Irish Fiscal Advisory Council

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Assessment of Budgetary Forecasts

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2. ASSESSMENT OF BUDGETARY FORECASTS

SUMMARY

- The budgetary outturn in 2012 was significantly better than estimated by the Department of Finance throughout the course of last year. Stronger than expected receipts helped to offset higher than anticipated spending in key areas. While *Budget 2013* projected a General Government deficit of 8.2 percent of GDP in 2012, based on the end-year Exchequer returns and a higher than forecast level of nominal GDP, a deficit of significantly less than 8 percent is now more likely.

- The better than expected 2012 Exchequer outturn has improved the outlook for the General Government deficit in 2013. A deficit of less than the 7.5 percent of GDP projected in *Budget 2013* looks achievable. The promissory note announcement in February improves the General Government deficit by 0.6 per cent of GDP in 2014 and 2015.

- Based on the better than expected 2012 outturn and the promissory note transaction in February, the General Government deficit to GDP ratio in 2015 now appears likely to be closer to 2 percent of GDP (compared to the official target of 2.9 percent) based on technical adjustments made by the Council to *Budget 2013* projections. This assumes the full implementation of the Government’s planned €5.1 billion in consolidation measures in 2014-15 taking the nominal GDP growth outlook from *Budget 2013*.

- While the budgetary outlook has improved, significant macroeconomic and public finance risks remain. The *Budget 2013* projections assume the delivery of sizable expenditure savings. Achieving these savings, notably in the health sector, will be a key challenge.

- Fan chart analysis by the Council highlights the sensitivity of key budgetary aggregates to changes in the macroeconomic outlook. This analysis suggests there is approximately a one-in-three probability that the General Government deficit will exceed 3 percent of GDP in 2015 based on unchanged policies.

2.1 INTRODUCTION

Under the *Fiscal Responsibility Act*, the Council is required to assess the official forecasts in relation to each Budget and Stability Programme. This chapter assesses the budgetary forecasts contained in *Budget 2013*. The Council's assessment follows the approach of the previous *Fiscal Assessment Report* (IFAC, 2012b) and involves a number of steps: (i) a review of the accuracy of Department of Finance forecasts for 2012 (Section 2.2); (ii) an assessment of the forecasts in *Budget 2013*, which includes a comparison with recent forecasts of other agencies (Section 2.3); and (iii) an examination of the sensitivity of the main budgetary aggregates to changes in the economic outlook (Section 2.4). The chapter also considers the accuracy of Department of Finance tax forecasts, the promissory note transaction in February and current expenditure ceilings.

2.2 HOW CLOSE WAS THE 2012 BUDGETARY OUTTURN TO DEPARTMENT OF FINANCE FORECASTS?

This assessment is based on the end-2012 Exchequer position. A full analysis of the accuracy of Department of Finance budgetary forecasts in 2012 will not be possible until official estimates of the General Government balance and debt are published in April.[16]

EXCHEQUER BALANCE

The 2012 Exchequer deficit was consistently overestimated by the Department of Finance last year (Table 2.1). Although the forecasts of the deficit were reduced successively as the year progressed, the *Budget 2013* projection, made in December 2012, still overestimated the deficit by €0.8 billion or 0.5 percent of GDP. This overestimate was relatively large by historical standards (Figure 2.1).

The divergence between the deficit outturn and projections made in *Budget 2012* and *SPU 2012* reflected unforeseen one-off factors such as the change in the accounting treatment of the 2012 promissory note payment.[17]

[16] The General Government balance (GGB) is a more comprehensive measure of the Government's financial performance than the Exchequer balance (see Glossary). For more details on the GGB see *Budget 2013* (Table 13) and the *National Income Expenditure Accounts 2011* (Table 21a). The official General Government estimates will be published in the Maastricht returns (EDP Notification Tables). These are submitted to Eurostat by each Member State twice a year, at end-March and end-September. The tables contain official estimates for the levels of the GGB and General Government debt for the preceding four years as well as forecasts for the current year. They are compiled by the Department of Finance and the Central Statistics Office.

[17] The Exchequer deficit projections in *Budget 2012* and *SPU 2012* included €3.1 billion in capital expenditure in respect of the promissory note payment to Irish Bank Resolution Corporation (IBRC). This payment was settled through a Government bond, which was reflected in the end-April Exchequer statement. This had the effect of lowering capital expenditure and the 2012 Exchequer deficit by €3.1 billion.

Much of the remaining differences reflected a significant underestimation of revenues, an aspect that persisted up to and including *Budget 2013*.

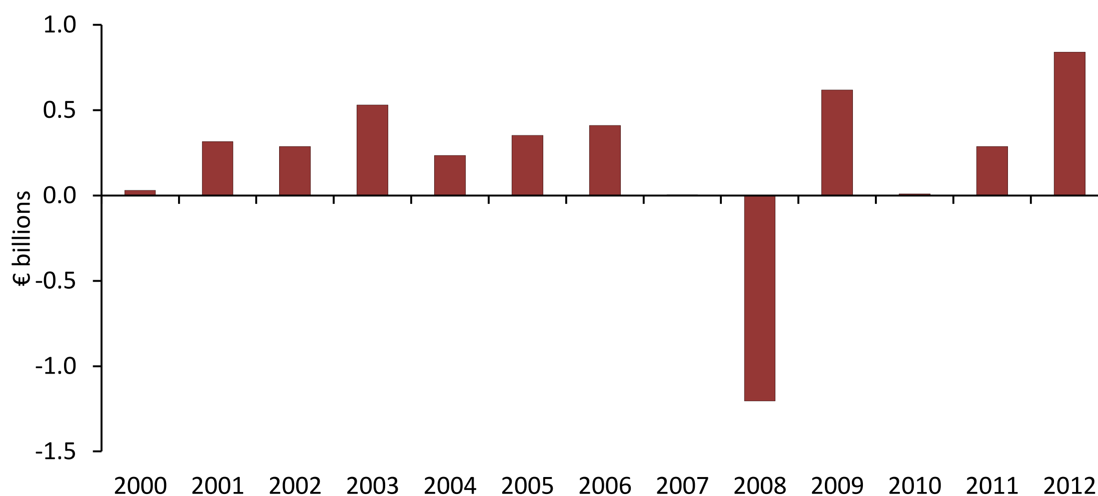
TABLE 2.1: DEPARTMENT OF FINANCE PROJECTIONS FOR 2012 AND OUTTURN

€ Billions	*Budget 2012*	*SPU 2012*	*Budget 2013*	Outturn
	Dec-11	Apr-12	Dec-12	
Exchequer Deficit	**18.9**	**18.7**	**15.7**	**14.9**
Revenue	40.1	40.9	40.9	41.7
Tax	35.8	36.4	36.2	36.6
Non-Tax	2.5	2.7	2.8	2.8
Capital	1.8	1.7	2.0	2.3
Expenditure	59.0	59.5	56.6	56.6
Primary Current Expenditure	42.9	43.3	44.1	43.9
Interest[18]	6.6	6.1	5.7	5.7
Capital	9.5	10.1	6.8	7.1
Adjusted Expenditure (excluding promissory note)	55.9	56.4	56.6	56.6
General Government Deficit	13.7	13.1	13.3	12.7 (e)
General Government Deficit, % of GDP	8.6	8.3	8.2	7.7 (e)
General Government Debt, % of GDP	115.0	117.5	117.6	116.8 (e)
Nominal GDP	159.1	158.9	163.2	163.6

Sources: Budget 2012, SPU 2012, Budget 2013, end-2012 Exchequer Returns, CSO and IFAC calculations.
Note: General Government deficit outturn in 2012 based on IFAC estimates (see Section 2.3 for details).

[18] This is an IFAC estimate as the data were not published. Interest is derived based on figures for General Government interest and the profiles for Exchequer debt servicing costs published during the course of last year. General Government interest in 2012 is estimated at €6.3 billion with only a minor interest charge in relation to the promissory note due to the interest holiday (for more details see *Budget 2013*, Table 11, page C.20).

FIGURE 2.1: EXCHEQUER BALANCE FORECASTING ERROR



Note: Values above the axis indicate that the current year Exchequer outturn was better than the Budget day estimate .
Source: IFAC estimates.

