3. Assessment of Budgetary Forecasts

Key Messages

- *Budget 2017* projections for the General Government deficit in 2016 show an improvement on a headline basis of 1 percentage point of GDP. However, excluding the one-off AIB transaction in 2015 the deficit shows an improvement of just 0.1 percentage point. The primary balance (excluding the AIB transaction) is forecast to deteriorate by 0.1 percentage point in 2016 as rising non-interest expenditure is expected to exceed revenue increases.

- The *Summer Economic Statement* revised up the Exchequer tax revenue forecast for 2016 by €0.9 billion, mainly due to an upward revision to corporation tax receipts. Within-year expenditure increases for 2016 of €0.85 billion see most of the upward revision to corporation taxes in 2016 spent within the year. Given the volatility and unpredictability of corporation tax receipts, care should be taken in using unanticipated revenues from this source to fund difficult to reverse current expenditure and taxation measures.

- Increases in current expenditure for 2017 in *Budget 2017* mainly in Social Protection, Health and Education are estimated to have additional carryover costs for 2018 of €0.47 billion. Moreover, tax cuts introduced for 2017 have a further estimated carryover cost of €0.17 billion in 2018. The total carryover cost of €0.65 billion will have to be met from the estimated net fiscal space of €1.2 billion for 2018, leaving limited scope for new tax reductions and spending increases.

- The Council's stand-still expenditure analysis suggests that accommodating estimated demographic pressures and the cost of maintaining real public services and benefits would absorb almost the full amount currently budgeted for expenditure increases from 2017-2021. This analysis is a useful input for helping to inform policymakers of the scope for new spending or tax initiatives, in the absence of efficiency gains or cuts to services and real benefits.

- The medium-term fiscal forecasts in *Budget 2017* take account of the planned use of the available fiscal space over the medium term. This welcome improvement makes the projections for expenditure and tax revenue more realistic than previous purely technical projections published by the Department of Finance by aligning them to the Government's stated policy. Nonetheless, serious issues with expenditure management and planning remain to be resolved. The limited implementation of the system of expenditure ceilings impedes expenditure planning and raises the risk of funding increases in expenditure from windfall revenue sources.

3.1 Introduction

This Chapter assesses the latest set of budgetary projections published in *Budget 2017*. Section 3.2 examines developments in the main fiscal aggregates in 2016. Section 3.3 assesses the projections for revenue and expenditure contained in *Budget 2017* for 2017 to 2021, and provides an update of the Council's stand-still expenditure scenario. The final section provides an analysis of the sensitivity of the budgetary projections to changes in macroeconomic conditions, as well as providing an assessment of the key risks to the public finances.

3.2 Budgetary Projections for 2016

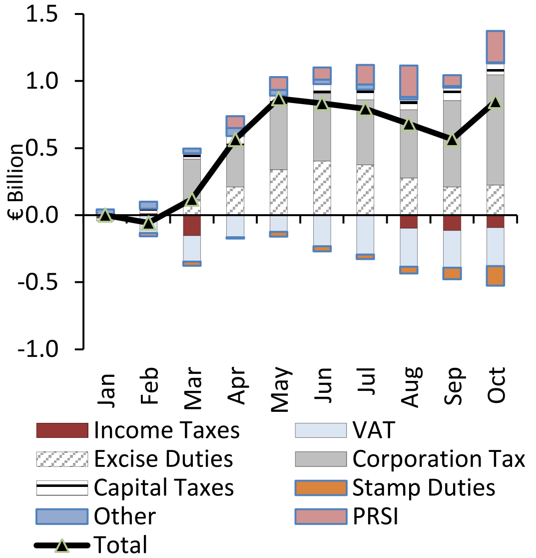
3.2.1 Exchequer Revenue in 2016

Projections for Exchequer tax revenues set out in *Budget 2017* for 2016 remain unchanged from the June *SES* forecast of €48.1 billion, which itself represented an upward revision to the *Budget 2016* forecast of €0.9 billion. The expected tax take for this year represents a 5.6 per cent increase on the 2015 outturn. The upward revision to tax revenue between *Budget 2016* and *Budget 2017* was made up mostly of corporation tax. Income tax and PRSI receipts for 2016 were also revised up compared to the *Budget 2016* forecast, though forecast VAT receipts were revised down following a weak performance early in the year.

Corporation tax (CT) receipts in 2015 were €6.9 billion, exceeding the prior year's receipts by 49 per cent as well as the forecast (by 50 per cent). CT receipts to end-October 2016 continue to perform strongly and are likely to at least match the 2015 outturn, suggesting that there has been no unwinding of the exceptional increase in receipts in 2015. However, as highlighted in previous *FARs* and in analytical work by Casey and Hannon (2016),[1] the volatility and unpredictability of CT receipts represents a significant risk. Some 41 per cent of CT in 2015 was paid by only ten companies. Furthermore, CT is expected to account for 16 per cent of total tax revenue in 2016, while also accounting for a disproportionate share of overall tax revenue volatility (See Box C below) as well as some 70 per cent of the overperformance of total tax revenue in 2015. The concentration of CT receipts is one of the fiscal risks identified by the Department of Finance in *Budget 2017* (see Table 3.1). For these reasons, care should be taken in using unanticipated revenues from this source to fund difficult to reverse current expenditure and taxation measures.

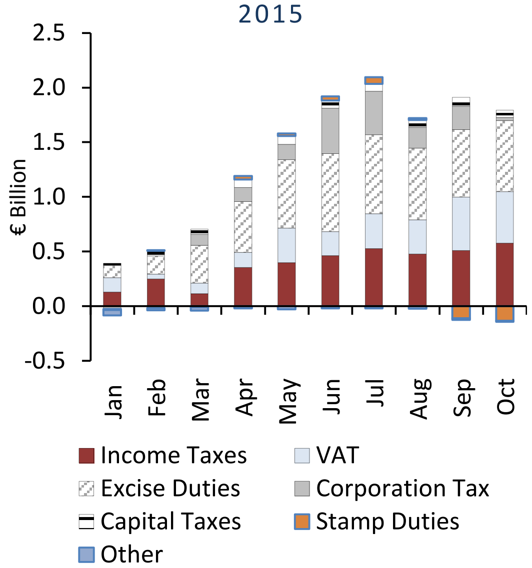
[1] Casey, E. and Hannon, A. (2016). "Challenges Forecasting Irish Corporation Tax". IFAC Analytical Note No. 10

FIGURE 3.1:TAXES AND PRSI RELATIVE TO CUMULATIVE PROFILE IN 2016



Source: Department of Finance.
Note: "Other" is the sum of Local Property Tax, Customs and other. The forecasts are based on the *Budget 2016* profile.

FIGURE 3.2: CUMULATIVE EXCHEQUER TAX RECEIPTS TO END-OCTOBER 2016 RELATIVE TO 2015



Source: Department of Finance.
Note: "Other" is the sum of Local Property Tax, Customs and other.

