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

Our Ref: FIN-MO-05848-2022

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

5th December 2022

Dear Sebastian,

I refer to the Irish Fiscal Advisory Council's *Fiscal Assessment Report* published on 23rd November 2022.

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

**Tithe an Rialtais, Sráid Mhuirfean Uacht, Baile Átha Cliath 2, D02 R583, Éire**
Government Buildings, Upper Merrion Street, Dublin 2, D02 R583, Ireland
T +353 1 676 7571 LoCall: 1890 66 10 10
www.finance.gov.ie

## Formal response of the Minister for Finance, Paschal Donohoe T.D., to *Fiscal Assessment Report*, November 2022[1]

### Introduction

At the outset, let me begin by thanking the Council for its work in producing the *Fiscal Assessment Report (FAR)* and its thorough analysis of *Budget 2023*. Before I turn to the analysis set out in the FAR, I would like to provide some brief general comments on the economic and fiscal situation.

Following the easing of pandemic restrictions earlier this year, economic activity rebounded strongly with little, if any, evidence of permanent 'scarring' to the economy. This recovery has been most clearly evident in the labour market with a record number of people in employment and an unemployment rate of just 4.4 per cent in November.

However, the invasion of Ukraine and Russia's weaponisation of gas supplies have triggered an exceptionally large energy price shock and undermined global economic prospects, with inflationary pressures across almost all advanced economies rising sharply as result. Rising consumer prices are having a real impact on households and businesses, with the latest data suggesting some loss of momentum over the summer months. Against this backdrop, my Department expects domestic economic activity to remain subdued in the final quarter of this year and into the first half of next year, reflecting the substantive headwinds facing both businesses and households alike.

In relation to the public finances, the fiscal surplus this year is now set to be better than projected at the time of *Budget 2023* driven, in large part, by stronger-than-expected corporation tax receipts. It is our expectation that some of these receipts are one-off in nature.

The large jump in receipts – effectively doubling in size from the period immediately before the pandemic – from the corporate sector raises a number of important issues. Most important is the possibility that some of these may be transient in nature. My Department has estimated that between €8-10 billion of corporate tax revenue may be windfall in nature; the performance since the Budget would suggest that this figure could be even higher.

It is for this reason that I have decided to transfer €6 billion to the *National Reserve Fund*, while also running a budget surplus. To increase transparency and for communication purposes, my Department will now publish an estimate of the budget balance excluding its estimate of transitory receipts.

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

### Macroeconomic assessment

I note the Council's recent endorsement of my Department's short-term macroeconomic forecasts for *Budget 2023*. Similar to my Department's outlook in the autumn, the Council notes that downside risks have intensified over the course of the year, including the possibility for prolonged higher inflation and a global recession. Amongst the potential threats to the outlook include the potential challenge of securing sufficient gas supplies over the coming winters, lower levels of foreign direct investment from the multinational sectors and broadening price pressures resulting in higher wage demands and a loss of competitiveness. On the upside, I note the Council's view that short- and

---

[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.

medium-term growth could prove higher-than-assumed, particularly given the resilience of the Irish economy throughout the pandemic.

My Department's central scenario is conditional on the assumption that the fallout from disruptions to energy supplies in Europe remains contained, with alternative supplies and demand management efforts preventing widespread rationing of energy supplies. At this point, I think it's fair to say that the risks of significant outages in continental Europe in winter 2022/2023 have eased; the risk has, however, shifted to winter 2023/2024 with natural gas stores likely to be very difficult to replenish and additional demand likely to come on-stream from the assumed recovery in the Chinese economy.

## Budgetary assessment

### *Short-term*

Turning to budgetary policy, I welcome the Council's assessment that *Budget 2023* stuck an appropriate balance between supporting vulnerable households and avoiding adding to inflationary pressures. The Government's approach involved providing a significant mix of permanent and temporary supports to households, public and community services and businesses to mitigate the impact of rising prices while avoiding second-round inflationary effects.

I also welcome the Council's assessment that the trajectory for the public finances set out in *Budget 2023* is conducive to prudent economic and budgetary management.

