



Our Ref: FIN-MO-03073-2023

Professor Michael McMahon
Acting Chair
Irish Fiscal Advisory Council
Whitaker Square (ESRI Building)
Sir John Rogerson's Quay
Dublin 2

25 July 2023

Dear Michael,

I refer to the Irish Fiscal Advisory Council's *Fiscal Assessment Report* published on 7th June 2023.

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,

A handwritten signature in black ink, reading "Michael McGrath". The signature is fluid and cursive, with a horizontal line underneath the name.

Michael McGrath T.D.
Minister for Finance

**Formal response of the Minister for Finance, Michael McGrath T.D.,
to *Fiscal Assessment Report*, June 2023¹**

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 the *Stability Programme Update 2023*. Before I turn to the FAR, I would like to provide some general comments on the economic context and the Government's budgetary strategy, which has been updated and set out in the *Summer Economic Statement*.

Over the past year, Ireland, along with almost all other advanced economies, has had to grapple with the effects of multi-decade high inflation. What started as a surge in global energy prices quickly spread through the economy, generated more broad-based inflationary pressures. Notwithstanding this terms-of-trade shock, the Irish economy has proven to be remarkably resilient with the domestic economy growing very strongly in recent quarters. This has yielded major benefits, including in the labour market with over 2.6 million people now in employment.

With inflationary pressures easing, the domestic economy is expected to record solid growth over the remainder of the year. That said, significant challenges remain on the horizon, including widespread capacity constraints, particularly in the labour and housing markets, persistently high 'core' inflation and the potential for a wage-price spiral. Internationally, growth is expected to remain subdued across Ireland's main trading partners, with knock on implications for Irish export demand.

As you are aware, the Government adapted its budgetary strategy in this year's *Summer Economic Statement* to take into account the fact that, while easing, inflation is still expected to remain above 'target' next year.

Government is providing for a total package of €6.4 billion in *Budget 2024*, consisting of slightly above €1.1 billion in taxation measures and additional core expenditure of just over €5.2 billion. This brings core spending growth to 6.1 per cent next year. I believe this strikes the right balance between supporting households and firms, protecting living standards and the real value of public services, while not adding unduly to inflationary pressures.

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 macroeconomic forecasts for the *Stability Programme Update 2023*. In addition, the Council has also welcomed the extension of the Department's macroeconomic forecasts out to 2030. The forecasts indicate that the Irish economy is expected to remain resilient this year given the strong momentum and the lower pathway for inflation.

My Department shares the Council's assessment that whilst global risks relating to Russia's war in Ukraine and the fragility of the global financial sector remain central, domestic capacity constraints are becoming increasingly binding. Similar to the Department's views, the Council notes that these capacity constraints could give rise to further price and wage pressures and may exacerbate the affordability challenges in the housing and rental markets.

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.

Budgetary assessment

Short-term

Turning to budgetary policy, I welcome the Council's assessment that the fiscal stance for 2023 is conducive to prudent economic and budgetary management.

I also welcome the Council's assessment that Government has struck an appropriate balance between supporting households and businesses without adding unduly to inflation and that the Government have used an appropriate mix of temporary supports, welfare payments, and pay increases in *Budget 2023* to address higher prices.

Regarding the targeting of measures, it is worth noting that ESRI research has found that a blend of fuel allowance, living alone allowance and qualifying child payment is optimal to target energy costs in low income households and all of these measures were increased in *Budget 2023*, with additional bonus payments made in the cost of living package. While the accompanying energy credits were provided to every domestic household, and are therefore untargeted, it is worth noting that the credits were still likely progressive overall.

I note the Council's comments in relation to capital project delivery and note that work is ongoing in the Department of Public Expenditure, NDP Delivery and Reform to address these issues. The renaming and reconstitution of the Department, to specifically include NDP Delivery, has brought about a greater emphasis and mandate for the delivery of the NDP. In light of this new role, a review of the support structures and levers available across Government to maximise delivery of projects was undertaken. As a result, a series of actions and reforms were identified as priorities to improve delivery of NDP projects, including reducing the administrative burden on Departments charged with infrastructure delivery and a review of capacity in the section to deliver on NDP priorities.

The *Summer Economic Statement* also set out that additional capital expenditure of €2.25 billion, from windfall receipts, will be made available over the period 2024 to 2026 to boost delivery of critical infrastructure projects.

Fiscal Rules

In relation to the fiscal rules, the "exceptional circumstances" and general escape clauses of the domestic and EU fiscal rules activated at the start of the Covid-19 pandemic will remain in place throughout 2023. Nevertheless, I welcome the Council's assessment that Ireland would be on track to comply with the existing set of domestic and EU fiscal rules.

I note the Council's summary of the European Commission's legislative proposals for the reform of the EU fiscal rules. The publication of the Commission's legislative proposals is a positive step forward on the road to reform, although there is still a significant way to go towards a final agreement. Discussions are currently ongoing at the EU level, and my officials will continue to engage constructively in the negotiating process.

I note the Council's first assessment of Government compliance with the national spending rule, with the Council observing that the Government has broadly stuck to the rule. I welcome the Council's assessment that allowance made for recent increases in the cost of living in *Budget 2023* were warranted given the exceptional nature of the price shock.

Medium-term

Turning to the medium-term, the Council highlights the future fiscal pressures coming down the line from an ageing population and I agree that acting sooner rather than later will help to contain these costs.

I note that the Council welcomes the Government's plan to introduce a new long-term savings vehicle, where windfall receipts are saved and which can help respond to future fiscal challenges. My Department has outlined a number of potential options for establishing such a fund in the recently published paper *Future-proofing the Public Finances – the Next Steps*. A key message from that paper, and also emphasised by the Council, is that the fiscal challenges posed by an ageing population are substantial, and a long-term fund would be a complement to and not a substitute for other necessary reforms.

Work on proposals for establishing such a long-term savings vehicle is ongoing and will take into account the analysis contained in the Department's paper.

As you are aware, in parallel, my Department is working on proposals for an additional public investment fund to be utilised during an economic downturn. In the past during challenging economic times, we have had to cut back on capital investment which has had a negative impact on employment. It is intended that this fund would help maintain capital investment during an economic downturn thus supporting jobs at a critical time and ensuring that major infrastructure projects are delivered.

I intend to bring proposals in this regard to Cabinet over the coming weeks.

Conclusion

To conclude, the strategy announced in the *Summer Economic Statement* is a roadmap for building on the progress that we have made and it ensures that we have the flexibility to respond as needed to the challenges of today and those we face in the future.