

3. Assessment of Budgetary Forecasts

Key Messages

- The General Government balance (excluding one-off items) for 2016 is estimated at -0.7 per cent of GDP, representing an improvement of 0.4 percentage points relative to 2015. For 2017, the *SPU 2017* forecasts show a further improvement, with the balance rising to -0.4 per cent of GDP, broadly the same as forecast at budget time.
- *SPU 2017* keeps tax revenue forecasts for 2017 unchanged from *Budget 2017*. Outturns during the first four months of the year are weaker than expected and there is a slowdown in year-on-year growth. Recent developments would suggest that trends in revenues should be closely monitored. However, continued strong economic growth may warrant leaving the 2017 forecasts unchanged for now. More certainty is needed about the drivers of the weaker-than-expected outturns, and whether these will persist.
- The “Top 10” payers of Corporation Tax continue to play a substantial role, accounting for 37 per cent of net Corporation Tax receipts in 2016. High concentration exposes these and overall revenues to volatility risk.
- *SPU 2017* projects the budget to be barely in balance by 2019, evolving thereafter in line with the Government’s stated policy of minimum compliance with the fiscal rules. Forecasts show tax revenues growing slightly faster than domestic demand, falling interest payments, spending on services and welfare payments growing more slowly than GDP, and €1 billion each year being set aside for a proposed future Rainy Day Fund.
- The Council’s illustrative estimate of future spending pressures – the “Stand-Still” scenario – is based on the calculation of the cost of providing today’s level of public services over the forecast horizon to 2021. The scenario implies that the spending increases currently budgeted for in *SPU 2017* over 2018-2021 would be fully absorbed by accommodating demographic pressures and the cost of maintaining real public services and benefits.
- The Department of Finance’s assumption in the *SPU* forecasts (as in *Budget 2017*) of using the available fiscal space, in line with Government policy, is welcomed by the Council. This provides more realistic forecasts for expenditure and tax revenues. The Council also notes the work being undertaken on expenditure modelling as per the *Mid-Year Expenditure Report 2016*, which will “separately model the evolution of volume/demand and price impact” on public expenditure.

3.1 Introduction

This Chapter assesses the latest set of budgetary forecasts produced by the Department of Finance in *SPU 2017*. Section 3.2 examines the outturn of the main fiscal aggregates for 2016. Section 3.3 assesses the projections for revenue and expenditure for 2017 contained in *SPU 2017* and discusses the upcoming Spending Review. Section 3.4 examines the forecasts for the period 2018-2021 and provides an update of the Council's Stand-Still expenditure scenario. Section 3.5 provides an assessment of the fiscal risks.

The main fiscal aggregate outturns/forecasts for 2016-2021 are set out in Table 3.1. The General Government balance, excluding one-offs, is expected to improve over the forecast horizon (2017-2021), turning positive in 2019. Excluding one-offs, total revenues are forecast to grow at an average annual rate of 3.8 per cent from 2017 to 2021, with total expenditure planned to grow at a slower average annual rate of 2.5 per cent over the same period. The proposed Rainy Day Fund plans to allocate €1 billion euro each year from 2019 to 2021 to an Exchequer Contingency Reserve. Although these amounts would be counted as Exchequer spending, they will remain within the General Government sector and therefore have no impact on General Government spending. Primary expenditure, expenditure excluding interest spending, is forecast to grow at a slightly faster average annual rate of 2.9 per cent for the forecast period (2017 to 2021). Primary expenditure, excluding one-offs, is expected to average 24 per cent of GDP over the same period, but is expected to gradually fall over the forecast period (2017-2021). This decline is due, in part, to falling social welfare spending, as the unemployment rate decreases. However, the fall in expenditure as a share of GDP reflects expenditure plans, which keep spending constant in real terms.

