12th November 2019

Opening Statement to the Budgetary Oversight Committee by the Minister for Finance and Public Expenditure and Reform, Paschal Donohoe, T.D.

Chairman,

At the outset, I wish to thank the Committee for the invitation to appear here today as part of your *ex-post* scrutiny of *Budget 2020* and I look forward to a fruitful and positive exchange.

Budget 2020

I would like to begin by setting out the Government's main priority which is to deal with the impact of a disorderly Brexit.

As the Committee is aware, on 11th September the Government agreed to base *Budget 2020* on the assumption of a disorderly Brexit at the end of October.

A primary reason for making this decision was to give certainty to businesses and citizens that the Government is prepared for a No Deal Brexit and stands ready to support the economy in such a scenario.

Although the risk of a disorderly Brexit in 2019 has receded, considerable uncertainty still remains as regards the final outcome.

Consequently, assuming a No Deal Brexit ensures the Government has the necessary resources at its disposal to meet the impact of this exceptional challenge, whilst preserving the longer-term sustainability of the public finances.

Those sectors and regions most effected by a disorderly Brexit will be supported through timely, temporary and targeted support measures.

Before taking account of certain Brexit related costs of €1.2 billion and timing related cash costs of €169 million, the overall increase in core voted expenditure on public services and infrastructure in 2020 is estimated at over €3.3 billion.

After taking account of discretionary revenue raising measures of over €0.4 billion, this results in a net budgetary package of over €2.9 billion.

This package is broadly in line with the amount of €2.8 billion set out in the Summer Economic Statement that would apply under the orderly Brexit scenario.

Further, taking into account commentary, including from the Irish Fiscal Advisory Council, in relation to in-year spending increases, estimated spending overruns for 2019 that carry into next year are accommodated within the Budget day package.

This package is appropriate given the current position in the economic cycle and the risks in the external environment.

As outlined on Budget day, in the event of a No Deal Brexit, the Government will intervene to protect the impacted sectors and regions.

This funding will be borrowed money to be specifically used to protect our economy.

If a No Deal Brexit does not happen it will not be borrowed for other purposes.

In the event of a No Deal Brexit, the Government's response includes sectoral expenditure of €650 million which will be released in multiple tranches.

The additional funding for the Department of Employment Affairs and Social Protection would also only be made available in the event of a No Deal outcome.

The allocation of the funding in relation to facilities and infrastructure for compliance checks will be assessed taking into account the up to date Brexit position.

Of course, mitigating the effects of Brexit has been a feature not just of *Budget 2020*, but of the last three years' work as well.

This has included initiatives to increase competitiveness and embed greater resilience in our economy.

For these ongoing initiatives, which are already in place, approximately €0.2 billion is included within the Departmental allocations published on Budget Day. This amount is additional to the €1.2 billion discussed above.

Since I published *Budget 2020* on 8^{th} October, an extension of the EU's deadline for withdrawal to 31^{st} January 2020 has been agreed.

As such, the risk of the UK departing the EU without a deal has been averted for now.

However, the ultimate outcome is still uncertain and a disorderly Brexit is still possible.

We still hope that the UK's withdrawal will take place on the basis of the deal agreed between the UK and EU at the October European Council while also awaiting the outcome of the UK's general election.

The extension of the Article 50 exit means that there is likely to be some upside to my Department's forecasts.

Indeed, if the withdrawal agreement is ratified, Ireland's position will, *inter alia*, improve with increased revenues and lower expenditure than forecast in *Budget 2020.*

Growth could be expected to be the order of 3.1 per cent for next year, approximately 2½ percentage points higher than forecast.

In addition, the general government balance could be around a ½ per cent of GDP in 2020.

Furthermore, I want to indicate to the Committee, because of the distinct possibility of stronger Corporation Tax receipts, it is conceivable that the fiscal position could be better than assumed at Budget time, with continued careful management of public expenditure.

As such, I will make a call on the end-year position following the publication of the November Fiscal Monitor given that November is the single most important month of the year for tax receipts.

In addition, the Government is committed to running surpluses over the medium term, in order to reduce our debt and guard against fiscal vulnerabilities, such as the possible transient nature of some Corporation Tax receipts and potential reductions in revenues as a result of the OECD Base Erosion and Profit Shifting (BEPS) project.

Our public finances continue to move in the right direction and this is testament to the sound, sustainable fiscal policies we have implemented over the past number of years.

Brexit is not the only risk we face in the short term.

Due to the highly open nature of the Irish economy, our public finances are vulnerable to potential knock-on impacts from a rise in trade protectionist policies and a more generalised slowdown in the global economy.
Should these risks not materialise, the principal risks relate to potential overheating as the economy approaches full-employment and changes in other jurisdictions that affect the competitiveness of Ireland’s corporate tax regime.

