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 7th September 2022

Confidential until 2pm Wednesday 8 September

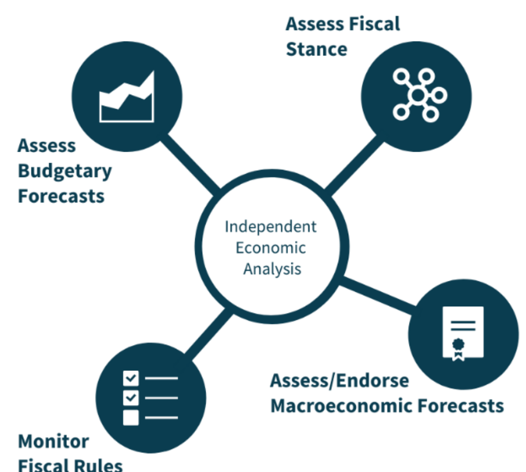
The Council would like to thank the Chair and members of the Committee for inviting us to appear before you to discuss the Council's *Pre-Budget 2023 Statement*. We value our engagements with the Oireachtas and see these opportunities as an important part of our work.

Joining me are Council Member Prof Michael McMahon, and Dr Eddie Casey from the Council's Secretariat.

The Fiscal Council

The Fiscal Council is an independent body established under the 2012 Fiscal Responsibility Act.

Its mandate is to endorse and assess the Government's official macroeconomic forecasts, assess its budgetary projections, assess compliance with fiscal rules and assess the Government's overall fiscal stance.



The Economic outlook ahead of the Budget

While still strong, Ireland's recovery following Covid may have lost some momentum in recent months. Official data suggest consumer spending slowed early this year, pulling down domestic demand, though data are mixed. This comes as prices have risen, reducing households' spending power.

The global recovery has been hindered by the sharp rise in the cost of energy. At the same time, central banks have responded to rising inflation by tightening policy and raising interest rates. These factors have contributed to a downgrading of growth forecasts in Ireland's trading partners.

The current outlook for oil and gas suggests that prices, while expected to fall eventually, will stay higher for longer than previously thought. This could add to, or prolong, the current high rates of inflation, particularly if wages were to respond strongly.

There are major risks to the economy going into this winter, particularly of a shutoff in gas supplies to Europe. Covid-19 and Brexit still pose uncertainties. Financial conditions could tighten. And domestically, we could see competitiveness issues and capacity constraints arising from labour shortages, rising wages, and housing costs.

The Public finances ahead of the Budget

The Government entered the pandemic with one of the highest debt ratios in the OECD and borrowed significantly during the crisis. At the end of 2021, its net debt ratio was 82% of GNI*. This puts it as the tenth highest in the OECD. Only three other small open economies in the OECD have larger debt burdens (Greece, Portugal, and Belgium).

Strong tax receipts are likely to push the Government's budget into a headline surplus of around 2% of GNI* this year. Corporation tax receipts have continued to surge and are likely to overtake VAT as the second largest tax heading. Without the excess corporation tax receipts – those unexplained by the performance of the domestic economy — a deficit of close to €5 billion would be likely this year (2% GNI*).

Overreliance on corporation tax revenues carries large risks. These receipts are highly concentrated: ten firms account for 53% of last year's net receipts. These receipts are unpredictable; they depend on company-specific developments and there are risks associated with changes in the international tax regime.

The Government should cap and, over time, reduce its overreliance on "excess" corporation tax receipts, including by saving them in the Rainy Day Fund or a new National Pension Reserve Fund so that those resources are available to meet future needs.

Budget 2023

The Government faces difficult choices in Budget 2023. Its budgetary stance must strike an appropriate balance between creating space to protect those most vulnerable to the rising cost of living and avoiding stoking inflation further.

The *Summer Economic Statement* plans entail a 6.5% increase in core spending for 2023, with core spending €4.9 billion higher than earlier plans, and a larger-than-planned tax package. This pushes the budgetary expansion beyond the Government's 5% Spending Rule introduced last year — the pace that, in normal circumstances, would be considered sustainable.

A temporary deviation from the 5% Spending Rule is sensible, given the exceptional rate of inflation. The pace of expansion planned is less than what would be implied by tracking higher price rises in full.

It is now important that the Government sticks to its announced budgetary plans. This would support economic stability and would imply saving any additional excess corporation tax receipts. Further temporary measures may be warranted and the Government should stand ready in case the situation this winter is more severe than expected.

Within the overall spending envelope, the Government faces difficult choices on Budget Day and needs to prioritise what it wants to achieve.

Tracking wage and price increases in full this year and next and implementing existing plans could mean core current spending would have to increase by almost €7 billion in 2023. However, this would exceed the available space under the Government's spending ceiling for 2023.

Choices will need to be made between how far to uprate public sector wages, pensions, and social welfare payments and to what extent existing spending plans, or any new permanent spending or tax initiatives are pursued. The proposed public sector pay deal, which increases pay by less than the full amount of expected inflation, would help to create space to support more vulnerable households.

Improved targeting of cost-of-living supports would be less costly and would help get the balance right. Ireland's welfare and income tax system offer useful avenues through which to better target supports.

At the same time, the Government needs to set out how it will address major medium-term challenges. Tackling the costs of an ageing population, halving Ireland's greenhouse-gas emissions by 2030, and implementing other policies such as "Sláintecare" will be expensive and need to be built into budgetary plans.

Ageing is likely the biggest challenge: annual spending on pensions is set to rise by about €4 to 5 billion in today's prices by 2030. The Government has not responded to the Pensions Commission recommendations, but it has indicated a costly decision not to raise the retirement age. The increase in employee and employer PRSI contributions for a worker on a typical wage of €35,000 by 2040 would be around €1,850 in today's terms if the pension age remains unchanged compared to €1,000 if the pension age were increased as proposed by the Pension Commission.

Strengthening medium-term budgeting would help meet these challenges. The 5% Spending Rule should be reinforced to recognise the impact of tax measures, give it legislative status, capture the full range of general government spending, and link it to debt targets. Multiyear baseline expenditure plans should be published with the headline ceiling.

Looking ahead to the Budget, the documentation should be improved to increase transparency.

First, the White Paper, an important pre-Budget document covering a no-policy change scenario, should be modernised. This should include a full breakdown of the expected "no policy change" forecast for expenditure and revenue on a general government basis. Figures should be presented on a "Gross" basis rather than on a net basis, which tends to mask underlying developments when there are offsetting transactions.

Second, the Budget forecasts should cover at least the next 5 years, out to 2027, as the Department has committed to in the past. This would help ensure sound medium-term planning and make clear the future costs of current policies are properly accounted for. Figures for expected spending for each Department should be included over the full forecast horizon.