Summary Assessment

The recovery in the Irish economy has gathered momentum with stronger growth and lower unemployment benefitting the public finances. With positive Exchequer tax data for the early months of 2015, it is likely that the Government will succeed in bringing the deficit to below 3 per cent in 2015 and exit the Excessive Deficit Procedure (EDP) based on the 2015 outturn.

An important accomplishment of recent years has been the institutionalisation of a new budgetary framework. If respected, this framework provides an important safeguard against a return to the boom-bust cycle. In the context of Ireland's new *Medium-Term Budgetary Framework (MTBF)*, the *Spring Economic Statement (SES)* provides a useful innovation in Ireland's medium-term planning by setting out the broad policy stance for 2016 in advance of the budget in October. However, the implementation of the new budgetary framework shows weaknesses that could undermine its effectiveness.

The plan in *Stability Programme Update 2015 (SPU 2015)* for 2016 is not in line with the requirements of the domestic Budgetary Rule or the Preventive Arm of the *Stability and Growth Pact (SGP)* on a forward-looking basis. Until Ireland reaches its Medium-Term Objective (MTO) of a balanced budget in structural terms, the Government is required to lower the structural deficit by 0.6 per cent of GDP each year. *SPU 2015* sets out a plan that lowers this deficit by just 0.3 per cent of GDP in 2016, thus falling short of this requirement on a forward-looking basis. The rule to lower the structural deficit is supported by the Expenditure Benchmark (EB), which sets a limit on allowable expenditure growth. As described by the Council in April, the original method for calculating the EB contained an anomaly. This has now been corrected. However, the Government has introduced a further adjustment for "tax buoyancy" that goes against the letter and spirit of the EB rule. The Council does not include this tax buoyancy effect in its calculation of the EB and on this basis there is a considerable risk of non-compliance with the rule in 2016. The Council is strongly of the view that Government plans should be based on expected compliance with the fiscal rules and that the reasons for any deviation should be clearly explained.

The budgetary projections in *SPU 2015* do not present a full picture of the likely costs of demographic ageing and cost pressures in delivering existing programmes, as well as not taking into account explicit Government commitments to reduce taxes. The post-2016 budgetary projections in *SPU 2015* are based on mainly technical assumptions for government revenue and expenditure and as a result show over-compliance with the fiscal rules even though stated policy in the *Spring Economic Statement* is to target minimum rule compliance. The ratio of non-interest government spending to

GDP is projected to fall by over 5 percentage points between 2015 and 2020. This would appear very challenging to achieve while maintaining current services and meeting demands for increases in public services due to demographic and other pressures. Fully accounting for ageing and cost pressures would lead to a less favourable budgetary position over the medium term than shown in the *SPU 2015* projections. Any discretionary tax cuts would further increase the need to squeeze public spending over the coming years making it difficult to fund known future expenditure demands.

Post-2016, the medium-term projections for expenditure and tax revenue in *SPU 2015* do not fully meet the requirements of a medium-term fiscal plan as envisaged in the Government's budgetary framework. Under the Budgetary Frameworks Directive, plans should be provided both on a no-policy change basis and also based on "policies envisaged" by the Government. *SPU 2015* falls short of these requirements. Providing detailed budgetary plans as envisaged in the Directive is a more demanding task than current practice; however, a realistic projection for the medium-term budgetary position is essential in assessing the fiscal stance.

The move to annual revisions to the allowable expenditure growth under the Expenditure Benchmark has removed the multi-year anchor from the domestic medium-term expenditure ceilings. These multi-year expenditure ceilings represent a core component of the new domestic budgetary architecture. This system is not working effectively because the Government has consistently made adjustments to the ceilings. This undermines its value as an expenditure planning and control tool. The Government needs to clarify how the system of multi-year ceilings will operate under the revised EB framework.

Alternative models for estimating Ireland's medium-term potential growth should be developed. It is essential that the Government's macroeconomic forecasts for the medium term are well-founded to provide a sound basis for setting the public finances on a sustainable path. Ensuring this requires the development of a fuller picture of the supply-side of the economy, outside of the EC framework required to measure compliance with the fiscal rules. To this end, the Department of Finance should develop supply-side estimates of potential growth that are aligned to their forecasts and actual view of the medium term.