Table 3.1: SPU 2017 Fiscal Forecasts (2016-2021)

% of GDP, Unless Otherwise Stated

	2016	2017	2018	2019	2020	2021
General Government Balance, € Billions	-1.5	-1.2	-0.4	0.3	1.8	3.3
General Government Balance	-0.6	-0.4	-0.1	0.1	0.6	1.0
General Government Balance, excl. one offs ¹	-0.7	-0.4	-0.1	0.1	0.6	1.0
Primary Balance	1.7	1.7	1.9	2.0	2.3	2.6
Primary Balance excl. one offs ¹	1.6	1.7	1.9	2.0	2.3	2.6
Total Revenue, € Billions	73.0	75.2	78.0	80.8	84.2	87.4
Total Revenue excl. one offs, ¹ € Billions	72.5	75.2	78.0	80.8	84.2	87.4
Total Revenue excl. one offs growth y/y ¹	2.7	3.7	3.8	3.6	4.2	3.9
Total Revenue excl. one offs ¹	27.3	26.8	26.5	26.2	26.2	26.1
Total Expenditure, € Billions	74.6	76.4	78.4	80.5	82.4	84.1
Total Expenditure excl. one offs ¹ € Billions	74.4	76.4	78.4	80.5	82.4	84.1
Total Expenditure excl. one offs growth y/y ¹	1.2	2.7	2.6	2.7	2.3	2.1
Total Expenditure excl. one offs ¹	28.0	27.2	26.6	26.1	25.6	25.1
Primary Expenditure, € Billions	68.4	70.4	72.4	74.6	76.8	78.9
Primary Expenditure growth y/y	-0.5	2.9	2.9	3.1	2.9	2.7
Primary Expenditure excl. one offs ¹ € Billions	68.2	70.4	72.4	74.6	76.8	78.9
Primary Expenditure excl. one offs ¹ growth y/y	2.4	3.2	2.9	3.1	2.9	2.7
Primary Expenditure excl. one offs ¹	25.7	25.1	24.6	24.2	23.9	23.5
Nominal GDP Growth %	3.9	5.5	5.0	4.6	4.4	4.2

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

Note: ¹One-offs/temporary measures are as assessed by the Council to be applicable. These one-offs are removed from variables to get a sense of the underlying fiscal position. The main one-offs assessed by the Council to be applicable include the AIB transaction in 2015 (€2.1 billion); an amount related to the contribution to the EU Budget prompted by GNI revisions for 2016 (€0.17 billion) and the EFSF pre-paid margin in 2016 (€0.55 billion).

3.2 2016 Outturn

General Government Revenue and Expenditure 2016

The General Government balance (excluding one-off items) recorded a deficit of 0.7 per cent of GDP in 2016.¹ Table 3.2 shows the evolution of the Department of Finance's budgetary projections for 2016 over time and compares them to the outturn.

¹ One-offs are examined in Box H of Chapter 4 and relate to those identified by the Council as being applicable.

Table 3.2: General Government Receipts and Expenditures 2016

€ Billions, Unless Otherwise Stated

	Budget 2016	SPU 2016	Budget 2017	Outturn
General Government Balance	-2.8	-2.5	-2.4	-1.5
General Government Balance (% of GDP)	-1.2	-1.1	-0.9	-0.6
General Government Balance excl. one offs (% of GDP)	-1.4	-1.2	-1.1	-0.7
Primary Balance (% of GDP)	1.8	1.6	1.4	1.7
Primary Balance excl. one offs (% of GDP)	1.5	1.5	1.3	1.6
Revenue				
Taxes on Production and Imports	23.4	23.8	23.4	23.6
Current Taxes on Income, Wealth	28.3	28.2	29.3	29.1
Capital Taxes	0.4	0.3	0.4	0.4
Social contributions	11.9	11.7	11.9	12.1
Property Income	2.1	2.0	1.9	1.7
Other	5.2	5.4	5.1	6.1
Total revenue	71.3	71.4	72.2	73.0
Total Revenue excl. one-offs (% of GDP)	31.7	30.7	27.2	27.3
Expenditure				
Compensation of Employees	19.9	20.0	19.7	19.4
Intermediate Consumption	9.7	9.8	9.9	9.7
Social Payments	28	27.7	28.1	28.5
Interest Expenditure	6.6	6.3	6.2	6.2
Subsidies	2.0	1.7	1.7	1.7
Gross Fixed Capital Formation	4.2	4.0	4.6	4.9
Capital Transfers	1.1	1.5	1.4	1.4
Other	2.7	2.9	3.0	2.7
Total expenditure	74.1	73.9	74.6	74.6
Total Expenditure excl. one-offs (% of GDP)	33.1	31.9	28.3	28.0
Primary Expenditure	67.5	67.6	68.3	68.4
Primary Expenditure excl. one-offs	67.3	67.4	68.2	68.2
Primary Expenditure excl. one offs (% of GDP)	30.2	29.2	25.9	25.7

