Contents

4. ASSESSMENT OF COMPLIANCE WITH FISCAL RULES

KEY MESSAGES

- Two separate fiscal objectives frame the *Stability Programme Update 2014* (*SPU 2014)* budgetary plan. The first is the requirement to achieve a General Government deficit of less than 3 per cent of GDP in 2015 under the Excessive Deficit Procedure (EDP). The second is to meet the Medium-Term Budgetary Objective (MTO) of a balanced budget in structural terms by 2018.

- Ireland's excessive deficit is forecast to end in 2015, although there is no margin of safety in the *SPU 2014* projection. A successful exit from the EDP also requires that the deficit is on a path that ensures it will remain below 3 per cent of GDP on a sustainable basis.

- The fiscal projections in *SPU 2014* imply compliance with the Budgetary Rule in each year from 2014 to 2018 by some margin, as 2018 has been set as the deadline to meet the MTO. This deadline is more ambitious than necessary under the minimum requirements of the fiscal framework.

- The 2013 fiscal outturn published in the *SPU 2014* complies with the Budgetary Rule through the Adjustment Path condition. In parallel, expenditure growth was below the EU Expenditure Benchmark.

- On the basis of the *SPU 2014* forecasts, the planned evolution of the debt to GDP ratio to 2018 is compliant with the debt rules.

4.1 Introduction

The Council's mandate includes reporting on the compliance with the Budgetary Rule and also monitoring compliance with the full range of EU fiscal rules as part of a broader assessment of the fiscal stance. *SPU 2014* sets out the Government's most recent medium-term fiscal plan. This chapter examines the consistency of this plan with the fiscal rules and discusses some of the key elements of the fiscal framework at both the domestic and European levels. Finally, Analytical Note 5 provides further background to this chapter covering the topic of the Future Implications of the Debt Rule.

4.2 Compliance with the Budgetary Rule

This section assesses the consistency of *SPU 2014* projections with the Budgetary Rule, which the Council is explicitly required to monitor. The Council also examines the role of the EU Expenditure Benchmark (EB) in assessing compliance with this rule.

4.2.1 Clarification on the Interpretation of the Budgetary Rule

This section clarifies the interpretation of certain elements of the Budgetary Rule by reference to the *Medium-Term Budgetary Framework* (MTBF), published by the Department of Finance in December 2013.[113] This document provides an overview of the set of arrangements, procedures, rules and institutions that underpin the conduct of the reformed budgetary framework supported by the relevant provisions in national and European legislation.

The 'budget condition' of the *FRA* provides that the Budgetary Rule is complied with when "... the budgetary position of the general government is in balance or in surplus". Taken in isolation, this may be interpreted as providing for the 'budget condition' to be met through either a headline General Government balance/surplus or a structural budget balance/surplus. This interpretation was used by the Council in previous *Fiscal Assessment Reports* (FAR). However, the MTBF states that for the Budgetary Rule to be respected one of the two following conditions must be satisfied.

> These conditions are that the budgetary position of general government:
> - is in balance or in surplus and this will be deemed to be the case if the medium-term budgetary objective set under the *Stability and Growth Pact* is achieved or,
>
> - if it is not, that it is on the adjustment path towards our medium-term budgetary objective.
>
> Page 5, Medium-Term Budgetary Framework

[113] As required under Article 9 of the Budgetary Frameworks Directive (EU Council Directive 2011/85/EU, 8 November 2011).

The Adjustment Path condition is framed around the provisions of the preventive arm of the *Stability and Growth Pact (SGP)*. If a country is not at its MTO, it must be on an appropriate adjustment path towards it. An assessment of this adjustment focuses on the change in the structural balance but also considers expenditure growth by reference to the EU expenditure rule. This rule was introduced to the *SGP* framework in the 2011 reforms and limits expenditure growth to a country specific benchmark rate.

This EU EB is designed to ensure that expenditure policies are consistent with remaining at the MTO or an appropriate adjustment path towards it, while allowing revenue to fluctuate with the economic cycle. This should ensure that sustainable expenditure policies are pursued while addressing some of the uncertainties around estimates of the structural budget balance (see Box C). Furthermore, the growth of expenditure is predominantly under the direct control of government allowing for a more direct approach in addressing an *ex ante* deviation. An analysis of expenditure growth by reference to the EU EB should be part of an assessment of any actual or expected significant deviation of the budgetary position from the Budgetary Rule.[114, 115, 116]

4.2.2 Assessment of Compliance with the Budgetary Rule

Structural Budget Balance

The structural budget balance complies with the Budgetary Rule in 2013 under the Adjustment Path condition based on the forecasts contained in *SPU 2014*. The Department of Finance estimates the structural balance for 2013 at -6.2 per cent of GDP, which is in excess of Ireland's MTO of a structural budget balance (Table 4.1). However, the improvement in the structural balance of 1.6 percentage points from 2012 to 2013 is larger than that required in the Adjustment Path condition. As Ireland's

[114] In the Irish context, the EU EB is also used as a reference in setting Ministerial ceilings for gross voted expenditure (see Annex H, IFAC (2013b), for a wider discussion of the *Medium-Term Expenditure Framework*).

