



26 April 2017

Dear Mr Buti,

The Irish Fiscal Advisory Council has an obligation under the Fiscal Responsibility Act (2012) to monitor and assess compliance with Ireland's domestic budgetary rule as set out in the Act as well as to assess whether the fiscal stance of the Government is conducive to prudent economic and budgetary management, with reference to the EU Stability and Growth Pact (SGP).¹

Recent changes to how estimates of Ireland's potential output growth rate are calculated have meant that the application of the Expenditure Benchmark – a key pillar of the aforementioned rules – could be subject to significant distortion. By incorporating the level shift in Ireland's real GDP in 2015 in supply side estimates under the commonly agreed methodology, potential output is now estimated to have grown in excess of 24 per cent for 2015. As the Expenditure Benchmark sets a "sustainable growth rate for expenditure" on the basis of a ten-year average of potential output growth estimates, this level shift would inform what is deemed as Ireland's sustainable growth rate under an unchanged application of the SGP. It would, therefore, over a number of years inflate the adjudged "sustainable growth rate for expenditure" by approximately two percentage points.

The Irish Fiscal Advisory Council considers it necessary that an adjustment is made to the application of the SGP for Ireland such that the exceptional potential output growth rate estimated for 2015 does not form the basis on which a "sustainable expenditure growth rate" is set.

It is essential that the reference rate for permitted expenditure growth is well-founded so as to provide a sensible basis for setting fiscal policy.

An adjustment for the level shift in terms of the ten-year average used for setting the Expenditure Benchmark could take, for example, the form of an interpolated potential output growth rate (e.g., an average of potential output growth rates in surrounding years). This is in line with the approach adopted by the Department of Finance in *Budget 2017*.²

A detailed discussion of the fiscal rules and an assessment of the fiscal stance will be provided in the Council's forthcoming *Fiscal Assessment Report*, which is scheduled for publication in June.

Yours sincerely,

Seamus Coffey, Chair.

¹ The Fiscal Responsibility Act (2012) is available at: <http://www.fiscalcouncil.ie/wp-content/uploads/2013/02/FRA.pdf>. The budgetary rule requires that the Government's budget is in surplus or in balance, or is moving at a satisfactory pace towards that position and is aligned with the Preventive Arm requirements of the SGP.

² Table A7, note (c) indicated that reference rate values for 2018 onwards were calculated using an "interpolated linear average value of 3.7 per cent for 2015 not the 25 per cent potential growth figure for 2015" to take adjust for the distortion related to the level shift in potential output.