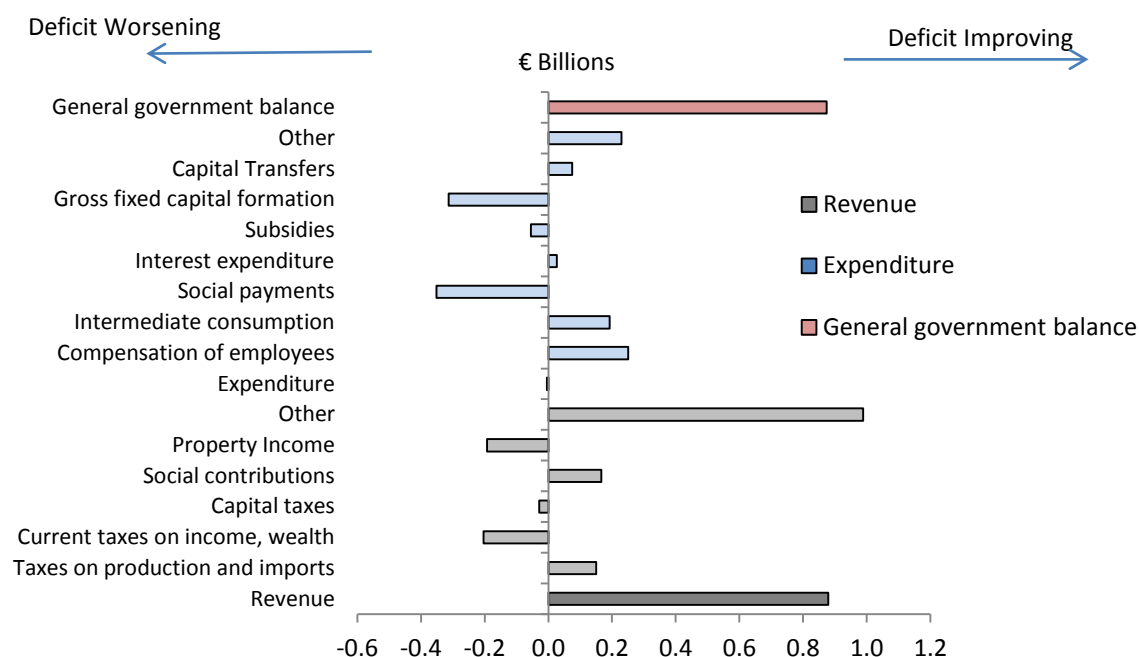
Sources: CSO, Department of Finance; Department of Public Expenditure and Reform (DPER); and internal IFAC calculations.

Note: One-offs are examined in Box H of Chapter 4 and relate to those identified by the Council as applicable.

For 2016, total General Government revenues outperformed previous forecasts, and the final outturn was €0.8 billion (0.3 per cent of GDP) above the *Budget 2017* forecast, driven mainly by “other” revenues (Figure 3.1). The most substantial difference in “other” revenues, when compared to *Budget 2017*, relates to the receipt of the prepaid margin from the EFSF (€550 million). A further €250 million relates to higher than expected revenues from local authorities, with the remainder (€195 million) made up of a number of larger-than-forecast current transfers receivable.