The outturn for Exchequer revenues in 2012 exceeded the *Budget 2012* forecast by €1.6 billion. Much of this was accounted for by technical and timing factors.[19] The tax revenue outlook was subsequently revised in *SPU 2012* and the 2012 outturn for overall tax revenues was €0.2 billion above that estimate. Non-tax revenues were underestimated in both *Budget 2012* and *SPU 2012* due to larger than expected receipts from the Spectrum auction in November 2012. In *Budget 2013*, taxes were underestimated by approximately €0.5 billion due to stronger than expected receipts in December.[20] This had followed relatively weak tax outturns in October and November (see Box B for a discussion of Department of Finance tax forecasts).

Total expenditure in 2012 was below both the *Budget 2012* and *SPU 2012* projections by €2.4 billion and €2.9 billion, respectively. However, the accounting treatment of the promissory note distorts comparisons. If the latter element is excluded, primary current expenditure exceeded *Budget 2012* and *SPU 2012* projections by an estimated €1.0 billion and €0.6 billion, respectively. Much of this reflected higher expenditure in the Departments of Social Protection and Health, in

[19] These relate mainly to the late receipt of Corporation Tax income, a reclassification of PRSI receipts to income tax and Social Insurance Fund receipts.

[20] In *Budget 2013* it was assumed that end-year Exchequer taxes would be €0.2 billion below the Department of Finance tax profile for 2012 whereas end-year taxes outperformed the profile by €0.3 billion. On the capital side there was a €0.3 billion repayment of loans to the Social Insurance Fund which added to capital receipts in December. This transaction, however, was revenue neutral as both the loan and its repayment occurred in December.

part due to weak PRSI receipts (see Box D for more details).[21] In contrast, interest payments last year were significantly below what was estimated in *Budget 2012* and *SPU 2012*. The outturn for overall expenditure in 2012 was close to the *Budget 2013* estimate, with primary current spending below the estimate.

GENERAL GOVERNMENT BALANCE

It appears likely that the General Government outturn in 2012 will be significantly better than was projected in *Budget 2012*, *SPU 2012* and *Budget 2013* (Table 2.1). The *Budget 2013* estimate of a General Government deficit of 8.2 percent of GDP in 2012 was based on an Exchequer deficit of €15.7 billion. As the actual Exchequer outturn was €0.8 billion lower, it is likely that the General Government deficit will have improved. This is consistent with recent official statements.[22] In addition, the outturn for nominal GDP in 2012 was approximately 0.3 percentage points higher than was estimated in *Budget 2013*. The exact figure for the General Government deficit, however, will not be known until the publication of revised General Government estimates in April. The subsequent analysis contained in this report is based on the assumption that the General Government deficit in 2012 was 7.7 percent of GDP with a positive annual carryover improvement of 0.2 percent of GDP over the period to 2015.[23]

GENERAL GOVERNMENT DEBT

Over the course of 2012, the forecast for the level of General Government debt was revised upwards by almost €9 billion reflecting borrowing by the NTMA in the bond markets.[24] This borrowing will ease funding requirements in early 2014.[25] By end-2012, the Government had substantial holdings of cash balances (€19.3 billion). This provides an important cushion in respect of post-2013 funding needs.

[21] Of the €560 million net overrun in current spending in the Department of Social Protection, €356 million related to a shortfall in PRSI receipts.

[22] See the transcript of the Oireachtas Committee on Public Accounts, 07 March 2013.

[23] The carryover assumption is that 90 percent of the better than expected Exchequer outturn in 2012 translates into the General Government balance in 2012 with a positive carryover of 0.2 percent of GDP in subsequent years. This is a technical assumption and not a forecast.

[24] This included bond switches (€4.5 billion); the issuing of conventional bonds (€4.2 billion); the issuing of amortising bonds (€1.0 billion); and a return to regular Treasury Bill auctions.

[25] Ireland had faced a bond repayment of €11.9 billion in January 2014. This payment has now been eliminated as a result of NTMA activity, which included a further €2.5 billion syndicated bond sale in January 2013. In March, a further €5 billion was raised with the sale of a new 10-year benchmark bond.

BOX B: DEPARTMENT OF FINANCE ONE-YEAR-AHEAD TAX FORECASTS

This box examines the Department of Finance's tax forecasting performance over the period 1997-2012. Of interest are the size and direction of forecast errors as well as the relative contributions of different tax categories to the overall error.[26] Forecasting errors are measured by comparing one-year-ahead tax forecasts published in the Budget for total tax revenue and for individual tax heads with outcomes from the end-year Exchequer returns.[27]

Summary measures of forecasting errors are shown in Table B1 and Figure B1, both for the entire period under review and for three sub-periods (corresponding roughly to the pre-crisis period, the height of the crisis and the aftermath). The mean error (ME) shown in Table B1 is calculated as the average of the yearly differences between tax outturns and the corresponding one-year-ahead Budget forecast, expressed as a percentage of the actual outturn.[28] This measure is a useful indicator of the average direction of the forecast errors and can be informative about possible bias in the forecasting process. The root mean square error (RMSE) measure shown in Figure B1 gives a better sense of the magnitude of the errors, as it is not differentially affected by positive and negative errors.[29]

For the period as a whole, the ME across tax heads was slightly negative (-1.1 percent). It is evident from Table B1, however, that this average was influenced heavily by large negative errors in 2008-2009, as the Department of Finance (and forecasting agencies generally) failed to predict the sharp economic downturn.[30] For 10 of the 16 years in the sample, forecast errors for overall tax revenue were positive, peaking at 8.5 percent in 2006 (Figure B2).

With the exception of the 2010-2012 period, the largest RMSEs have been consistently in capital taxes and the "other" category, with the latter including stamp duties. The major influence of property market developments on these tax categories is reflected in the large positive MEs during the boom years, as revenues from this source were underestimated, followed by even larger negative errors during the subsequent correction. Figure B2 shows that the contributions of errors in capital and "other" taxes became more significant between 2003 and 2009, when these categories had a major influence on the overall tax forecasting error, despite the small size of their contributions to the total tax take. For example, in 2005,

[26] We examine six tax categories. These include the four main tax heads – income tax, VAT, excise and corporation tax – which accounted for 33 percent, 29 percent, 15 percent and 14 percent of the total tax take respectively over the 1997-2012 period. The remaining two categories are capital taxes, comprising capital gains tax and capital acquisitions tax (5 percent of total) and "other", that includes stamp duties and customs duties (4 percent of total). Customs duties are forecast by the Revenue Commissioners.

[27] For example, for 2012, tax outturns published in the end-year Exchequer Statement for 2012 are compared with forecasts made in *Budget 2012*, published in December 2011.

[28] A positive error indicates that the outturn was greater than the forecast and implies that the Department of Finance underestimated the actual outturn in a particular year. Negative errors imply that the Department of Finance overestimated actual outturns.

[29] The RMSE is calculated as the square root of the mean of the errors squared, where the error is defined in the same way as for the ME.

[30] Forecasting errors during the previous economic downturn in 2001 and 2002 were also negative.

capital and "other" taxes contributed 13 percent to total tax revenue but accounted for over two-thirds of the forecasting error.

Table B1: Mean Error by Tax Head

	1997-2012	1997-2007	2008-2009	2010-2012
Income Tax	0.3	2.3	-8.6	-1.2
Excise	-2.5	-0.9	-16.0	0.4
Capital Taxes	-0.7	21.8	-128.8	2.5
VAT	-1.9	1.3	-20.7	-1.1
Corporation Tax	-3.0	2.0	-42.4	5.3
Other	0.6	7.9	-54.9	10.9
Total	-1.1	2.7	-24.7	0.6

