pandemic period. The note concludes by examining some of the potential causes for this stagnation, highlighting the importance of measures to support market dynamism and encourage investment in Research and Development (R&D).

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[1] The data and analysis set out in this document are compiled by Department of Finance staff. Every effort is made to ensure accuracy and completeness. When errors are discovered, corrections and revisions are incorporated into the digital edition available on the Department's website. Any substantive change is detailed in the online version.

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Rising Costs, Ageing Population: Considerations for the Fiscal Sustainability of the Irish Healthcare System[2]

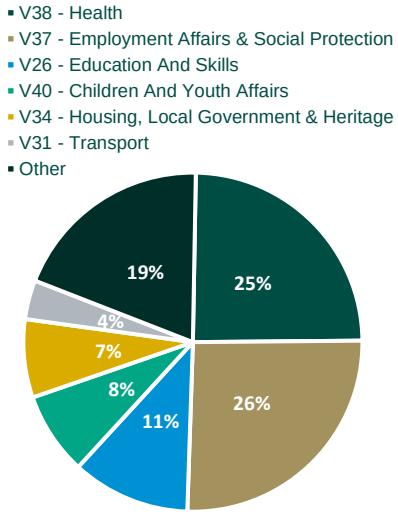
1.1 Introduction

Public spending in Ireland has increased significantly in recent years. Since the pandemic, real general government expenditure has increased by 23 per cent, rising from €81.3 billion in 2019 to €100.4 billion in 2024.[3] While the Irish economy is strong at present, it faces numerous risks including to its revenue base[4] which if realised could precipitate a slowdown in growth and constraints on spending. In this context, it is sensible to examine the core drivers of expenditure growth in recent years in order to anticipate likely future expenditure developments and risks. This insight focuses on one of the largest components of government expenditure – health, examining how spending trends, demographic shifts and structural factors have evolved and the implications of these developments for future funding requirements.

There are three facts about healthcare expenditure trends in Ireland which should be acknowledged at the outset. First, healthcare accounts for a quarter of total voted government expenditure, making it the largest funding area other than social protection (**figure 1a**). Second, healthcare expenditure has risen dramatically in recent years (**figure 1b**), rising in real terms from €11.4bn in 2015 to €18.3bn 2024 (a 60 per cent increase).[5] Despite this dramatic rise in expenditure, the health vote has also consistently overrun its budget allocation each year since 2014. The 2024 overrun of close to €2bn is the largest of these, equivalent to an unbudgeted rise in expenditure of 8 per cent of the overall allocation for health in 2024.[6]

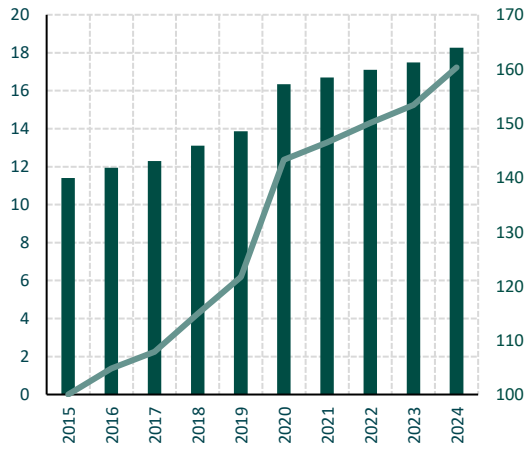
Figure 1: Government Gross Voted Expenditure on Healthcare

A: Composition of gross voted expenditure, 2025, per cent



Note: Employment Affairs & Social Protection includes Expenditure for V37A – Social Insurance Fund
Source: Department of Public Expenditure, NDP Delivery and Reform and Department of Finance Calculations

B: Real voted health spending, €bn and index (2015=100)



Note: AMECO Government Consumption Deflator is applied
Source: Department of Public Expenditure, NDP Delivery and Reform and Department of Finance Calculations

[2] This note was prepared by Mark Hennessy, an economist in the Department of Finance. The analysis and views set out are those of the author and do not necessarily reflect the views of the Department of Finance or Minister for Finance.
[3] General government expenditure deflated using AMECO government consumption deflator. Over the same period, nominal general government expenditure rose from €86.8 billion in 2019 to €125.3 billion in 2024.
[4] A loss of windfall corporation tax receipts, or a move towards more protectionist policy globally are two key risks facing the public finances. For further details see *Annual Progress Report 2025,* Department of Finance (May 2025), available at: https://www.gov.ie/en/department-of-finance/publications/annual-progress-report/
[5] Health Expenditure figures exclusive of disability spend, as this was transferred to V40 – Children and Youth Affairs in 2023.
[6] For further details, see *Pre-Budget Statement Budget 2025,* Irish Fiscal Advisory Council (September 2024). Available at: https://www.fiscalcouncil.ie/pre-budget-statement-budget-2025-2/

Third, Ireland has one of the youngest populations in Europe. As such, *ceteris paribus*, spending on healthcare as a share of government expenditure, or national income, should be lower than in peer countries. It is not. Moreover, over the next two decades it will become an older country, akin to Greece or Italy currently.[7] Accordingly, health care costs are set to increase. This, combined with Ireland's already high healthcare expenditure, raises concerns about the long-term fiscal sustainability of the healthcare system.

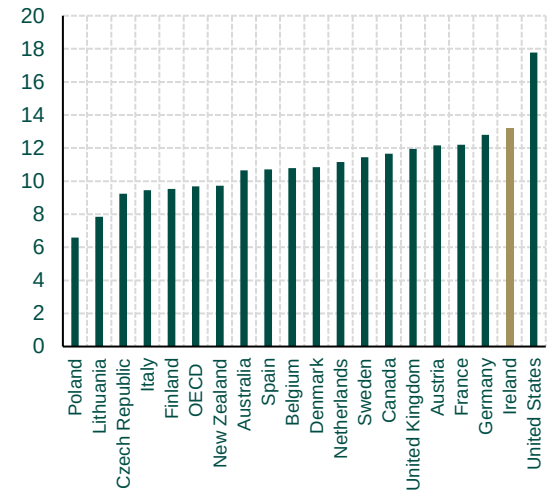
1.2 Health expenditure from a comparative perspective

Ireland has strong health outcomes relative to its high-income peers. Life expectancy has grown considerably in recent decades, placing the country among those with the highest life expectancy at birth in the OECD[8]. The healthcare system also performs well on other broad performance measures, with mortality rates from preventable and treatable causes 20 per cent lower than respective EU averages[9], and self-reported measures of health status and unmet healthcare needs ranking better than OECD peers.[10]

However, the strong performance of the Irish healthcare system has come in part because spending on healthcare is high, and particularly so given the country's younger demographic profile than peers. This can be demonstrated across several metrics describing comparative healthcare spend. For example, when health expenditures are compared across the OECD as a per cent of GDP (and Ireland vs GNI*), Ireland has the second highest expenditure, with health spending at 13 per cent of GNI* in 2021, compared to an OECD average of 9.5 per cent (**figure 2a**). Ireland also exceeds the OECD average on health expenditure per capita.

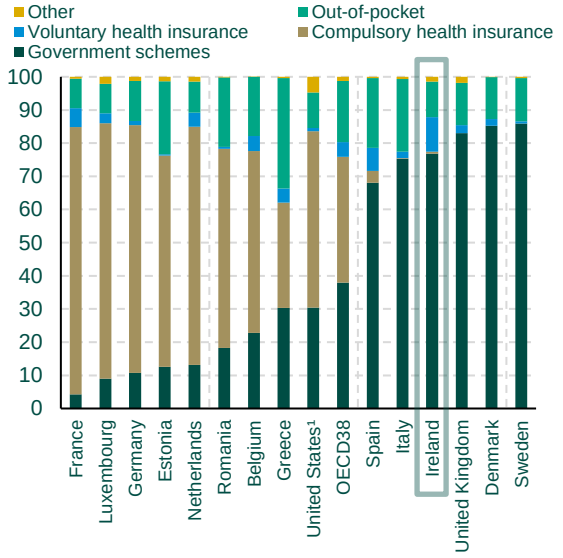
Figure 2: Expenditure on Healthcare Compared to the OECD

A: Health expenditure 2021, per cent GDP / GNI*



Note: 2021 or nearest year
Source: OECD

B: Health expenditure by type of financing 2021, per cent



Source: OECD

[7] For further details, see *Population Ageing and the Public Finances in Ireland – Changing Demographics*, Department of Finance (June 2024). Available at: https://www.gov.ie/en/publication/dc825-population-ageing-and-the-public-finances-in-ireland-changing-demographics-and-population-ageing/

[8] For further details, see *OECD Economic Surveys of Ireland 2022*, OECD (April 2023). Available at: https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-ireland_19990324

[9] For further details, see *Ireland: Country Health Profile 2023*, OECD (December 2023). Available at: https://www.oecd.org/en/publications/ireland-country-health-profile-2023_3abe906b-en.html

[10] For further details, see *OECD Economic Surveys of Ireland 2022*, OECD (April 2023). Available at: https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-ireland_19990324

The healthcare system also has a relatively distinct funding structure, one that is majority funded through taxation, rather than the social insurance schemes that are in place in many other EU countries (**figure 2b**). From a fiscal perspective, the health system is thus 'in competition' with other areas and represents a draw on Ireland's relatively narrow tax base.