Figure 3.1: Outturn vs. Budget 2017 Forecast (for 2016)

Impact on Deficit, € Billion



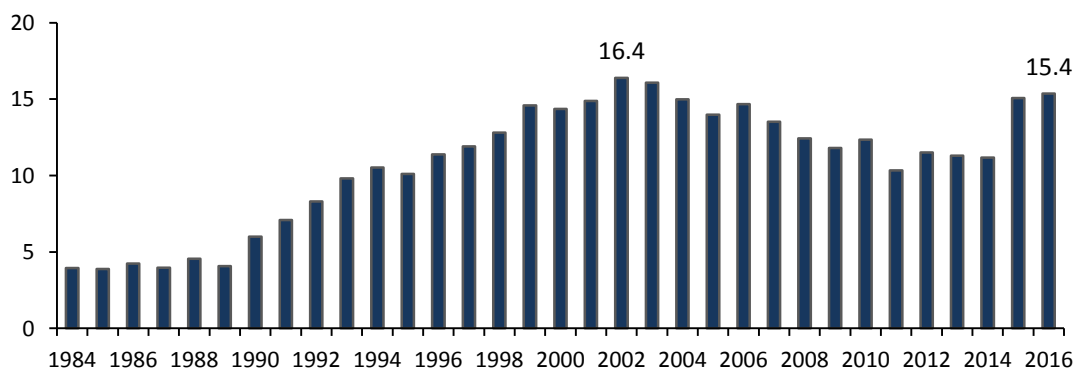
Sources: Department of Finance; and internal IFAC calculations.

Note: Impact on deficit shown - worsening if revenue is less than forecast/expenditure greater than forecast.

Corporation Tax revenues accounted for 15.4 per cent of Exchequer tax revenue and 10.1 per cent of total revenue in 2016. Figure 3.2 shows the evolution of the proportion of Exchequer Tax Revenue accounted for by Corporation Tax over time. *SPU 2017* notes that over the medium term (2018 to 2021) “Corporation Taxes will account for just about 15 per cent of all tax revenues, which is within previous parameters”. However, as shown in Figure 3.2, Corporation Tax has only accounted for a greater share of Exchequer taxes than it currently does on two previous occasions in the past three decades – in 2002 and 2003. Furthermore, the recent share is far above the average share from 1984 to 2016 (10.8 per cent), and higher than the average during the boom years from 2000 to 2008 (14.6 per cent).

Figure 3.2: Corporation Tax Accounting for Greater Share of Revenues

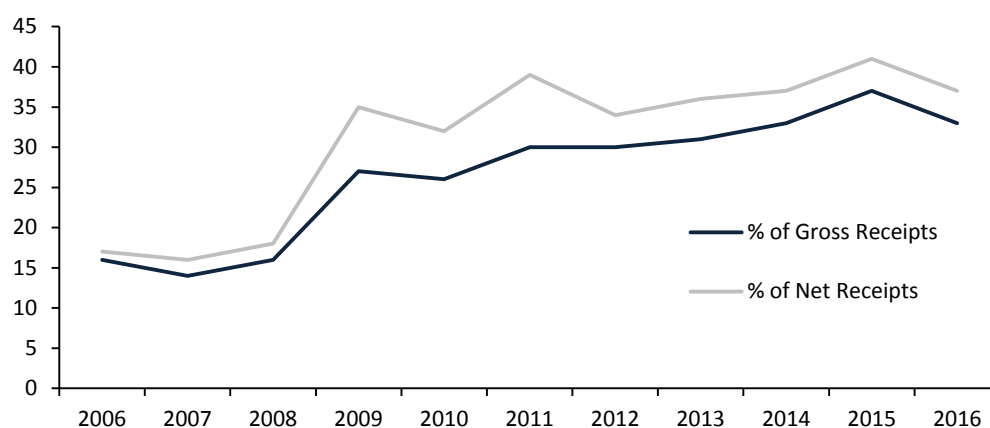
% Total Exchequer Tax Receipts



Sources: Department of Finance; and internal IFAC calculations.

Corporation Tax plays a disproportionate role in revenue volatility. The high level of volatility of Corporation Tax receipts was highlighted in 2015, with an increase in net receipts by €2.3 billion over 2014, to €6.78 billion. In 2016, receipts rose by €480 million to €7.35 billion. Recent research by the Office of the Revenue Commissioners offers some insights into this volatility (Tancred, 2017). Of the 7 per cent increase in receipts in 2016, the majority is accounted for by companies managed by Revenue Large Cases Division (LCD), which represented 82 per cent of total Corporation Tax receipts in 2016. These companies had net receipts of €6,034 million in 2016, an increase of €506 million when compared to 2015.