On a cumulative basis to end-October (Figure 3.1), income tax and VAT are below expectations. VAT receipts are below the forecast in *Budget 2016* by €280 million and are expected to fall short of this forecast by €230 million by end-December primarily due to weaker price inflation than forecast in *Budget 2016*.[2] Income tax was largely on profile up to July 2016. In August, receipts fell short of the *Budget 2016* forecast but have been close to the monthly profile in September and October. Stamp duties are also marginally below profile. However, this underperformance is more than offset by strong CT receipts, which are a cumulative €820 million above profile at the end of October. Excise receipts are up by €220 million against the cumulative profile to the end of October. The Department of Finance has noted the front-loading of receipts ahead of plain tobacco packaging legislation. This process peaked in June, and is expected to continue to unwind over the coming months, with overall excise duty receipts projected to come in on profile by the end of the year according to *Budget 2017.*

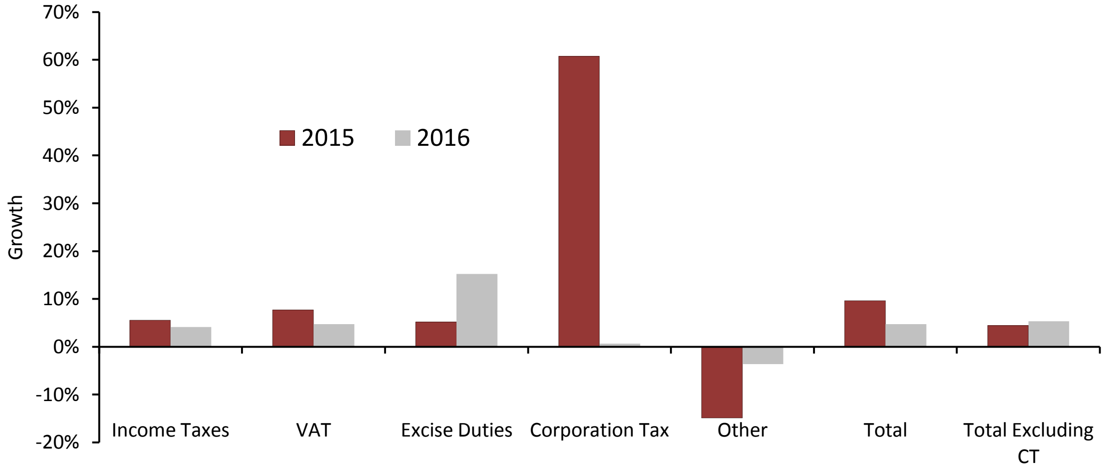
Assessing Exchequer tax revenues relative to the published profiles offers limited insights given that these profiles do not reflect the Department of Finance's most recent forecast for overall tax revenue from *Budget 2017*. Therefore, Figure 3.2 shows the cumulative growth in tax receipts (in millions of Euro) in each month to end-October 2016 relative to the same period in 2015. On this basis, taxes generally show an excess over 2015 in the year to date. Figure 3.3 shows total

[2] See *Budget 2017,* page C.20

Exchequer tax revenue in the first ten months of 2016 compared to the same period in 2015. There is some evidence of a slowdown in tax revenue growth in 2016. Overall tax revenue for the first ten months of the year grew by 4.7 per cent compared to 9.6 per cent growth for the same period in 2015. This is due to the slower growth in CT revenue in 2016. Excluding corporation tax, the growth of Exchequer Tax revenues is marginally higher in 2016 compared to 2015.

Despite continued employment growth this year, income taxes receipts to end-October 2016 have grown at a slower rate than in 2015. Moreover, the forecasts for the macroeconomic drivers of income taxes, namely non-agricultural wages and earnings, are broadly unchanged in *Budget 2017* relative to those contained in the previous budget. *Budget 2017* refers to an underperformance of DIRT and an underestimation of the first-year cost of the reductions in the USC in *Budget 2016* as the main source of the underperformance. [3] For *Budget 2017*, the Revenue Commissioners published revised estimates of the impact of reductions to income tax and USC that allocate more of the cost of reductions in these taxes to the first year rather than to a full-year impact.

FIGURE 3.3: YEAR-ON-YEAR EXCHEQUER TAX REVENUE PERFORMANCE TO END-OCTOBER



Source: Department of Finance.
Note: "Other" is the sum of Stamp Duties, Local Property Tax, Customs, Capital Gains, Capital Acquisitions and other taxes.

[3] The Revenue Commission used fixed proportions of first year splits for PAYE and self assessed individuals going back a number of years. Based on an assessment of payment data earlier in the year, Revenue decided to update these proportions, resulting in change in the USC estimate. A tax change has both a first year cost in the year a measure is introduced and a carry-over cost in the following year, which together account for the 'full year' cost of a measure. In recent years the first and full year costs of a measure have been apportioned as follows: PAYE – 78 per cent first year; self-employed – 30 per cent first year. However following analysis of recent trends, the first year costs was increased to the following: PAYE – 89 per cent; and self-employed – 56 per cent. It should be noted that this revision does not impact on the total cost/yield of a measure. It only changes the apportionment of the Exchequer impact over the first and second years in which it comes into effect. A summary of the changes is available here (see page 42): http://www.finance.gov.ie/what-we-do/tax-policy/publications/reports-research/income-tax-reform-plan

On VAT, *Budget 2017* cites lower than anticipated inflation as the cause of the weaker VAT receipts in 2016 (both on an annual basis and relative to the forecast in *Budget 2016)*. This is reflected in the *Budget 2017* forecast for growth in the personal consumption deflator for 2016 of 1.1 per cent, which compares to an initial forecast of 1.8 per cent in *Budget 2016.*

In terms of other revenue sources, *Budget 2017* forecasts indicate that non-tax revenues for 2016 will be €635 million lower than predicted in the June *SES*. *Budget 2017* notes that this predominantly relates to lower-than-anticipated dividends from semi-state bodies and financial institutions and lower transfer payments from the Local Government Fund to the Exchequer. Lower non-tax revenue from these sources is expected to be partially offset by offset by higher than expected capital receipts of €0.3 billion, the bulk of which relates to a loan repayment from the IBRC special liquidators. In 2016, €1.6 billion was realised from the redemption of Contingent Convertible capital notes (CoCos) in AIB. As a financial transaction, the bulk of the proceeds from the CoCo redemption have no effect on the General Government position, with only the interest earned on the notes improving the GG balance. See Appendix E for a more detailed examination of the GG sector.

Box C: The Disproportionate Impact of Corporation Taxes

Corporation tax receipts average close to one in every eight Euro of Exchequer tax revenues each year (Table C1). This Box highlights how Corporation Tax (CT) receipts have also had a disproportionately large impact on recent developments in overall Exchequer tax revenues.

