



Irish Fiscal Advisory Council

Ireland's Medium-Term Budgetary Framework

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Overview

- Background
 - Importance of medium-term fiscal planning
 - Budgetary Frameworks Directive
 - Ireland's Medium-Term Budgetary Framework
- Integration of national and European elements
- Role of IFAC
- Some recent issues
 - Absence of well-specified medium-term plan in Budget 2015
 - An anomaly in the calculation of the Expenditure Benchmark



Current context

- Ireland exited official assistance programme at the end of 2013
- Expected to exit the corrective arm of the SGP in 2016
- Value of a medium-term focus in the context of:
 - Pending election
 - Strong growth
 - Pressures to reverse past austerity measures

Importance of medium-term fiscal planning

- Medium-term planning incorporating principles of sound fiscal policy in the context of uncertainty
 - Room for counter-cyclical management
 - Ensure debt sustainability and creditworthiness
 - Stable tax/benefit rates in the face of demographic pressures
- Avoid repeating past mistakes:
 - Pro-cyclicality
 - Expenditure growth based on unsustainable revenues



Budgetary frameworks directive

Definitions:

Budgetary framework means the set of arrangements, procedures, rules and institutions that underlie the conduct of budgetary policies of general government

Medium-term budgetary frameworks as a specific set of national budgetary procedures that extend the horizon for fiscal policy-making beyond the annual budgetary calendar, including the setting of policy priorities and of medium term budgetary objectives



Article 9 of Directive on the MTBF

Article 9(1)

Member states shall establish a credible, effective medium-term budgetary framework providing for the adoption of a fiscal planning horizon of at least 3 years, to ensure that national fiscal planning follows a multiannual fiscal planning perspective

Requirements under Article 9(2)

- **Multiannual budgetary objectives**
- Projections of each major expenditure and revenue item under **unchanged policies**
- **Description of medium-term policies envisaged, showing how adjustment towards the MTO is achieved compared to projections under unchanged policies**
- Assessment of how the policies envisaged will affect the **long-term sustainability** of the public finances



Medium Term Budgetary Framework

July 2014



An Roinn Airgeadais
Department of Finance



MTBF as a procedural manual

In accordance with the Directive, this Medium Term Budgetary Framework acts as a procedural manual, providing an overview of the set of arrangements, procedures, rules and institutions that underlie the conduct of budgetary policies of general government. This document is consistent with the provisions in national and European legislation, including relevant references.

This document contains information on the planning process underlying the two annual economic and fiscal policy documents, namely the Stability Programme Update and the Budget. These are the key medium-term fiscal strategy documents in which Ireland sets out its official macroeconomic and budgetary forecasts for the coming three years. It also lays out the required procedures if, despite its best efforts, Ireland becomes subject to a new Excessive Deficit Procedure, a Correction Plan under the Fiscal Responsibility Act 2012 or enhanced surveillance under the Stability and Growth Pact.

This document is complementary to the existing systems of budgetary accounting and statistical reporting, and aims to consolidate the technical details of the procedures necessary. It will be subject to regular revision and updating, as required.²



Contents of the MTBF

Contents

	Page No
Section 1 – Introduction and overview	3
Section 2 - Background – underlying EU fiscal architecture	4
Section 3 - The main Irish fiscal outputs	11
Section 4 - Overview of the annual Budgetary process	15
Section 5 - Forecasting methodology	16
Section 6 – Fiscal Performance Monitoring	23
Section 7 - Fiscal rules governing Ireland’s fiscal planning and implementation	26

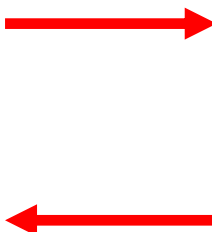
Annex 1 – Tax Forecasting Methodology	30
Annex 2 – Translation of Expenditure Benchmark into the Government Expenditure Ceiling	32
Annex 3 – Emergency Procedures – Corresponding actions to be taken	37
Annex 4 – Protocol for the control and monitoring of local authorities contribution to the General Government Balance – DEHLG circular	40
Annex 5 - Medium-Term Expenditure Framework: Application to Current Expenditure – D/PER circular	43
Annex 6 – European Union (Requirements for Budgetary Frameworks of Member States) Regulations 2013	53
Annex 6(b) – Transposition table on Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States	57
Annex 7 – Box 1.7, Vademecum on the Stability and Growth Pact	65