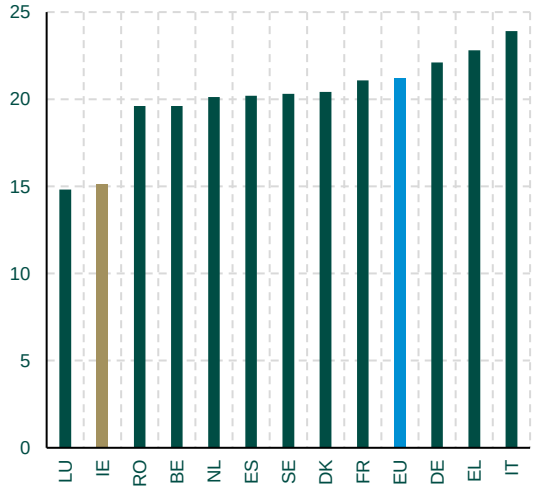
1.3 Irish demographics and implications for expenditure

Ireland has a relatively young population at present. In 2022, the share of persons over 65 as a percentage of the population was just 15 per cent, compared to an EU average of 21 per cent (**figure 3a**).[11] The median age of the population (at 39 years) was also the second lowest in Europe, driven in part by the highest number of persons under 19 (26 per cent).[12]

This younger population distribution has a considerable dampening effect on healthcare expenditures. In general, health expenditure rises sharply on a per capita basis with age, with persons over 85 being two to six times more expensive than the average person depending on the country examined.[13] Drawing on this, analysis from the OECD provides a clearer picture of what health expenditure would be in the event that all countries had the same demographic base (**figure 3b**).[14] Ireland is one of only three countries where this age related adjustment increases rather than decreases expenditure, with expenditure increasing by 7 per cent, versus a 5-10 per cent decrease in most European peer countries.

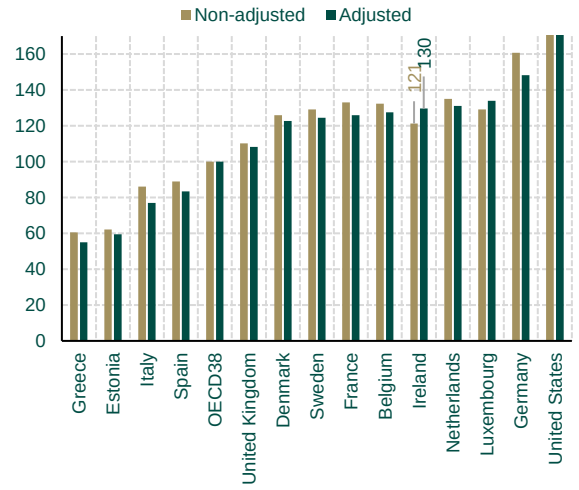
Figure 3: Population Age and Age-related Expenditure Adjustment In EU and OECD

A: Persons 65+ as a share of total population, per cent



Note: 2022 or the nearest year
Source: European Commission

B: Age-adjusted health expenditure per capita, 2022



Source: OECD

[11] For further details see, *2024 Ageing Report. Economic and Budgetary Projections for the EU Member States (2022-2070)*, European Commission (April 2024). Available at: https://economy-finance.ec.europa.eu/publications/2024-ageing-report-economic-and-budgetary-projections-eu-member-states-2022-2070_en

[12] Ibid.

[13] Department of Finance analysis of data in Comparison of Health Care Spending by Age in 8 High-Income Countries, Papanicolas et al. (August 2020), available at: https://jamanetwork.com/journals/jamanetworkopen/fullarticle/2769102

[14] For further details see, Understanding International Measures of Health Spending: Age-adjusting Expenditure on Health, OECD (October 2023), available at: https://www.oecd.org/en/publications/understanding-international-measures-of-health-spending_043ed664-en.html

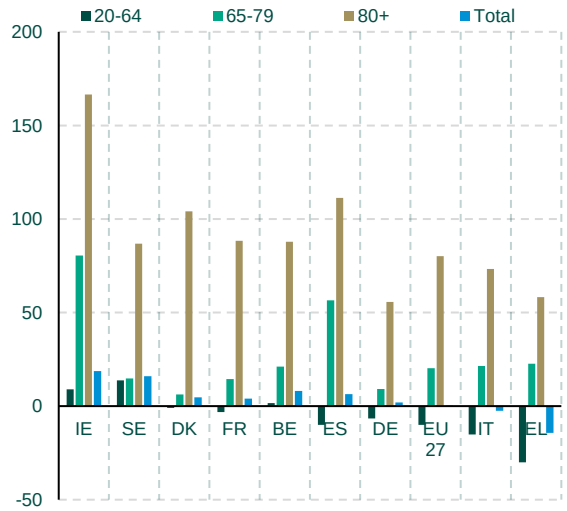
Ireland's age-related healthcare costs will rise beyond those currently being experienced in other countries in the coming decades. By 2050, the population aged 65 and older will exceed the current levels in any EU member state.[15] This will be driven by an 80 percentage point rise in persons aged 65-79, and a 166 percentage point rise in persons over 80, compared to a 9 percentage point increase in persons aged 20-64. This change in demographic structure is significantly larger than in any other EU country (**figure 4a**) and corresponds to a change in the old age dependency ratio from 26 per cent in 2022 to 47 per cent in 2050.

This dramatic change in demographic structure will have a corresponding impact on expenditure, including health expenditure. Health expenditure (inclusive of long-term care) in Ireland is projected to rise from 9.8 per cent of GNI* in 2022 to 12.9-14.8 per cent in 2050.[16] This comes alongside a 4 per cent increase in pension expenditure relative to GNI* over the same period (**figure 4b**). This increase in expenditure from population ageing is projected to be the highest in the EU, and by the mid-2040s Ireland will exceed the EU average for age-related costs as a share of GNI* / GDP.

Government expenditure currently makes up 40 per cent of GNI* in Ireland, with health making up c. 10 per cent of this. With healthcare expenditure projected to rise by 30-50 percentage points as a proportion of GNI* from age-related costs, this will lead to a significant increase in demand for public expenditure. This will necessitate a response from the State, including a) an increase in the size of government (with associated increases in taxation) to meet these expected costs b) accommodation of the increase in age-related costs through reductions in expenditure elsewhere and/or c) changes to the cost associated with healthcare service delivery through efficiency improvements or changes in the composition of care so as to reduce the cost per patient treated in the service.

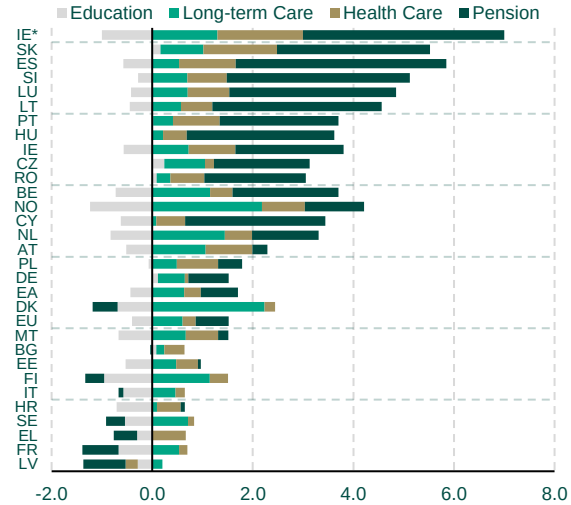
Figure 4: Age-related expenditure projections

A: Population change by age group 22-50, pp change



Note: pp is percentage point change
Source: Eurostat

B: Change in age-related exp. 2022-2050, pp GDP



Note: pps is percentage points. IE* refers to Irish-age related projections scaled by GNI*
Source: European Commission and Department of Finance calculations.