Going forward, we must continue to build on the hard won gains of recent years and ensure that our public finances remain on a stable and secure footing.

Some of the policies I have implemented in this regard include the establishment of a Rainy Day Fund which will increase the State's resilience to potential economic shocks.

In addition, by continuing to maintain a broad and stable tax base we can ensure that the State continues to be financed properly.

Rainy Day Fund

I am very happy to tell the Committee that I commenced the National Surplus (Exceptional Contingencies) Reserve Fund (the Rainy Day Fund) on Thursday 31 October 2019.

On foot of commencement and the necessary Delegation Order to the National Treasury Management Agency (NTMA) regarding the management of the Fund, I then directed the NTMA to transfer €1.5 billion from the Ireland Strategic Investment Fund to the Rainy Day Fund by 30 November 2019.

In preparing *Budget 2020*, I set out that a disorderly Brexit was the baseline scenario for budget planning purposes, and therefore a budget deficit was in prospect.

On that basis, I decided that there would be no transfer of €500 million from the Exchequer in 2019 to the Rainy Day Fund.

The €500 million will remain as Exchequer cash balances and therefore will be used to meet the Exchequer funding requirement, such as for public spending priorities.

However, on Budget day, I also set out that the funds transferred to the Rainy Day Fund can be deployed in the event that the economic impact of a disorderly Brexit is larger than assumed.

Fiscal Position

Turning to the fiscal position.

Our economy has performed very well in the year to date.

GDP growth of 5.5 per cent is expected for 2019 generating a modest surplus of 0.2%; indeed, this surplus would have been in the region of 1-1¼ per cent of GDP had the Government not increased capital expenditure from levels prevailing in 2016.

Public capital investment will increase by 22 per cent.

Unemployment at 4.8 per cent is now at its lowest level since 2012.

The end-October Exchequer returns indicate that tax revenues are up 6.7 per cent year-on-year, driven by broad-based buoyancy in all major tax heads.

We expect to meet our tax revenue target of €58.6 billion by year end. This represents a €0.2 billion increase on the *SPU 2019* forecast.

Turning to the outlook for next year, the economy is forecast to grow by just 0.7 per cent as a result of the significant impact of a disorderly Brexit in 2020.

That said, the economy will still grow. It will be a ‘two speed’ economy with continued growth in the multinational-dominated sectors but a much more difficult situation in UK-facing sectors.

As a result my Department is forecasting a deficit of 0.6 per cent for 2020 in the event of a disorderly Brexit.

We also expect to see a slower increase in the rate of employment.

However, as I stated on Budget Day and as outlined by the Irish Fiscal Advisory Council, there is much more uncertainty regarding short-term prospects than is normally the case.

Expenditure

Turning to the expenditure side, I will first give a brief overview of the outturn for 2019 to date.

At end-October, total gross voted expenditure was just over €53.5 billion, made up of €48.9 billion in current expenditure and €4.7 billion in capital expenditure.

This amount is €3.6 billion, or 7.2 per cent, ahead of the outturn for the same period in 2018. Of this, €2.7 billion relates to current expenditure, while just over €900 million relates to capital expenditure.

This is broadly in line with the projections set out on Budget day, when the need for additional spending was announced for 2019 in a number of areas.

The biggest pressure remains in the health sector, with the 2020 Expenditure Report outlining the potential scale of the Supplementary Estimate.

In recognition of the risks arising in health expenditure in recent years, a new health budget oversight group was established this year, incorporating members from the Department of Health and the HSE and chaired by the Department of Public Expenditure and Reform.

The purpose of the group is to monitor health spending and staffing against the current budget allocation and act as an early warning mechanism for any deviation.

In recent years the Government's priority has been in capital investment and where we have seen a 90% increase since 2016.

Making large strategic capital investments was the right course of action over recent years given the fall-off during the crisis period.

Given the scale of investment over recent years the growth rate is set to decline to more normal levels from 2022 onwards.

Fiscal Vulnerabilities

<u>Debt</u>

An important milestone is in prospect for this year, namely that the ratio of debt-to-GDP is projected at below the 60 per cent threshold set out in the *Stability and Growth Pact,* for the first time in the post crisis era.

Having said that, and as I have stated on a number of occasions, our debt burden remains highly elevated and is forecast at 100.2 per cent of GNI* for 2019 albeit declining to 97.4 per cent in 2020.

Reducing the nominal level must be our priority. In that context, at Budget time, my Department projected a surplus in headline terms of 0.2 per cent of GDP for this year.