FIGURE B1: ROOT MEAN SQUARE ERRORS BY TAX HEAD

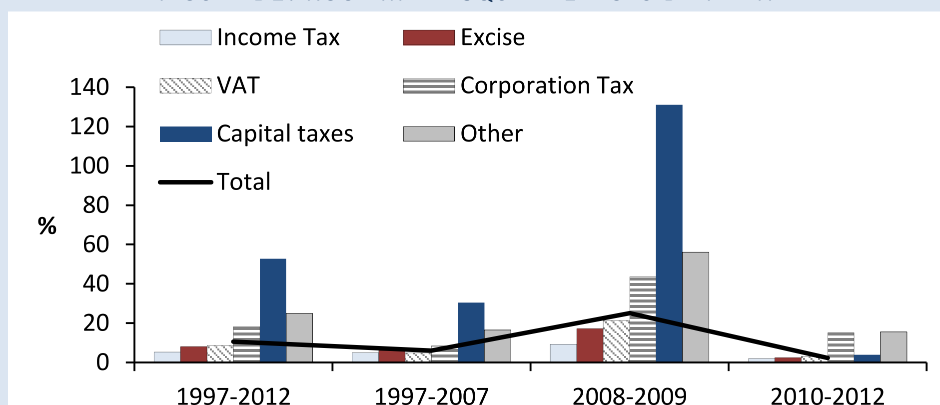
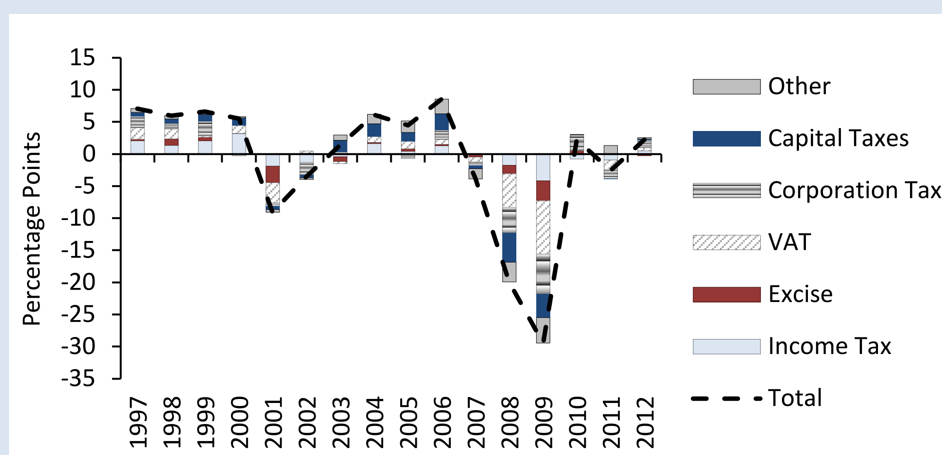


FIGURE B2: CONTRIBUTION OF EACH TAX HEAD TO THE OVERALL ERROR[31]



[31] This chart shows the proportion of the overall percentage forecasting error that can be attributed to each tax head. A negative error implies that the outturn was less than the forecast and vice versa. For example, in 2009, total tax receipts were overestimated by almost 30 percent. The overestimation of VAT and corporation tax accounted for over 8 and 6 percentage points of this error respectively.

2.3 AN ASSESSMENT OF THE BUDGET FORECASTS FOR 2013 TO 2015

2.3.1 OVERVIEW AND UPDATED BUDGETARY OUTLOOK

Budget 2013 involved total consolidation measures of €3.5 billion with the objective of reducing the General Government deficit to 7.5 percent of GDP in 2013.[32] Further measures of €3.1 billion in 2014 and €2.0 billion in 2015 were planned to bring the General Government deficit down to 2.9 percent of GDP by 2015 (See Appendix Table B1 for details on the consolidation measures).

There have been two important post-Budget developments which improve the budgetary outlook. First, as mentioned above, the Exchequer outturn in 2012 was €0.8 billion better than was estimated in *Budget 2013.* Given this, the Council is basing its analysis on a General Government deficit in 2012 of 7.7 percent of GDP. In addition, the Council is making a technical assumption that this provides a positive annual carryover of 0.2 percent of GDP for the period to 2015 relative to the outlook in *Budget 2013*. Second, in February the promissory notes owed by the Government to the Irish Bank Resolution Company (IBRC) were replaced with a portfolio of Irish Government bonds as part of the orderly wind-up of the IBRC (see Box C). According to Department of Finance estimates, this transaction is largely deficit neutral in 2013 but improves the General Government deficit by 0.6 percent of GDP in 2014 and 2015 (Department of Finance, 2013b).

In Table 2.2, the *Budget* 2013 projections updated based on these technical assumptions is shown. The 2013 General Government deficit would be less than 7.5 percent of GDP and by 2015 would be approximately 1 percentage point of GDP below the *Budget 2013* outlook.[33] Similarly, the level of General Government debt is likely to be below the *Budget 2013* outlook by 2015 reflecting the effects of the promissory note transaction and lower budget deficits.

[32] The composition of this adjustment was altered between *SPU 2012* and *Budget 2013* with a €0.3 billion reduction in the expenditure adjustment offset by measures on the revenue side.

[33] This update is based on the outlook for nominal GDP growth from *Budget 2013*. The figures in this report refer to the underlying General Government deficit. According to *Budget 2013*, the underlying deficit was 9.1 percent of GDP in 2011, 8.2 percent in 2012, 7.5 percent in 2013, 5.1 percent in 2014 and 2.9 percent in 2015. This compares with an actual General Government deficit of 13.4 percent in 2011, 8.2 percent in 2012, 7.6 percent in 2013, 5.2 percent in 2014 and 3.0 percent in 2015, as set out in *Budget 2013*. The difference between the actual and underlying deficit reflects financial sector measures estimated at €6.8 billion in 2011, €0.1 billion in each of 2012-2014 and €50 million in 2015 (for more details see *Budget 201*3, Table 12).

The most recent data from the Exchequer returns showed an Exchequer deficit of €3.7 billion in the first quarter of 2013 down from €4.3 billion at end-March 2012.[34] Exchequer tax revenues and overall expenditures were in line with Government expectations in the first quarter. These data have not affected the Council's view on the fiscal outlook in 2013.

Table 2.2: Technical Update of *Budget 2013* Outlook for the General Government Deficit

% of GDP	2013	2014	2015
Budget 2013	7.5	5.1	2.9
Impact on General Government Deficit			
Promissory Note Transaction	0.0	+0.6	+0.6
Carryover from 2012 Exchequer Outturn	+0.2	+0.2	+0.2
Updated Budgetary Outlook			
General Government Deficit	7.3	4.3	2.1

Note: IFAC calculations. Numbers rounded to one decimal place.

[34] This included €934 million in ELG payments associated with the liquidation of the Irish Bank Resolution Corporation. This is largely offset by a €1 billion Exchequer receipt from the sale of the Bank of Ireland CoCo in January.

Box C: Impact of the Promissory Note Announcement on the Government Accounts

In February 2013, the Government announced a set of transactions related to official support for the financial sector, including the orderly wind-up of the state-owned IBRC and the replacement of the promissory notes (PNs) issued by the Government to IBRC with a portfolio of Irish Government bonds. The transactions are explained in a number of Department of Finance documents (see, for example, Department of Finance 2013b and 2013c). The details in this box are based on the calculations and assumptions in the documents published by the Department of Finance at the time of the transaction.

Overview of the Pre- and Post-Promissory Note Transaction

The February transactions involve the Exchequer and the General Government sector, as well as a number of institutions outside the General Government sector:

- The former IBRC, a vehicle set up to wind down two nationalised financial institutions:
- Anglo Irish bank and Irish Nationwide Building Society.
- The National Asset Management Agency Investment Ltd (NAMAIL), a special purpose vehicle in which the Government has a 49 percent stake.[35]
- The Central Bank of Ireland (CBI), which is owned by the Government but remains independent in the performance of its functions.

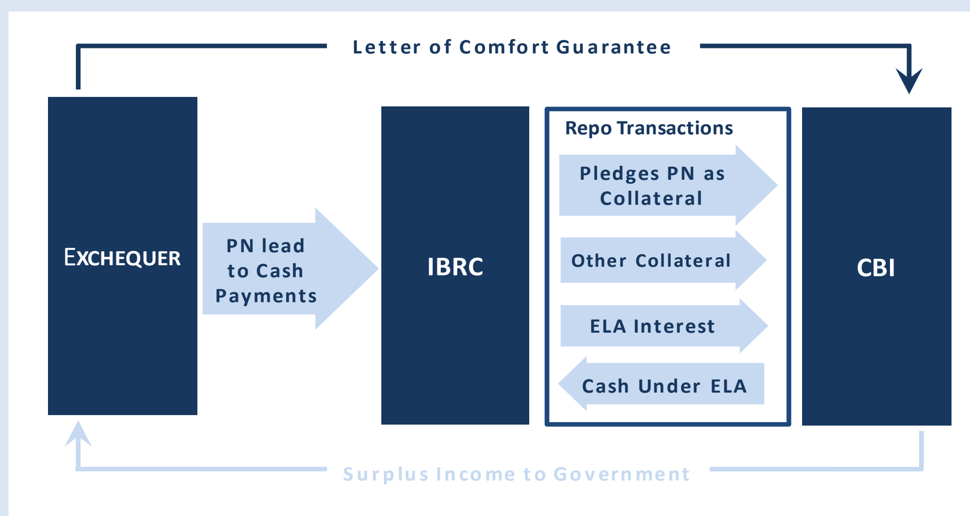
Immediately prior to the February 2013 transactions, the Exchequer was committed to making annual interest and remaining principal payments under the PN with a nominal value of approximately €25 billion that had been previously issued to IBRC. The arrangement aimed to provide capital to IBRC and allowed it to access CBI funding. Exceptional Liquidity Assistance (ELA) from the CBI was secured by the PNs, along with a Ministerial Guarantee and a floating charge over all IBRC assets. The majority of CBI net interest income from the ELA facility provided to IBRC was remitted back to the Exchequer, allowing for the cost of funding to the Eurosystem and any retention of profits by the CBI in accordance with legislation.