Table C1: The Share of Exchequer Tax and General Government (GG) Revenues accounted for by Main Tax Heads, 2001-2015

	% Total Exchequer Tax (2001-2015)	% Total GG Revenue (2001-2015)
Customs	0.6	0.4
Excise Duty	13.3	8.4
Capital Taxes	3.9	2.4
Stamps	4.7	3.0
Income Tax	34.4	21.8
Corporation Tax	13.3	8.5
Valued Added Tax	29.5	18.8
Other	0.2	0.2
Total Exchequer Tax	100.0	63.5
Total GG Revenue	-	100.0

Sources: *Department of Finance; CSO; and internal IFAC calculations.*

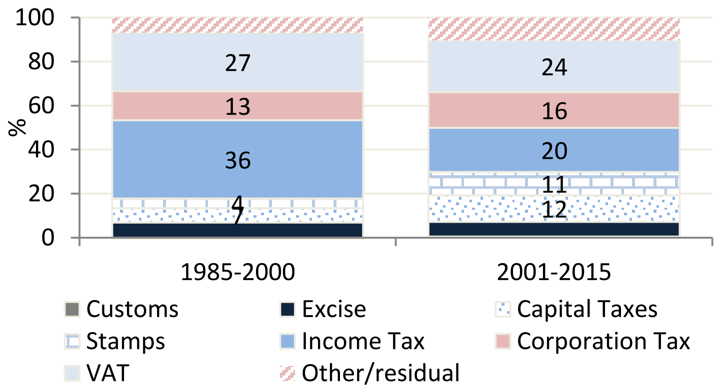
Variance Decomposition

A simple decomposition of tax revenues shows that the volatility of CT receipts has resulted in large contributions to the variability of total Exchequer tax receipts in recent years. In order to examine the influence of individual tax heads on the variability of total tax returns, we consider a simple portfolio variance decomposition of the form:

$$PCV_{ip} = \frac{x_i C_{ip}}{V_p}$$

where PCV_{ip} is the Percentage Contribution to the Variance of total tax changes (or portfolio "p" returns) attributable to a given tax head "i"; x_i is the share of the tax head of interest; C_{ip} is the Covariance of tax head i changes with total tax changes; and V_p is the Variance of total tax changes.[4]

FIGURE C1: SHARE OF TOTAL TAX VARIATION FROM INDIVIDUAL TAX HEADS, SELECTED PERIODS (%)



Sources: *Department of Finance; and internal IFAC calculations.*

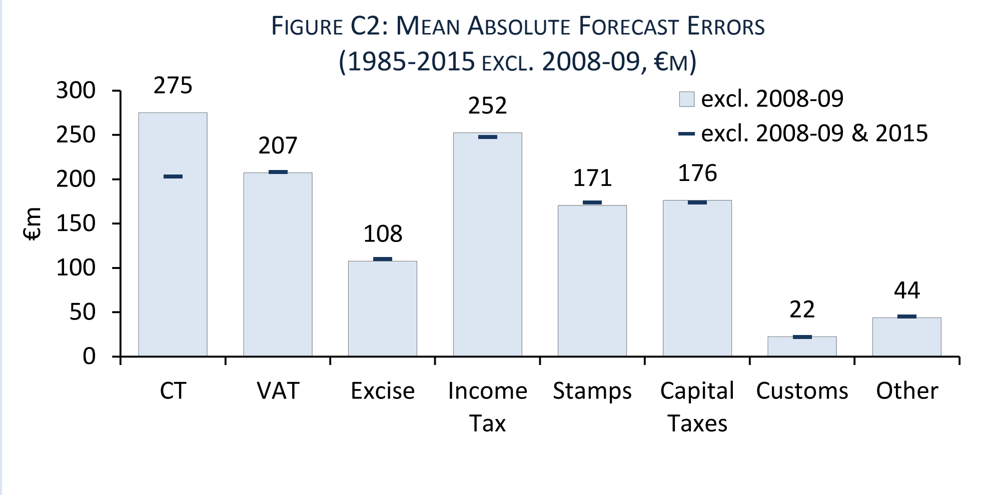
Figure C1 shows the decomposition of the variance of total annual Exchequer tax changes. Notwithstanding their relatively smaller size, CT receipts have tended to account for relatively larger shares of annual variance in tax revenues over the past three decades. For the most recent period assessed here, 2001-2015, CT accounted for 16 per cent of total tax variation, whereas VAT and income tax (the largest tax heads) accounted for 24 per cent and 20 per cent, respectively. Capital taxes and stamps represented a combined 23 per cent of the variance of tax returns during the same period reflecting the impact of the property bubble.

FORECAST ERROR DECOMPOSITION

It is not just the scale of the variation in CT receipts that causes difficulties, but the unpredictability of these changes. The typical errors on tax forecasts for CT receipts are disproportionately large.

Figure C2 decomposes total tax forecast errors one year ahead (comparing forecasts from Budget day of the previous year to final outturns) since 1981. Excluding the crisis years 2008-2009 when unusually large forecast errors were seen across most tax heads, CT represents the largest mean absolute error on forecast revenues at €246 million on average as compared to €234 million for income tax and €193 million for VAT. The two latter tax heads, however, have accounted for typically 2-3 times more of the share of annual revenues when compared to CT over the past three decades. Even if the 2015 outturn is also excluded, the typical error observed is still as large as that evident for VAT.

[4] Changes refer to year-on-year percentage changes of annual tax receipts.

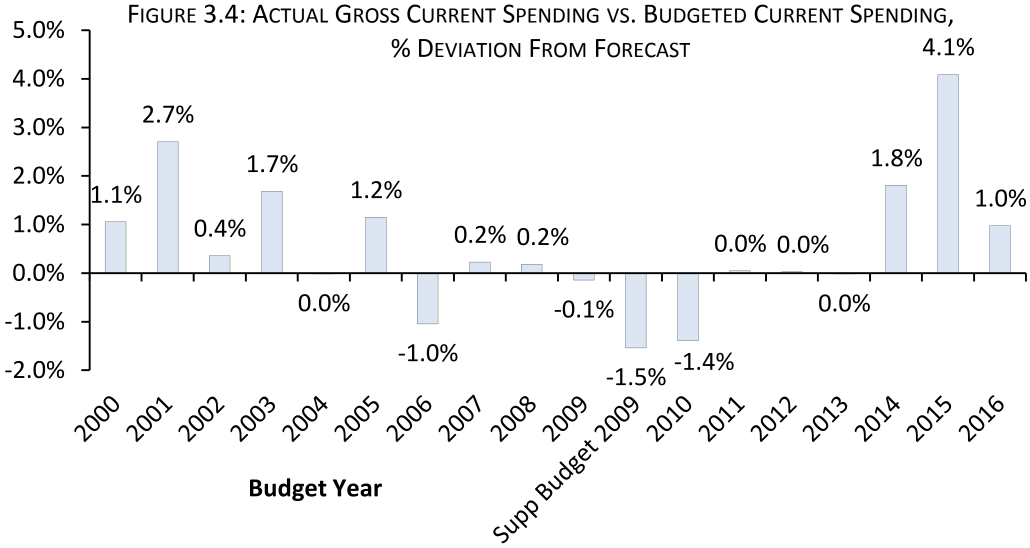


3.2.2 EXPENDITURE IN 2016

For 2016, total gross voted expenditure on an Exchequer basis is expected to be €56.1 billion, €0.31 billion (0.6 per cent) higher than projected in the June *SES.* Of this, €0.2 billion in additional capital expenditure has been allocated for education and the repair of infrastructure damaged in flooding earlier this year, and a further €0.11 billion for an 85 per cent payment of the Christmas bonus for long-term social welfare recipients.[5] Coupled with the additional €0.54 billion increase in expenditure announced in June, total gross voted expenditure for 2016 is to exceed the initial *Budget 2016* forecast by €0.85 billion. Figure 3.4 below shows the deviation of actual expenditure from the initial Budget estimate in percentage terms. Although the deviation in 2016 is smaller than last year (the 2015 deviation was the largest in over a decade) and overall spending growth in 2015 and 2016 is modest, a pattern of expenditure overruns has re-emerged since the ending of the EU/IMF Programme in 2013. The overruns since 2013 are mainly due to higher spending in the health area than initially budgeted for.

