

1. Introduction

The Irish Fiscal Advisory Council was established in June 2011 as part of a wider agenda of reform of Ireland's budgetary architecture. Forthcoming legislation under the Fiscal Responsibility Bill (FRB), which was published in July 2012, will establish the Council as an independent body on a statutory basis. Under the proposed legislation, the Council will monitor and assess compliance with fiscal rules set out in the Bill. The Council will also be required to provide an assessment of official forecasts and, in relation to each *Budget* and *Stability Programme*, assess whether the fiscal stance is conducive to prudent economic and budgetary management, including with reference to the provisions of the Stability and Growth Pact. Although the legislation is not expected to be enacted until later in the year, this report is written in line with the proposed mandate.

This report is the third fiscal assessment produced by the Council. The report is structured as follows: Chapter 2 assesses the macroeconomic forecasts set out in the *Stability Programme Update 2012* (SPU). More recent forecasts on the Irish economy are also examined in this context, as is the pattern of downward growth revisions. The Council also illustrates the high levels of uncertainty surrounding growth prospects. Chapter 3 assesses the medium-term budgetary forecasts in *SPU 2012*. The chapter also documents some of the more significant fiscal developments since the Council's last assessment report in April. Recognising the uncertainties inherent in the growth outlook, the sensitivity of medium-term projections to changes in the macroeconomic outlook is examined. Chapter 4 assesses the appropriateness of the Government's proposed fiscal stance over the period to 2015 in advance of *Budget 2013*. The chapter also considers the issue of debt sustainability based on different measures of fiscal capacity. Finally, Chapter 5 considers what the implications of the proposed fiscal rules might be in the longer term, and specifically beyond 2015, using an illustrative scenario.

A number of themes are developed in this report. Continuing a theme from the Council's previous assessment (IFAC, 2012a), this report stresses the *uncertainty* that surrounds macroeconomic and budgetary projections. Fan charts are developed as a useful graphical depiction of this uncertainty. The report also explores the fiscal implications of a number of alternative growth scenarios.

A second theme is the *large size of remaining adjustments required for debt sustainability*. Planned adjustments in real expenditure are especially large up to 2015. Even after 2015, a preliminary analysis of what might be required to meet fiscal rules indicates limited room for expenditure growth through the rest of the decade, notwithstanding significant underlying expenditure pressures. Given the total size of these adjustments, it is important that all adjustment margins – including tax, public-sector pay and welfare rates – are considered. The perceived adjustment challenge is even greater if GNP is taken

as the appropriate measure of fiscal capacity. The report also explores a “hybrid” measure that puts differential weights on GNP and the excess of GDP over GNP. Although official relief on banking-related State debt will not be a panacea, reasonable success in the Government’s effort to reduce the burden of official debt will be important given the size of the adjustment challenge.

A third theme is the importance of *transparency* in the recording of revisions in the fiscal accounts and plans. While recognising the complexity of the fiscal accounts and the rapidly evolving fiscal situation, the Council encourages more detailed reporting with regard to methodological and data revisions, forecast revisions and the composition of non-tax revenue.

The Council is chaired by Professor John McHale, National University of Ireland, Galway. The other members are Mr Sebastian Barnes, Organisation for Economic Co-operation and Development; Professor Alan Barrett, Trinity College Dublin (on secondment from the Economic and Social Research Institute); Dr Donal Donovan, University of Limerick (formerly of the International Monetary Fund) and Dr Róisín O’Sullivan, Associate Professor, Smith College, Massachusetts. The Secretariat is Diarmaid Smyth (Head of Secretariat), Rachel Joyce and Eimear Leahy. Council members would like to thank the Secretariat for their excellent work in producing this report. The assistance of Gerard O’Reilly and Colin Bermingham (Central Bank of Ireland), who provided valuable advice on the use of fan charts, is also gratefully acknowledged.