I note the Council's estimates that around one-third of the temporary spending measures for households in *Budget 2023* are targeted. However, temporary measures need to be viewed alongside the permanent spending measures introduced. Increases in core social welfare rates are more heavily targeted at those most in need. Ensuring that the most vulnerable were prioritised in the permanent budget package was a critical part of the budgetary strategy.

### *Fiscal Rules*

Regarding the fiscal rules, while the General Escape Clause remains activated for 2023, I welcome the Fiscal Council's analysis that Ireland is on track to comply with domestic and EU fiscal rules, should they be reinstated in their current form in 2024.

As set out in my Department's recent *publication "De-risking the Public Finances – Assessing Corporation Tax Receipts",* and as I set out earlier, the headline fiscal balance is flattered by 'excess' corporation tax receipts. Importantly, the Council assess that even if 'excess' corporation tax receipts were excluded, the structural balance is expected to be in surplus in 2022.

I note the Council's synopsis of the proposed reforms of the EU fiscal framework, which the European Commission published on November 9th. The Commission's proposals are wide-ranging and would represent a fundamental reform of the current system. Though many of the details of how the proposals would operate in practice remain to be teased out, the suggested move away from the use of the structural balance towards a greater focus on an expenditure rule is to be welcomed and in line with the views expressed by the Fiscal Council over many years. My officials will continue to engage in technical discussions at a European level on the proposed changes to the framework over the coming weeks and months.

### *Medium-term*

Turning to the medium-term, I welcome the Council's assessment that the planned reduction in the Government's net debt ratio is prudent.

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

It is important to stress that the level of resources being set aside for core spending out to 2025 under the medium-term expenditure strategy is significant. 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.

I also welcome the analysis provided by the Council in relation to staffing and recruitment in the health service. I recognise the importance of this issue in light of the size of the health service workforce and the record levels of recruitment that were achieved in 2020 and 2021 at the height of the pandemic.

*Corporation tax*

Returning to the issue of corporation tax, I note the Council's views on the need to reduce the over-reliance on this tax head and the potential level of 'excess' receipts (i.e. that is the amount that cannot be explained by the growth rate of the domestic economy).

To assist with planning for these risks, as part of *Budget 2023*, my Department published a new metric, GGB* or the underlying fiscal position, which removes estimates of 'excess' corporation tax from the headline general government balance.

More importantly, there are three key elements to the Government's strategy for addressing 'excess' receipts.

First, the medium-term framework, set out in the *Summer Economic Statement* last year, anchors budgetary policy via an expenditure rule. As noted by the Council, keeping core spending growth in line with the trend growth rate of the economy will help ensure that expenditure policy is de-coupled from windfall tax revenue. As agreed at the publication of the SES, Government will allow tax revenue to fluctuate with the economic cycle without amending the expenditure ceiling.

Second, the Government transferred €2 billion of the 'excess' corporate tax yield to the *National Reserve Fund* in November, and has committed to transfer an additional €4 billion next year. This will help rebuild our fiscal buffers and avoid these receipts being used to fund permanent expenditure, reinforcing the sustainability of the public finances over the medium-term.

Third, the Government is running a budget surplus this year and plans to continue doing so over the medium-term. This would provide headroom for when corporate tax receipts begin to decline. As shown by GGB*, when excess CT receipts are removed, the public finances only being to record a surplus in 2024.

I also note the Council's suggestion that the Government should consider increasing the cap on the *National Reserve Fund* and potentially changing the purpose of the Fund, to a new National Pension Reserve Fund as a means of bridging the funding shortfall for Ireland's pension system that will develop. The Government will consider these issues going forward.

## Conclusion

To conclude, the Government has responded decisively to help households and businesses adjust to higher energy and other prices while, at the same time, ensuring that budgetary policy is not at cross-purposes with other policy goals, namely achieving price stability.

Government is also conscious of potential vulnerabilities in the public finances and is putting in place the necessary architecture to minimise these risks. There are major fiscal challenges in the years to come and we must meet these from a position of strength.