[15] Persons over 65 will make up 25.6 per cent of the Irish population in 2050. In 2022, the proportion of persons over 65 at an EU level is 21.2, while in Italy (which has the highest proportion) it is 23.9

[16] Projected range as per *2024 Ageing Report: Economic and Budgetary Projections for EU Members States (2022 – 2070),* European Commission (April 2024), available at: https://economy-finance.ec.europa.eu/publications/2024-ageing-report-economic-and-budgetary-projections-eumember-states-2022-2070_en

1.4 Drivers of high healthcare expenditure

Together, Ireland's high level of healthcare expenditure coupled with the significant age-related costs it will face emphasises the need to better understand the core drivers of this expenditure and its trajectory. While there are many factors which influence healthcare expenditure, a core driver is healthcare prices. In an analysis of healthcare prices from the OECD[17], Ireland is shown to have a price level 30 per cent above the OECD average (**figure 5a**). Equally, the same analysis demonstrates that Irish healthcare prices have grown faster than the economy-wide average. These high prices are in part attributable to "cost disease", with the high cost level in the Irish economy leading to demands for higher wages in healthcare settings without a corresponding increase in productivity. This will continue to be a factor contributing to high healthcare expenditure, although cost control efforts such as future pay deals, changes to agency staffing and improvements to procurement practices could help to bring the Irish price level more in line with the OECD average.

Another factor driving higher healthcare expenditure is a focus in the system on the delivery of comparatively expensive hospital-based care at present.[18] While Sláintecare reform efforts are focussed on a move towards greater delivery of preventative healthcare, existing empirical evidence on whether this approach will be effective in driving down acute care demand, and thereby the cost of service delivery is uncertain. Two studies from the ESRI examining this area found no statistically significant impact on healthcare demand from increases in preventative care delivery.[19] [20] It follows that these types of reforms cannot necessarily be relied upon to resolve the high cost of our healthcare service.

Productivity is also an important consideration for the healthcare system. The OECD has highlighted the potential for efficiency gains in health spending, estimating that Ireland could save up to 15% of its current expenditure on health with no impact on care quality (**figure 5b**).[21] The Department of Health also acknowledges health productivity as a concern, with the recently established Productivity and Savings Taskforce pursuing a number of measures to improve the cost of patient treatment across the service.[22]

While it remains to be seen if these efforts will have a material impact on productivity, these come at a time when the aggregate productivity of the service has declined, rather than improved. A recent study from the Department of Health demonstrates that the cost per patient treated in hospitals became substantially more expensive between 2016 and 2022, with a 45 per cent increasing in real resourcing over this period equating to activity gains of less than 5 per cent.[23] A continued decline in productivity would further threaten the fiscal sustainability of healthcare expenditure, especially given the increased demand that the service will face from an older population.

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[17] For further details, see *Health at a Glance 2023: OECD Indicators* (November 2023). Available at: https://www.oecd-ilibrary.org/social-issues-migration-health/health-at-a-glance-2023_7a7afb35-en

[18] For further details, see *OECD Economic Surveys of Ireland 2022*, OECD (April 2023). Available at: https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-ireland_19990324

[19] *Did the expansion of free GP care impact demand for Emergency Department attendances? A difference-in-differences analysis, Walsh et al.* (February 2019). Available at: https://pubmed.ncbi.nlm.nih.gov/30623795/

[20] *An extension in eligibility for free primary care and avoidable hospitalisations: a natural experiment, Nolan* (February 2011). Available at: https://pubmed.ncbi.nlm.nih.gov/21831496/

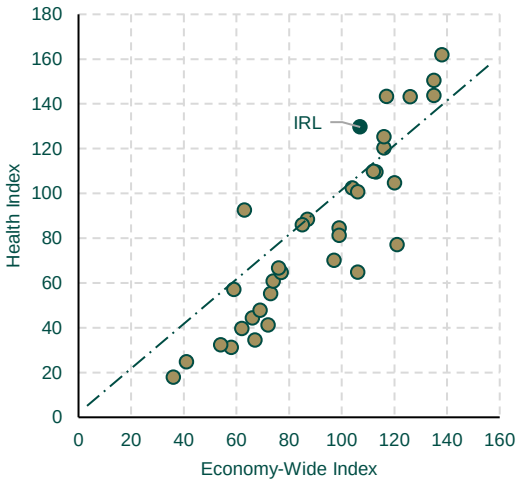
[21] For further details, see *Health at a Glance 2023: OECD Indicators* (November 2023). Available at: https://www.oecd-ilibrary.org/social-issues-migration-health/health-at-a-glance-2023_7a7afb35-en

[22] For further details, see Minister for Health publishes the *Productivity and Savings Taskforce Action Plan* (April 2024). Available at: https://www.gov.ie/en/press-release/d4eb9-minister-for-health-publishes-the-productivity-and-savings-taskforce-action-plan/

[23] For further details, see *An Examination of Trends in Activity, Expenditure and Workforce in Publicly Funded Acute Hospitals in Ireland* (April 2024). Available at: https://www.gov.ie/en/publication/36169-an-examination-of-trends-in-activity-expenditure-and-workforce-in-publicly-funded-acute-hospitals-in-ireland/

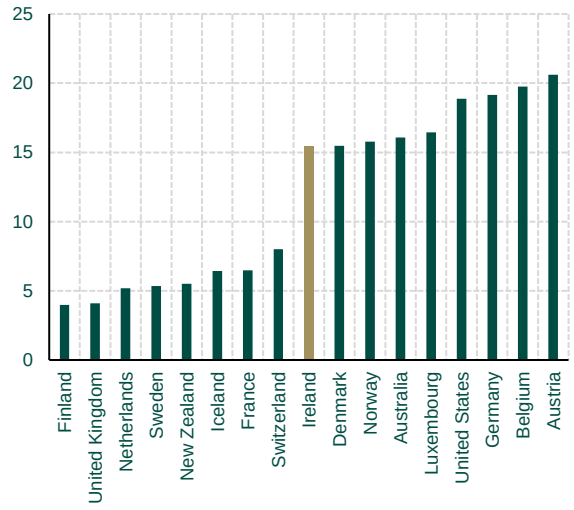
Figure 5: Price of Healthcare in Ireland

A: Price levels in the healthcare sector for selected countries 2021



Source: OECD (2023) and Department of Finance Calculations

B: Potential reduction in total per capita healthcare expenditure from efficiency improvements, per cent



Note: Frontier analysis of health spending efficiency (input / output) based on a basket of relevant comparator countries.
Source: OECD (2023)

1.5 Conclusion

Ireland's health expenditure has risen significantly over the past decade and makes up a substantial proportion of government spending. Despite having a relatively young demographic profile, Ireland spends a higher proportion of national income on healthcare than many of its peers.

In addition to already high expenditure on healthcare, Ireland will experience the greatest increase in older persons as a proportion of the population in Europe over the coming decades. The implications of this demographic development for healthcare expenditure are known and substantial, with a c. 30-50 percentage point increase in healthcare expenditure relative to GNI* expected from age-related costs by 2050.

Ireland has a number of avenues for addressing the high cost of patient treatment, including in relation to prices, productivity and the model of care for service delivery. While progress in these areas remains uncertain, recent experience suggests that this will not be a panacea for our long-term fiscal commitments. In particular, the recent substantial decline in productivity in healthcare service delivery represents an additional and material threat to long-term fiscal sustainability.

Without substantial productivity gains, rising healthcare costs from an ageing population will consume a greater share of government resources. This will necessitate an increase in the size of the State and/or a change in the scope and type of healthcare services delivered through public funding.

