

Opening Statement to the Oireachtas Committee on Budgetary Oversight

The National Development Plan in 2023: Priorities and Capacity

ESRI, 31 January 2024

Introduction

Let me begin by thanking the Chair and the committee members for inviting us to discuss the recent ESRI report on the National Development Plan. I am Alan Barrett, the Director of the Institute, and I am joined by my colleagues Sheelah Connolly, John Curtis, Kelly de Bruin, Niall Farrell, Kieran McQuinn and Conor O'Toole. The report was commissioned by the Department of Public Expenditure, NDP Delivery and Reform and most of the work was undertaken in early summer 2023.

Context for the report

When the current National Development Plan (NDP) was launched in 2018, it identified a clear need for substantial public investment in Ireland. The needs were set out again with the launch of the renewed NDP in 2021. In spite of the ambition which underpinned the NDP, the latest information suggests that the earlier level of ambition may have underestimated what is needed. Population growth is exceeding expectations and targets on greenhouse gas emissions look increasingly challenging.

In the absence of any constraints, the obvious response would be to increase the near-term ambition of the NDP through higher spending allocations and the acceleration of projects. However, the existence of capacity constraints implies that the policy options which would apply in an unconstrained setting may not be optimal in the immediate future. In essence, an accelerated NDP risks generating increased inflation in the construction sector whereby the costs of delivery increase.

This conflict between the need for public investment and the constraints on investment provided the context for the report, and the challenge was to provide high-level guidelines on how the conflict can be managed.

Capacity constraints

The economy is performing strongly and this is reflected in the current rate of unemployment – around 4 per cent – which is historically low. Noting limits to increased labour supply from sources such as increased participation and increased immigration, it is clear that the economy – and hence the NDP – faces severe capacity constraints.

Studies are reviewed in the report which sought to quantify the amount of labour needed to deliver on some of Ireland's investment needs. For example, the Expert Group on Future Skills Needs (2021) asked how many additional construction workers would be needed to raise housing output. Looking at 'direct' employees and 'indirect' (which is supply-chain related), they estimate that approximately 40,000 full-time equivalent employees would be required to build 20,000 housing units. Based on this and other studies, including the analysis in the Energy chapter of the report, it is clear that an accelerated NDP will create levels of labour demand in the construction sector where supply is simply unavailable.

We go on to ask what the effect might be of injecting additional demand into such a constrained setting. Based on simulations using macroeconomic models, it seems likely that such additional demand would lead to construction wage inflation. However, the models could well be underestimating the inflationary

impact. With the unemployment rate at a historically low level, previous trends suggest that the relationship between the unemployment rate and the inflation rate might not be linear. Instead, inflation might accelerate as unemployment is lowered.

Sectoral analysis

A key point to emerge in the chapter on **housing** is the likelihood that existing targets for housing supply might understate need, given the stronger than expected increase in the population seen in Census 2022. This chapter also recognises the capacity constraints which confront efforts to increase output. However, it is noted that increased housing output should dampen the price of existing houses and rents. Hence any increase in the costs of new building arising from increased investment could be offset by an easing in housing costs.

Ireland has well-established targets with respect to **energy** infrastructure and these are set out in the corresponding chapter. The focus on the chapter is on translating these targets into levels of investment in terms of euros but also in terms of labour inputs. Combining likely labour needs for onshore wind, offshore wind, solar PV, conventional generation and energy efficiency, it is estimated that the annual additional employment requirement would be approximately 24,000.

The benefits of investment in **transport** infrastructure are well-known and well-understood and range from economic considerations such as improved labour mobility to broader social, cultural and recreational opportunities. However, Ireland's transport system – being heavily reliant on roads and motor vehicles – is a significant contributor to greenhouse gas emissions. Echoing advice from the OECD, this chapter discusses the need for truly transformational policy with a focus on sustainable mobility at a system level. In that context, even if the 2:1 expenditure ratio favouring public transport over new roads is maintained, the roads element of expenditure should be based on design which includes active travel modes.

Healthcare policy has an over-arching framework – namely Sláintecare – and the discussion of investment needs in the Health chapter is grounded in Sláintecare. However, the faster pace of population growth has implications for capital needs in healthcare. In addition, the pace of population ageing presents particular issues for healthcare, especially with regard to long-term care. So while the basic policy framework is in place and identifies the needs for investment in acute, primary and community care, the required scale and geographic distribution of the investment is likely to be evolving.