However, given that the external economic outlook is deteriorating and the remaining uncertainty around Brexit, our policy approach should be to run budget surpluses into the future if the economy continues to perform strongly and to use them to reduce our national debt.

Furthermore, any windfall receipts that arise from the State reducing its involvement in the banking and financial sectors will be used to reduce the level of public debt.

We must continue to prepare for the inevitable slowdown, ensuring we don't spend money we might not have in the future and building on the achievements thus far.

Corporation Tax

Turning to Corporation Tax revenue which has been growing strongly driven by increased company profitability.

Receipts to end-October now stand at 10.6 per cent ahead of target. November is the largest collection month of the year and we expect that receipts may be stronger than forecast in *Budget 2020.*

Ireland has been very successful over several decades in attracting leading multi-nationals here.

Given the size of these multinational firms and our high level of integration with the global economy, we have seen the Corporation Tax base become somewhat concentrated, with the ten largest firms currently accounting for approximately 45 per cent of all Corporation Tax receipts.

While Ireland's Corporation Tax as a proportion of economic activity is broadly in line with that of other small, open, trade-orientated European economies, the Government is acutely aware of the risks associated with the concentration of receipts.

That is why we will continue to:

- broaden the tax base; and
- prioritise the reduction of debt, which in the event of a shock to our tax base, would enhance our fiscal capacity to deal with such an occurrence.

Using the surplus Corporation Tax receipts in 2018, the Government wisely ran an Exchequer surplus which meant that we did not have to borrow to meet day-to-day expenditure.

In addition, on Budget Day my Department published a scoping paper titled *'Addressing Fiscal Vulnerabilities'* which identifies some possible solutions and initiates a discussion around how best to mitigate against our increasing reliance on Corporation Tax receipts.

The paper also sets out several proposals to ensure that the fiscal rules do not contribute to budgetary imbalances.

I am currently considering these, and possibly other suggestions, with a view to making recommendations to Government in due course. In addition, my Department will undertake a further assessment of Corporation Tax receipts, in the context of the OECD BEPS process that is due to come to a conclusion next year.

This analysis will be published next March.

Turning to specific matters which I understand the Committee wish to discuss, I will firstly set out recent developments relating to the spending review process.

Spending Review process

A sustainable expenditure policy needs to meet certain key requirements including:

- Ensuring that the overall level of expenditure remains affordable over the longer term; and
- Delivering sustainable improvements in public services and infrastructure.

Consequently, this requires that expenditure growth is set at a level that is consistent with the longer-term growth potential of the economy and that there is an ongoing focus on the quality of expenditure.

In this regard, Spending Review papers provide an evidence base in relation to Departmental spending that inform budgetary choices.

The spending review process is aligned to the estimates process as most papers are published in July/August each year allowing the findings from the reviews to feed into early budgetary discussions and negotiations.

In addition given the rolling nature of the Spending Review process, the analysis produced in one year can also inform considerations in subsequent years.

Publication of the papers on the Spending Review website facilitates engagement with the process by all stakeholders.

The findings of Spending Review papers feed into policy process by providing evidence to make well informed decisions in the relevant policy area.

Demographic Pressures

As to demographic pressures and their impact on the Budget, I would make the following points.

Ireland's population is at present one of the youngest in the EU, but our demographic profile is set to change significantly in the coming decades.

In September 2018 my Department published a report titled '*Population Ageing and the Public Finances in Ireland'.*

The report outlines that the ratio of retirees to workers is set to more than double by 2050 - there are currently around five persons of working age for each person aged 65 and over; by 2050, the equivalent figure will be just over two.

The 'greying' of the population will have an adverse impact on the public finances, with age-related expenditure expected to rise by 6 per cent of GDP by 2070.

Accommodating demographic related costs was a feature of Budget 2020.

As with previous budgets, *Budget 2020* includes €0.5 billion for demographic pressures in the areas of Health, Social Protection and Education.

These allocations are informed by the paper *'Budgetary Impacts of Changing Demographics 2017 – 2027'*, published by the Irish Government Economic and Evaluation Service (IGEES).

An update of this paper was published alongside *Budget 2020.*

Conclusion

To conclude, while we are potentially heading into choppy economic waters, we do so from a position of strength.

We do not have the imbalances which characterised our economy a decade ago – there is no credit driven bubble for instance.

However, there is still uncertainty in relation to the final outcome of Brexit.

Consequently, we must look to manage the public finances next year within the parameters set out on Budget day with borrowing to fund the Brexit contingency measures only being triggered in the event of a No Deal Brexit.

I would like to thank the Committee again for the opportunity to speak here today and I am happy to address any questions you may have.

Thank you.

ENDS