[115] The *FRA* links the assessment of a deviation from the Budgetary Rule with the evaluation of a deviation under the Balanced Budget Rule under the *SGP*. Part 3 Section 8(3)(b) of the *FRA* identifies the monitoring and compliance role of the Council as including identification of any failure to comply with Section 6(1) of the same Act. Section 6(1) of the *FRA* cites Article 6 Part 2 of EU Council Regulation (EC) No 1466/97, which outlines the consequences of a significant deviation under Article 5(1), which states that, "Sufficient progress towards the medium-term budgetary objective shall be evaluated on the basis of an overall assessment with the structural balance as the reference, including an analysis of expenditure net of discretionary revenue measures."

[116] A significant deviation occurs where the structural balance deviates by at least 0.5 per cent of GDP in one or at least 0.25 per cent of GDP on average per year in two successive years from the appropriate adjustment path.

debt ratio is greater than 60 per cent of GDP, the *SGP* requires that the annual change in the structural balance must be greater than a 0.5 percentage point benchmark.[117]

Table 4.1: Summary of Main Fiscal Aggregates

	Outturn		*SPU 2014* Forecast				
	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Main Aggregates, % of GDP							
General Government Balance[118]	-8.2	-7.2	-4.8	-2.9	-2.2	-1.2	0.0
Structural Balance (SB)	-7.8	-6.2	-4.7	-2.8	-2.1	-1.2	0.0
Change in the SB	*0.7*	*1.6*	*1.5*	*1.9*	*0.7*	*0.9*	*1.1*
Output Gap (% of Potential GDP)	-3.8	-1.3	-0.7	-0.3	-0.1	0.0	0.0
General Government Debt	117.4	123.7	121.4	120.0	115.9	112.0	107.2

Source: SPU 2014, Department of Finance.
Note: Rounding may affect figures.

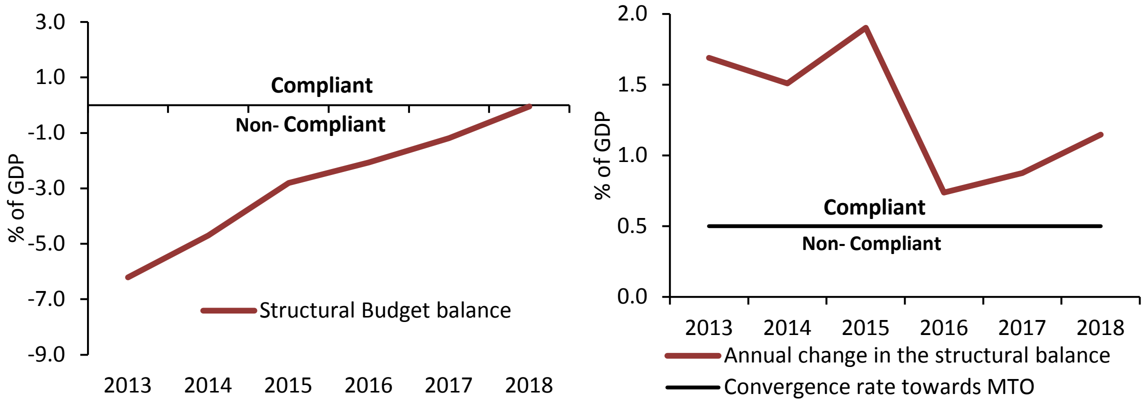
While the Council's formal requirement to assess (*ex post*) compliance with the Budgetary Rule is backward-looking in nature, the mandate to assess the fiscal stance suggests considering compliance on a forward-looking basis. Figure 4.1 shows the structural balance estimates for 2014 to 2018 against the requirements of the budget condition and the Adjustment Path condition. The budget condition (Figure 4.1(A)) is first met in 2018, at which point the structural position is in balance. The forecasts are compliant with the Adjustment Path condition (Figure 4.1(B)) for all years to 2018, as the change in the structural balance is greater than 0.5 percentage points of GDP.

[117] There are indications that the minimum benchmark for high-debt countries will be set at 0.6 percentage points of GDP. For example, the *Country Specific Recommendations* for Austria state, *"Austria is required to pursue an annual structural adjustment of above 0.5% of GDP in 2014, which has been operationalized in consultation with Member States as a requirement of an effort of at least 0.6% of GDP".* (EC, 2014d).

[118] Table refers to the underlying General Government Balance.

Figure 4.1: Assessment of Compliance with the Budgetary Rule

(A) Budget Condition (B) Adjustment Path Condition



Source: SPU 2014, Department of Finance *Source: SPU 2014,* Department of Finance

The Government's stated fiscal objective is "... the correction of the excessive deficit by next year. Thereafter, fiscal policy will be set in line with the requirement to move towards Ireland's medium-term budgetary objective, which is for a balanced budget in structural terms."[119] The structural budget balance for the years 2016 to 2018 is driven by the targeting of a 2018 deadline to meet the MTO, which was proposed by the EC and agreed with the Department of Finance following *SPU 2013*.[120] This 2018 target was first published by Government in the *Medium-Term Economic Strategy* in November 2013 and shortened the convergence path from the 2019 deadline published in *SPU 2013*.[121] Given that this deadline is more ambitious than would be achieved with minimum compliance under the EU rules, it ensures that the Budgetary Rule would be complied with by some margin out to 2018 and implies a primary surplus of 4.8 per cent of GDP in 2018.[122, 123]

[119] Page 1 of *SPU 2014*.