Slack in the Irish labour market[24][25]

2.1 Introduction

The Irish labour market has demonstrated remarkable resilience over the past five years, recording one of the largest expansions of employment in the euro area. That this expansion has been driven by additions to labour supply is well documented. Looking ahead, however, labour force growth of this magnitude is unlikely to be sustained reflecting the ageing of the population and an expected slowdown in net migration from current elevated levels. As a result, it will become increasingly important to maximise the labour force contributions of our existing working age population as well as productivity improvements.

Against this backdrop, this note examines the degree of slack that currently exists in the Irish labour market. Labour market slack describes the shortfall between workers' desired amount of work and the amount of paid work available. Indicators of labour market slack include the unemployment rate, underemployment of those currently employed, as well as those individuals who are classed as inactive or outside the labour force. An understanding of the characteristics of these cohorts; their preferences, skills and previous work experience can shed light on the extent to which these groups are likely to increase their labour supply and/or enter employment in the future.

2.2 Underemployment

A key feature of the post-pandemic labour market is a reduction in the average number of hours worked per week by those in employment. While employment has risen by 18 per cent over the past five years, total hours worked has risen by only 10 per cent due to a decline in average hours worked of almost 7 per cent. In other words, achieving the same level of labour input (total hours worked) now requires more workers than it did prior to the pandemic.

While there remains uncertainty as to the drivers of this decline, examining worker preferences can shed light on the extent to which workers may be likely to work more hours in the future. Labour Force Survey data captures information on those who are 'underemployed' or in other words those who would like to work more hours than they are currently working and are available to do so. Increasing underemployment may suggest some slack in the labour market such that increases on the intensive margin could contribute to labour supply growth going forward.

That said, looking at part-time underemployment does not suggest a significant increase in excess capacity, with the share of part-time workers that are underemployed remaining below the 2019 level in 2024 (**figure 6a**). Aggregate figures do however mask differences across sectors, with the share of part-time underemployment above its pre-pandemic level in five sectors including accommodation and food, education and professional and technical services (**figure 6b**).

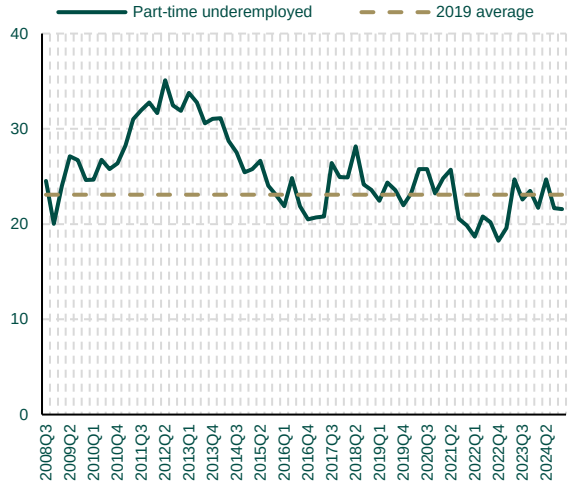
The picture among those in full-time employment is different. The share of underemployed full-time workers averaged just under 14 per cent in 2024, around 4½ percentage points (pp) above the 2019 level, a somewhat puzzling result given that the labour market was, on aggregate, in a stronger position last year than prior to the pandemic (**figure 7a**). The increase in the underemployed share was largest

[24] This note was prepared by Eimear Flynn, formerly an economist in the Department of Finance. The analysis and views set out are those of the author and do not necessarily reflect the views of the Department of Finance or Minister for Finance. The analysis in this note is based on data to Q4 2024.
[25] The analysis in this note is based on strictly controlled Research Microdata Files provided by the Central Statistics Office (CSO). The CSO does not take any responsibility for the views expressed or the outputs generated from this research.

among males (+4.9 pp), though underemployment also increased among female workers (+4 pp). The increase has also been broad-based across sectors (**figure 7b**).

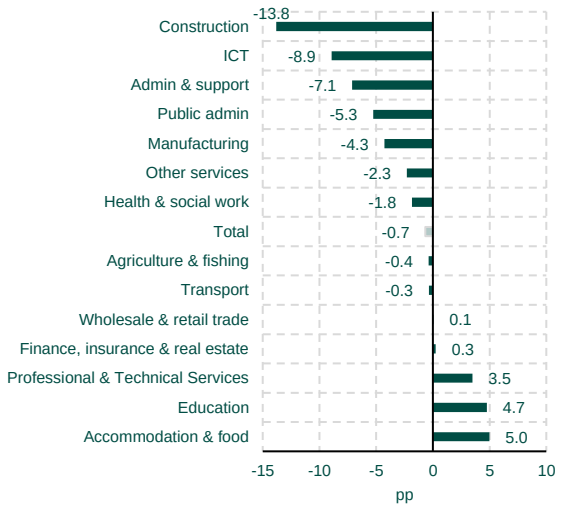
Figure 6: Part-time underemployment

A: Share of p/t employment that is underemployed



Source: CSO

B: Change in p/t underemployed share, 2024 vs 2019

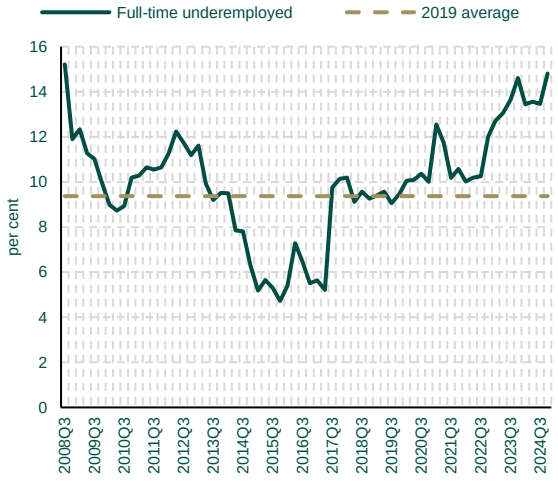


Source: CSO

It is not immediately apparent what is behind the increase in full-time underemployment. It could for example reflect labour hoarding behaviour by firms, if in the face of a temporary deterioration in the economic outlook firms reduced staff working hours. However, the decline in average hours worked among full-time workers has been driven by those who are not underemployed, with average hours worked for the underemployed down only marginally on the pre-pandemic level last year. Alternatively, it could be that these individuals wish to work more hours due to rising cost pressures in recent years, a notion that is perhaps supported by the fact that the largest increases in underemployment have been observed in those sectors that earn lower wages on average.

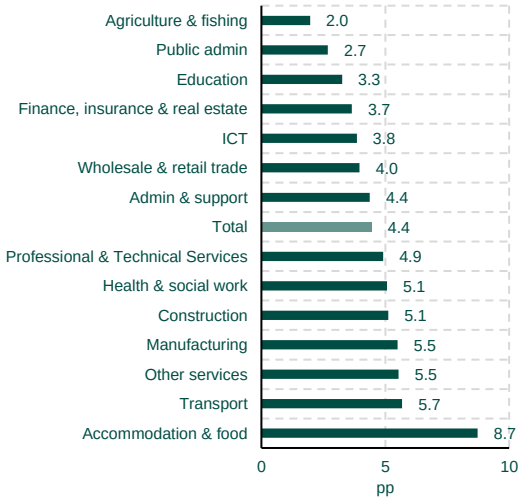
Figure 7: Full-time underemployment

A: Share of f/t employment that is underemployed



Source: CSO

B: Change in f/t underemployed share, 2024 vs 2019



Source: CSO

While the elevated level of underemployment among full-time workers suggests some scope to increase labour supply, it is important to note that this slack could have been offset in part by these workers taking up a second job. Indeed, the number of full-time workers with a second job has risen significantly in recent years, up almost 60 per cent since 2019.