<http://www.finance.gov.ie/what-we-do/public-finances/medium-term-budgetary-framework-legislation>



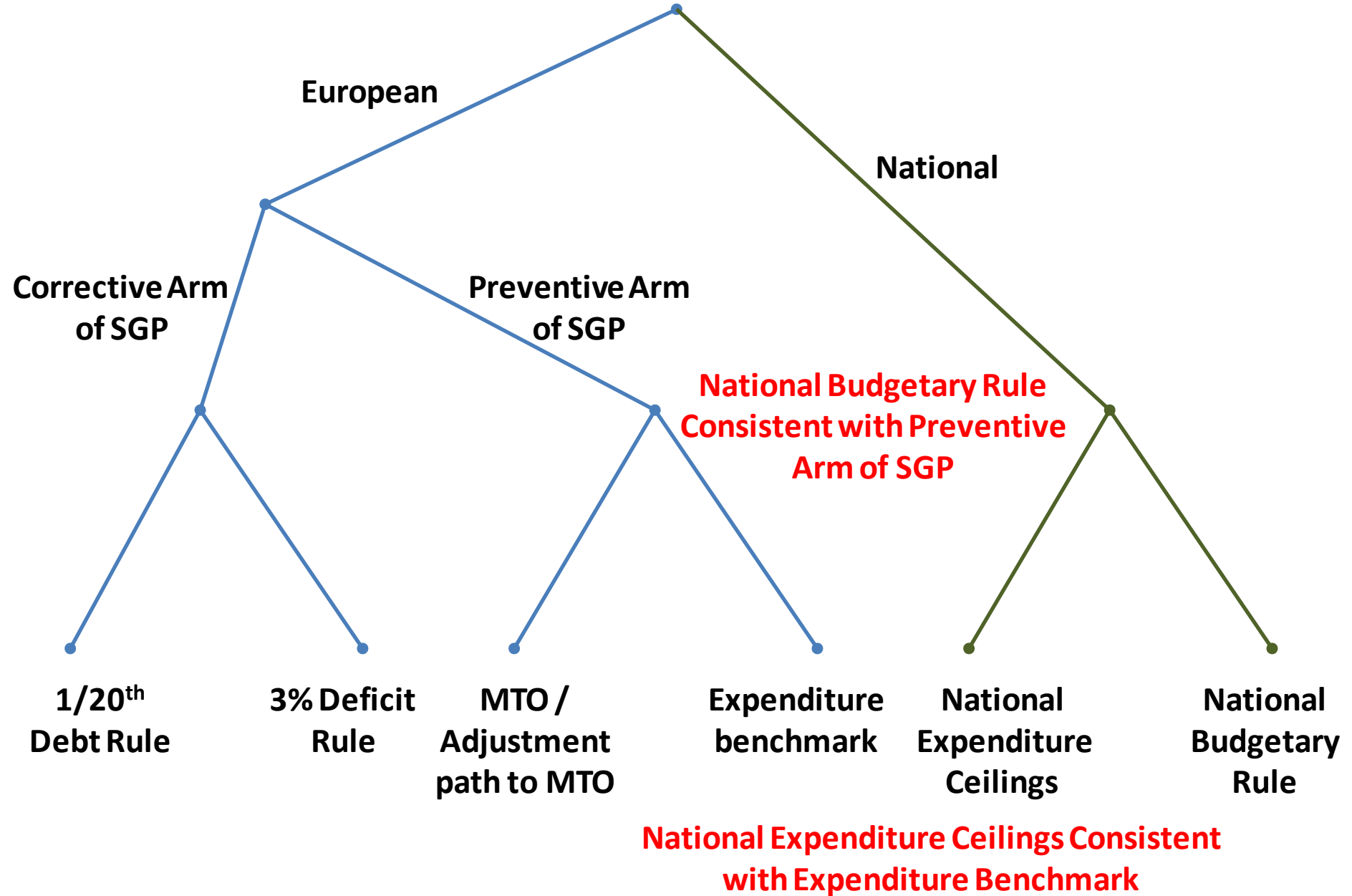
Complementary national and European elements