Population growth and increasing participation will lead to an increased need for **education** facilities from early childhood through to higher education. This is well understood but an additional issue in education is the standard of facilities and the need for upgrades. Although more systematic information is needed, we know through the *Growing Up in Ireland* survey that many school principals rate school facilities poorly. We also know from previous ESRI research that facilities in many further education colleges are viewed as being poor by FE providers. Investment in digital infrastructure is also needed in education if stated policy ambitions are to be realised.

Cross-cutting themes

On **climate**, Ireland has committed to an ambitious GHG emission reduction target of 51 per cent by 2030. This target was made legally binding by the *Climate Action and Low Carbon Development (Amendment) Act of 2021* and further commits to net-zero emissions by 2050. The Climate Action Plan

(CAP23) outlines a roadmap with specific targets, policies, and measures across various sectors in order to achieve these targets. However, based on achieved emission reductions to date and planned actions under the CAP23, success in meeting targets is far from guaranteed. Hence, our climate policy efforts need to increase rapidly to ensure our targets are met.

The section on **planning** reflects on a number of issues including the delays that seem to arise in a system which is under-resourced. Another point which is addressed is the situation where nationally important projects that are designed to facilitate decarbonisation and to address the potential impacts of climate change are substantially delayed, reduced in scale or abandoned. Examples arise in the cases of energy networks and sustainable mobility. Sustainable development requires striking a balance between individual and community concerns and wider national needs in the context of national housing, environmental and climate targets.

The achievement of **balanced regional development** is a key component of Project Ireland 2024. In support of that goal, investment under the NDP should ideally be spread in an integrated and systematic manner across the country. While the spread of projects appears to reflect a reasonable degree of alignment between investment and population targets, the data available are too limited to assist in any level of rigorous assessment. CSO data on population growth across counties and regions are more useful and allow for the following observations. The fact that all counties experienced population growth between 2016 and 2022 is to be welcomed. However, the fact that the Eastern and Midland region is experiencing a share of population growth beyond that envisaged in the 2040 target is a concern.

Prioritisation guidelines

It was not possible for the ESRI to say if one policy goal (such as housing) should be prioritised over another (such as climate), and we do not attempt to do so. That is the role of the elected government. But we do provide some broad principles which might be applied in deciding how projects might be prioritised.

An acceleration of the NDP could avoid an inflationary impulse if it was combined with an overall budgetary package where other measures such as taxation and current expenditure balanced any NDP-related stimulus. Another option would be to direct construction activity towards, for example, housing and away from other activities such as office space, hotels and carparks. A tax could be used, not for the purpose of aggregate demand management but for the more microeconomic purpose of re-directing activity. Yet another approach would be to delay any acceleration until labour market conditions had changed.

Clearly, approaches based on tax increases, spending reductions and deliberate delays are likely to present political challenges so we sought to think creatively about the speed and sequencing of NDP delivery.

Decisions on public spending will almost always have a judgment component and such judgement is particularly important in giving weight, for example, to socially valuable outcomes in health and education. However, it is important that some form of metrics inform decisions too. It is suggested that Cost-Benefit Analyses for projects be re-assessed to account for the more severe capacity constraints and the more demanding climate targets which have arisen since the original NDP was drafted. For

capacity constraints, the labour intensity of projects should be considered, with the climate impacts of projects (whether positive or negative) also featuring more prominently in the CBAs.

A further factor which could be incorporated into revised CBA metrics is the impact of projects on easing inflationary pressures through supply-side impacts even if the demand-side impact in the short-run is inflationary. Increased building of housing units will lower the price of the existing stock, all else being equal. With regard to energy, a faster transition to renewable sources could reduce energy costs.

A similar consideration arises in terms of whether the demands created by investments are largely met from domestic resources or through imports. An increased demand for imports will have no impact on inflation given that Ireland is a price-taker in the relevant markets. It would also be desirable to favour projects which use innovative methods and materials that economise on labour and other inputs.

Regardless of the degree to which projects can be rationally re-ordered in terms of the sequence of delivery, a challenge will remain around the scale of investment at any point in time. Just as decisions on priority should be informed by metrics, it would be important to base any acceleration of the NDP on evidence of a loosening of capacity constraints.