2.3 Unemployment

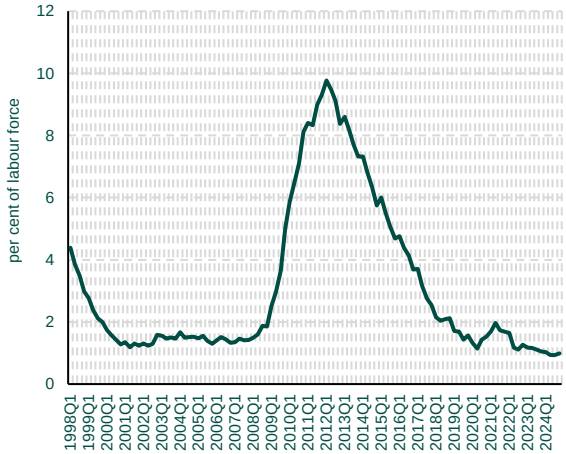
Since the pandemic the unemployment rate has fallen to near historic lows, remaining below 5 per cent since early 2022. While this is a welcome development and speaks to the strength of the economy, it implies limited slack to support labour supply via this channel going forward. Given the low level of unemployment, it is increasingly important to analyse the characteristics of these workers to shed light on whether these workers are likely to meet labour demand in the future and the type of interventions that may be required to encourage them into employment.

Encouragingly, there has been a shift in the composition of unemployment over the past decade. During the global financial crisis, the share of long-term (>1 year) unemployed in total unemployment rose sharply, from around 25 per cent in 2008 to a peak of almost 60 per cent in 2012. This share subsequently declined as economic conditions improved, though remained elevated at around 30 per cent in 2019. Despite the significant labour market disruption caused by the pandemic, the share of unemployed workers out of work for more than one year has continued to fall to below 23 per cent in 2024 (c.28,000), with the long-term unemployment rate falling to a record low of 1 per cent (**figure 8a**).

This is significant as the length of time an individual is unemployed influences the likelihood that they re-enter employment in the future, with those out of work for longer more likely to become 'discouraged' and leave the labour force. Such detachment from the labour force increases an individual's risk of material deprivation, poverty and social exclusion and underscores the role for policy in supporting engagement with the jobs market for example via skills development.

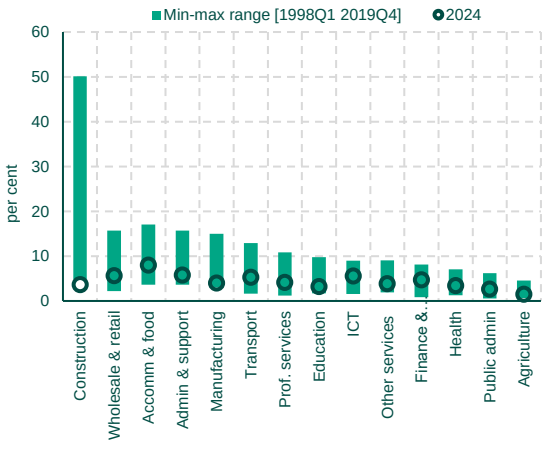
Figure 8: Unemployment

A: Long-term unemployment rate



Note: aged 15-74
Source: CSO

B: Sectoral unemployment rates



Note: UR = (unemployed + PALF) / (labour force + PALF)
Source: CSO

Approximately 70 per cent of those in unemployment have previous work experience. Additionally, the proportion of workers whose last employment was less than two years ago has risen to account for close to ½ of unemployment, compared with just under 40 per cent on average between 2000 and 2019. The share of the unemployed cohort with high educational attainment (tertiary education) has also increased and stood at around 40 per cent last year, compared with 30 per cent just before the

pandemic. Despite this improvement, this differs from the educational attainment of those in employment, with 55 per cent of this cohort considered highly educated, suggesting that individuals with lower education face greater employment barriers.

While the existence of recent employment may increase the likelihood that the unemployed re-enter employment, it is also important to consider the previous sectors of employment of this cohort. Labour demand currently remains elevated in the public sectors as well as high-skilled service sectors. While the vacancy rate in the construction sector is currently in line with the economy-wide average, demand for labour in the sector is set to accelerate over the coming years. Demographic change is also expected to sustain labour demand in the health sector going forward.

Among the unemployed, almost one fifth were previously employed in either wholesale and retail trade or accommodation and food. A further 11 per cent were employed in the health and ICT sectors – sectors in which demand remains elevated such that these individuals may be able to meet labour demand in these sectors in the future. Incorporating the potential additional labour force (PALF)[26], sectoral unemployment rates were highest in accommodation and food, administrative and support services, wholesale and retail trade, and ICT (**figure 8b**). Notably, the unemployment rate in the construction sector declined to a record low in 2024, which underscores the importance of either attracting skilled labour from abroad or increasing the pipeline of apprentices or graduates in the sector.

Overall, while the sectoral employment experience of those in unemployment does not align perfectly with sectoral labour demand, the declining share of long-term unemployment and the increase in the skill level of this cohort is positive. Indeed, the increasing share of workers with recent work experience as well as the higher educational attainment of this cohort in recent years may increase the likelihood that these individuals can re-enter employment going forward.

2.4 Inactivity

The inactive population refers to those individuals who are not in employment or unemployment (i.e. those outside of the labour force). There were approximately 1.5 million in the inactive cohort last year, of which around 780,000 were of working age (15-64). As involuntary inactivity impacts both social and economic wellbeing and has broader macroeconomic implications in terms of labour supply and economic growth, maximising the participation of this cohort is essential.

Despite the significant expansion of the population in recent years, the level of inactivity in Ireland remains close to historic lows, reflecting the increase in labour force participation seen since the pandemic (**figure 9a**). In 2024, the inactive cohort accounted for 22 per cent of the working age population, down from 27 per cent in 2019 and below the euro area average of almost 25 per cent. This was driven by a decline in female inactivity, consistent with the increase in female labour force participation over the period (**figure 9b**). Notwithstanding this, females still account for around 60 per cent of the inactive cohort – consistent with patterns in the euro area.

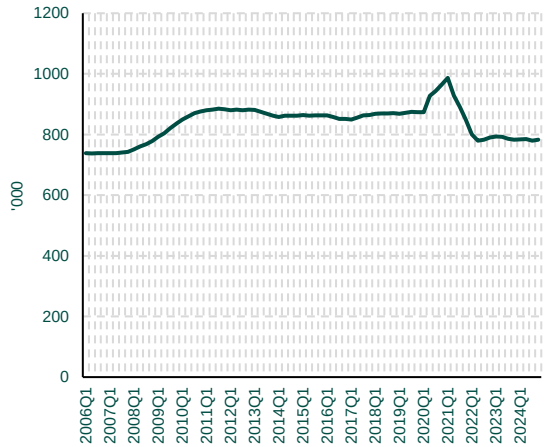
Analysis of the reasons behind inactivity can shed light on the extent to which these individuals are likely to join the labour force in the future and the policy interventions that may be required to activate them. The inactive cohort is made up of a number of groups, including retirees, students, individuals fulfilling domestic tasks and those unable to work due to long-standing health issues.

[26] The PALF captures those inactive individuals who are closest to the labour force. The PALF includes those seeking work but not immediately available and those available but not seeking work.

The decline in inactivity since the pandemic has been driven primarily by students and those fulfilling domestic duties (**figure 10a**). While this fall may partly be cyclical, the increased availability of flexible working patterns along with reduced childcare costs may also have contributed to this change. Notwithstanding this decline, these cohorts still account for the largest shares of inactivity, together accounting for more than half of the inactive population in 2024. Importantly, the composition of inactivity also differs by gender, with ¼ of inactive females fulfilling domestic duties last year, compared with around 2½ per cent of males. By contrast, students account for around ½ of inactive males, compared with around one-third of females.

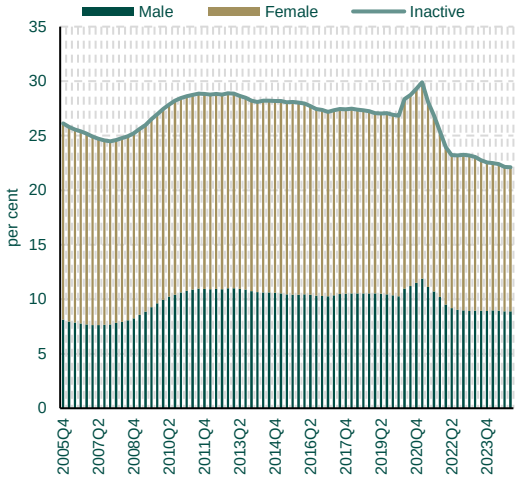
Figure 9: Inactive population of working age at near record low

A: Inactive population (15-64), 4 quarter m.a.