[120] It is important to note that MTOs are updated every three years and consequently Ireland's MTO will be reassessed before 2018.

[121] The *SPU 2013* showed a relatively small structural deficit of 0.4 per cent in 2018 and a structural surplus of 1 per cent in 2019.

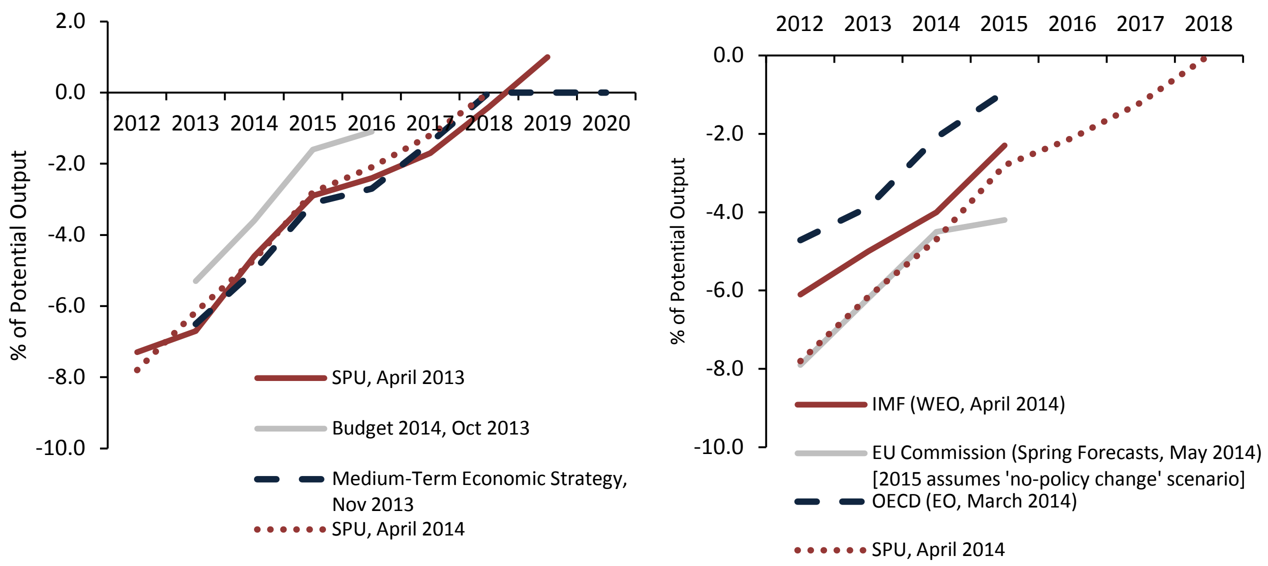
[122] Article 3(1)(b) of the Treaty on Stability Coordination and Governance (TSCG) requires signatory countries, when not at their MTO, to be making sufficiently rapid progress towards it. In a case where a country would have to maintain a primary surplus in excess of 5.5 per cent of GDP for a sustained period in order to meet their MTO an exception is made by the EC requiring an MTO corresponding to a primary surplus of 5.5 per cent to be presented.

[123] The European Commission (EC, 2014b) have commented that the 2018 deadline, and implied structural primary surplus, represents "... an ambitious plan relative to past experience across Member States ...". By way of illustration, applying a 0.6 percentage point adjustment on a mechanical basis from 2015 (post-EDP) would lead to the MTO being met in 2020.

The extent of revisions to structural balance estimates has been highlighted previously by the Council.[124] This is a particular concern given the central role of the structural balance in assessing compliance with both domestic and European fiscal rules. Figure 4.2 shows structural balance estimates published by the Department since the *SPU 2013* and also compares the latest structural balance estimates from other institutions.[125] See Box C for an examination of the causes of the revision to the 2013 structural balance estimate between *SPU 2013* and *SPU 2014*.