Figure 3.3: Corporation Tax Receipts Accounted for by ‘Top 10’ Payers
Percentage of Total Corporation Tax Receipts



Sources: Revenue; and internal IFAC calculations.

Note: Gross receipts describe receipts before repayments while net receipts describe receipts after repayments.

The increased concentration of Corporation Tax receipts among a small number of firms raises the risk associated with volatility of this tax head due to idiosyncratic shocks. Emphasising the importance of idiosyncratic developments, Casey and Hannon (2016) note that recent variation in Corporation Tax receipts is largely unexplained by economic fundamentals. Figure 3.3 shows how the proportion of net receipts accounted for by the ‘Top 10’ payers has risen over the past decade from 17 per cent in 2006 to 37 per cent of total Corporation Tax receipts.

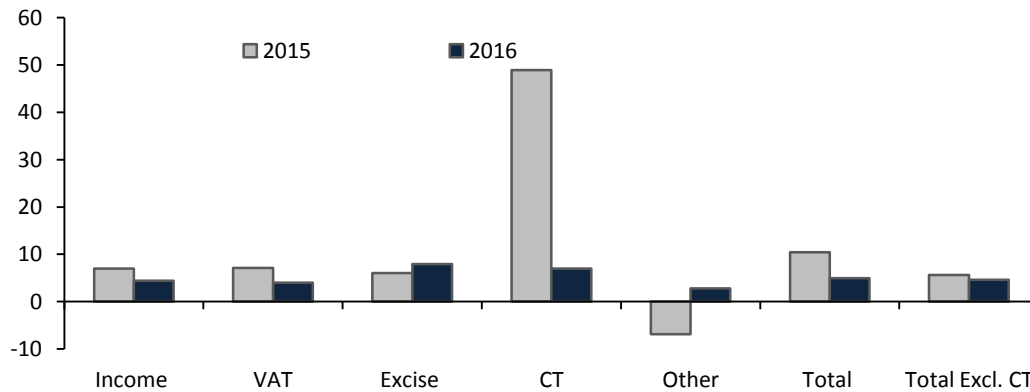
Looking at the year-on-year performance, Exchequer tax revenue for 2016 was €47.9 billion, an increase of €2.3 billion (5 per cent) over 2015. Excluding Corporation Tax, the increase was 4.6 per cent. Overall, receipts from the four main tax heads (Corporation Tax, VAT, Income Tax and Excise Duties) grew in 2016, although all except Excise Duties grew at a slower rate than in 2015 (Figure 3.4). Excise Duties showed an increase of 7.9 per cent in 2016.² In contrast, the growth of VAT receipts slowed to 4 per cent from 7.1 per cent in 2015. Income tax increased by 4.4 per cent in

² High growth of excise duties in 2016 was attributed largely to increased Vehicle Registration Tax and other oil receipts by the Department. High growth of Excise Duties in 2016 also reflects the front loading of stock in the tobacco industry ahead of the introduction of plain packaging legislation. See Department of Finance Fiscal Monitor, January 2017: http://www.finance.gov.ie/sites/default/files/Fiscal_Monitor_January_2017_0.pdf

2016, compared to 7 per cent in 2015. The slower revenue growth observed in 2016 is broadly in line with growth in GDP drivers.