Source: CSO

B: Inactive share of 15-64 population, 4 quarter m.a.



Source: CSO

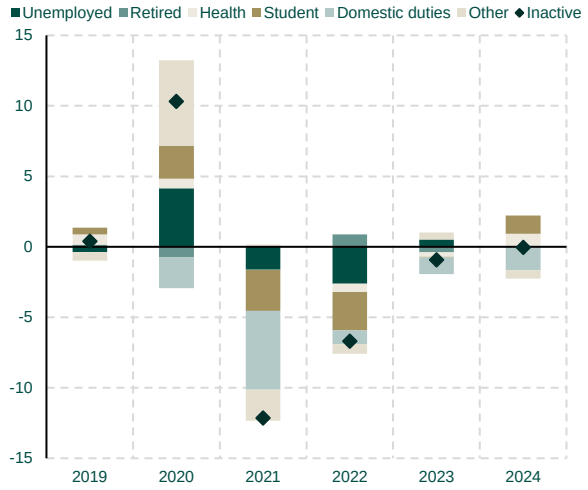
While policy intervention can help activate these groups, it may be the case that they do not wish to work. Among the inactive population (15-64), around ¾ do not wish to work though some of this cohort are students and will likely enter the labour force in the future. About 14 per cent – or c.106,000 workers - however belonged to the PALF in 2024. The PALF's share of the population has also picked up from the lows reached in mid-2022 when labour demand peaked and is now close to its pre-pandemic level, suggesting some increase in slack of late (**figure 10b**).[27]

The picture differs, however, across cohorts. The PALF's share of the retired cohort is low at around 6 per cent (around 4,000 workers), with more than 90 per cent expressing a preference not to work despite being of working age, suggesting limited potential to deliver additional labour supply. However, with the ageing of our population, and people now living longer, healthier lives, it will be important to encourage workers to remain in the labour force for longer by supporting life-long learning. While the share that do not wish to work among those with health issues is lower at around 80 per cent last year, barriers may exist to this group's participation in the labour market. Although this cohort's share of the PALF is low at around 6 per cent (c. 10,000), around 13 per cent (c.21,000) would like to work but are not seeking a job due to an illness or disability (**figure 11a**). Additionally, among those on domestic duties c.13,000 (6 per cent) belong to the PALF.

[27] The cohorts shown in figure 11A (retired, health, domestic duties) account for just under ½ of the inactive cohort (15-64). The PALF's share of the full cohort exceeds the average of the cohorts shown as a greater proportion of the remaining individuals belong to the PALF.

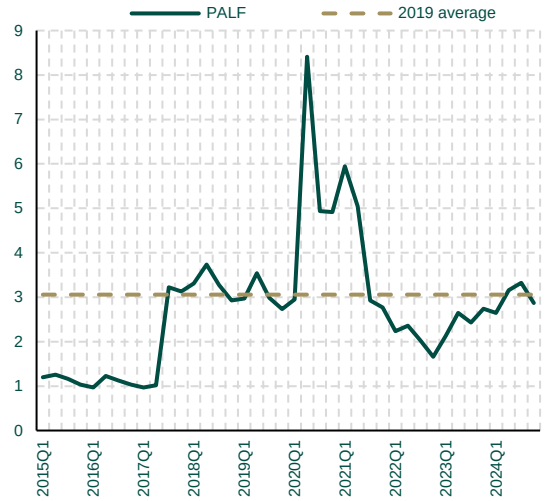
Figure 10: Factors influencing inactivity

A: Contributions to change in inactive population, pp



Source: CSO

B: PALF, share of working age population (15-64)



Source: CSO

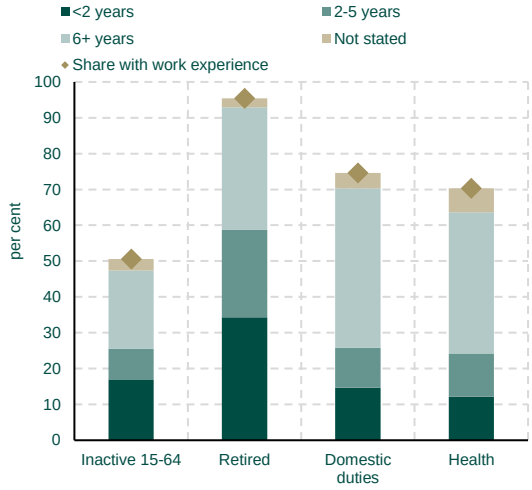
While these individuals may wish to join the labour force, their ability to do so may also be influenced by their skills and prior experience. Approximately half of the inactive population had previous work experience in 2024 – a share that has been relatively stable since before the pandemic. Like those in unemployment, the main sectors of previous employment include health, wholesale and retail trade and accommodation and food. This could in part reflect the large share of inactive women as these are sectors in which women tend to be overrepresented. Again, however, prior work experience differs across cohorts. Around 40 per cent of those unable to work due to health issues or among those engaged on domestic duties had not worked for at least six years (**figure 11b**).

Figure 11: Characteristics of inactive cohorts

A: PALF vs 'do not want to work', share of cohort

Source: CSO
Note: Shares do not sum to 100 as individuals can also belong to the following categories: Wants job but not seeking as in education / training, looking after children or because of illness/disability.

B: Time since last employment, share of cohort



Source: CSO

2.5 Conclusion

The post-pandemic labour market rebound has been fuelled by a rapid expansion of labour supply, both via increased participation and inward migration flows. However, this pace of growth is unlikely to be sustained even in the absence of shocks. Demographic change and slowing migration flows (from current elevated levels) will see a moderation of labour force growth over the medium term, making it increasingly important to maximise the labour market contributions of the existing working age population.

Examining the preferences of those already in employment shows some potential to increase hours worked among those in full-time employment, though it's possible some of this slack could have been offset by the increase in the number of individuals with second jobs in recent years.

In terms of the unemployed, while labour demand is likely to be concentrated in construction and the public sector over the medium term, the unemployment rate remains close to record lows in these sectors, suggesting limited available domestic labour supply to meet this demand. That said, the decline in the long-term unemployment rate to a record low in 2024 along with the increasing educational attainment of those in unemployment is welcome and may increase the likelihood that these individuals enter employment in the future.

Finally, this analysis assesses the potential degree of slack of the inactive population by cohorts – students, retirees, those unable to work due to health issues and those fulfilling domestic duties. The share of the PALF in each cohort is non-negligible and indicates a potential source of additional labour supply in the future. That said, skills and educational attainment differ across these cohorts potentially pointing to a need for re-training or upskilling measures. It is also apparent that barriers to participation may remain for those with health issues and caring responsibilities. Targeted efforts to remove any potential barriers would help increase participation.

Overall, while there appears to be some scope, albeit limited, to increase labour supply among the current working age population, this will not be sufficient to meet labour demand in the future and underscores the role that both inward migration and productivity improvements will need to play to support employment and economic growth going forward.

Continental drift: Unpacking the divergence in income per capita in the US and euro area[28]

3.1 Introduction

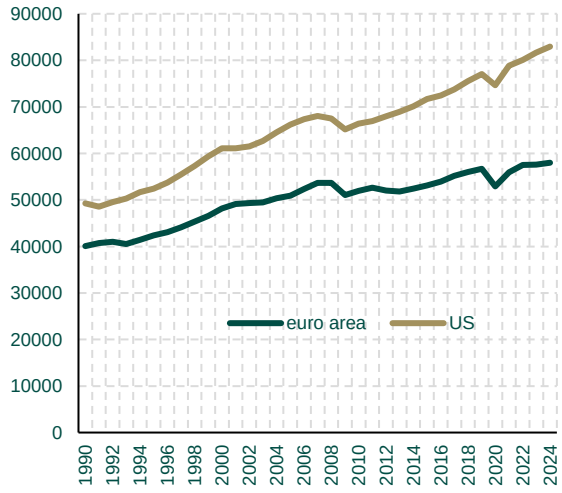
Recent decades have seen a significant divergence in economic performance between the US and the euro area, manifesting most clearly in a growing difference in GDP per capita, a proxy for living standards. This note examines this trend and its drivers, showing the divergence in output per person between Europe and the US is almost entirely due to a widening gap in productivity, caused by a stagnation in European Multifactor Productivity (MFP). The impact of this trend has been partially offset by an increase in the share of the euro area population in employment, though this has not been sufficient to negate the impact of the productivity stagnation and may be difficult to maintain in the face of population ageing.