FIGURE 4.2: ALTERNATIVE STRUCTURAL BALANCE ESTIMATES

(A) DEPARTMENT OF FINANCE, FORECAST VINTAGES (B) OTHER AGENCIES LATEST ESTIMATES



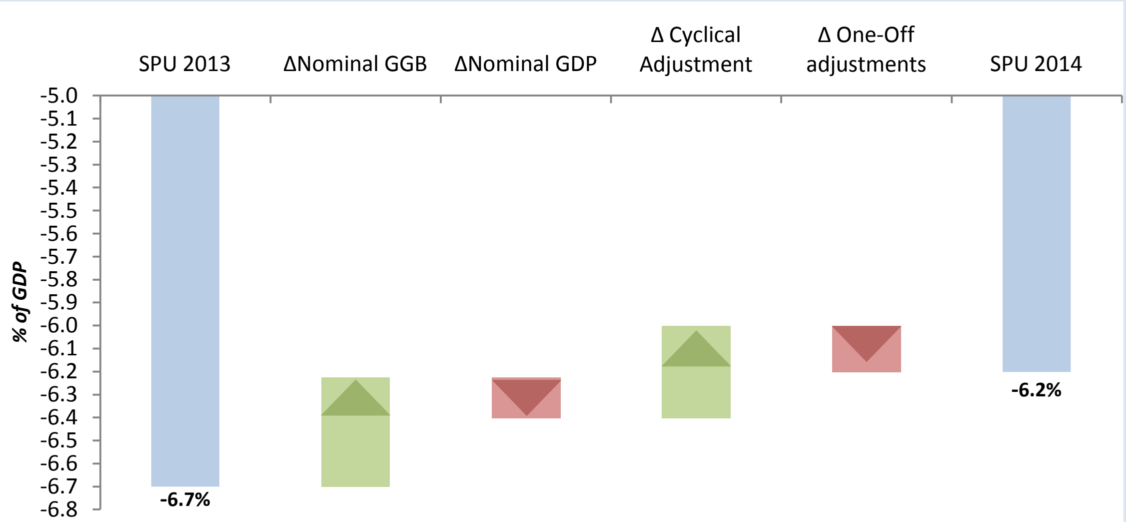
[124] See IFAC (2013b).

[125] A recent paper by the ESRI estimated a structural balance for 2014 using the *HERMES* macroeconomic model of the Irish economy. The structural balance estimate produced using this approach is close to zero for 2014. This implies that the bulk of the headline general government deficit this year is cyclical in nature and consequently that the structural balance is already at, or very nearly at, the MTO. (Bergin and Fitzgerald, 2014).

Box C: Revisions to Structural Balance Estimates for 2013

This Box examines the source of the 0.5 percentage point revision to the structural balance estimate for 2013 since *SPU 2013*. Broadly speaking such revisions can arise from three areas; (i) changes to the headline deficit ratio, (ii) changes to the estimated impact of the economic cycle or (iii) adjustment to the calculation of one-off and temporary measures.

Figure C: Decomposition of Changes to the Structural Balance Estimate for 2013



Source: Internal calculations. As the residual from this calculation is minor and does not materially impact on results it is omitted from the chart.

General Government Balance

The 2013 General Government balance as a percentage of GDP was forecast at 7.5 per cent in *SPU 2013* and the latest outturn figure is 7.2 per cent in *SPU 2014*. This change in the headline ratio masks the extent of the reduction in the nominal deficit estimate as it is offset in part by downward revisions to the nominal GDP level. (See Chapter 3).

Cyclical Adjustment

A revision of 0.4 percentage points arises from changes to the cyclical component of the budgetary balance. The cyclical component is calculated by multiplying the output gap by the estimated sensitivity of the budget balance to changes in the output gap.

The estimate of the output gap for 2013 was revised from -0.5 per cent of potential GDP in SPU 2013 to -1.3 per cent of potential GDP in *SPU 2014*. Over this period, real GDP growth was revised from 1.3 per cent to -0.3 per cent, while potential GDP growth was revised marginally from 0.3 per cent to 0.4 per cent. This arises not only from data and forecast revision but also from the change in the methodology for calculating the NAWRU (see Analytical Note 2).[126] In estimating the sensitivity of the budget

[126] The composition of potential growth over this period changed, with a labour contribution of -1.1 percentage points being revised up to 0.1 percentage points. This was offset by a downward reduction in the contribution of Total Factor Productivity (TFP) from 1.3 to 0.1 percentage points.

balance to changes in the output gap, the EC approach is based on a methodology devised by the OECD, which was recently updated.[127] This update gives a semi-elasticity of the budgetary balance for Ireland of 0.5, which was used for both *SPU 2013* and *SPU 2014*.

One-offs and Temporary Measures

The 'two-pack' Code of Conduct defines 'one-off and temporary measures' as measures having a transitory budgetary effect that do not lead to a sustained change in the inter-temporal budgetary position.[128] More detailed guidance from the EC identifies certain principles aimed at ensuring consistent treatment across countries but the interpretation remains relatively subjective.[129] This element of the structural balance estimation is typically the least technically complex but is also open to more subjectivity.[130] The one-off measures of -0.4 percentage points of GDP (€0.6 billion) for 2013 in *SPU 2014* arise predominantly from a combination of:

(i) €1.1 billion from the Eligible Liabilities Guarantee (ELG) call relating to the promissory note restructuring

(ii) -€0.7 billion in mobile license sales

(iii) €0.2 billion in promissory note interest.

The estimate of -0.4 per cent of GDP represents a downward revision from -0.6 percentage points of GDP in *SPU 2013*, while the latest EC estimate of -0.3 percentage points of GDP is somewhat lower.

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[127] See Mourre *et al* (2013).

[128] Examples of one-off and temporary measures are sales of non-financial assets; receipts of auctions of publicly owned licenses; short-term emergency costs emerging from natural disasters; tax amnesties; revenues resulting from the transfers of pension obligations and assets.