The PN required the Government to make fixed payments for a number of years. The full details of the arrangements are complex and were set out in IFAC (2012a, pp. 26-29). From 2011 to 2023, the Government was committed to paying €3.1 billion each year (including an interest charge and amortisation of the capital) with lower final payments out to 2031.[36]

[35] "In order to achieve its objectives, NAMA established a special purpose vehicle (SPV), National Asset Management Limited, which is responsible for the purchase, management and disposal of loan assets from participating institutions and financing such purchases through the issuance of debt securities. The SPV is owned jointly by private investors (51%) and NAMA (49%) through an investment holding company, National Asset Management Agency Investment Limited. NAMA maintains a veto over all activities of the SPVs. The annual return to the private investors is capped as it is linked to the Irish Government 10 year bond yield at the time it is declared with the potential upside of 10% of capital invested to be paid at maturity if NAMA meets its objectives. All other profits and losses accrue to NAMA" (NAMA 2010, p.15).

[36] Total Government payments due under the PN to IBRC amounted to €47.4 billion (€30.6 billion in capital and €16.8 billion in interest) over the twenty year period to 2031.

The operation of these arrangements is summarised in the following diagram:



The February 2013 transactions had several elements. There is an orderly wind up of IBRC. The CBI took economic ownership of the PNs that it held as collateral for the provision of ELA. The CBI then exchanged this for a portfolio of new Irish Government bonds and also took ownership of a related bond held by Bank of Ireland.[37,38] NAMA paid its own senior bonds in exchange for the remaining assets in IBRC which were secured by a floating charge.

The CBI will assign rights and entitlements over the remaining IBRC assets to NAMA in exchange for NAMA bonds. The Special Liquidators of IBRC will be obliged to dispose of the assets and apply the proceeds of the sale to discharge the creditors of IBRC including NAMA. Any assets not sold to third parties will be acquired by NAMA. Any resulting losses for NAMA will be compensated by the Government. The full impact on the Government accounts will, therefore, not be known until the final required transfers to NAMA are concluded.

The new Irish Government bonds pay interest based on the variable 6-month Euribor interest rate plus an interest margin which averages just over 2.6 percent. The maturities range from 25 to 40 years and have bullet redemptions, meaning that the capital is only repaid at end of the life of the bond rather than being amortised during the course of the loan. The maturities are:

- Three tranches of €2 billion each maturing after 25, 28 and 30 years.
- Three tranches of €3 billion each maturing after 32, 34 and 36 years.
- Two tranches of €5 billion each maturing after 38 and 40 years.

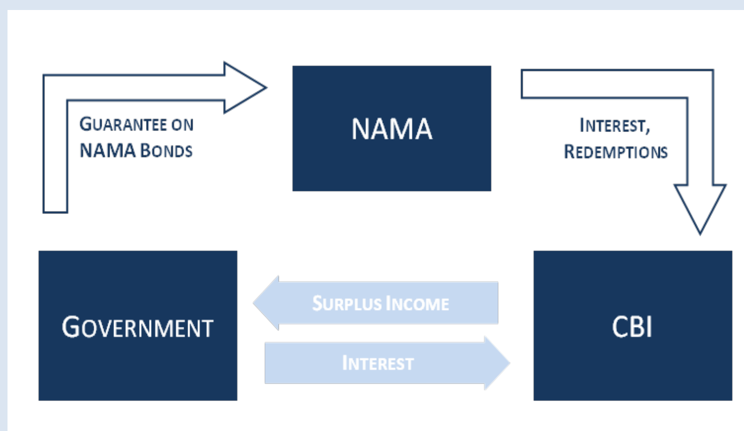
[37] The 2025 Government bond repo agreement between IBRC and Bank of Ireland has been unwound with the CBI now holding this asset. This bond related to the settlement of the 2012 PN payment.

[38] In contrast to the original PN structure, the February transaction involves fully marketable instruments.

The new arrangements imply that the Government will pay interest to the bond holders, eventually repaying the capital beginning in 2038.[39] Where the CBI continues to hold these assets, it will receive income from the coupon payments on the bonds. The CBI will continue to remit surplus income to the Exchequer in accordance with accounting standards and legislative requirements.

The CBI has undertaken to sell the Irish Government bonds that it owns due to the liquidation of IBRC to market investors "as soon as possible" but subject to financial stability considerations.[40] The CBI has committed to a minimum schedule of sales beginning by end-2014. These sales will result in an inflow of cash to the CBI, thereby allowing it to reduce Eurosystem *TARGET* liabilities. However, future interest payments and redemptions on those bonds sold will be made to private investors, which will reduce future potential CBI surplus income payable to the Exchequer. Any capital gains or losses on CBI bond holdings could also affect the surplus income to be transferred to the Exchequer. Sales of the CBI bond holdings to the market may have a broadly similar market impact as an increase in sales of Government bonds directly to the primary market.[41]

The initial operation of these arrangements, prior to CBI sales to the private sector, are shown in the following diagram:



[39] See NTMA (2013) for details.

[40] In addition, the CBI will have an option to exchange a portion of new floating rate bonds for fixed coupon bonds.

[41] These bond sales will add to the Exchequer Borrowing Requirement by, at least, the amount of the reduction in surplus income that will be returned to the Exchequer. The income recorded by the CBI is determined by a number of factors including market valuations.

ACCOUNTING TREATMENT IN THE GENERAL GOVERNMENT ACCOUNTS

On a cash basis in the Exchequer accounts, €3.1 billion of PN payments were included in the Exchequer borrowing requirement from 2011 and would have been added to the Exchequer Accounts in every year to 2023 (with smaller amounts out to 2031). In 2012, this PN payment was settled through the issuance of a 2025 Government bond rather than in cash. This bond was held by Bank of Ireland through a repo with IBRC, which is now being unwound, with the CBI now holding the bond.

The General Government (GG) ESA 95 Eurostat accruals accounting treatment of the PNs was complex. In 2010, the face value of future redemptions under the PN (then amounting to €30.85 billion) worsened the GG deficit and increased GG debt.[42] This amounted to approximately 20 percent of GDP in 2010.[43] For 2011 and 2012, the GG accounts allowed for an "interest holiday" during which no interest payments were made. As a result, in 2013, prior to the February transaction being agreed, there was due to be a sharp increase in recorded interest spending of €1.8 billion. The level of these interest payments under the PN accrued to the GG would have declined gradually in future years.

The Department of Finance estimates that the February 2013 PN transaction may have almost no impact on the GG balance for 2013 but a positive impact of around €1 billion in both 2014 and 2015 based on a no policy change assumption (Table C1). In 2013, there will be costs of approximately €1 billion incurred by the Government associated with claims under the Eligible Liabilities Guarantee (ELG). The improvement in the GG balance in 2014 and 2015 reflects lower (ESA 95) interest costs for the Government, with a small additional benefit in terms of higher CBI surplus income because the interest income for the CBI on the new bonds is higher than the interest income arising from the ELA provided to IBRC. For 2013, these gains are effectively offset by estimated ELG claim costs related to the winding up of IBRC. The Department of Finance did not show the effect of the February transactions on the Structural Budget Balance (SBB). There is likely to be an improvement in the SBB in 2013 as the one-off nature of the ELG claim costs means that it is excluded from this balance.