3.2 Divergence in living standards

The last three decades have seen a significant divergence in performance between the US and euro area economies, with real GDP per capita in the euro area falling from around 80 per cent of the US level in 1990, to 70 per cent in 2024 (**figure 12a**)[29].This relative stagnation was one of the key themes of the recently published Draghi report, which highlighted that "EU economic growth has been persistently slower than in the US over the past two decades."[30]

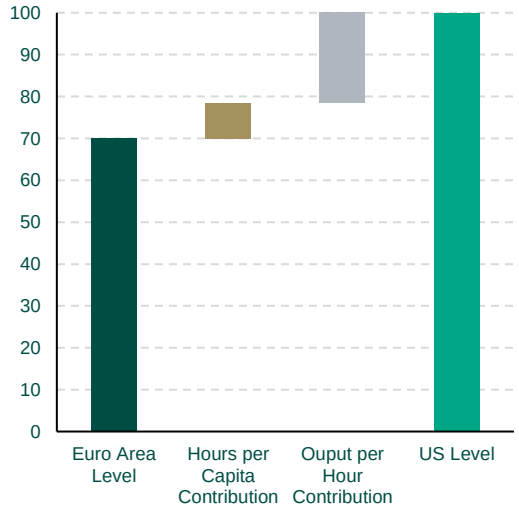
Figure 12: Euro area/US divergence

A: GDP per Capita in Real USD, euro area vs. US



Source: The Conference Board

B: Source of GDP per Capita Differences in 2023, %



Source: Draghi, 2024

Looking at 2023, Draghi identifies two fundamental causes for this difference in output per person. First, Europeans work fewer hours per capita than Americans, accounting for almost one third of the gap in 2023. Second, workers in the euro area produce less output for each hour of labour (aka labour productivity), which explains the remaining c. 70 per cent of the gap (**figure 12b**).

[28] This note was prepared by Fionn Roche and Luke Rehill, economists in the Economics Division of the Department of Finance. The analysis and views set out are those of the authors and do not necessarily reflect the views of the Department of Finance or Minister for Finance.
[29] The euro area series used in this note includes all countries which are currently part of the currency block, regardless of when they joined. This is to ensure consistency throughout the period.
[30] Draghi, M. (2024; 12). *The future of European competitiveness – A competitiveness strategy for Europe.* Brussels: European Commission.

However, this point estimate tells us relatively little about what has driven the divergence over recent decades (**figure 12a**). For the gap in GDP per capita to have grown, either the difference in hours worked per person or in labour productivity must have increased over time. The following sections analyse the source of this divergence since 1990.

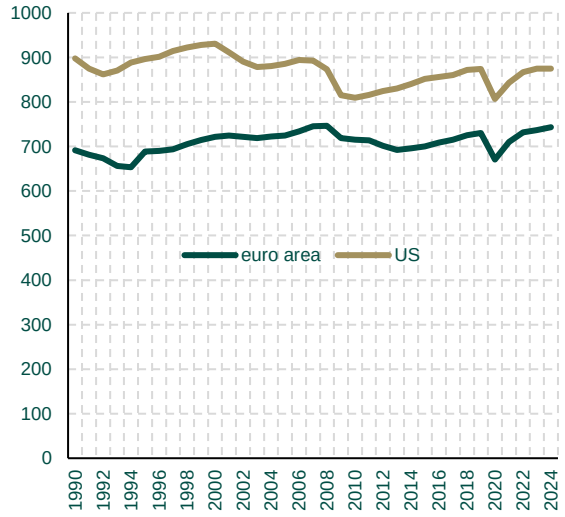
3.3 Average hours worked

As noted above, part of the gap (30 per cent) in GDP per capita between the US and the euro area can be attributed to the difference in average hours worked per person (**figure 12b**). However, charting the trajectory of this variable since 1990 reveals that the US and euro area levels have actually slightly converged over time (**figure 13a**). This indicates that, had productivity levels remained constant, the gap in income per capita between the two regions would have narrowed. In order to establish what is driving this convergence, hours worked per capita can be broken down into its two subcomponents: the average hours worked by those in employment, and the proportion of the population participating in the labour market.

Disaggregating the variable in this manner reveals that the gap in average hours worked per worker has remained broadly unchanged over this period (**figure 13b**). While hours worked per employee is lower in the euro area than in the US, the gap has remained relatively constant between 1990 and 2023. Therefore, while fewer hours per worker contributes to the lower level of income per capita in the euro area relative to the US, its relative stability over time means that it cannot explain the convergence in hours worked per person.

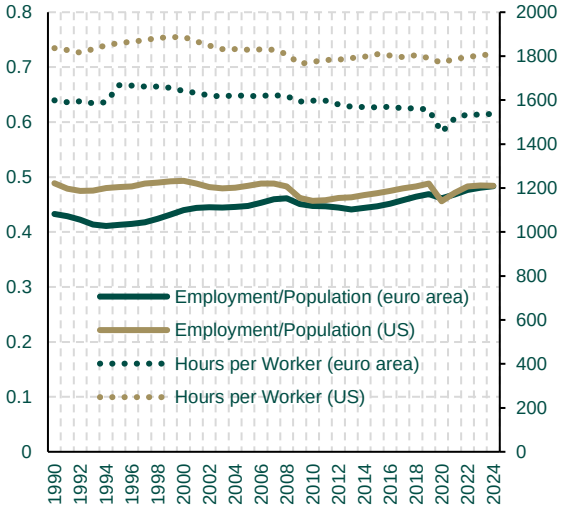
Figure 13: Labour market trends

A: Hours Worked per Capita, euro area vs US



Source: The Conference Board

B: Employment share (LHS), Hours Worked per Worker (RHS), euro area vs US



Source: The Conference Board

However, the share of the population in employment has narrowed between the regions over the last three decades, reflecting the euro area incorporating a larger share of the population into the labour market (**figure 13b**). While the number of workers as a share of the population in the euro area was significantly below that of the US in the 1990s, this gap has gradually narrowed over time, owing, in part, to an increase in the European female labour force participation rate. The two trends eventually converged in 2020 and have moved virtually in lockstep since then. It is this trend which has driven the slight convergence in average hours per capita, and which has helped to offset some of the stagnation in euro area productivity, examined in more detail in the next section.

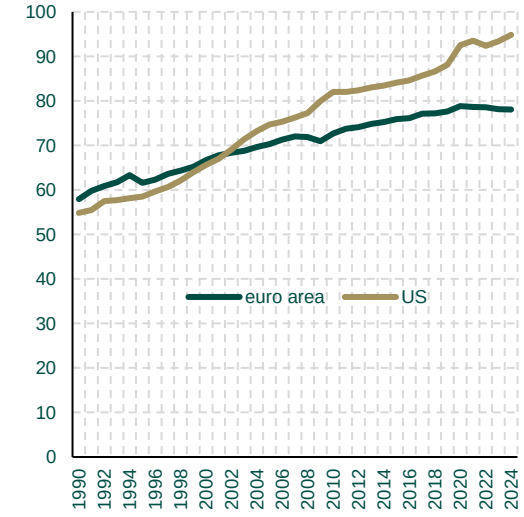
3.4 Divergence in Labour Productivity and its drivers

As noted above, most of the gap in GDP per capita between the US and the euro area in 2023 reflects differences in labour productivity (**figure 12b**). In general, recent decades have seen a slowdown in labour productivity growth across advanced economies. A variety of explanations have been provided for this trend, ranging from a slowdown in the rate of innovation,[31] an increase in the concentration of market power,[32] or a weakening of investment.[33] Europe is no exception in this regard, and a slowdown in productivity was evident even prior to the COVID-19 pandemic, with growth in labour productivity falling from 2.6 per cent in 1990 to 0.2 per cent in 2019. The pandemic appears to have exacerbated this slowdown, with growth in labour productivity averaging -0.2 per cent in the period between 2020 and 2023. This stagnation has resulted in the emergence of a growing gap between output per hour worked in the euro area versus the technological frontier, here represented by the US (**figure 14a**).