[5] The total cost of this measure is €0.22 billion; however, half of the cost is expected to be met from savings in other Departments by the end of 2016.

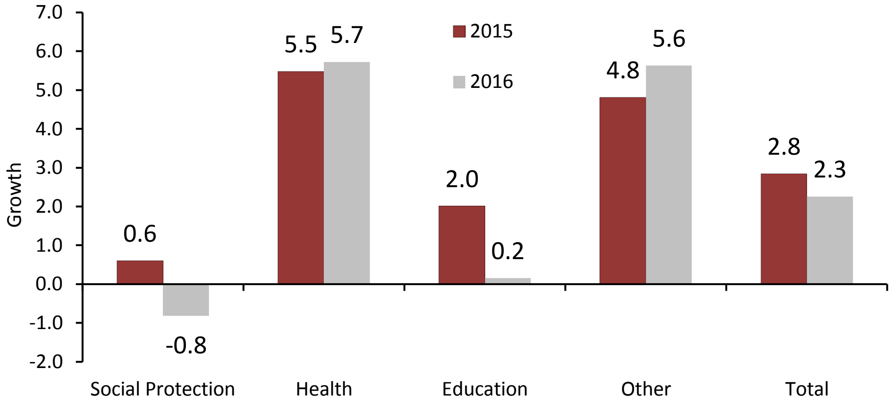
FIGURE 3.4: ACTUAL GROSS CURRENT SPENDING VS. BUDGETED CURRENT SPENDING, % DEVIATION FROM FORECAST



Source: Department of Finance.
Note: The figure compares the budgeted gross voted current spending on an Exchequer basis to the actual outturn. The *Budget 2015* gross voted spending figure is adjusted to reflect the disestablishment of the HSE Vote.

Figure 3.5 shows year-on-year growth in gross voted current expenditure in 2015 and 2016 by the main Departments. Expenditure growth in the Department of Health in 2016 is expected to be higher than in 2015, largely reflecting the additional allocation of €500 million made in June 2016. Elsewhere, reflecting falling unemployment, expenditure in Social Protection is expected to be down slightly in annual terms. The main increases in expenditure in the “other” category come from higher spending in the Department of Housing, Planning, Community and Local Government (€340 million), with smaller increases in Justice, Agriculture and Arts. Overall current expenditure growth is projected at 2.3 per cent in 2016, marginally lower than the 2.8 per cent recorded in 2015.

FIGURE 3.5: YEAR-ON-YEAR GROSS VOTED CURRENT EXPENDITURE GROWTH TO END-DECEMBER



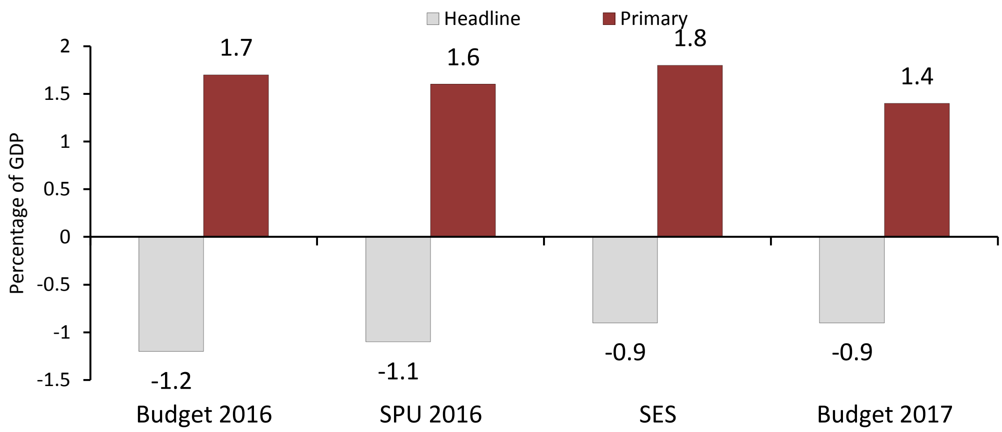
Source: Department of Public Expenditure and Reform databank.
Notes: The expenditure figures are adjusted to take account of the disestablishment of the HSE Vote.

On non-voted expenditure, debt interest costs in 2016 are €0.2 billion lower than forecast in *Budget 2016*. The estimate of Ireland's EU budget contribution for 2017 has increased, mainly due to the measured increase in Ireland's Gross National Income (GNI) in the National Accounts published in July. The estimated EU Budget contribution is €2.1 billion in 2016 and €2.4 billion in 2017. The EU budget contribution increased relative to the *SPU* outlook by €70 million and €280 million in 2016 and 2017, respectively.

3.2.3 General Government Balance in 2016

Budget 2017 forecasts a headline deficit of 0.9 per cent of GDP, a one percentage point improvement over the outturn for 2015. However, stripping out the 2015 one-off AIB preference share transaction shows an improvement in the deficit of only 0.1 percentage point of GDP 2016, and a worsening of the primary balance (excluding some financial sector measures) by 0.1 percentage points of GDP.[6] The deterioration in the primary balance in 2016 reflects a projected increase in non-interest government spending that exceeds the increase in General Government revenue in 2016. General Government revenue in 2016 is negatively impacted by a decline in property income of €0.7 billion. This is mainly due to lower dividend payments from semi-state bodies and from AIB. Figure 3.6 below shows the evolution of the forecasts for the General Government headline and primary balances as shares of nominal GDP. As noted, tax and PRSI revenue was revised up by €1 billion in the July 2016 *SES.* Despite this, Figure 3.6 shows that *Budget 2017* forecasts a smaller primary budget surplus than in *Budget 2016.*

Figure 3.6: General Government Balance Forecasts for 2016, (% GDP)



Source: Department of Finance.

[6] Assuming the €850 million increase in current and capital expenditure announced during 2016 had not taken place, the General Government balance would have been 0.2 percentage points of GDP lower in both 2016 and 2017. This is based on the Council's Fiscal Feedbacks Model.