The impact on the GG debt is shown in Table C2. In 2013, the level of GG debt has been revised up by €1.35 billion due largely to ELG claim costs. The higher interest costs are due to the fact that coupon payments on the newly issued Government bonds exceed the coupon payments on the PN. By 2015 cumulatively there is a slight decline in the GG debt to GDP ratio as a result of the transaction.

[42] The face value of future redemptions had fallen to €25 billion by 2013 due to repayments already made in earlier years.

[43] In 2010 in accordance with ESA 95 rules the full PN amount of €30.85 billion was included in the GG balance for that year.

TABLE C1: GENERAL GOVERNMENT BALANCE IMPACT 2013-2015

€ millions	2013	2014	2015
Promissory Note – GG Interest Savings	1,875	1,775	1,675
Government Bonds – Coupons	-800	-875	-950
Change in Central Bank Surplus Income	0	50	125
Interest Cost Savings[44]	0	100	225
ELG Claim Costs	-1,000	0	0
Interest Costs Adjustment[45]	-50	-50	-50
NAMA Compensation		(not known)	
Change in Underlying GGB due to transaction	**25**	**1,000**	**1,025**
Change in GGB relative to *Budget 2013* Outlook, % of GDP	**0**	**0.6**	**0.6**

Source: Department of Finance (2013b).

TABLE C2: GENERAL GOVERNMENT DEBT IMPACT 2013-2015

€ millions	2013	2014	2015
Promissory Note – GG Interest Savings	-500	-1,825	-1,750
Government Bonds – Coupons	800	875	950
Change in Central Bank Surplus Income	0	-50	-125
Interest Savings	0	-100	-225
ELG Claim Costs	1,000	0	0
Interest Costs Adjustment	50	50	50
NAMA Compensation		(not known)	
Change in GGD in year	**1,350**	**-1,050**	**-1,100**
Change in GGD relative to *Budget 2013* Outlook, % of GDP	**0.8**	**0.2**	**-0.4**

Source: Department of Finance (2013b).

This box has focused on the known impact of the February 2013 transactions on the General Government accounts to 2015. The overall impact of these transactions on the General Government accounts may be additionally affected by currently unknown factors, namely, potential capital gains or losses from the sales of CBI held bonds from end-2014 onwards as well as the possibility of transfers being required to NAMA related to IBRC assets.[46] To understand the full impact on the overall public finances, further work is required by means of a comprehensive analysis of the State's balance sheet going beyond the standard General Government Accounts (Barnes and Smyth, forthcoming).[47] In order to undertake a full net present value assessment of the PN transactions, assumptions would also be required regarding key variables such as the discount rate for which a range of alternatives could be considered appropriate.

[44] This relates to savings from lower borrowing requirements.

[45] This relates to interest on borrowings to meet claims under the ELG.

[46] The breakdown of bonds purchasers between domestic and foreign residents will also impact on the CBI's borrowings from the Eurosystem. This would, in turn, affect the CBI's surplus income due to the interest paid by the CBI on these borrowings.

[47] Forthcoming IFAC paper: "Towards a Comprehensive Government Balance Sheet: A Preliminary Analysis", Barnes, S., and Smyth, D.

The main revenue and expenditure projections from *Budget 2013* are set out in Table 2.3.[48] On the revenue side, the outlook in *Budget 2013* is similar to that in *SPU 2012*, with revenues projected to increase by just over 4 percent per annum from 2013-15, about half a percentage point higher than the outlook for nominal GDP.

In 2013, Exchequer taxes were projected to increase by €1.8 billion or by 5 percent, driven by revenue raising measures announced in the Budget (see Appendix Table B2 for details). The projected increase in taxes is close to the underlying rate of increase in 2012.[49] Non-tax revenues are projected to decline by €0.4 billion this year. This reflects an assumption that fees from the Bank Guarantee Scheme will fall by close to 60 percent as the Scheme is phased out. This will be partly offset by an increase in surplus income from the Central Bank.[50] These non-tax revenue items are a significant source of income and were discussed in the Council's previous *Fiscal Assessment Report* (IFAC, 2012b).[51]

In 2014 and 2015, revenues are projected to increase slightly faster than nominal GDP. This reflects carryover effects from past tax changes and an assumed gradual recovery in domestic demand as well as a further €1.5 billion in new taxation measures.

On the expenditure side, the forecasts assume a period of negative growth in primary (non-interest) spending. The bulk of the expenditure adjustment is split between public sector pay (compensation of employees), social payments and intermediate consumption (Table 2.3 and Figure 2.2).

[48] These projections do not take account of the two post-Budget developments discussed above.

[49] On an unadjusted basis, Exchequer taxes increased by 7.7 percent in 2012, partly as result of new tax measures announced in *Budget 2012*. However, once adjustments are made for delayed corporation tax receipts and a technical reclassification of PRSI, taxes increased by 5.3 percent.

[50] This relates to *Budget 2013* forecasts and does not account for post-Budget news.

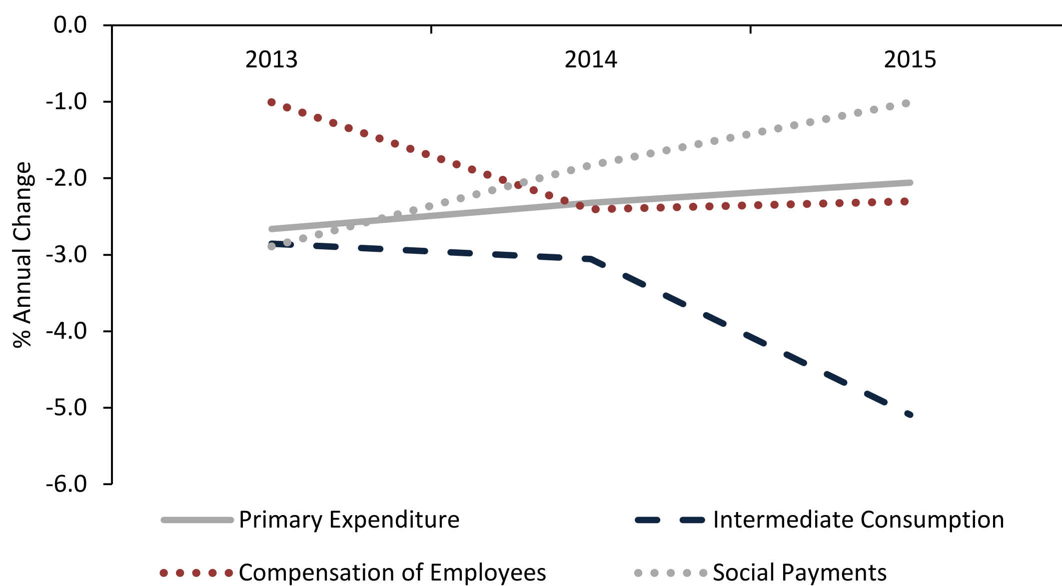
[51] The Department of Finance (2013a) publication 'Monthly EBR Profiles 2013', presented a very informative outline of projected monthly tax and non-tax revenues as well as expenditures over the course of 2013.

TABLE 2.3: *BUDGET 2013* PROJECTED CHANGES IN GOVERNMENT REVENUE AND EXPENDITURE

€ Billions	2013	2014	2015	Cumulative 2013-15
Total Revenue	**1.9**	**2.7**	**2.7**	**7.4**
Tax	1.9	2.9	2.6	7.3
Social Contributions	0.4	0.3	0.2	0.9
Other	-0.3	-0.5	-0.1	-0.9
Primary Expenditure	**-1.7**	**-1.4**	**-1.2**	**-4.3**
Compensation of Employees	-0.2	-0.5	-0.4	-1.1
Intermediate Consumption	-0.3	-0.3	-0.4	-0.9
Social Payments	-0.8	-0.5	-0.3	-1.5
Other	-0.4	-0.2	-0.2	-0.8

Note: This table makes no allowance for post-Budget 2013 news. Numbers rounded to one decimal place.