Figure 3.4: Tax Revenue Growth

Year-on-year Growth (%)



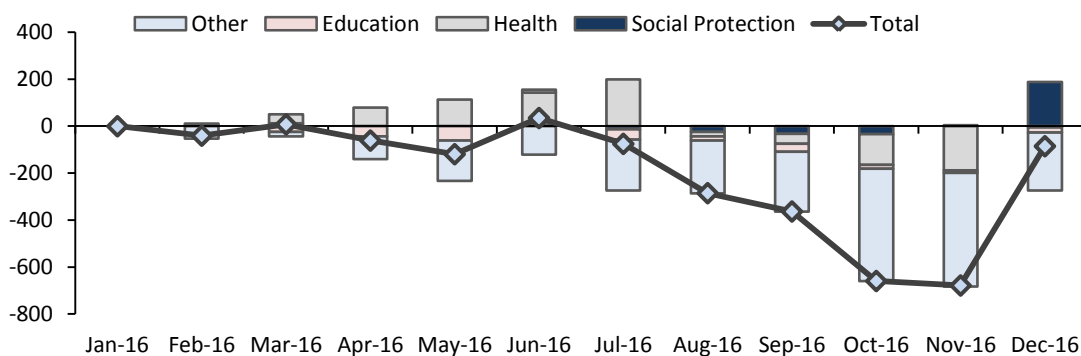
Sources: Department of Finance Exchequer Returns, internal IFAC calculations and Budget 2016.

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

General Government expenditure in 2016 was the same as expected at the time of *Budget 2017* (Figure 3.1). This was despite additional allocations of funding for both the Health and Justice areas that were voted on in July 2016. Gross voted current expenditure was remained marginally below the *Budget 2017* forecast for 2016 of €52 billion (Figure 3.5). Considerable savings in the "other" category seen in the year-to-November were distributed broadly across all departments. However, these savings unwound somewhat in December, driven largely by an overrun of some €188 million in Social Protection related to the payment of the "Christmas Bonus" which had not been included in spending plans.³

Figure 3.5: Gross Current Expenditure Relative to Budget 2017 Profile

€ Millions



Source: Department of Finance Exchequer Returns; and internal IFAC calculations.

Note: Figures are relative to the cumulative profile adjusted to include the supplementary estimates announced June 2016.

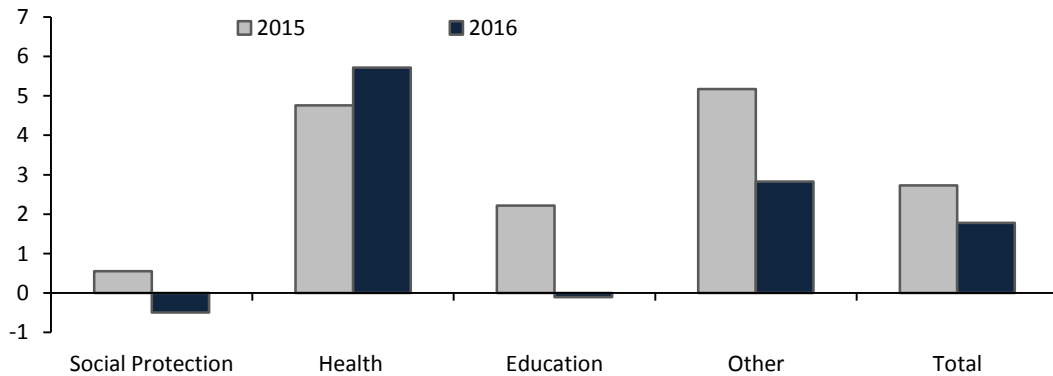
³ However, it was factored into the revised *Budget 2017* estimates for 2016.

Figure 3.6 shows the change in gross voted current expenditure in year-on-year terms for 2015 and 2016. Total spending grew more slowly in 2016. Falling unemployment suggests that there may be some scope for lower Social Protection spending as in 2016. Health spending registered relatively high growth in both years.

Health expenditure has been subject to frequent overruns in recent years (Howlin, 2015). The Department of Health outturn was below profile in 2016 only due to the use of mid-year supplementary estimates, with substantial overruns up until mid-year (Figure 3.5). The use of supplementary estimates reinforces the “soft budget constraint” issue, which undermines the credibility of the expenditure ceilings.⁴ The planned expenditure in *Budget 2017* will bring the level of Health funding to its highest in the history of the State.

Figure 3.6: Gross Voted Current Expenditure

% Change, Year-on-Year



Sources: DPER.

Note: The amount for Health is adjusted in 2014, to reflect changes to the vote structure in that year.