Effectiveness
of **National**
Fiscal
Framework



Effectiveness
of **European**
Fiscal
Framework

European/National fiscal rules





Statutory role of IFAC

- Endorsement of macroeconomic forecasts underlying Budget and SPU
- Assessment of the official forecasts
- Assessment of compliance with national Budgetary Rule and Correction Mechanism
- Assessment of fiscal stance
 - “[I]n relation to each Budget and stability programme, provide an assessment of whether the fiscal stance for the year or years concerned is, in the opinion of the Fiscal Council, conducive to prudent economic and budgetary management, including by reference to the provisions of the Stability and Growth Pact.”
Fiscal Responsibility Act 2012

Some recent issues

- Absence of medium-term plan in Budget 2015 showing impact of policies envisaged compared to a no-policy change scenario
- An anomaly in the calculation of the Expenditure Benchmark

Absence of well-specified medium-term plan in Budget 2015

- IFAC criticised the absence of a well-specified medium-term plan in Budget 2015
 - Revenue projections post-2015 based on a no-policy change scenario, although the intention to pursue further discretionary tax cuts was signalled
 - Expenditure projections based on the technical assumption of constant voted expenditure. The projections were not consistent with published expenditure ceilings

Extract from Minister for Finance response to IFAC report

With regard to your assertion that the post-2015 revenue forecasts do not reflect the Government's intention to reduce the tax burden in coming years, I would strongly make the point that our approach is correct. We consider that Budgetary arithmetic can only reflect existing legislative provisions and specific policy announcements that are going to be legislated for in the coming year. Budget forecasts cannot be based on general policy intentions, such as that to reduce the level of income tax in the future. Specific policy decisions will be taken on an annual basis taking account of the economic and fiscal situation prevailing at the time and of the available fiscal space that is compatible with continued compliance with rules set out in our fiscal framework. Once specific decisions have been taken to be included in proposed legislation, then forecasts for future years can take account of them.

Extract from Statutory Instrument implementing the MTBF

The medium-term budgetary framework . . . shall include –

(a) all the national budgetary procedures to provide for a fiscal planning horizon over a period including the then current fiscal year and, at least, the 3 following years, and

(b) procedures for establishing the following:

...

(iii) a description of medium-term policies envisaged with an impact on general government finances, broken down by major revenue and expenditure item, showing how the adjustment towards the medium-term budgetary objectives is achieved compared to projections under unchanged policies;

Anomaly in the calculation of the Expenditure Benchmark

- Ireland expected to exit the corrective arm of SGP in 2016
- Then subject to preventive arm and Budgetary Rule
 - Adjustment path to MTO
 - Expenditure benchmark
- Existing calculation of benchmark implies very limited expenditure growth
 - 10-year averaging formula for reference rate
 - Set in 2013 for 2014-16
- Government seeking flexibility in the application of the benchmark



IFAC position

- Strong support for the new budgetary framework
- But recognise an anomaly in the benchmark formula due to the profile of potential output growth
 - Reference rate currently a poor measure of medium-term revenue growth
- IFAC recently published an *Analytical Note* explaining the issue and providing guidance on how it plans to deal with it in its own assessments

(Available at: <http://www.fiscalcouncil.ie/>)



