Summary Assessment

The Irish economy is experiencing a strong economic recovery, but faces numerous uncertainties about the pace of future growth. A confluence of favourable external developments along with a recovery in domestic economic activity is driving rapid growth in the Irish economy, faster than that of its EU neighbours. Notwithstanding the positive central growth scenario, numerous fragilities in the external environment and domestic risks mean that these growth prospects are far from assured. Following prudent fiscal policy during relatively good times will help ensure a sustainable growth path and limit the need for austerity measures in any future downturn.

While the planned fiscal stance from 2016 meets the requirements of the rules, the Council assesses that the decision to loosen the fiscal stance in 2015 was a deviation from prudent economic and budgetary management. *Budget 2016* showed an increase in gross government expenditure for 2015 of €1.5 billion compared to the projection in *SPU 2015.* The additional spending absorbs the majority of the better than expected tax revenues in 2015 and results in a significantly more expansionary fiscal stance than earlier planned by the Government. This keeps the deficit and debt higher than could have been achieved and provides an unnecessary stimulus to an already fast-growing economy. Using unexpected incoming revenues to fund permanent increases in expenditure at a time of strong economic growth has worrying echoes of past fiscal policy errors and goes against the spirit of the new budgetary framework. In addition, an unusually large surge in corporation tax receipts accounts for a large proportion of the better than expected tax revenue in 2015. While the Revenue Commissioners have noted that the majority of the corporation tax overperformance in 2015 is not due to one-off factors, until there is more certainty as to the sustainability of this gain, the Council is concerned about the decision to use unexpected revenues to increase expenditure.

Despite starting from a less favourable position than could have been achieved in 2015, the fiscal stance for 2016 and later years is consistent with the deficit and debt remaining on a downward path. The Council's September 2015 *Pre-Budget Statement* assessed that the planned budget package for 2016 in the *Spring Economic Statement (SES)* was within the range of prudent policies. *Budget 2016* contained a €1.5 billion package of planned spending increases and tax cuts for 2016 in line with the package proposed in the Government's *SES* in April. As this package comes on top of the increase in spending for 2015, the fiscal stance in 2016 is less prudent than planned in the *SES*. Nevertheless, government revenues in 2016 are forecast to grow at a higher pace than non-interest government spending by some margin, which is appropriate given the on-going recovery. The projections signal an intention to comply with the Preventive Arm of the *Stability and Growth Pact (SGP)* and the domestic Budgetary Rule from 2016, which would be consistent with prudent policy.

***Budget 2016* did not address previously identified weaknesses with the Government's medium-term fiscal plans beyond 2016.** The Government's projections for the deficit and debt in *Budget 2016* from 2017 onwards are based on mainly technical assumptions and do not present a realistic picture of the public finances over the medium term. The Budget forecasts again show an implausibly large decline in the ratio of non-interest government spending to GDP over the medium term. The forecasts fail to show how the Government intends to use the fiscal space that will be available in the coming years to reduce the deficit and debt while implementing its stated policy commitments and accommodating spending pressures. Analysis in this Report shows that funding current levels of public services in future years and accommodating likely expenditure needs would absorb the majority of the estimated fiscal space available after 2016. Further tax cuts would make it very difficult to fund these expenditure pressures while complying with the rules.

The system of multi-year expenditure ceilings – a core component of the Government's budgetary framework – is not being implemented effectively owing to continuous upward revisions to spending. The failure to respect expenditure ceilings raises the risk of funding increases in expenditure from windfall revenue sources. The domestic Medium-Term Expenditure Framework should be strengthened to ensure that multi-annual planning becomes a central element of the budget process.

Budget projections imply compliance with the relevant fiscal rules in 2016 but there is limited room for manoeuvre. Under the Budget forecasts, the Expenditure Benchmark will be complied with in 2016 but with no margin for overruns. Any expenditure increases similar to those announced for 2015 would likely lead to a breach of the EU Expenditure Benchmark. Moreover, there has been a sustained pattern of overruns in health spending in recent years. The European Commission projects that spending will be 0.4 per cent of GDP above the Expenditure Benchmark in 2016, and consequently note that there is a risk of a deviation from this Benchmark next year. The risk of non-compliance is heightened in light of the weaknesses of the domestic expenditure ceilings designed to operationalise the Expenditure Benchmark.