3.3 SPU Forecasts For 2017

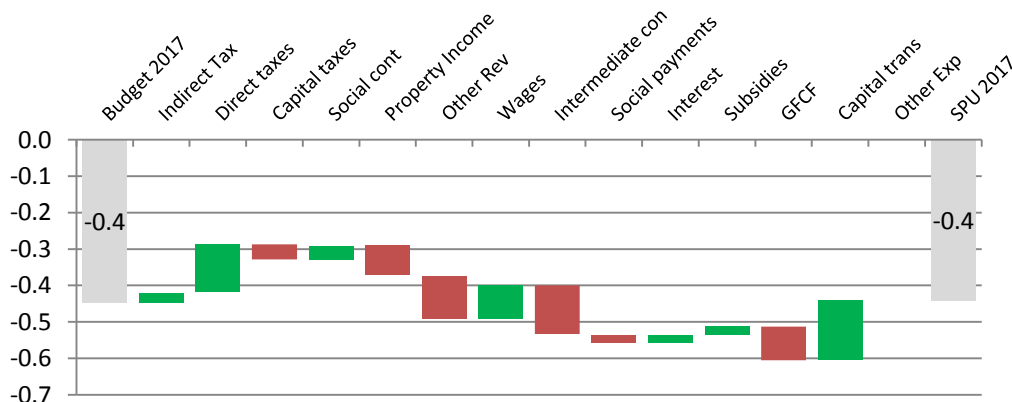
General Government Balance 2017

Figure 3.7 shows how *SPU 2017* revised the *Budget 2017* forecast for the general government balance expected this year. Though the headline figure remains broadly unchanged, with a deficit

⁴ The soft budget constraint, as originally formulated (Kornai, 1992), posits that a budget constraint is soft where the decision maker in control of day-to-day expenditure anticipates that the constraint is likely to be relaxed *ex post* if the original constraint is not met, notwithstanding any *ex-ante* threats to impose a hard constraint. Where the budget setting process is weak, this may further ‘soften’ the constraint as the manager – knowing plans are poorly set – has less of an incentive to adhere to them.

of approximately 0.4 per cent, there are several factors making positive and negative contributions (Figure 3.7).⁵

Figure 3.7: Revision to 2017 Deficit: SPU 2017 vs Budget 2017
% of GDP



Sources: Department of Finance; and internal IFAC calculations.

Note: Floating bars indicated the sources of revision to the 2017 deficit; a green bar represents a positive impact (deficit reducing); and a red bar indicates a negative impact (deficit increasing). These revisions are not the result of any policy change or statistical decisions which impact 2017.

Revenue 2017

The headline *SPU 2017* General Government revenue forecast for 2017 is largely unchanged (-€0.1 billion) since the budget, with an expected overall increase in General Government Revenues of 3 per cent year-on-year.

In terms of Exchequer taxes, *SPU 2017* budgetary projections left the overall level forecast for 2017 unchanged from the *Budget 2017* estimate at €50.6 billion. Given that the outturn in 2016 was lower than forecast on budget day by some €0.3 billion, there is an implied increase in the expected growth rate of 0.6 percentage points to 5.8 per cent year on year. This is marginally above the expected nominal GDP growth rate of 5.5 per cent for 2017, which has also been revised up since *Budget 2017* (Chapter 2).