Some mechanics

$$d\left(\frac{def^*}{Y^*}\right) < -0.005.$$

**Required adjustment
path for structural deficit**

**Allowable expenditure
growth under EB**

$$\frac{d(E^*)}{E^*} < \bar{g}^* - \frac{0.005}{\frac{E^*}{Y^*}}.$$

Reference medium-term rate

Convergence Margin

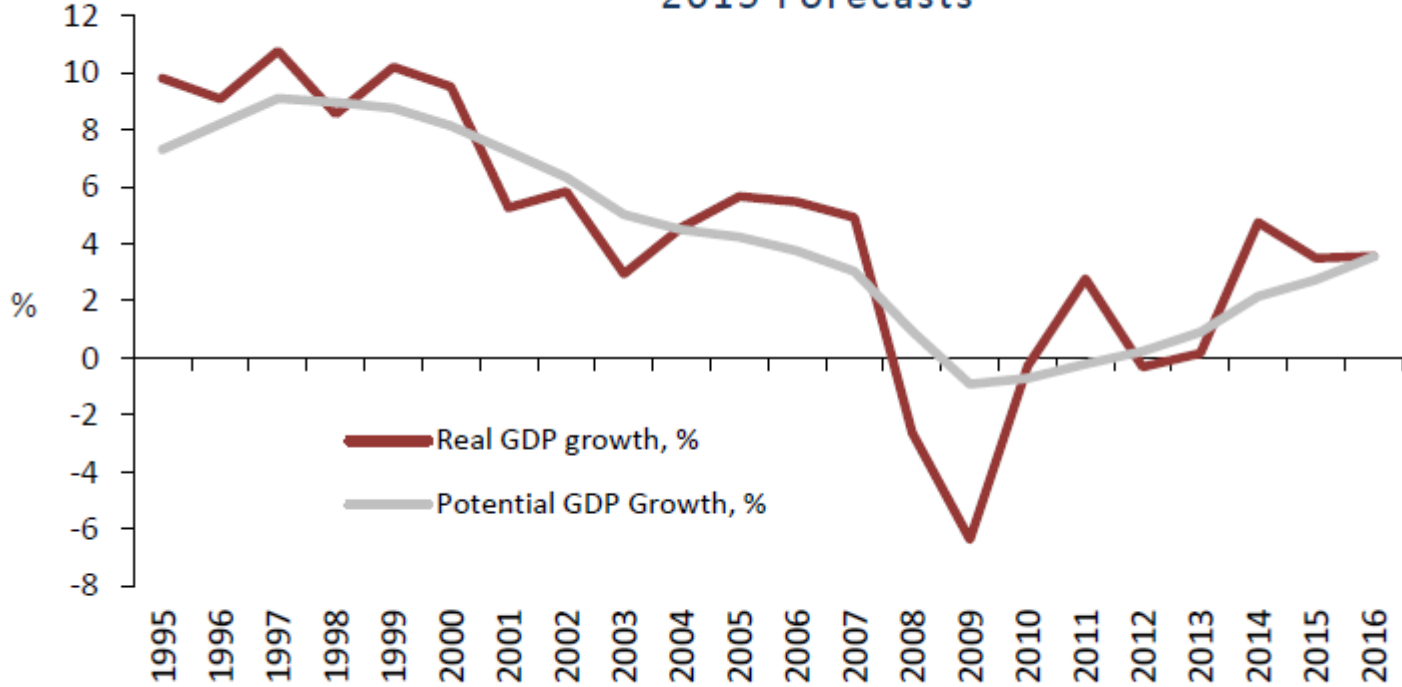
$$d\left(\frac{def^*}{Y^*}\right)^{EB} < (\bar{g}^* - g^*) \frac{E^*}{Y^*} - 0.005.$$

Contemporaneous rate



10-year averaging formula affected by crisis years

Figure 1: Actual and Potential GDP Growth, EC Winter 2015 Forecasts



Source: EC Winter 2015 forecasts.



Alternative benchmark calculations

Table 1: Expenditure Benchmark Estimates using Alternative Forecast Vintages and 10 year Windows¹²

Vintage and Range	Measure	2016
Original Expenditure Benchmark, centred on 2013 Autumn 2012 EC forecasts, 10 year avg. 2008-2017	Reference Rate	0.6
	Expenditure Benchmark: real	-0.7
	Implied nominal growth	-0.1
	Change in structural balance	0.9
Updated Vintage Expenditure Benchmark, centred on 2013 Winter 2015 EC forecasts, 10 year avg. 2008-2017	Reference Rate	1.1
	Expenditure Benchmark: real	-0.3
	Implied nominal growth	0.3
	Change in structural balance	0.7
Updated Vintage and Range Expenditure Benchmark, centred on 2016 Winter 2015 EC forecasts, 10 year avg. 2011-2020	Reference Rate	1.8
	Expenditure Benchmark: real	0.4
	Implied nominal growth	1.0
	Change in structural balance	0.5

Notes: Calculations based on equation 5 in Section 3 using data from EC Winter 2015 forecasts. Implied nominal expenditure growth under the expenditure benchmark is calculated using the EC forecasts for the GDP deflator.

Summing up

- Importance of sound medium-term fiscal planning
- Value of the new MTBF, integrating complementary national and European elements
- Central role for IFAC in monitoring, endorsement and assessment