



FIN-MO-00140-2022

21 January 2022

Mr Sebastian Barnes
Chair
Irish Fiscal Advisory Council
Whitaker Square (ESRI Building)
Sir John Rogerson's Quay
Dublin 2

Dear Sebastian

I refer to the Irish Fiscal Advisory Council's *Fiscal Assessment Report, December 2021* published on 1st December 2021.

My formal response to the Council is set out in the attached. It is my intention to publish this letter on my Department's website.

Yours sincerely,

Paschal Donohoe T.D.
Minister for Finance

The Minister is a Designated Public Official under the Regulation of Lobbying Act, 2015 (details available on www.lobbying.ie).

**Formal response of the Minister for Finance, Paschal Donohoe T.D.,
to *Fiscal Assessment Report*, December 2021¹**

Introduction

At the outset, let me begin by thanking the Council once again for its work in producing the *Fiscal Assessment Report* (FAR) and its thorough analysis of *Budget 2022*. Before I turn to the individual chapters of the FAR, I would like to provide some brief general comments on the economic and fiscal situation.

The fiscal deficit last year is now expected to be somewhat better than assumed at the time of *Budget 2022*. This reflects several factors, including underspending in voted public expenditure, a stronger revenue performance and the more rapid than anticipated recovery in the domestic economy, in particular, the labour market. The deficit for the Exchequer account was €7.4 billion, compared with a projection of €12.1 billion in October. On this basis, my Department estimates a general government deficit of approximately 2 per cent of GDP (4 per cent of GNI*).

That said, the economic and fiscal outlook has become increasingly uncertain in recent months, following the emergence of the Omicron variant and re-introduction of some public health restrictions. The latter has, of course, necessitated further government financial support, in order to protect incomes, employment and support businesses. After having fallen rapidly in the autumn, the number of workers in receipt of the *Pandemic Unemployment Payment* has increased to 76,000 (as per 11 January) while the number of workers being supported by the *Employment Wage Subsidy Scheme* was 275,000 in December.

While there are clearly high levels of uncertainty, the Government is cautiously optimistic that, once this Omicron wave of the virus retreats, we could be in a better situation from an epidemiological and immunological perspective. At that stage, it is the Government's intention to exit the various financial supports.

I now turn to some of the main points highlighted in the FAR.

Chapter 1

I note the Council's recent endorsement of my Department's short-term macroeconomic forecasts for *Budget 2022*. In addition, I note that, similar to my Department's outlook at the time of the Budget, the Council assesses that risks to the economy over the medium-term are broadly balanced. In particular, the risks related to 'scarring' effects – permanent losses in the productive capacity of the economy – are now lower than initially anticipated at the start of the pandemic.

Unfortunately, one of the main downside risks to the outlook – namely a further epidemiological shock – has now come to pass. The Omicron strain has proved far more transmissible than the original Wuhan virus or any of the subsequent variants, and has necessitated the reintroduction of public health restrictions in Ireland and elsewhere. On a more positive note, the incoming evidence appears to confirm that this strain is less virulent than its predecessors. From an economic perspective, therefore, the public health restrictions have not been as stringent as previously and are unlikely to be *in situ* for as long. This means that the economic fall-out from the Omicron strain is likely to be

¹ The *Irish Fiscal Advisory Council* publishes two Fiscal Assessment Reports each year. During the legislative scrutiny phase of the *Fiscal Responsibility Bill 2012*, which *inter alia* established the Council on a legislative basis, the Minister for Finance committed to formally responding to each of the Reports.

relatively contained.

It is also worth pointing out the supply-side impact of the Omicron strain. The higher levels of transmissibility, and the associated isolation requirements, have led to labour shortages in many sectors, including in healthcare provision. Because of this, and taking into account guidance from the *European Centre for Disease Control*, the Government has decided to partly relax some of the isolation requirements. This should help address some of the economic capacity constraints that have emerged since before Christmas.

Government is monitoring the data closely and, in line with practice, my Department will produce an updated macroeconomic projection in the spring, taking into account all relevant information.

Chapter 2

I note the Council's comments in relation to fiscal risks surrounding the costs and implementation of major policy commitments on health and climate change.

Returning the public finances to a sustainable trajectory puts us in the best position to meet these challenges, as well as the unforeseen challenges which will undoubtedly emerge in the coming years. This underlies the medium-term fiscal strategy set out in the *Summer Economic Statement*.