[129] The EC paper (Larch and Turrinni, 2009) specifies that items classified as one-off or temporary in their impact on the cyclically adjusted balance should: (i) have an impact of at least 0.1% of GDP; (ii) should be concentrated in a single year of very limited number of years; (iii) typically but not exclusively be classified as a capital transfer; and (iv) deficit increasing measures should not be regarded as one-off on the basis that expenditure measures initially regarded as one-off can become permanent.

[130] For example, work by the EC has shown that there are typically more and larger one-off adjustments when the deficit is closer to 3 per cent of GDP. (EC, 2009).

EXPENDITURE BENCHMARK

The expenditure aggregate assessed under the EU EB is estimated to have fallen in real terms by just under 6 per cent in 2013 on the basis of *SPU 2014* outturn figures.[131, 132] This compares to the -0.8 per cent reference rate of real growth required under the EU EB for 2013.[133]

Between 2014 and 2016 real annual growth in the expenditure aggregate is limited to -0.7 per cent under the EU EB.[134] Figure 4.3(A) shows that this requirement is complied with as the annual change in the expenditure aggregate is forecast to fall faster than that. A consequence of setting the EU EB in advance for a three year period is that the potential growth rate underpinning the benchmark may become decoupled from the potential growth forecasts underpinning the structural balance. Meeting the current EU EB given the revised estimates for potential output would – in the absence of discretionary tax changes – lead to over-performance relative to the required adjustment path to the MTO.

The EU EB reference rate will be updated in late 2015 for the period 2017 to 2019. On the basis of *SPU 2014* forecasts, the rate of expenditure growth consistent with compliance with the EU EB would be higher than under the current benchmark for 2014 to 2016 (see Figure 4.3(A)).[135] The impact of the EU EB on nominal expenditure over the forecast horizon is shown in Figure 4.3(B). General Government expenditure is expected to contract in 2014 and 2015 before expanding from 2016, although a significant element of this growth is accounted for by the increase in debt servicing costs.

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[131] The expenditure aggregate is general government expenditure excluding interest, exceptional investment costs relating to infrastructure, cyclical unemployment benefit spending and certain spending on EU programmes. The exclusion of cyclical unemployment expenditure makes the EU EB more demanding when cyclical unemployment is falling, i.e., this source of falling expenditure does not 'count' towards meeting the EU EB reference rate of growth. However, the fact that the EC/EU methodology identifies little of the currently high unemployment as cyclical significantly attenuates this effect, with some portion of the fall in expenditure now being allowed to count.

[132] The deflator used in this calculation is the average of the forecast deflators produced by the Department of Finance in their *SPU 2013* and *Budget 2014* forecasts.

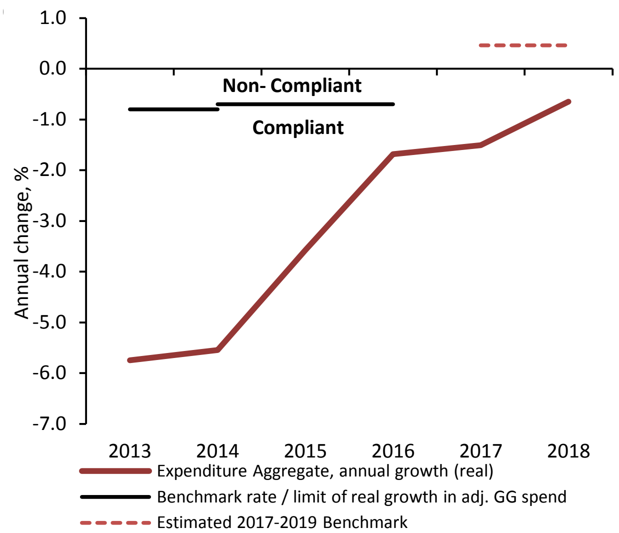
[133] See Annex 4 of EC (2013a) for the 2013 EU EB reference rate.

[134] See Box 1.7 of EC (2013a) for the current EU EB reference rate.

[135] Illustratively, based on *SPU 2014* data the 2017-2019 benchmark rate of expenditure growth is estimated to be approximately ½ per cent. The reference rate of potential growth is calculated as the average growth from 2011 to 2020 and assumes growth in 2019 and 2020 remains at the 2018 rate of 3.5 per cent published in *SPU 2014*. It also allows for this reference rate to be reduced by a convergence margin as the MTO will not be met until 2018. It is important to note that the formal update of the EU EB in 2015 will be based on EC data and forecasts.