Comparative studies of the European economy have traditionally characterised the European system as one in which the relatively high productivity of workers compensates for their comparatively lower hours worked.[34] This was, indeed, the case in the 1990s, with productivity per hour remaining above US levels for most of the decade (**figure 14a**). However, from about 1995 onwards, growth in output per hour worked accelerated in the US and slowed in the euro area, eventually even stagnating in the period after 2020. As a result of these divergent growth rates, output per hour worked in the US overtook the euro area in the early 2000s and is now over 20 per cent above euro area levels.

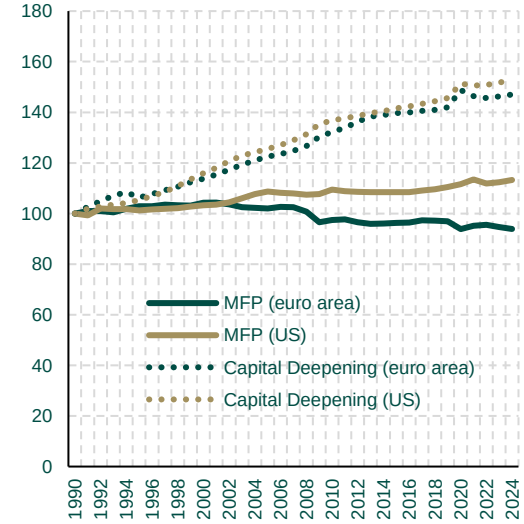
Figure 14: Labour productivity in the US and euro area

A: Output per Hour Worked in USD, euro area vs US



Source: The Conference Board

B: Indexed Drivers of Productivity Growth, euro area vs US



Source: CSO

Within standard growth accounting approaches, labour productivity is jointly determined by the stock of capital per worker and MFP[35], either of which could potentially be driving the stagnation in euro area labour productivity. Breaking output per hour worked into these subcomponents reveals that, while the

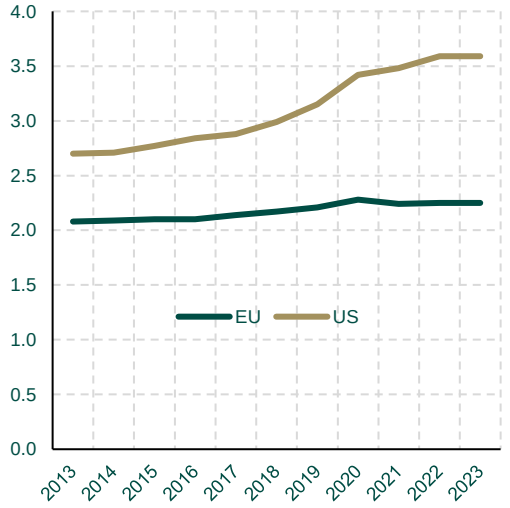
[31] Brynjolfsson, E., Rock, D., & Syverson, C. (2021). The productivity j-curve: How intangibles complement general purpose technologies. *American Economic Journal: Macroeconomics*, 333-72.
[32] Loeker, J. D., Eeckhout, J., & Unger, G. (2020). The Rise of Market Power and the Macroeconomic Implications. *The Quarterly Journal of Economics*, 561-644.
[33] Ollivaud, P., Guillemette, Y., & Turner, D. (2016). Links between weak investment and the slowdown in productivity and potential output growth across the OECD. *OECD Economics Department Working Papers*, No. 1466.
[34] Eichengreen, B. (2007). The European Economy Since 1945: Coordinated Capitalism and Beyond. New Jersey: Princeton University Press.
[35] Multifactor productivity (MFP) is a measure of how efficiently firms combine inputs like labour and capital to produce goods and services.

euro area underperforms the US in both categories from 2002 onwards, the magnitude of this underperformance is much larger for MFP, particularly in the period since 2008 (**figure 14b**). Indeed, MFP grew by an average of 0.3 per cent per year over this period in the US but fell by 0.5 per cent annually in the euro area. This divergence was not limited to the period during the eurozone crisis. Looking exclusively at the period from 2016 onwards, and so excluding the years directly affected by the crisis, the gap between US and euro area growth rates remains remarkably similar, with MFP growing by an average of 0.5 per cent in the US and falling by -0.3 per cent in the euro area. The period after 2008 therefore appears to constitute a structural break in European MFP, and this stagnation has accelerated the divergence from the US in output per hour worked.

A number of potential explanations have been offered by researchers and policymakers to account for this stagnation. Many of these arguments, such as that offered by the European Commission in their European Semester report, stress a "a lack of investment in research and innovation" as a key factor in lagging productivity growth.[36] While spending on Research and Development (R&D) in the euro area does lag behind the US (**figure 15a**), Bergeaud argues that this underestimates the problem, given that what R&D expenditure does occur in the euro area is less effective at raising productivity than in the US.[37] This occurs because R&D resources tend to be misallocated, flowing into firms specialising in "mid-technologies" that yield relatively minor increases in productivity, rather than into industries developing radically new products or production methods.

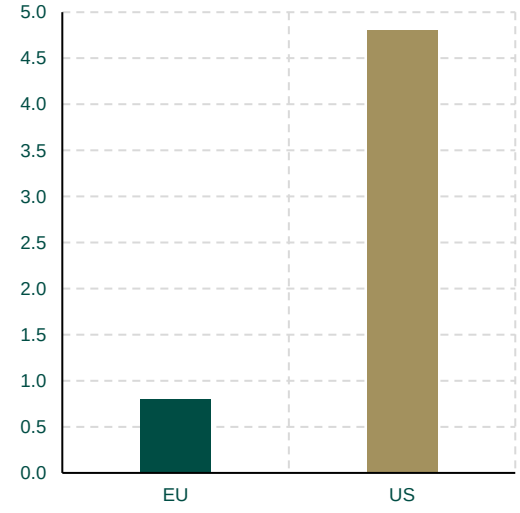
Figure 15: Drivers of the productivity slowdown

A: R&D Spending as a Percentage of GDP, EU vs US



Source: Eurostat

B: Employment Share of Fast-Growing Young Firms 2010-2020, EU vs US



Note: Fast-growing is here defined as being in or above the 90th percentile of employment growth.
Source: IMF

Other authors have placed less emphasis on R&D expenditure, instead focusing on factors such as trade frictions within the Common Market that have prevented European firms from "exploiting economies of scale and network effects as much as US firms do",[38] the tendency of European financial institutions and restructuring laws to support "zombie firms" that congest markets and constrain the

[36] European Commission. (2024). *Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank.* Brussels: European Commission.
[37] Bergeaud, A. (2024). *The past, present and future of European productivity.* Monetary policy in an era of transformation: European Central Bank.
[38] International Monetary Fund. (2024; 7). *Europe's Declining Productivity Growth: Diagnoses and Remedies.* Regional Economic Outlook Notes: International Monetary Fund.

growth of more productive firms,[39] or Europe's insufficient and delayed investment in ICT infrastructure.[40] All of these factors combine to ensure that the proportion of the euro area population which is employed in fast-growing young firms is approximately a sixth that of the US (**figure 15b**), indicating a significantly less dynamic market.

3.5 Conclusion

The Draghi report drew renewed attention to the underperformance of the euro area economy relative to that of the US and argued that the stagnation of European productivity growth was the primary driver of this divergence.

The analysis presented here shows that the divergence in productivity growth has been driven primarily by a decline in euro area MFP since the crisis. Further, the economic impact of this divergence has been partially offset by an increase in the European employment rate, which has converged to the US level. Looking forward, however, the euro area may struggle to maintain this convergence, given that the European population is projected to age at a significantly faster rate than that of the US. In the absence of a significant increase in the participation rate of the working age population, this ageing is likely to drive living standards in the euro area and the US still further apart, particularly if the stagnation in European productivity were to persist in the long run.

[39] Andrews, D., & Petroulakis, F. (2019). *Breaking the shackles: Zombie firms, weak banks and depressed restructuring in Europe.* No. 2240: European Central Bank.
[40] Van Ark, B. (2015). Productivity and Digitalization in Europe: Paving the Road to Faster Growth. *Digiworld Economic Journal*, 107-24.

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