Irish Fiscal Advisory Council

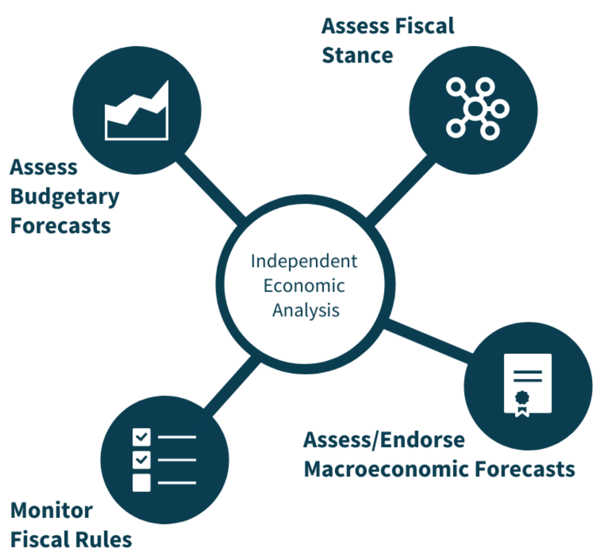
Meeting with Oireachtas Committee on Budgetary Oversight

Opening Statement by Mr Sebastian Barnes, Chairperson of the Irish Fiscal Advisory Council, Wednesday 8th December 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 21st *Fiscal Assessment Report*. The report noted the continued recovery in the economy from recent lockdowns. Pre-crisis levels of underlying activity were reached in the second quarter of 2021, but the recovery is uneven. Sectors such as tourism and hospitality still show more pronounced effects compared to high-income sectors that have seen little disruption to growth. The economy is expected to grow at around 3 per cent in the medium-term. Risks around the official forecasts are broadly balanced. Growth could be higher if scarring from the pandemic is less severe than assumed, if wages grow faster, or if savings unwind and boost consumer spending more than assumed. But there are also adverse risks associated with virus mutations, further restrictions, reduced FDI due to international tax developments, and uncertainties around Brexit.

Welcome progress made on budget strategy

The Council welcomes the Government's steps towards developing a medium-term fiscal strategy. This has three key elements.

First, the spending forecasts are more credible. These allow for the cost of maintaining existing levels of public supports amid demographic and price pressures.

Second, the Government has introduced a spending rule that seeks to limit core spending increases to an average of 5 per cent annually. This covers Exchequer non-interest spending and the idea is to broadly align spending increases with the economy's trend growth rate, and hence with sustainable growth in government revenues.

Third, the Government has set out public investment plans to 2030 in the new National Development Plan published in October.

Plans stuck to for Budget 2022

A sharp narrowing of the deficit to 5.9% of GNI* in 2021 looks achievable. The deficit could ultimately be narrower due to higher revenue and underspends.

For 2022, the Government stuck to its planned €4.7 billion budgetary package. This provides around €1.6 billion to maintain existing services, €1.5 billion in new current spending and an increase of €1.1 billion in public investment. The Budget forecasts a deficit of 3.4 per cent of GNI* for 2022, but it could be lower.

Keeping to the planned package means that the Government is striking an appropriate balance between supporting the economy and keeping the public finances on a sustainable path. The plans would allow public investment to increase to record levels and should be sufficient to maintain existing levels of services. The budget deficit would close by 2023 and the debt ratio would fall to below 90 of GNI* by 2025, declining at a steady pace of around 3 percentage points each year. This would comply with the domestic fiscal rules.

Need to follow through on the strategy and clarify major commitments

To help achieve the strategy set out, the Government should reinforce the strategy. First, departmental spending ceilings should be set out as is legally required. Second, the spending rule could be: a) linked more closely to the domestic fiscal rules, b) expanded to cover non-Exchequer spending and tax changes, and c) given legislative backing.

Moreover, the Government needs to clarify how major commitments around Slaintécare and climate actions fit into these plans. Slaintécare costings have not been updated since 2017. There is no estimate of the budgetary cost of implementing the Climate Action Plan.

The space leftover for additional current spending implied by the Government's plans will be limited in the years ahead unless there are offsetting spending cuts elsewhere or tax increases. The Budget suggests around €1.6 billion per year on average of new current spending remains to be allocated, while the Council's estimates that only around €0.5 billion would remain once Stand-Still costs are met. Any additional spending beyond this level would require either tax increases or reduced spending in other areas to be consistent with the Government's strategy.

Major challenges remain

The Government's over-reliance on corporation tax receipts to fund public services should be addressed. One-in-five euros of tax receipts were from corporation tax in 2020, and more than a half of those receipts were from ten corporate groups. This concentration, coupled with the ongoing volatility of receipts and their vulnerability to international tax developments is a source of serious concern.

To deal with these risks, the Council assesses that the Government should allocate corporation tax receipts above what is forecast for a given year to the Rainy Day Fund. This would potentially include any increase due to the rise in the minimum corporation tax rate to 15 per cent. This would help to reduce the reliance on volatile, unpredictable, and potentially finite resources in much the same way that Norway treats its oil revenues.

The Government must also contend with the challenge of an Irish population that is rapidly ageing. The Commission on Pensions set out a package of reforms that would restore the long-run sustainability of the pensions system including through raising the retirement age with life expectancy and a significant increase in PRSI contributions. The Government now needs to set out how it will respond. The proposal to delay raising the retirement age to 2028, however, raises questions about the willingness of future governments to impose such measures. Setting out a plan to phase in any PRSI increases over the coming years could make these measure more credible.

To summarise, the Government's medium-term strategy is appropriate and allows a large increase in public investment, while bringing debt to safer levels helped by expected growth and low interest rates. However, some major questions need to be answered and decisions taken to ensure that the strategy is delivered.