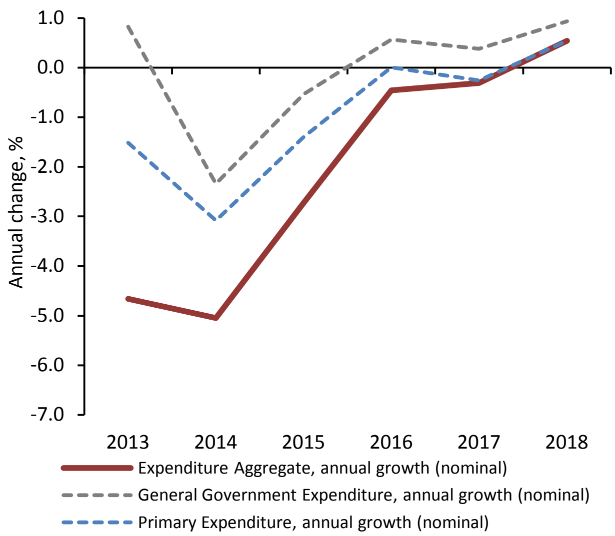
FIGURE 4.3 ASSESSMENT OF COMPLIANCE WITH THE EXPENDITURE BENCHMARK

(A) Compliance of Expenditure with the EU EB



Source: Internal calculations based on *SPU 2014*

(B) Nominal Expenditure Growth



Source: Internal calculations based on *SPU 2014*

4.3 COMPLIANCE WITH OTHER IRISH AND EU FISCAL RULES

The Council has no formal mandate to assess compliance with the domestic Debt Rule enacted in the *FRA* or the EU Fiscal rules. However, the *FRA* provides that in its assessment of the fiscal stance the Council must make "...reference to the provisions of the *Stability and Growth Pact*".

4.3.1 OVERVIEW OF OTHER FISCAL RULES

SPU 2014 sets out a fiscal path that meets the requirements of domestic and European fiscal rules. In terms of compliance with other individual domestic and EU rules:

Ireland remains in an Excessive Deficit Procedure (EDP) as the General Government deficit, net of one-off banking reform measures, is in excess of the target of below 3 per cent of GDP. The *SPU 2014* sets out a deficit path that meets the requirements of the targets established under the EU Council decision and shows a deficit of 2.9 per cent of GDP in 2015. This leaves no margin to accommodate negative shocks (see Chapter 3). The specific arrangements related to an EDP exit are discussed in detail in Section 4.3.2.

After 2015, and assuming the planned 2015 General Government deficit is met and the debt-to-GDP ratio declines as anticipated, Ireland will move from the corrective arm of the *SGP* to the preventive arm. The requirements under the preventive arm are consistent with the discussion in Section 4.2, with an *ex post* assessment undertaken by the EC to identify any significant deviation from the appropriate convergence path with the MTO.

Debt in 2013 remains higher than the requirements of the domestic Debt Rule and the requirement under the *SGP*. However, the full Debt Rule and the European debt criteria will not apply to Ireland until three years after exit from the EDP, i.e., from 2019. See Analytical Note 5 for an assessment of the *SPU 2014* debt forecasts in relation to debt targets.

4.3.2 Excessive Deficit Procedure (EDP) Exit

Ireland formally entered an EDP on 27 April 2009 with a deadline of 2013 for the closing of the excessive deficit. As shown in Table 4.2, two later EU Council decisions extended this deadline to 2014 and subsequently to 2015.

On the basis of the *SPU 2014* forecasts, Ireland's excessive deficit will be corrected in 2015, but the formal process to end the EDP will not be complete until the following year. A formal decision of the EU Council is required to end, or 'abrogate' an EDP even if the actual budget deficit is less than 3 per cent of GDP. For all countries that entered an EDP after November 2011 this decision is based on an EC assessment of whether the excessive deficit has been corrected in a sustainable manner and that the debt criteria are met.[136] As Ireland entered an EDP prior to the November 2011 reform of the *SGP* this second requirement will not apply in the abrogation assessment.

[136] This assessment is based on "notified", i.e., outturn, data provided by countries under the Maastricht Returns. The sustainable element is assessed by reference to EC forecasts.

Table 4.2: Timeline for the EDP[137]