FIGURE 2.2: *BUDGET 2013* PROJECTIONS FOR GROWTH IN MAJOR EXPENDITURE CATEGORIES

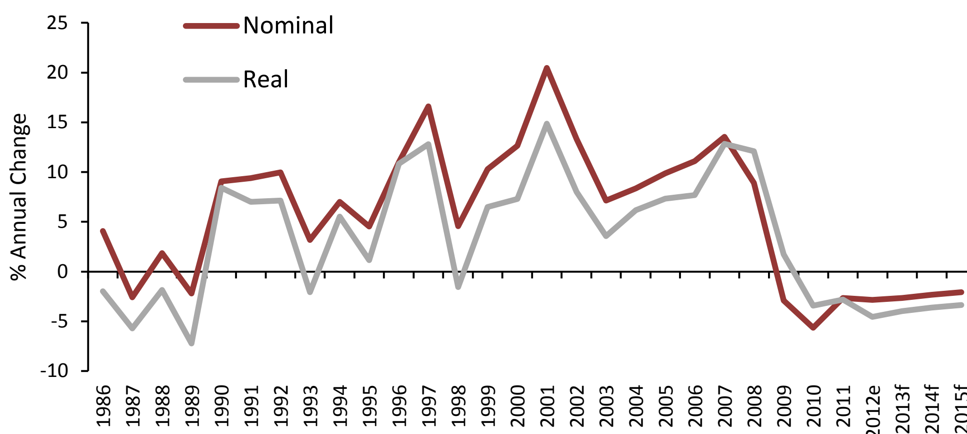


Source: Budget 2013.

In 2013, primary expenditure is projected to decline by €1.7 billion. Almost all of this adjustment was anticipated to come from the two largest spending departments: Social Protection and Health, where there were significant expenditure pressures in 2012. This contributed to a number of changes to the departmental expenditure ceilings in 2013. These ceilings are discussed in more detail in Box D.

In 2014 and 2015, the bulk of the budgetary adjustment will be on the expenditure side split between social payments, government consumption and public sector pay. These three areas combined account for nearly 80 percent of total spending and are expected to deliver cumulative savings of €2.3 billion in 2014 and 2015. Implicit in these projections, notably for social payments, is the assumed recovery in the labour market. In addition, substantial "unallocated savings" which include payroll savings of €0.8 billion are assumed in 2014 (See Box D). In total, primary expenditure in 2014 and 2015 is projected to decline by 2.2 percent per annum. With annual inflation expected to average over 1 percent, this amounts to a significant decline in real terms. Judging by historical experience, sustaining negative expenditure growth over a number of years will be difficult (Figure 2.3).

FIGURE 2.3: PRIMARY EXPENDITURE 1986-2015



Source: Eurostat, Budget 2013 and IFAC calculations.
Notes: Series exclude capital transfers. GDP deflator used to derive real series.

There are significant risks associated with the delivery of the necessary expenditure adjustments given the experience with expenditure ceilings in 2012. The scale of expenditure savings planned over the period to 2015 is sizable (notably in Health). Careful monitoring of expenditure will be essential. The options for further expenditure reduction have also narrowed partly reflecting the very large reductions to date in the capital budget.[52]

In February 2013, following negotiations between the Public Services Committee of the Irish Congress of Trade Unions (ICTU) and the Government, under the auspices of the Labour Relations Commission, a series of proposals aimed at reducing the public service pay bill by €1 billion by 2015 were set out.[53] This new agreement, if passed, would make a valuable contribution to achieving the necessary payroll savings.

BOX D: CURRENT EXPENDITURE CEILINGS

With the publication of the *Comprehensive Expenditure Report 2012-14 (CER*) in 2011, the annual Estimates campaign was replaced by a multi-annual expenditure ceilings framework. The new approach was aimed at encouraging more medium term expenditure planning and adherence to budgetary targets. The *CER* set out departmental expenditure allocations over a three-year period to 2014. The following statements contained in the *CER* pointed to the binding nature of the ceilings:

"Ceilings for 2012 are binding and fully specified in terms of programme–level allocations."

"Ceilings for 2013 are binding, although there may be some reallocations between Departments, within the set aggregate expenditure level."

"Ceilings for 2014 should be viewed as upper limits of expenditure in that year" (Department of Public Expenditure and Reform, 2012, p.21).

In 2012, spending exceeded ceilings in the Departments of Social Protection and Health partly due to cyclical pressures. The *Expenditure Report 2013 (ER 2013*), published in December 2012, revised the ceilings for 2013 by almost €500 million, thus breaching the "set aggregate expenditure level". This increase has essentially been passed through to 2014 (Table D1). Given these developments, the question arises as to what is meant by the "binding" nature of the ceilings referred to originally.

[52] According to *Budget 2013*, Government investment is projected to decline to 1.4 percent of GDP by 2015. This compares with a share of 4.7 percent of GDP in 2007.

[53] For details see: http://per.gov.ie/wp-content/uploads/LRC-Proposals-printed.pdf

TABLE D1: EXPENDITURE CEILINGS FOR 2013 AND 2014

€ million	Comprehensive Expenditure Report		Expenditure Report	
	2013	2014	2013 (change in ceiling)	2014 (change in ceiling)
Health	13,565	13,359	13,627 (+62)	13,420 (+61)
Social Protection	19,906	19,296	20,246 (+340)	19,633 (+337)
Other Departments	17,298	16,891	17,415 (+117)	17,009 (+118)
Unallocated Savings (incl. pay bill measures)	180	830	220 (+40)	830
Gross Current Expenditure	**50,589**	**48,716**	**51,068 (+479)**	**49,232 (+516)**

EXPENDITURE OUTTURN IN 2012

In 2012, current expenditure exceeded its target for the year by €666 million due to spending overruns in the Departments of Social Protection and Health.[54] The overrun in the Department of Social Protection amounted to €560 million and mainly reflected labour market pressures, which included weaker than expected receipts from PRSI and higher spending on unemployment-related allowances. Labour market outturns last year were significantly less favourable than was expected in *Budget 2012*. For example, in *Budget 2012* the unemployment rate was forecast to average 14.1 percent in 2012 but the outturn according to the *QNHS* was 14.7 percent.

The Department of Health exceeded its ceiling by €311 million. According to the *ER 2013*, this arose in part from "service and demographic pressures" which amounted to €713 million. The demographic pressures were largely attributed to a greater than anticipated demand for medical cards.[55] Most of the other departments kept within their expenditure budgets, which helped to partly offset the current expenditure overruns in the Departments of Social Protection and Health.[56] On the capital side, expenditure in 2012 amounted to €3,489 million which was €145 million below budget.

REVISED AGGREGATE EXPENDITURE CEILINGS IN 2013 AND 2014

In the *ER 2013*, the overall current expenditure ceiling in 2013 was increased by approximately €500 million to €51,068 million with the 2014 ceiling revised by a similar amount (see Table D1). The 2013 ceiling was increased in part due to cyclical pressures associated with the labour market, although little detail has been provided on how the

[54] These figures refer to net voted cumulative current expenditure in the end-2012 Exchequer Statement.

[55] Despite the policy changes announced in *Budget 2013* that will reduce eligibility for approximately 40,000 people currently in receipt of medical cards, the anticipated net growth in medical cards in 2013 is 60,000 (HSE, 2013).

[56] Current spending in Government departments excluding the Departments of Social Protection and Health in 2012 was €205 million under the allocation for the year.

adjustments were made. Offsetting adjustments on the revenue side were taken to keep to the planned €3.5 billion fiscal adjustment in 2013 so the overall budgetary stance was not affected.

DEPARTMENT OF HEALTH CEILING

The Department of Health's current expenditure ceiling for 2013 was revised upwards from the *CER* ceiling by €62 million. However, in order for spending to be kept within this ceiling, a total of €781 million in saving measures were announced in the *ER 2013*.[57] The savings for this year are partly aimed at correcting an ongoing operating deficit in the Department in the region of €500 million but are also aimed at correcting additional spending pressures that arose in 2012. Half of the €781 million in savings are to be delivered through pay-related initiatives (which include professional fees). Most of the remaining adjustment arises from a reduction in prescription charges and drug related costs (see Table D2). Anticipating expenditure pressures in the Department of Health is more difficult than in other departments given the demand-driven nature of the health services. A welcome recent development is that the Health Service Executive (HSE) and the Department of Health will report on a monthly basis to the Cabinet Committee on Health on the implementation of the Health sector measures to proactively prevent expenditure overruns.