3.3 *Budget 2017* Forecasts For 2017 Onwards

3.3.1 Expenditure

Budget 2017 introduced certain expenditure increases for 2017 in the areas of Health, Education, Social Protection, Housing, and Children and Youth Affairs. The Department of Public Expenditure and Reform calculates that to fund these increases in expenditure on a full-year basis in 2018, an additional €473 million will be required over and above the cost in 2017.[7] The estimated fiscal space for 2018 in *Budget 2017* is €1.2 billion. While this amount is subject to revision as the horizon shortens, the approximately €0.5 billion cost will have to be met from the fiscal space before any new measures are announced unless savings are found elsewhere. Furthermore, these known future costs are not included in the Ministerial Expenditure Ceilings (MECs) for 2018 and later years. Instead, the projections in the *Expenditure Report* include an aggregate category labelled "unallocated resources".[8] It is not clear why the full-year cost of the expenditure increases in *Budget 2017* has not been factored into the expenditure ceilings for 2018 and later years.

As noted earlier, *Budget 2017* allocated an additional €0.31 billion in expenditure for 2016 for capital spending and the Christmas bonus for social welfare recipients. While the capital expenditure has been included in the detailed expenditure estimates for 2017, it appears that the remaining €0.11 billion for the Christmas Bonus is not included in the expenditure estimates for 2017. Having been abolished in 2009, the Christmas bonus was partially reintroduced in 2014 with the payment of a 25 per cent bonus. A 75 per cent bonus was paid in December 2015 and *Budget 2017* increased the payment to 85 per cent in 2016. Given the phased reintroduction of the payment since 2014, spending estimates should make an allowance for this, except if the Government does not intend to pay it in the future.

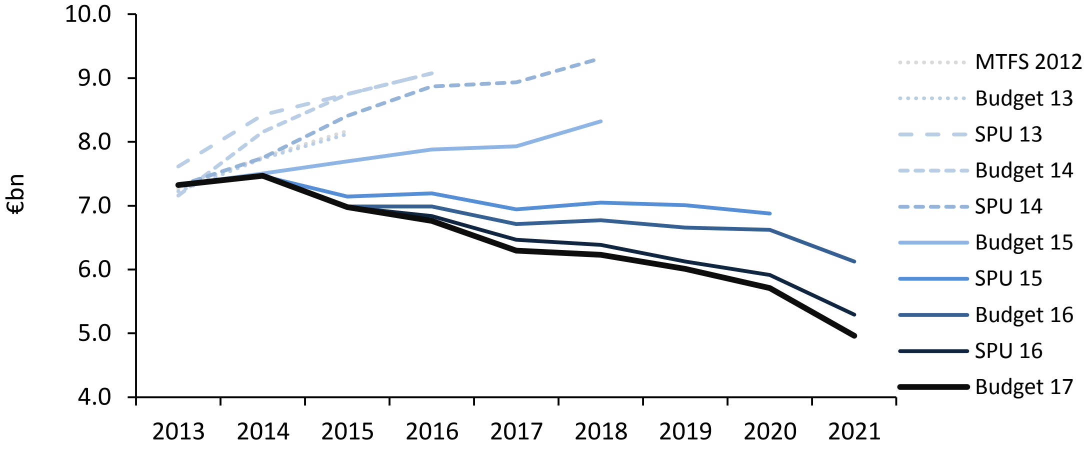
Over recent years, the public finances have benefitted from falling interest costs on government debt. Figure 3.7 below shows how interest costs have progressively improved amid the low interest rate environment globally, but also as the economy improves, debt is restructured and IMF loans were repaid. While debt costs are projected to fall over the forecast horizon in *Budget 2017*, there are risks from potential exogenous shocks to the Irish economy. These could arise, for example, from Brexit, changes in US monetary policy or another recession in the Euro Area, any of which could have a substantial negative impact on Irish government borrowing costs. The Department of Finance attaches a low likelihood to the risk of less favourable bond market conditions. Given the

[7] Budgetary measures often have both a first year cost in the year they are introduced and a carryover cost in the following year, which together account for the 'full year' cost of a measure. Table 9 of the *Expenditure Report* shows a carryover impact of €473 million for current expenditure measures introduced in *Budget 2017.*

[8] *Expenditure Report 2017* (page 36) states that the carryover cost of the *Budget 2017* expenditure measures would need to be met from the unallocated resources in 2018 or savings/reprioritisation of expenditure identified during the spending review in 2017.

exceptionally low level of interest rates currently and the likelihood that rates will eventually increase, a medium likelihood would be more appropriate. The relatively long maturities on much of the outstanding stock of government debt, the vast majority of which is held at fixed interest rates, should insulate somewhat against a mild interest rate shock.[9] However, given that the stock of debt remains high, and there are still substantial maturities of existing debt expected in coming years that will have to be rolled over, a more substantial interest rate shock could have serious implications for the public finances.

FIGURE 3.7: NATIONAL DEBT CASH INTEREST PROJECTIONS 2012-2016



Sources: Department of Finance; internal IFAC calculations.

In previous budget and SPU publications, the medium-term fiscal projections were purely technical in nature, with expenditure and tax revenue forecasts not incorporating the planned use of the estimated available fiscal space under the Government's stated policy. As argued by the Council, the Government's forecasts for the debt and deficit therefore did not present a realistic estimate of the likely path of the public finances over the medium term, showing a more favourable fiscal position than planned by not allowing for spending and tax measures. In *SES 2016,* the Department of Finance improved the presentation of the budgetary forecasts by publishing *ex post* fiscal projections which show the path for revenue, expenditure and the overall debt and deficit assuming the estimated fiscal space is allocated to tax and expenditure measures and the proposed Rainy Day Fund, as envisaged by the Government. The forecasts for expenditure in *Budget 2017* continued the progress made in the *SES* by publishing updated *ex post* forecasts for 2017-2021 (see Chapter 1, Box A).

[9] At end-June 2016, around 92.5 per cent of gross national debt was at fixed rates, including debt where hedging had been undertaken (Office of the Comptroller and Auditor General, 2016), while the weighted average maturity on outstanding Irish Government bonds and programme funding is estimated at 11.7 years (NTMA, 2016).

While the recent progress is welcome, further improvements are needed to enhance the quality of the medium-term expenditure forecasts presented in the budget and in expenditure reports. In particular, the Department of Finance/Department of Public Expenditure and Reform continue to present a single forecast for Government expenditure over the medium term. As argued by the Council in previous *Fiscal Assessment Reports,* an estimate of the cost of maintaining today's level of public services and benefits in real terms in future years should be an important input into the expenditure planning process.

The Council's stand-still expenditure scenario (Box D) aims to provide an estimate of these bottom-up pressures given a full accounting for demographics, inflation and the Lansdowne Road Agreement. Including the *Budget 2017* package for 2017*,* the total amount of net fiscal space from 2017-2021 is estimated at €10.5 billion in the budget. Of this, €4.4 billion has been allocated to current expenditure increases, with €3 billion for the proposed Rainy Day Fund and the remainder to be split between capital spending and tax reductions. The stand-still analysis suggests that accommodating estimated demographic pressures and the cost of maintaining real public services and benefits would absorb almost the full amount currently budgeted for expenditure increases from 2017-2021 (Figure D1).