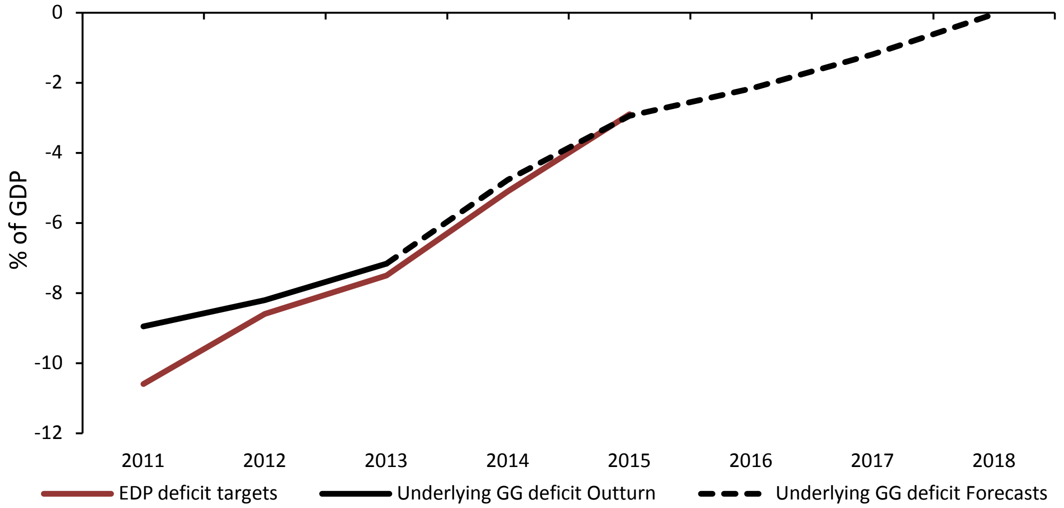
Date	
January 2009	The Irish Authorities provided an addendum to the October 2008 *Stability Programme* forecasting excessive deficits in each year to 2013 (Department of Finance, 2009).
18 February 2009	The EC assessed Ireland's deficit position to be exceptional but not temporary under terms of the *SGP*. Their report also took into account other factors including the debt position and medium-term outlook and concluded that that there was a need for enhanced surveillance under the EDP.
24 March 2009	The EC presented three reports to the EU Council, (i) establishing that the EC considered that an excessive deficit existed in Ireland, (ii) recommending an EU Council decision that an excessive deficit exists and (iii) proposing recommendations for the Council to make to the Irish authorities to end the excessive deficit.
27 April 2009	On the basis of the documents of 24 March 2009, the EU Council decided that an excessive deficit existed in Ireland. Furthermore, the EU Council recommended, on the basis of the EC report that the Irish authorities should end the excessive deficit by 2013. The Council also established a deadline of 27 October 2009 for effective action to be taken by the Irish authorities in implementing measures to achieve the 2009 deficit target.
2 December 2009	Following a proposal from the EC, the EU Council concluded that the Irish authorities had taken effective action in compliance with the Council recommendations of 27 April 2009 but that unexpected adverse economic events could be considered to have occurred in Ireland and had major unfavourable impact on the public finances. The EU Council postponed the deadline for the correction of the excessive deficit to 2014. A deadline of 2 June 2010 was established for determining effective action on the part of the Irish authorities.[138]
13 July 2010	On the basis of an EC assessment, the EU Council concluded that the Irish authorities had taken effective action in compliance with its previous recommendations.
7 December 2010	Following a proposal from the EC, the EU Council adopted revised recommendations extending the deadline for the correction of the excessive deficit to 2015.
16 December 2010	The Memorandum of Understanding on Specific Economic Policy Conditionality (the "Memorandum of Understanding") between the Commission and the Irish authorities was signed.
24 August 2011	The EC assessed that Ireland had made adequate progress towards the correction of the excessive deficit within the time limits set by the EU Council on 7 December 2010. As such, the EDP was held in 'abeyance', i.e., no further formal steps under the EDP were required.

[137] Relevant documents are available on the EC website at:
http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/ireland_en.htm

[138] Article 3(5) of EU Regulation 1467/97 provides for revised EU Council recommendations in exceptional circumstances where effective action is assessed to have been taken.

Figure 4.4 shows that the forecast of the General Government deficit-to-GDP ratio complies with the deficit path required under the EDP to 2015.[139] Post-2015, the General Government balance is forecast to converge to a balanced position by 2018, respecting the requirement that the correction of the excessive deficit will be sustained over the medium term.

FIGURE 4.4: GENERAL GOVERNMENT DEFICIT CEILINGS COMPARED WITH *SPU 2014* FORECASTS



Source: SPU 2014.

If the EC assess that the excessive deficit is not corrected by 2015 in a sustainable manner, the next step is for the Commission to undertaken an assessment of “effective action”.

This assessment would focus on the key budgetary recommendations made by the EU Council to Ireland in December 2010; (i) that specified, annual, General Government deficit ceilings be met to ensure a deficit of less than 3 per cent of GDP in 2015 and (ii) that a structural balance improvement (“fiscal effort”) of at least 9½ per cent of GDP over 2011-2015 be achieved. Furthermore, they recommended that further action be taken if necessary to ensure the 2015 deficit target is met.[140]

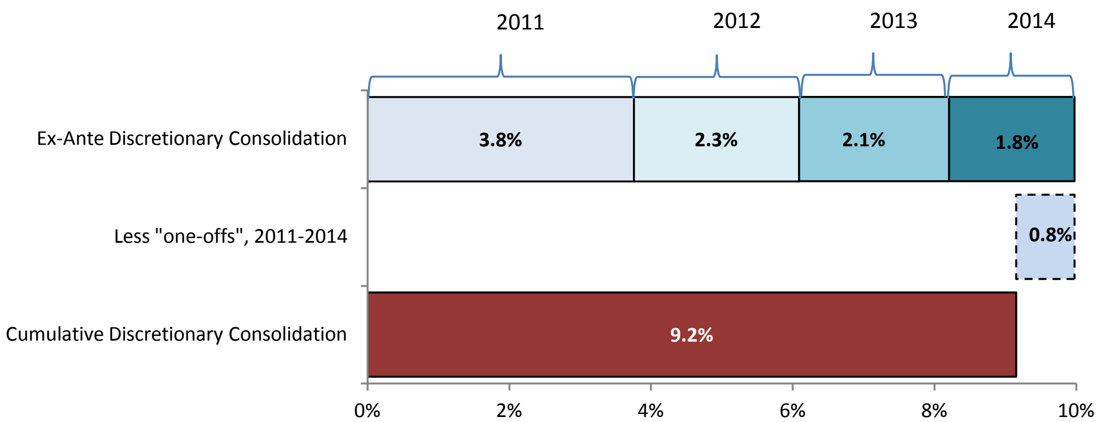
[139] The EDP recommendations specified that the target deficit path “... does not incorporate the possible direct effect of potential bank support measures in the context of the government's financial sector strategy [...]”. Adjusting the headline balance for these bank support measures gives the underlying deficit position.