DEPARTMENT OF SOCIAL PROTECTION CEILING

The Department of Social Protection's current expenditure ceiling was revised upwards by €340 million. Most of this reflected cyclical labour market pressures that arose in 2012. The remainder of the increase was accounted for by the decision in *Budget 2013* to increase spending in social welfare by €150 million. To adhere to the new ceiling for 2013, however, €390 million in new saving measures were announced in *Budget 2013*, the most important of which was a reduction in child benefit (see Table D2). For future expenditure reports, it would be helpful if changes to expenditure ceilings as a result of cyclical and non-cyclical developments were documented more explicitly.

RISKS

While the Department of Social Protection exceeded its ceiling in 2012, the reasons appear to reflect predominantly cyclical pressures. In the case of the Department of Health, while there were also cyclical pressures, the impact arising from other areas is less clear. The Department of Health has persistently exceeded its expenditure budget in recent years.[58] A recent report by the HSE highlighted the challenges facing the sector in 2013.[59] The failure to deliver on planned current expenditure savings in 2012 and the significant measures planned for 2013

[57] The required level of savings for the Department of Health in 2013 has been revised upwards significantly since the publication of the *CER 2012-2014* which specified savings of €71 million.

[58] In 2009, 2010, 2011 and 2012, the current expenditure overruns in the Department of Health were €0.2 billion, €0.4 billion, €0.1 billion and €0.3 billion, respectively. The Department of Social Protection exceeded its budget in 2010 and 2012 but under spent in 2009 and 2011.

[59] The HSE (2013) report referred to "... unavoidable pressures of €748 million" facing the HSE and the need to achieve savings of €721 million.

are a key risk to meeting budgetary targets this year. While savings of €781 million have been specified in the *ER 2013*, questions must be raised about the capacity of the Department of Health (and of the HSE) to deliver. These may ultimately be achieved but recent experience suggests that careful monitoring throughout the year will be needed.

Beyond the Departments of Health and Social Protection, there are also sizable unallocated savings, primarily pay bill savings, in the *ER 2013* of €0.2 billion in 2013 and €0.8 billion in 2014. These pay bill savings account for half of the planned expenditure adjustment in 2014. A failure to deliver on these pay savings is another sizable risk and would necessitate cuts in expenditure in other areas and/or higher taxes and charges. However, the Croke Park Extension Agreement could make a valuable contribution to achieving the necessary payroll savings.

While the binding nature of the ceilings was discussed in the *CER*, the intended legal nature of the ceilings is set out in the *Ministers and Secretaries (Amendment) Bill* (*MSAB*), published in September 2012.[60] The *MSAB* sets expenditure ceilings on a rolling three-year financial basis.

TABLE D2: SAVINGS MEASURES IN THE DEPARTMENTS OF HEALTH AND SOCIAL PROTECTION

Department of Health	**Savings in 2013**	**Full Year Savings**
	€ million	
Reduction in cost of drugs and other prescribed items	160	330
Increase DPS threshold to €144 per month	10	10
Increase prescription charges for medical card holders	51	51
Reduced professional fees	70	80
Other changes to Primary Care scheme	32	44
Pay-related savings	308	458
Increased generation of private income	65	115
Savings on Department vote	60	60
Procurement measures	20	20
Other measures	5	5
Total net savings	**781**	**1,173**

[60] http://www.oireachtas.ie/documents/bills28/bills/2012/8112/b8112.pdf

Table D2 (continued): Savings Measures in the Departments of Health and Social Protection

Department of Social Protection	Savings in 2013	Full Year Savings
	€ million	
Child Benefit: Reduction in Rates	136	142
Back to school clothing and footwear allowance: Reduction in rates	17	17
Changes to the Farm Assist programme	4	5
Job Seekers Benefit: Reduction in duration	33	82
Changes to Redundancy Payments Scheme	25	30
Changes to Supplementary Welfare Allowance	6	6
Changes to Back to Education Allowance	11	24
Reduction in Respite Care Grant	26	26
Changes to Household Benefits Package	81	84
Fraud, Control and Overpayments: Increased control measures	60	60
Administrative savings	5	5
Increased funding for activation programmes and school meal provision	(13)	(28)
Total net savings	**390**	**452**

2.3.2 Forecasts by Other Agencies

A comparison of *Budget 2013* projections with recent forecasts of other agencies is shown in Table 2.4. Around the time of the Budget, there was a consensus on the outlook with all agencies expecting the budget deficit to fall to just below 3 percent of GDP in 2015. Similarly, the debt to GDP ratio was projected to peak this year at just over 121 percent of GDP. A more recent forecast from the IMF based on more up to date information has a more positive outlook for the General Government balance, with the deficit projected to improve to 2.2 percent of GDP in 2015.

TABLE 2.4: FISCAL OUTLOOK 2013 TO 2015

% of GDP	*Budget 2013*	OECD Dec 2012	ESRI Jan 2013	EC Jan 2013	IMF[61] Apr 2013
2013					
General Government Balance	-7.5	-7.5	-7.5	-7.5	-6.8
General Government Debt	121.3	121.9	121	122.1	122.5
Nominal GDP, % y/y	2.8	1.6	3.0	2.4	2.3
2014					
General Government Balance	-5.1	-5.3	-5.1	-5.1	-4.4
General Government Debt	120.2	122.0	118.0	119.5	120.7
Nominal GDP, % y/y	3.8	2.9	5.2	3.7	3.7
2015					
General Government Balance	-2.9	NA	NA	-2.9	-2.2
General Government Debt	116.8	NA	NA	117.4	116.9
Nominal GDP, % y/y	4.2	NA	NA	4.4	4.3

2.4 SENSITIVITY ANALYSIS

Previous *Fiscal Assessment Reports* by the Council have served to underscore the high uncertainty surrounding the budgetary outlook.

The Council's Fiscal Feedbacks Model can be used to highlight the effect on key fiscal ratios of different growth assumptions. *Budget 2013* projected an average annual nominal GDP growth rate of 3.6 percent from 2013-2015. In Figure 2.4, the growth rate is allowed to vary within two percentage points of this average in each of the years to 2015. These scenarios assume no change in the Government's planned discretionary budget adjustments but are updated to reflect the post-Budget developments described above. Under these assumptions, if growth turns out to be one percentage point weaker per annum over the projection period, then the General Government deficit by 2015 would be 1.3 percentage points higher than in the baseline case (Figure 2.4a). Conversely, if growth surprised on the upside and was one percentage point stronger per annum than in the baseline case, then the General Government deficit in 2015 would be 1.2 percent of GDP lower.

Despite the improvement in the budgetary outlook, overall debt levels in the economy will remain elevated and sensitive to changes in the growth outlook (Figure 2.4b). The sustainability of debt also appears more challenging when alternative measures of output are used. Using GNP, the debt

[61] The IMF figures exclude projected bank restructuring costs related to the Eligible Liabilities Guarantee associated with the liquidation of IBRC.

ratio peaks at 149 percent this year, or using the Council's Hybrid measure of output (IFAC, 2012b), the debt ratio reaches 137 percent.

FIGURE 2.4a: GENERAL GOVERNMENT DEFICIT

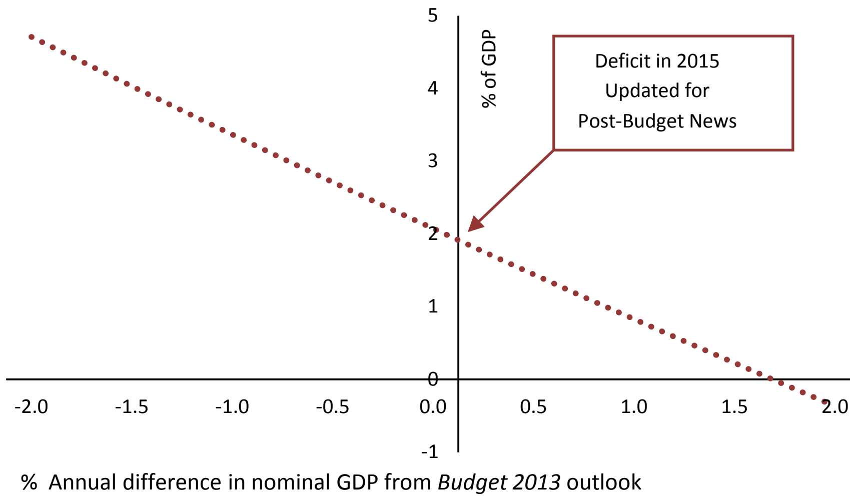
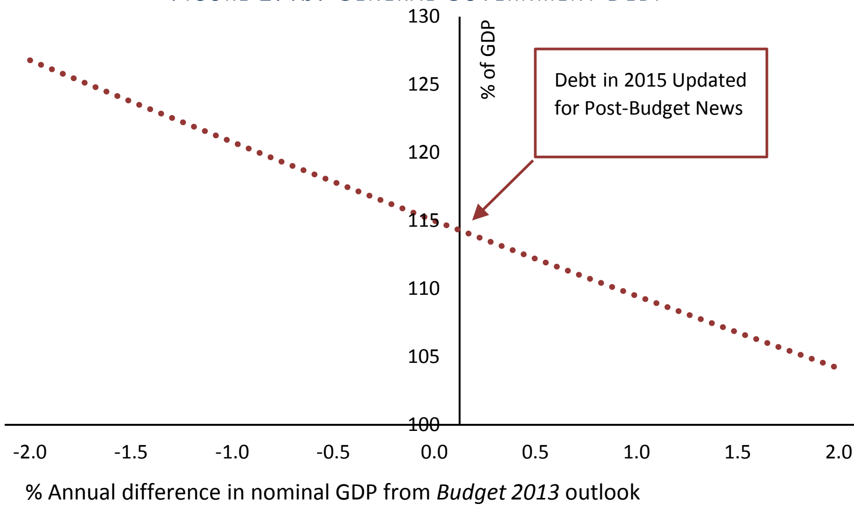