It is important to stress that the level of resources being set aside for core spending is significant – almost €93 billion in 2025 compared with just over €70 billion in 2020. This additional spending will provide for new expenditure measures, including for priorities such as *Sláintecare* and climate action, with allocations of the additional current funding being decided each year as part of the estimates process.

From my perspective, of course, it is imperative that these inputs are matched by outputs – ensuring that taxpayers get value for their money. My colleague, the Minister for Public Expenditure and Reform, is working to ensure that this is indeed the case.

Chapter 3

The Council has assessed the Government's response to the pandemic as being prudent and necessary, and I welcome this. The Council has assessed the fiscal stance this year as striking an appropriate balance between continuing to support the economy and keeping the public finances on a sustainable path.

Turning to the medium-term, the key innovation in the Government's *Summer Economic Statement*, published in July, was to set budgetary policy within a medium-term framework. In particular, (net) spending per annum will be aligned with sustainable growth in the economy; furthermore, the fiscal parameters for the period 2022-2025 are fixed. I welcome the Council's endorsement of this approach.

I fully agree with the Council's view on the importance of the medium-term challenges facing the public finances. While I think most people would have seen a global pandemic as in the tail of the probability distribution, there are certainly a number of structural challenges to the public finances. These include an ageing population, the need to address climate change and, last but not least, the high probability of a decline – at some stage in the not-too-distant future – of corporation tax receipts.

In helping to manage these fiscal risks, my Department routinely publishes *inter alia* its assessment of public debt dynamics (*Annual Debt Report*), its update of revenue vulnerabilities (*Annual Taxation Report*), its assessment of ageing costs (*Population Ageing and the Public Finances in Ireland*) and an

update of contingent fiscal liabilities (*Contingent Liabilities: an overview*). The purpose of this analysis is to inform the Government of the fiscal implications of various developments.

I note the Council's detailed examination of the recommendations proposed by the *Commission on Pensions* set out in the FAR. The Commission's report is a major and complex piece of work and it will need to be considered carefully at the official and political levels. It is important, however, to acknowledge that the demographic challenges to which the report relates are imminent and need to be front-and-centre in any policy approach we adopt. My own Department made a submission to the Commission, very much in line with that of the Council.

In relation to corporation tax, I note the Council's views on updating my Department's estimates on the impact of the OECD's Inclusive Framework. However, despite the broader clarity offered by the agreement, there remains numerous issues to be addressed and negotiated. My officials are continuing to work in this area and our intention is to publish a revised assessment over the summer.

Chapter 4

Regarding the fiscal rules, I note the Council's conclusion that the deficit last year was primarily a result of the exceptional circumstances that prevailed during the year. I also welcome the Council's assessment that the fiscal rules, in their current form, are forecast to be complied with over the medium-term.

The European Commission has recently relaunched the review of the fiscal governance framework. This review is timely and appropriate; there are fiscal challenges for all European countries and these must be addressed in a manner that, firstly, does not burden future generations with excessive public debt and, secondly, ensures that the debt sustainability of Member States is not compromised. My officials and I will continue to actively engage in these discussions at European level.

I note the Council's comments in relation to Departmental expenditure ceilings not being published beyond 2022. In line with the approach taken in last year's budget, indicative current expenditure ceilings for 2023 and 2024 were laid before *Dáil Éireann* in December 2021. The final Departmental ceilings for 2023 will be fixed as part of the estimates process this year, within the overall expenditure parameters set out in the *Summer Economic Statement and Expenditure Report 2022*. This approach reflects the need to consider *inter alia* the unwinding of Covid-19 related expenditure and the allocation of funding from the *Brexit Adjustment Reserve* in the estimate process.

Conclusion

I want to emphasise the important role the Council continues to play in Ireland's budgetary architecture. On behalf of my officials, I would also like to thank the Council and its secretariat for their engagement during the *Budget 2022* macroeconomic forecasting round, in particular against the backdrop of the ongoing current exceptional circumstances.

The fiscal cost of the pandemic has been enormous but this is a cost that has been worth bearing. Hopefully the worst of the pandemic is now behind us, though we cannot, of course, say this with any degree of certainty. All else being equal, restrictions are likely to be relaxed over the coming weeks, and this should support economic recovery in the sectors most exposed.

Thereafter, the Government will begin the process of exiting the various financial supports, and this will help put the public finances on a more sustainable trajectory. A better starting point is the best way to address the challenges, and to harness the opportunities, in the years ahead.