An Roinn Airgeadais
Department of Finance
Oifig an Aire Stáir
Office of the Minister of State

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Mr. Sebastian Barnes
Chair
Irish Fiscal Advisory Council
Whitaker Square (ESRI Building)
Sir John Rogerson's Quay
Dublin 2
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16th July 2021

Dear Sebastian

I refer to the Irish Fiscal Advisory Council's *Fiscal Assessment Report, May 2021* published on 26 May 2021.

My response, set out in an appendix to this letter, follows the same format as that adopted in my previous replies to the Council's *Fiscal Assessment Reports.* It is my intention to publish this letter on my Department's website.

Yours sincerely,

Paschal Donohoe T.D.
Minister for Finance

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Appendix

As you know, budgetary policy over the past year-or-so has had to contend with an unprecedented set of circumstances. Against the backdrop of a global pandemic and repeated public health containment measures, the Government has made available extraordinary levels of budgetary supports, in order to shore-up incomes, to protect jobs and to keep businesses alive. I welcome the Council's acknowledgement that this level of support has been appropriate.

As the virus begins to retreat, and hopefully this will continue, the process of reopening our economy has begun. Against this background, budgetary policy will pivot away from generalised, towards more tailored fiscal supports. The *Summer Economic Statement* (SES) – published 14th July –set out the deficit reduction path consistent with counter-cyclical budgetary support for the economy.

I now propose to address the main issues highlighted by the Council in its report.

Chapter 1

In relation to the economic situation and outlook, I note the Council's view that there is upside potential to my Department's short-run projections.

As set out in the *Stability Programme Update*, my Department's view at the time was that the balance of risk was tilted to the downside amid still-considerable (at the time) uncertainty regarding the epidemiology of the virus and the pace of re-opening. With the scaling-up of vaccine rollout and the associated improvement in the epidemiological situation, the re-opening of our economy has proceeded at a faster pace than initially assumed. This, of course, is a positive development and our current assessment is that the overall risk profile is now more balanced than in April.

Having said that, I am conscious of the so-called 'delta' strain of the virus which, as you know, is even more transmissible than its predecessor. Government is monitoring the data closely and, in line with practice, my Department will produce a fully-detailed macroeconomic projection in the autumn, taking into account all relevant information.

Chapter 2

Turning to budgetary policy, I welcome the Council's assessment that the Government's response to the pandemic to-date has been appropriate. In particular, I note the Council's view that the Government's decision to continue exceptional temporary supports in 2021 was warranted.

Looking ahead, I am sure you noted the clear timeline for the withdrawal of extraordinary support measures outlined in the *Economic Recovery Plan*, consistent with the Council's view.

Turning to the expenditure increases introduced in *Budget 2021*, I note the Council's view that the €5.4 billion (7.7 per cent) increase in core expenditure was not prudent. In response, I would highlight that the increase was driven by an increase of €1.6 billion (over 19 per cent) in core *capital* spending and nearly €1.9 billion (over 10½ per cent) in current health spending. These increases take into account the fact that public capital spending will play a key role, not alone in addressing infrastructural requirements in key areas such as housing, but also crucially in supporting and powering the economy as it recovers from the pandemic.

Furthermore, the additional allocation of core funding for healthcare includes a step-change in our investment in *Sláintecare* priorities. The Government took this step quite deliberately as we decided to invest in the resilience and the permanent capacity of our health system. The experience of Covid-19 underlines how much we all rely upon that system — and our health workers — to keep us safe and well.

The Council's concern is, of course, that such commitments are unfunded. I can assure the Council that I share its view that long-term spending commitments need to be matched by sustainable revenues. The Government's approach to the pandemic and, in particular, the separation of non-core-Covid spending from 'core' expenditure, will help to ensure that any increases in day-to-day spending are easily identifiable and quantifiable, allowing for a proper assessment of the level of revenues needed to fund such commitments over the medium- to long-term. The Summer Economic Statement (*SES)*, published 14th July, set out the trajectory of the public finances over the medium-term, showing how the gap between revenues and expenditures will close over time. It also provided a renewed fiscal framework within which *Budget 2022* will be delivered.

Finally, the Council was concerned that the SPU did not take account of the *Programme for Government* (PfG) commitment to index personal income tax credits and bands. I would like to highlight that the PfG commitment is caveated that such a policy would only be introduced "*in the event that incomes are again rising as the economy recovers*". That prospect was highly uncertain in late-March when the SPU was being finalised.

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Chapter 3

I note with interest the findings of the Council's debt sustainability analysis, based on the SPU macroeconomic projections. The Council's analysis finds that Ireland's public debt appears likely to remain on a sustainable path over the medium-term, which is positive. My own Department undertakes this type of analysis on a regular basis and, as usual, will publish this assessment in its annual assessment of public debt later this year.

I fully agree with the Council that the supportive financing environment will not last indefinitely, and that elevated levels of public debt raise risks to the future of our economy and society. As outlined in the SES, slowing the rate of debt accumulation – by reducing the size of the deficit at an appropriate pace – is the first step in this process As we move out of the acute phase of the pandemic and recovery takes hold, the Government is committed to steadily reducing Ireland's public debt to a safer and more manageable level.

Chapter 4

Regarding the fiscal rules, I note the Council's assessment that, in 2020, the budgetary rule was not complied with, as the headline deficit-to-GDP ratio of 5 per cent exceeded the Treaty reference value of 3 per cent. I welcome the Council's assessment that this was only due to the exceptional circumstances that prevailed during the year, and that this did not endanger medium-term fiscal sustainability.

I also note the Council's assessment that exceptional circumstances, as defined within the *Fiscal Responsibility Act* and applying to the domestic budgetary rule, continue to exist in 2021. This is in line with the European Commission's approach, which has also applied the general escape clause of the *Stability and Growth Pact* for 2021.

Conclusion

To conclude, I would like to thank the Council for your ongoing work and, in particular, for your continued contributions to the budgetary process.

As our vaccination programme continues at pace, we can now start to think about what the post-pandemic economy might bring. What is certain is that there will be both challenges and opportunities. And it is also certain that addressing these opportunities and challenges must be done in a fiscally sustainable manner.