As shown in Table D1, under the stand-still scenario, total current spending would rise by €6.8 billion from 2017 to 2021 accounting for demographic pressures and increases in expenditure in line with inflation as forecast by the Department of Finance. The Government has pre-committed expenditure increases amounting to €2.6 billion for the Lansdowne Road Agreement (2017 and 2018) and to meet demographic pressures (2017-2021). Subtracting the €2.6 billion pre-committed spending from the €6.8 billion estimated stand-still cost implies that €4.2 billion of the available net fiscal space would be needed to fully account for demographic pressures and the additional cost of maintaining real services and benefits. The amount of overall net fiscal space allocated to expenditure increases from 2017-2021 (€4.4 billion) is close to the estimated stand-still cost (€4.2 billion).

Box D: Stand-Still Expenditure Scenario

This Box updates the medium-term scenario for government expenditure contained in IFAC's June 2016 *Fiscal Assessment Report*. A description of the methodology used to produce the scenario is provided in Box E of the June *FAR*.

It is important to note that the stand-still scenario is not intended as an alternative expenditure forecast to that outlined in *Budget 2017.* Rather, the stand-still approach serves as an illustrative exercise which projects the cost of maintaining today's level of public services and benefits in real terms given demographic costs and price changes. Such information should provide a crucial input into the ultimate expenditure forecasts which are produced for policy purposes. It is important to stress that while the stand-still allows for price and wage changes, there is no suggestion on the Council's part that automatic indexation should be adopted as policy.

IFAC's stand-still analysis does not take into account possible efficiency gains or Government policy changes that could deliver expenditure savings over time.[10] Along with the approach developed by the Council, alternative methodologies could be used to estimate a stand-still scenario.

The current expenditure projections in *Budget 2017* make allowance for certain pre-committed nominal spending for demographic pressures in Health, Education and Social Protection and the Lansdowne Road Agreement (until 2018). Additional current spending for new programmes or to maintain the real value of existing services would need to be funded out of the estimated net fiscal space.

Table D1: Comparison of Estimated Stand-Still Current Expenditure and Allocated Fiscal Space

		2017	2018	2019	2020	2021	Total (2017-2021)
Gross voted current spending - IFAC Stand-still (A)	Annual change, € billion	1.2	1.2	1.4	1.5	1.5	6.8
of which: Demographics	€ billion	0.6	0.4	0.6	0.6	0.6	2.7
Prices	€ billion	0.6	0.8	0.9	0.9	0.9	4.1
Budget 2017 pre-committed gross voted current expenditure (B)	€ billion	0.7	0.6	0.4	0.4	0.5	2.6
of which: Demographics	€ billion	0.4	0.3	0.4	0.4	0.5	2.0
Lansdowne Road Agreement	€ billion	0.3	0.3	0.0	0.0	0.0	0.6
Amount of net fiscal space needed to stand still C=(A-B)	€ billion	0.5	0.6	1.0	1.1	1.0	4.2
Net fiscal space allocated to current expenditure (*Budget 2017/SES 2016*) (D)	€ billion	0.8	0.6	1.0	1.0	1.0	4.4
Difference Between Net Fiscal Space Needed to Stand still and Net Fiscal Space Allocated to Current Expenditure Increases E=(D-C)	€ billion	0.3	0.0	0.0	-0.1	0.0	0.2

Notes: Rounding may affect totals.

Table D1 below shows a comparison between the annual increases in current expenditure in the stand-still scenario, the pre-committed spending in *Budget 2017* and the overall amount of net fiscal space allocated to spending in *SES 2016*. Taking 2018 as an example, in the stand-still scenario the increase in spending required in that year to maintain real benefits and services is estimated at €1.2 billion (A). The Government has included €0.6 billion of pre-committed spending, half for the

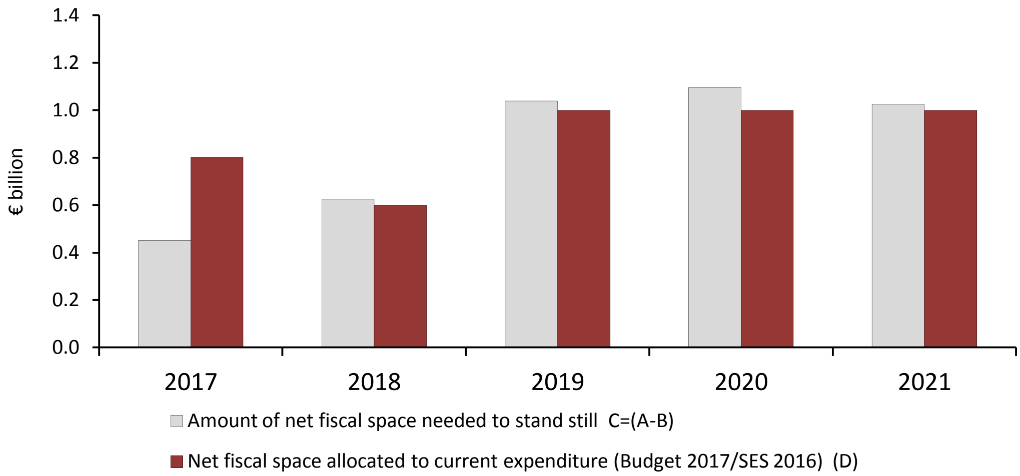
[10] For example, industry agreements such as the recent agreement on drug pricing could limit the direct impact of price increases on public service costs.

Lansdowne Road Agreement and half for demographics (B). Deducting this €0.6 billion pre-committed spending from the €1.2 billion estimated increase in the stand-still scenario means that €0.6 billion of the net fiscal space would be needed in 2018 to stand still (C). The 2017 *Expenditure Report* allocates €0.6 billion of the net fiscal space to current spending, almost exactly matching the estimated additional expenditure identified in the stand-still scenario (E).

From 2019-2021, the estimated additional expenditure in the stand-still scenario is close to the current allocation of net fiscal space for spending (Figure D1). This illustrates that fully accommodating estimated demographic pressures and the cost of maintaining real public services and benefits would absorb all of the net fiscal space currently budgeted for expenditure increases from 2019-2021.

In the Mid-Year Expenditure Report, the Department of Public Expenditure and Reform states that work is underway to develop a methodology that "will separately model the evolution of volume / demand and price impact" on public expenditure. The stand-still analysis presented here highlights the potential usefulness of developing this work. Starting from an estimate of the cost of standing still is an important basic input into good expenditure planning and would help inform policymakers of the scope for new spending or tax initiatives, in the absence of efficiency gains or cuts to services and real benefits.

FIGURE D1: STAND-STILL COSTS AND ESTIMATED NET FISCAL SPACE



Source: Budget 2017, Mid-Year Expenditure Report 2016, internal IFAC calculations.

