

Meeting with Oireachtas Select Committee on Budgetary Oversight

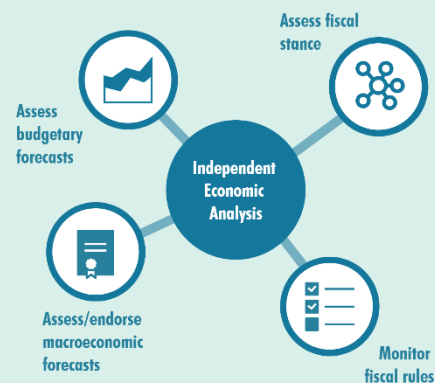
Opening Statement, Irish Fiscal Advisory Council, Wednesday 20 September 2023

The Council is grateful to the Chair and members of the Committee for inviting us to appear before you 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.

This means the Council's focus is on the broader fiscal perspective, not individual tax or spending measures.



In our “Pre-Budget 2024 Statement”, we assess the Government's official plans ahead of Budget 2024 as set out in the Summer Economic Statement. This updates the analysis in our June 2023 Fiscal Assessment Report.

When we think about the Government's stance, we think about two things. First, we consider what is right for the economy. In practice, this means assessing whether the economy needs widespread support as in a recession, or if it needs cooling, as is the case when price pressures are high and unemployment is low. Second, we consider what is likely to be sustainable. This often means assessing how likely it is that the tax base will be able to support spending needs over the medium term, without leading to sharp cuts to expenditure or tax increases.

Right now, we can see that the economy clearly does not require extra stimulus. We are above full employment — that is, we have never had this high a share of the population employed. This strength is one of the reasons why high price and wage pressures at present could persist.

In terms of sustainability, we are projected to run surpluses. But the strong fiscal position is flattered by excess corporation tax receipts. Without these, Ireland would be running its 17th annual deficit this year.

In the summer, the Government set out its plans which involve repeatedly breaching the National Spending Rule every year out to 2026. As a result, core net spending is expected to be €4 billion higher by 2026 compared to plans set out five months ago.

The breaches are serious.

First, they continue procyclical fiscal policies Ireland has struggled with in the past. That is, increasing spending and cutting taxes when the economy is already performing strongly. Such an approach can destabilise the economy in an upturn, fuelling more price increases. And it often means having to reverse those measures in bad times as revenues dry up. This approach has added to unemployment increases in downturns, exacerbating recessions.

Second, the breaches leave the fiscal framework and Ireland's National Spending Rule less credible. This comes at a time when EU fiscal rules are not applicable, and reforms will render them less useful for Ireland.

In the near term, spending overruns, especially in health, will add to the overall expansion. Further “non-core” measures would also add to the overall expansion and risk keeping inflation higher for longer. Labelling temporary measures “non-core” doesn’t mean they will not contribute to further price pressures in the economy. With energy prices falling, there is little to no justification for these.

Further ahead, the Government has not factored in other pressures that are going to hit the public finances.

The Savings Vehicle can help solve two fiscal headaches

Ireland faces three major fiscal policy challenges in the coming years and decades: 1) addressing ageing pressures, 2) meeting climate objectives; and 3) resisting the temptation of using unreliable corporation tax receipts for permanent commitments.

The Government’s proposals to establish a Savings Vehicle could help with two of these three challenges.

First, by saving the excess corporation tax receipts it is collecting, Ireland can prevent the risk that it builds up permanent commitments on the back of these.

The risks around relying on excess corporation tax receipts should not be understated. The risk is that these highly concentrated receipts — with three firms accounting regularly for a third of receipts — suddenly reverse for reasons outside our control. Depending on the commitments we make, that could involve painful austerity measures to unwind permanent spending increases or tax cuts made on the back of these receipts.

Second, saving and investing these receipts in a fund, at the same time as insulating us from risks of reversals, would generate a new revenue stream over time. This revenue stream has the potential to make a big dent on future ageing-related costs, lessening the burden we put on future generations.

Public investment is an important aspect of Irish fiscal policy. The National Development Plan provides a framework to plan longer term capital needs and existing plans imply a significant ramp up to over €15 billion in 2026 – nearly double 2019 levels. There are existing ways to achieve higher capital spending within the (net) National Spending Rule, though trying to spend too much money now, whether labelled as core capital spending or windfall, risks low value for money, as investment spending is typically concentrated in already constrained sectors. It is not easy to catch up on years of lower investment quickly – it must be done carefully and in a well-planned manner.

We need to plan more seriously

Addressing both ageing and climate change pressures will require much improved planning. The EU fiscal rules are unlikely to act as a serious guide for how we manage the public finances.

Reinforcing the National Spending Rule as a “first line of defence” would help Ireland to navigate the challenges it is facing into while ensuring that it does not undermine fiscal sustainability. Doing too much now risks having to unwind budgetary decisions later at a point in time when the economy most needs support.

Planning for future pressures, and making decisions today that can be sustained into the future will be essential to avoiding painful decisions at a later time. It would avoid repeating our past mistakes.

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