

Opening Statement, Irish Fiscal Advisory Council, Thursday 22 June 2023

The Council is grateful to the Chair and members of the Committee for inviting us to appear before you once again. We value our engagements with the Oireachtas highly and consider these opportunities an integral part of our work.

## The Council's Mandate

As an official independent body established under the Fiscal Responsibility Act (2012), the Council's mandate revolves around four elements: endorsing and assessing the official macroeconomic forecasts, assessing official budgetary projections, monitoring compliance with fiscal rules, and assessing the Government's overall fiscal stance. Our focus is on the broader fiscal perspective rather than individual tax or spending measures.



In our latest Fiscal Assessment Report, we assess the Government's official projections as set out in the Stability Programme Update 2023.

After slowing over winter, Ireland's growth looks set to recover as inflation eases. However, capacity constraints have emerged as a significant hurdle. There is an exceptionally tight job market and there is a risk that wage and rent pressures could be more persistent than anticipated.

The Government's underlying deficit, excluding excess corporation tax receipts, is projected to narrow to 0.6% of GNI\* this year, and is expected to register its first surplus in 17 years in 2024.

The projections assume the Government sticks to its National Spending Rule, which is prudent. They imply a fall in the Government's net debt-to-GNI\* ratio between end-2022 and end-2026 from 69% to 46%. This is on the back of forecast surpluses, relatively high inflation, and moderate growth. The saving of

windfall corporation tax receipts contributes about 16 percentage points of the overall decline.

Excess corporation tax receipts now account for more than one-in-every-four euros of tax receipts. Recent research by the Council's Secretariat estimates that just three corporate groups accounted for one-third of these receipts between 2017 and 2021. Moreover, the receipts are dominated by tech and pharmaceuticals firms. The high level of concentration means there are risks that these receipts could reverse depending on firm-specific factors and changes in the international tax environment. The Council's central estimates of how big these windfalls might be are slightly larger than the Department's at €11.5 billion for 2022 versus €10.8 billion. These are central estimates — not conservative estimates — with a wide range from €8.7 billion to €14.2 billion. These windfall receipts should not be relied on to fund permanent spending. Spending these revenues, which come from worldwide activities, would risk adding to overheating in the Irish economy.

The Council welcomes the extension of the SPU macroeconomic forecasts to 2030, shedding light on growth in the years ahead. However, there were a number of methodological shortcomings in the fiscal projections. Most importantly, the fiscal forecasts end in 2026 and so do not provide a clear picture of the challenges associated with an ageing population, delivering climate objectives, and Sláintecare healthcare reforms.

The Council assesses that it would be appropriate to stick to the National Spending Rule from 2024, given the exceptionally tight labour market, high inflation, capacity constraints, and risks associated with corporation tax receipts. The SPU clarifies that this is a net spending rule, so that discretionary tax increases create space for additional spending.

This would imply saving "excess" corporation tax receipts. Recent proposals on a Long-Term Saving Vehicle from the Department of Finance look at several options for how this fund might be capitalised and how withdrawals would work. The options range from transferring less than half of estimated windfalls to essentially all of them until 2030. And the withdrawal options considered range from allowing withdrawals by Dáil resolution in pre-defined circumstances to only allowing withdrawals equivalent to the expected real rate of return.

The Savings Vehicle proposals could help to manage the inflow of corporation tax receipts and address longer-term challenges. The Vehicle could reduce the risks of repeating the mistakes of the 2000s: using unreliable revenues to fund permanent tax cuts and spending increases. But the details of how it will work are key and still to be determined. The Council assesses that saving windfall corporation tax receipts to address ageing-related costs would be beneficial, given the substantial risks to the economy and public finances from using these to fund ongoing commitments.<sup>1</sup> This presents a huge opportunity to finally tackle a substantial portion of ageing costs — something still not addressed, considering that plans to increase the pension age were abandoned.

More recently, the debate has shifted to using a portion of the windfalls for additional investment. It should be noted that Ireland is already ramping up public investment quickly. About 30% is directly allocated to Housing areas and 7% to Climate over 2021–2025, though spending in other areas may also be supportive of those broader goals. The plans imply that annual outlays will be doubled between 2018 and 2025 — up from €6.6 billion to €13.2 billion. As a share of GNI\*, the plans will bring Ireland’s public investment rates to levels consistent with being in the top 25% of rates run by OECD countries in the past three decades.

Capacity constraints already appear to be undermining the Government’s ability to deliver on capital spending. The implied unemployment rate in construction is closer to 2% — far below the rate for the rest of the economy. Since Budget 2022, nominal government capital spending has been revised down, while inflation has increased. Both factors mean that a lower level of real output is now expected. In housing, there have been underspends during the last three years that in cumulative terms are close to €0.4 billion, given catch-up spending taking place later than planned.

Running budget surpluses in times of relatively strong growth is a necessary counterpart to the strongly counter-cyclical policies that were appropriate during the pandemic and energy crisis, both to manage the overall level of demand in the economy and to ensure fiscal buffers are rebuilt.

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<sup>1</sup> More details on the assessment of the Savings Vehicle are available in this box from the report: <https://www.fiscalcouncil.ie/wp-content/uploads/2023/06/Fiscal-Assessment-Report-June-2023-Box-E-.pdf>

Meeting the spending rule would require choices about taxation and spending: the €4.3 billion increase in spending planned for 2024 is less than the “Stand-Still costs” that would be needed to meet demographic needs, raising social payments and public sector pay in line with wages. On the tax side, the planned €0.6 billion tax package would be consistent with partial indexation of the income tax system. Demographics contribute costs of some €1.8 billion alone, given rising pension costs and the ageing population, while Government plans to increase investment contribute €0.9 billion.

While one-off fiscal measures were appropriate to address recent cost-of-living pressures, they cannot serve as a long-term solution. With energy prices lower, there is now less justification for one-off supports, although contingencies could be built in for next winter in case of need at that time.

For the longer term, improved planning would help to manage the challenges of ageing and climate change. In the context of the EU governance reforms, reinforcing the National Spending Rule as a “first line of defence” could help Ireland navigate these challenges and maintain a sustainable fiscal path.

It is worth noting that Ireland is in a relatively strong position — one that is enviable from an international point of view. Most EU countries are now running deficits and are having to address ageing challenges through substantial fiscal adjustments or pension age increases as well as meeting climate objectives, housing shortfalls and other pressures. The windfalls that Ireland is collecting may be vulnerable to reversals, but they offer an opportunity to save and hence reduce the burden of these adjustments on future generations.

Thank you for your attention. We remain committed to assisting the Oireachtas in achieving fiscal responsibility and economic stability.