Irish Fiscal Advisory Council

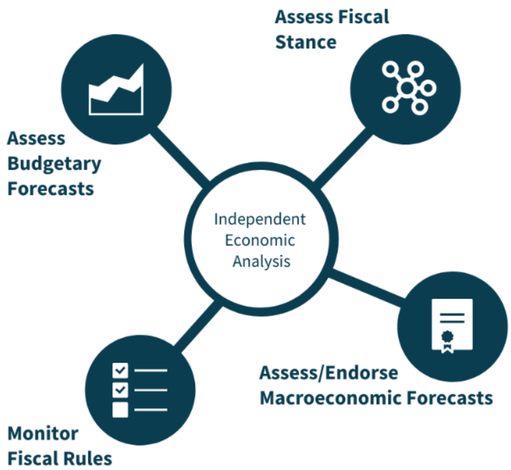
Meeting with Oireachtas Committee on Budgetary Oversight

Opening Statement by Mr Sebastian Barnes,
Chairperson of the Irish Fiscal Advisory Council,
Wednesday 30th November 2022

Confidential until 5pm Wednesday 30th November

The Council would like to thank the Chair and members of the Committee for inviting us to discuss the Council's *Fiscal Assessment Report*. We value our engagements with the Oireachtas and see these opportunities as an important part of our work.

Joining me are Council Members Dr Adele Bergin, Prof Michael McMahon, Ms Dawn Holland, Mr Alessandro Giustiniani, and Dr Eddie Casey from the Council's Secretariat.



The Fiscal Council

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

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

Recent economic developments

Ireland's growth has slowed considerably. The rapid post-Covid recovery has been stunted by surging prices, mainly for energy and food. This has led to weaker real incomes.

While the jobs market remains exceptionally tight, it shows some signs of softening, including in digital sectors.

Budget 2023 forecasts real GNI* growth of just 0.4% in 2023, before returning to more normal rates of about 3% in 2024 and 2025.

There are major risks: gas shortages this winter seem less likely, but Ireland's main trading partners could be on the verge of a recession. If high prices pass through to wages, this could mean more persistent high inflation, weakening growth further. Housing supply pressures continue to be an important challenge, though household and business debt levels have reduced in the past decade, helping overall resilience.

Budget 2023

Budget 2023 involved a large package of temporary measures, but the permanent expansion was more moderate.

In total, the Budget package was around €11 billion: some €7 billion of permanent measures, €5.8 billion in spending and €1.1 billion on tax. A further €3.9 billion was in the form of temporary measures aimed at helping households and businesses adjust to the rising cost of living.

The Council's assessment is that Budget 2023 struck an appropriate balance between supporting vulnerable households and avoiding adding to inflationary pressures.

The temporary deviation from the 5% Spending Rule is relatively limited, with core spending rising by 6.8% instead for 2023. The Council assesses that the permanent spending increases in both years are likely to be sustainable. These increases do not compensate for inflation in full, but the gap for lower income households in 2023 is more than made up for by substantial temporary supports.

The Government has helpfully introduced a new measure of the budget balance, excluding an estimate of excess corporate tax receipts. This measure – recommended by the Council in previous reports – provides a clearer picture of the underlying state of the public finances and is likely to be more robust.

On this basis, the budget deficit was forecast in the Budget to narrow substantially to 3.1% of GNI* this year. This reflects the lifting of pandemic supports and strong revenue growth. The budget balance, notably taxes, could ultimately be more favourable than forecast.

Following a further improvement in 2023, a budget surplus of 1 to 2% of GNI* is projected by 2025, when excess corporation tax receipts are excluded.

This assumes that the Government sticks to its 5% Spending Rule as planned. However, we estimate that current spending increases in 2024 and 2025 would not fully accommodate demographic and price pressures, falling short by €0.8 billion per year on average. This implies no space for additional spending without finding offsetting resources elsewhere.

A window of opportunity

There is now a good window for Ireland to reduce its debt burden to safer levels while interest costs remain low, despite recent rate increases.

Future shocks to interest rates, growth or debt will be much more manageable if we start from a lower level of debt.

Sticking to its plans, the Government could see its net debt ratio could fall from 73% of GNI* at the end of this year to 58% of GNI* by 2025, on the back of budget surpluses, relatively high inflation, and moderate growth. This would provide a buffer to help the Government respond to future recessions or crises.

However, this window of opportunity is likely to be short-lived.

Stepping up long-term planning

The public finances face major long-term challenges. These include pensions and the ageing of the population; the costs of climate transition; and the need to reduce overreliance on excess corporation tax receipts. The decision to maintain the pension age at 66 adds to future tax pressures.

The Government needs to step up its long-term planning about how these challenges will be addressed.

The Council is concerned that the l forecasts in Budget 2023 only go three years ahead. This does not allow for a proper analysis of the medium-term path for the economy or of the Government's fiscal plans, including how to address medium-term pressures.

The Government should return to medium-term forecasting on at least a five-year-ahead basis.

To support its planning, the Government should make three changes:

1) It should reinforce its 5% Spending Rule. This has proven to be a simple and effective anchor for the public finances. The Spending Rule should be put on a legislative basis, net out tax changes, be linked to debt targets, and capture general government spending.

2) It should make use of medium-term spending ceilings at the Departmental level, as required by law, to anchor the Spending Rule across Government.

3) It should rethink the National Reserve Fund. The Government's decision to restore the National Reserve Fund is welcome.

However, the Government should consider raising the cap and making it a new National Pension Reserve Fund. This could take pressure off tax increases in future years to fund pension shortfalls.

There are major choices to be made

While Budget 2023 navigates a steady path through the energy crisis, Ireland's big longer-term challenges are becoming ever more urgent. Difficult choices will need to be made in the years ahead, including about how to manage ageing and climate change. This will have major implications for spending and taxation.