[140] The EU Council also recommended that Irish authorities should “...seize opportunities, including from better economic conditions, to accelerate reducing the gross debt ratio towards the 60 per cent of GDP reference value”; that a budgetary advisory council and a fiscal responsibility law, including binding multi-annual ceilings, be established; and that further reforms to the social security system be introduced to reduce the risks to the long-term sustainability of the public finances.

On the basis of the *SPU 2014* estimates, the structural deficit is expected to be reduced by 5.7 percentage points between 2011 and 2015, below the recommended 9½ percentage point change (an annual average change of 1.9 percentage points). This "top-down" aggregate assessment does not take into account forecast errors arising since the EU Council recommendation. The EC have developed a methodology which attempts to compensate for the shortcomings of the simple "top-down" approach of assessing fiscal effort based on changes to the structural balance.[141] The latest assessment by the EC indicates the annual "adjusted fiscal effort" is expected to average 1.6 per cent a year, less than the adjustment required under the EDP.[142]

The "Two Pack" Code of Conduct requires that the analysis of fiscal effort should reference the achievement of expenditure plans, the implementation of discretionary revenue measures, and the composition of growth and its tax richness (see EC, 2013d). While elements of this analysis will be encompassed within the estimate of 'adjusted fiscal effort' more detailed evaluation is required, including a 'bottom-up' or 'narrative' style approach centred on the policy measures taken by government. *SPU 2014* states that "... discretionary consolidation measures implemented over the 2011-2014 period amount to around 9½ per cent of GDP."[143] Figure 4.5 shows the cumulative consolidation measures announced in the period 2011 to 2014, less the impact of one off measures.

FIGURE 4.5: CONSOLIDATION MEASURES 2011-2014,% OF GDP[144]



[141] This method accounts for the impact of: (i) revisions to potential output growth, (ii) the impact of revisions to the revenue elasticity arising from composition of economic growth or of revenue windfalls/shortfalls and (iii) the possible impact of other unexpected events.

[142] See EC (2014e).

[143] Page 39 of *SPU 2014*.

[144] Calculations are based on the sum of consolidation as a percentage of nominal GDP in each individual year.

This 'bottom-up' analysis of *ex ante* discretionary consolidation indicates some 9.2 percentage points of GDP has been undertaken. A detailed *ex post* assessment of individual measures would be required to determine if the planned revenue increases and expenditure reductions have been delivered in full. Given the uncertainty relating to estimates of the structural balance, a more detailed "bottom-up" assessment of fiscal effort is an important complement to any assessment of effective action.[145]

The final EC assessment of "effective action", and the consequent proposal to the EU Council, is a key determinant of whether a sanctions procedure is put in motion. If the Commission assessment shows effective action has been taken, and that targets were missed due to the existence of exceptional circumstances, then typically revised recommendations will be issued and the deadline for correcting the excessive deficit will be extended. If, however, effective action has not been taken the EDP will, on a decision by the EU Council, be 'stepped up'. This is the first step in a procedure that can end in the imposition of sanctions of up to 0.2 per cent of the previous year's GDP (0.2 per cent of Ireland's 2014 GDP level represents just over €0.3 billion). [146, 147]

In summary, the key target for 2015 is that the underlying General Government deficit must be below 3 per cent of GDP, and must be forecast by the EC to remain below 3 per cent into the medium term. If this excessive deficit is not corrected, an assessment of effective action is undertaken, which will include an analysis of the change in the structural balance ("top-down" assessment) and incorporate other measures of the 'fiscal effort' undertaken. This assessment is a key element in determining whether the deadline for correction of the excessive deficit is extended or whether sanctions are ultimately imposed.

[145] The most recent assessment by the EC (EC, 2014e) estimates that a discretionary fiscal effort of 9.9 per cent of GDP has been made between 2011 and 2014 on a 'bottom-up' basis.

[146] To impose a fine under the corrective arm, Reversed Qualified Majority Voting (RQMV) applies whereby a qualified majority of Member States is needed to reject an EC proposal. The Member State to which the vote applies is excluded. See Annex 7 (EC, 2013a) for a more detailed discussion of voting modalities.

[147] The EDP abrogation assessment will be based on data that incorporate the forthcoming revisions to the European System of Accounts (ESA) - see Chapter 2. In the absence of significant revisions to the nominal deficit, the impact of the upward revision to nominal GDP could reduce deficit to GDP ratio by less than 0.1 percentage points of GDP.