3.3.2 REVENUE FORECASTS FOR 2017-2021

On an Exchequer basis, *Budget 2017* revised up the *SES* Exchequer tax forecast for 2017 by nearly €1 billion, implying growth of 5.2 per cent in year-on-year terms in 2017, slightly ahead of forecasted nominal GDP growth of 4.5 per cent.[11] Excise, income tax, and VAT are expected to grow

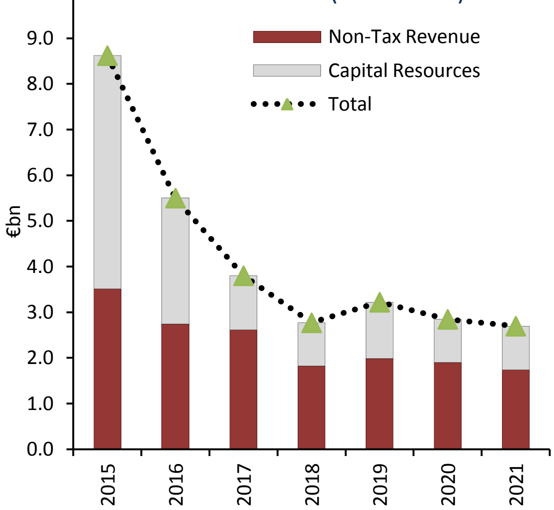
[11] While the 2017 tax forecast was revised up by €1 billion, *Budget 2017* revised down the *SES* tax forecast for 2018 by roughly €1 billion. This was due to the correction of a timing issue related to Single European Payments Area (SEPA) transactions. These payments had previously been booked for early 2018; however, they will now accrue in 2017. While this affects the Exchequer position, it will not impact the General Government balance as the tax receipts for the first two months of the year accrue to the previous year.

strongly in 2017, while corporation tax is expected to grow more slowly at 2.7 per cent, down from 9.4 per cent in 2016. In addition, a number of one-off adjustments are expected in 2017, resulting in a net negative effect of c. €0.4 billion to revenues in 2017.

Over the forecast horizon, current projections indicate annual Exchequer tax revenue growth of 5.4 per cent on average over the period 2016-2021. One issue which arises in 2018 relates to the estimated €0.17 billion carryover from the *Budget 2017* tax reductions. Similar to the carryover for new expenditure measures in 2018 mentioned above, this cost will have to be met out of the net fiscal space in 2018.

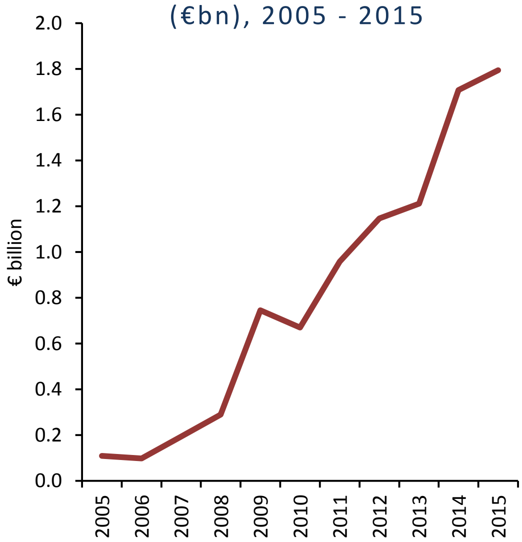
Appendix F describes the important factors influencing the *Budget 2017* forecasts for the four main tax heads over the period 2016-2021.

FIGURE 3.8: NON-TAX REVENUE AND CAPITAL RESOURCES (€ BILLION)



Source: Department of Finance.

Figure 3.9: CBI Surplus Income (€bn), 2005 - 2015



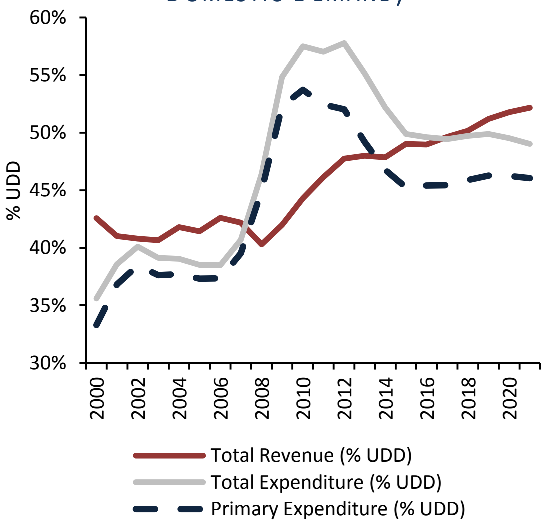
Sources: Central Bank of Ireland Annual Reports.

With regard to non-tax revenue sources in 2017, *Budget 2017* has revised up the forecast for non-tax revenue by €440 million and capital resources by €275 million relative to the *SES 2016.* This is primarily due to higher forecasts for Central Bank surplus income. Figure 3.9 shows that since the onset of the crisis, CBI surplus Income has increased substantially. Over the coming years, the positive contribution of CBI surplus income to the public finances is expected to decline as the Central Bank reduces its holdings of government bonds. *Ex post* budgetary forecasts (forecasts which incorporate policy decisions to use the available fiscal space) indicate that non-tax revenues will decline from 3.5 per cent of GDP in 2015 to 0.9 per cent in 2021. This is mainly due to a projected decline in capital resources, which in recent years was boosted by financial transactions related to the State's investments in the financial sector. The forecasts for non-tax revenue do not include any potential proceeds from the sale of the State's remaining investments in the banks.

3.3.3 General Government Total Revenue and Expenditure

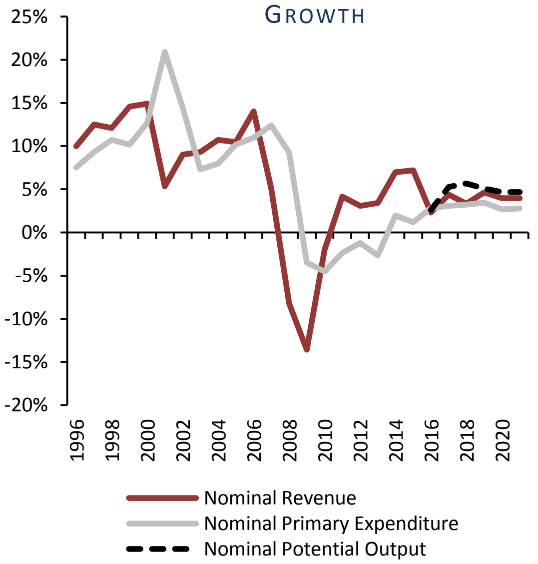
While the majority of the analysis presented in this chapter relates to revenues, expenditures and balances on an Exchequer basis, the Council also monitors public finances on a General Government (GG) basis (see Appendix E for an overview of the GG accounts). The domestic and EU fiscal rules are also defined on a GG basis. Figure 3.10 shows total revenue and total expenditure on a GG basis from 2000 to 2021 as a share of underlying domestic demand (UDD).[12] Given that GDP and GNP no longer reliably reflect domestic activity in the Irish economy, using these metrics as denominators to assess fiscal metrics could be misleading. UDD is a measure of the domestic economy, and excludes the distorting effects of aircraft leasing and intangible assets.

