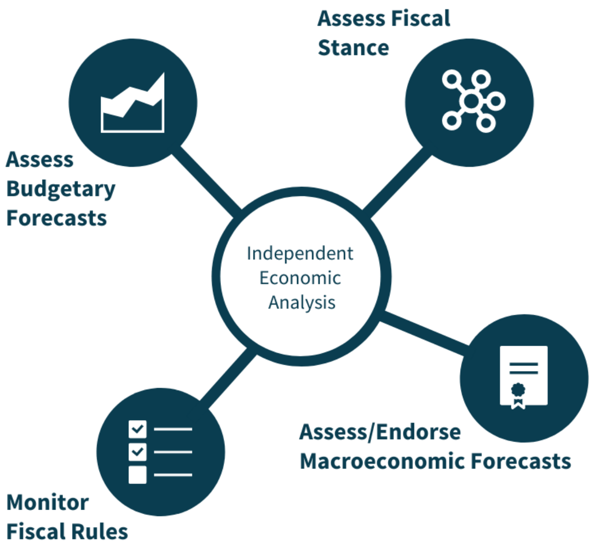
Meeting with Oireachtas Committee on Budgetary Oversight

Opening Statement by Mr Sebastian Barnes, Chairperson of the Irish Fiscal Advisory Council, Wednesday 22nd September 2021

The Council would like to thank the Chair and members of the Committee for inviting us. Joining me are Council Members Ms Dawn Holland, Prof Michael McMahon, Dr Adele Bergin, and Mr Alessandro Giustiniani as well as our Chief Economist and Head of Secretariat, Dr Eddie Casey. We value our engagements with the Oireachtas and see these opportunities as an important part of our work.

The Council is an independent body established under the Fiscal Responsibility Act (2012). Its mandate is to endorse and assess the official macroeconomic forecasts, assess the budgetary projections, assess compliance with the fiscal rules and assess the fiscal stance. Its focus is on the overall fiscal stance, rather than on individual tax measures or spending items.

The Council's Mandate:



Last week, the Council published its *Pre-Budget 2022 Statement*.

The economy is recovering quickly from the pandemic as vaccinations progressed and as individuals adapt to new circumstances. Upside risks to official projections for the economy include the potential unwinding of large household savings and boost from the Government's planned budgetary expansion. However, jobs are likely to recover more slowly than spending and the long-term scarring effects on activity from the pandemic are uncertain. Over the longer term, it is likely that Ireland's ageing population would tend to slow growth, with productivity growth also likely to moderate as it converges on norms for more mature economies.

The Council welcomes the July Summer Economic Statement (SES) as a significant step in the Government publishing a medium-term budgetary plan to 2025. This is something that was promised in the Programme for Government.

The Summer Economic Statement included more realistic spending forecasts for maintaining the "Existing Level of Services". This basically allows for pressures from rising prices and changing demographics that were not fully accounted for in past forecasts. The change in approach addresses a long-standing weakness in budgetary projections that the Council had been concerned about. The SES also set out a new spending rule and debt objective. These approaches are welcome and partly address recommendations made by the Council in the past.

While the progress made in the SES was welcome, there were three key areas for concern:

First, there has been a significant shift in policy for the medium-term, leading to higher risk. While a sizeable fiscal response to Covid was warranted, the sustained deficits now planned would prevent the debt ratio from falling steadily to safer levels. The Government's own projections imply a deficit of close to 3% of GNI* in 2025, while the Council's more positive view of the recovery would suggest something close to 1.5% if the Government sticks to its spending plans.

Running significant budget deficits for several years during a period of strong growth and with high public debt carries risks. Even allowing for low interest rates into the future, the Council estimates a one-in-four risk that the Government's debt ratio could end up on an unsustainable path. Ireland's deficit and net debt ratio could also still be among the highest in the OECD by 2025, which increases the risks of higher borrowing costs if Ireland is viewed as an "outlier", particularly as a relatively small economy. This leaves the public finances more exposed to shocks, particularly from unexpected shortfalls in growth. It also reduces the likelihood that the Government could respond to future crises by supporting the economy in the same way it did during the pandemic.

Second, key details of the fiscal plan are still lacking. The planned increase in public investment will see Ireland's public investment peak at around 6 per cent of modified gross national income in the coming years. There is a good case for higher spending in areas such as health, climate change, and housing, and interest rates are low. Yet the speed and timing of the ramp-up as well as Ireland's weak track record with public investment management means that capacity constraints might lead to higher costs. To assess the risks, more information is needed on the Government's investment plans and the underlying economic assumptions, particularly in relation to the new National Development Plan, the Climate Action Plan, Sláintecare and around Housing for All. The Government should plan to eventually bring investment down to more normal levels.

Third, the new spending rule and debt objective need more work if they are to be useful. The spending rule is intended to constrain permanent voted spending to grow at the same rate as potential output, assumed by the Government to be around 5 per cent. The Council has recommended a spending rule for several years to ensure that spending grows in line with the Government's ability to pay. However, applying the rule now, when sharp permanent spending increases already took place in the last Budget, means that the rule is likely to lock in a high path for spending. There are a number of design problems with the rule: (1) it is too narrow, focused only on a portion of spending and ignoring tax cuts; (2) it should be better calibrated to improve the deficit rather than maintain it and to not lock in high growth rates; and (3) it should be given a statutory footing and better linked to the debt objective, which is itself vaguely specified. The SES also did not set out how budgetary plans comply with the existing EU and domestic fiscal rules.

In relation to *Budget 2022*, the Council's assessment is that the Government's €4.7 billion package of measures appears to be at the limit of what is prudent. The implied 5.5 per cent expansion is modestly above estimates of the underlying potential growth rate of the economy but would help to support the recovery. The Council assesses that some of the temporary and targeted income and job supports may need to continue. These ongoing supports may be necessary for certain sectors to alleviate the impacts of the pandemic

Looking beyond 2022, the Government should prioritise between its plans for significant expansions in public investment, fast increases in current spending and a desire to simultaneously cut taxes. By expanding all areas at once, the Government is effectively evading difficult choices and slowing the return of debt ratios to safer levels. This reduces the scope to ensure that future downturns or crises could be cushioned by strong fiscal support in the same way as during the pandemic. A more prudent approach would be to limit current spending to a slower pace of increase or to avoid plans to reduce the tax base at the same time as a ramp-up in public investment spending is planned.