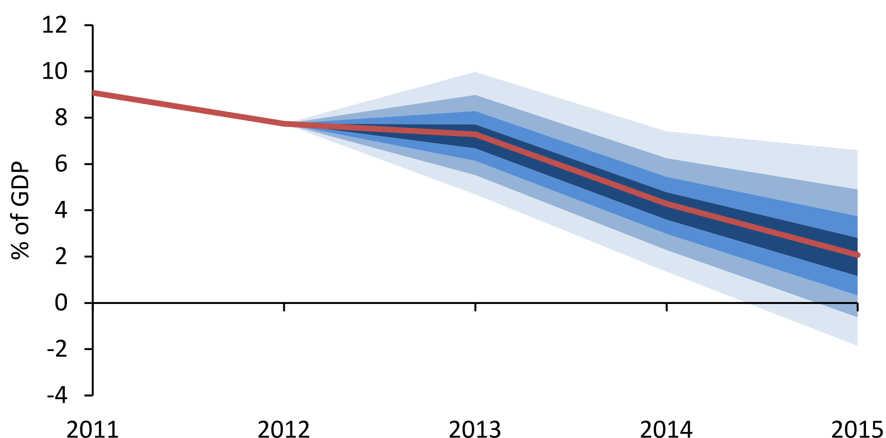
FIGURE 2.4b: GENERAL GOVERNMENT DEBT



In the previous *Fiscal Assessment Report*, fan charts were used to illustrate the impact of alternative growth paths on the public finances. Revised fan charts based on *Budget 2013* and updating for post-Budget developments are shown in Figure 2.5. While there are limitations associated with the use of fan charts, the figures serve to illustrate the fragility of the fiscal position.

The fan charts suggest approximately a one-in-three probability that the deficit to GDP ratio would be above the 3 percent of GDP in 2015 in the absence of offsetting adjustments (Figure 2.5a). Similarly, it implies an estimated one-in-four probability that the debt to GDP ratio will fail to stabilise by the end of the projection period unless further policy measures beyond those currently planned are taken (Figure 2.5b). A fan chart was also constructed for the additional cumulative budgetary adjustments that would be needed to meet existing *Budget 2013* deficit targets (Figure 2.5c).[62]

FIGURE 2.5a: GENERAL GOVERNMENT DEFICIT[63]

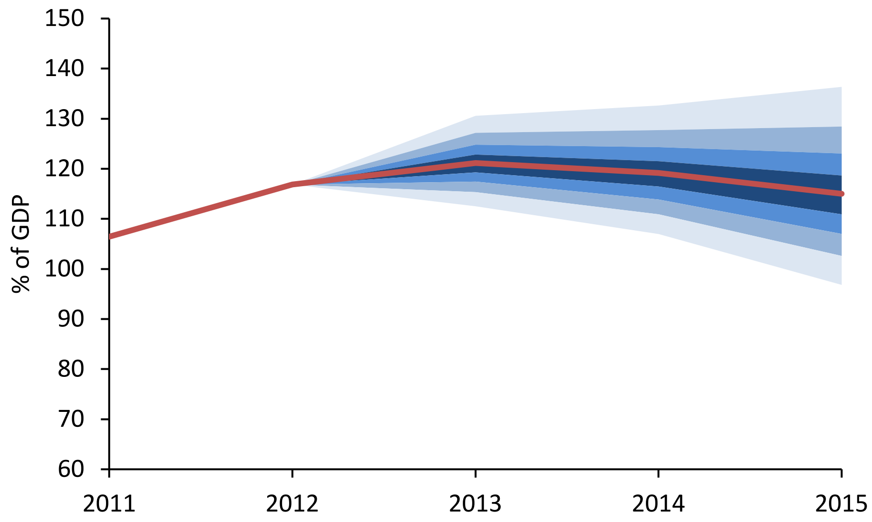


Source: Budget 2013 and IFAC calculations.

[62] These adjustments would be additional to the already planned €5.1 billion in 2014-2015.

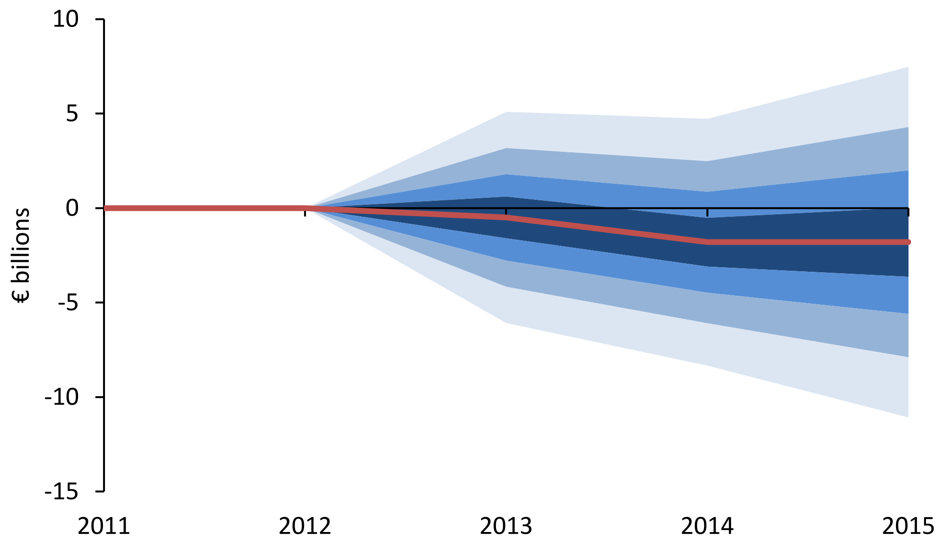
[63] Figure updates the underlying General Government deficit outlook from *Budget 2013*.

FIGURE 2.5b: GENERAL GOVERNMENT DEBT



Source: Budget 2013 and IFAC calculations.

FIGURE 2.5c: ADDITIONAL ADJUSTMENTS



Source: Budget 2013 and IFAC calculations.

APPENDIX B: CONSOLIDATION MEASURES TABLES

TABLE B1: CONSOLIDATION MEASURES: 2013-15

Consolidation Measures, € Billions	2013	2014	2015
Total Consolidation	**3.5**	**3.1**	**2.0**
Tax	**1.5**	**1.1**	**0.7**
New	*1.2*	*0.9*	*0.6*
Carryover	*0.3*	*0.2*	*0.1*
Expenditure	**1.9**	**2.0**	**1.3**
Current	*1.4*	*1.9*	*1.3*
Capital	*0.5*	*0.1*	*0.0*

Note: Numbers rounded to one decimal place. The carryover in 2013 includes dividends.

TABLE B2: DETAILS ON *BUDGET 2013* TAX MEASURES IN 2013

Revenue	€ Billions
Excise Duty	0.3
Property Tax	0.3
Income Tax	0.2
PRSI	0.3
Other Taxes	0.2
Total	**1.2**

Note: Numbers rounded to one decimal place.