Figure 3.10: General Government Revenue and Expenditure (% Underlying Domestic Demand)



Sources: Department of Finance and CSO.
Note: Expenditure is adjusted for financial sector measures. UDD is computed using a bottom -up method, and excludes stocks.

Figure 3.11: GG Primary Expenditure and Revenue Growth



Sources: Department of Finance and CSO.
Note: Expenditure is adjusted for financial sector measures.

As the chart shows, total revenue as a share of underlying domestic demand is projected to increase gradually over the forecast horizon from 49 per cent in 2016 to 52 per cent in 2021. Total expenditure shows a slight decline over the forecast horizon; however, stripping out debt interest costs which are projected to fall, primary spending is forecast to be broadly flat over the 2016 to 2021 period. Figure 3.11 shows the growth in nominal primary expenditure, revenue and potential

[12] Expenditure in this instance excludes capital transfers to remove the distorting effects of the banking crisis.

output (based on the CAM). Nominal primary expenditure is projected to grow at a slower pace than both revenue and the economy's estimated potential growth rate over the forecast horizon.

3.3.4 General Government Balance

Figure 3.12 shows the General Government balance path as set out in *Budget 2017.* Given the difficulties with using GDP as a denominator, the balance is shown in nominal Euro amounts instead.[13] As Figure 3.12 shows, the pace of adjustment in the deficit is relatively slow between 2016 and 2018. Thereafter, the government accounts are projected to move into surplus at a slightly faster pace in the outer years.

Figure 3.12: General Government Balance (€bn)

Source: Department of Finance, *Budget 2017.*

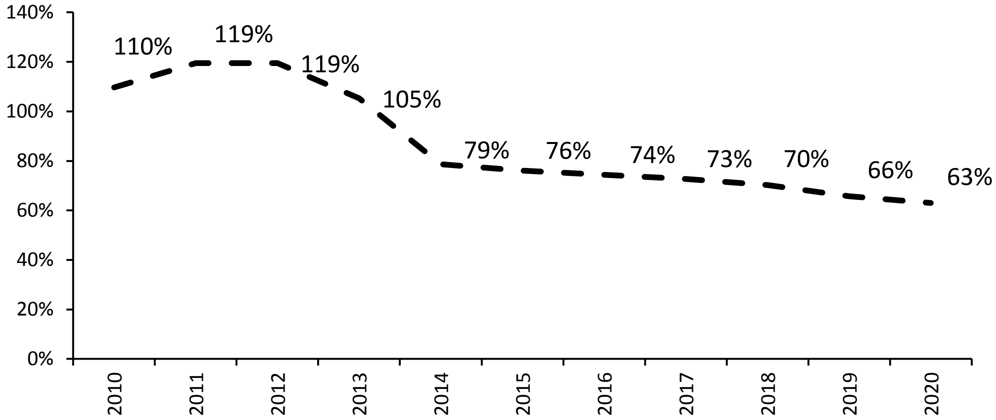
3.3.5 General Government Debt

The large revision to GDP in 2015 resulted in a drop in the debt-to-GDP ratio from 105 per cent in 2014 to 78 per cent in 2015 (see Figure 3.13). Such a decrease is misleading and overstates the reduction in the debt burden, as shown in Chapter 1.

Under the debt rule in the *SGP,* Ireland is required to gradually reduce the debt-to-GDP ratio to 60 per cent. On Budget day, the Minister for Finance announced a lower debt target of 45 per cent to be reached "by the middle to late part of the next decade". The fiscal rules require that the Government maintains a structural deficit of 0.5 per cent of GDP over the medium term. Assuming nominal GDP growth of 5 per cent per annum and compliance with the fiscal rules, this would see the debt-to-GDP ratio fall to below the Government's new 45 per cent target before 2030, based on estimates using the Council's Fiscal Feedbacks Model.

[13] At the time of writing this Report, an expert group involving the CSO and representatives from numerous Irish and international Economic and Statistical agencies (including IFAC) is working towards producing new indicators of Irish economic activity. It is expected that this group will report its findings in early 2017.

FIGURE 3.13: GENERAL GOVERNMENT GROSS DEBT (%GDP)



Source: CSO, Department of Finance, *Budget 2017.*

3.4 RISKS

Table 3.1 below shows the fiscal risks identified in *Budget 2017* along with the Department of Finance's assessments of relative likelihoods and impacts. This table also includes the Council's assessment of each of the risks.

TABLE 3.1: ASSESSING *BUDGET 2017* RISK MATRIX

Risk	Likelihood	Impact	IFAC Assessment
Tax forecast and payment timeline asymmetry	M	M	This risk refers primarily to corporation taxes, a large proportion of which accrues in November of each year. These highly volatile receipts are difficult to forecast. For 2016, strong growth in tax revenue, particularly from CT, is needed in order to achieve the Department of Finance's forecast for overall revenue for the year.
Corporation tax concentration risks	H	M	The Council continues to highlight concentration risks in CT. Both the likelihood and potential impact should be considered high, given that CT receipts account for 15 per cent of Exchequer tax revenues.
Financial sector developments	L	M	The State still holds substantial assets in the banking sector. Lower-than-expected proceeds from the sales of these assets over the medium-term could reduce the eventual potential gain to the State.
Receipts from resolution of financial sector crisis	L	M	Related to the previous risk. High levels of uncertainty surround the timing, prevailing market conditions and potential return arising from the sale of State held assets. It should be noted that potential upsides exist here also, with official debt projections excluding the bulk of expected disposal proceeds.
EU Budget Contributions	H	L	This risk has been realised in the wake of the revisions to the NIE 2015 accounts. Since the revisions represent level shifts in each series, higher contributions will persist into the future.
Contingent liabilities	L	M	Although still large, contingent liabilities are declining, with NAMA-related liabilities standing at less than 20 per cent of their peak value.
Bond market conditions	L	M	Given the large stock of outstanding debt still remaining, an interest rate shock could have serious implications. However, as noted above, the long maturities and fixed nature of much of the debt should insulate against moderate rate shocks. Notwithstanding this, the Council is of the view that this risk should carry a medium likelihood reflecting the pace at which bond market conditions can change in the wake of external shocks (e.g., a hard Brexit).
Changes to tax 'drivers'	M	M	This risk is exemplified by recent CT developments. The principal macroeconomic driver of CT receipts for forecasting purposes is taken to be Gross Operating Surplus by the Department of Finance. In the wake of the NIE 2015 revisions, this relationship may have weakened.
EU-level climate change and energy developments	H	H	Ireland is in danger of missing its 2020 emissions targets (see first report of the Climate Change Advisory Council, 2016). In order to meet existing obligations by 2020, additional allowances may need to be purchased. This could represent a substantial cost to the State.