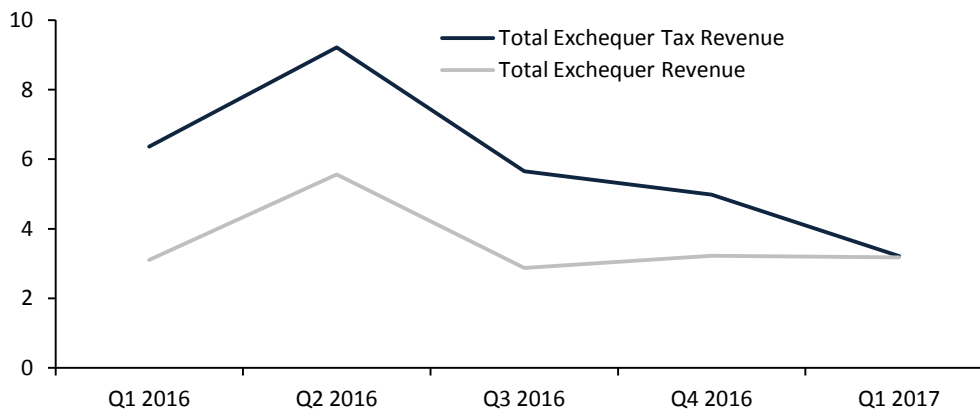
Appendix E outlines the important factors impacting *SPU 2017* forecasts for the four main tax heads (Income Tax, VAT, Excise Duties and Corporation Tax). It shows the role played by changes to the economic environment (i.e., to macro drivers as forecasted by the Department of Finance), starting point errors and judgement applied by the Department.

⁵ This, in part, reflects the suspension of water charges in the first half of 2017, which results in an estimated reduction of €70 million in “other revenues”. Also of note is the deficit-reducing effect of wage revisions (€255 million). This relates to the base effect of lower official outturn data for 2016, which partially offsets the decision to bring forward the Lansdowne Road pay increases. Similarly, other movements in General Government revenue classifications largely relate to base effects associated with the revised 2016 outturns.

In 2017, the starting point error played a substantial role in three of the four main tax heads. For Corporation Tax and VAT, the error was negative, while for PAYE it was positive. There was a strong positive macro-driver effect for PAYE. Summing across the four tax heads (Corporation Tax, VAT, PAYE and Excise Duties) the overall starting point error is negative. This combined with an overall positive macro effect and positive judgement applied by the Department of Finance keeps the total revision from *Budget 2017* at zero. The Department of Finance has thus, in keeping tax forecasts consistent with those at budget time, and given the outturns for 2016, imposed considerable offsetting judgement across individual tax heads.

Figure 3.8 shows the year-on-year growth in total revenue, excluding transactions with no General Government impact, and total tax revenue on a quarterly basis. Total Revenue growth year-on-year has moderated, and this is also reflected in Tax Revenue. Tax returns in 2017 as at the end of April were below profile by 2.4 per cent, representing an increase year-on-year of only 0.5 per cent. The fall in Tax Revenue growth is partially driven by softer Income Tax growth, and slow growth in Excise Duties.⁶ Stamp Duties, Capital Taxes and other taxes have seen a relatively poor performance year-on-year, with slow growth currently being offset somewhat by the growth in VAT, which is exceeding expectations.

Figure 3.8: Exchequer Revenue Growth (Q1 2016 - Q1 2017)
Percentage Change (Year-on-Year)



Sources: Department of Finance; and internal IFAC calculations.

Note: Comparison of 2015, 2016 and 2017 monthly Exchequer Returns.

For 2017 to end-April, VAT has been performing much stronger than forecast, and beyond what might have been expected given the pace of growth in retail sales. *SPU 2017* notes this performance is due to lower-than-expected repayments and stronger receipts from some of the

⁶ Other tax heads were also performing below profile to April 2017, except Local Property Tax and Capital Gains Tax, and all except Local Property Tax were down year-on-year.

Lower growth in Excise Duties is partially due to the base effect of front loading of tobacco in the early part of 2016 in anticipation of the introduction of plain packaging. See Department of Finance Fiscal Monitor, January 2017: http://www.finance.gov.ie/sites/default/files/Fiscal_Monitor_January_2017_0.pdf

main VAT components.⁷ However, if the repayments were to emerge later in the year, the over-performance could unwind. It is currently unclear if this will occur.

Income tax receipts have performed poorly throughout the first four months of 2017, following lower growth in 2016 than 2015. The soft performance to end-April 2017 against forecasts (under by 3.1 per cent, or €198 million) and year-on-year, increasing by just 1.2 per cent (€70 million), is surprising, given the recent pace of growth in employment at some 3.5 per cent year-on-year. In the first quarter of 2017 year-on-year growth in PAYE, a major component of Income Tax, was 6 per cent (an increase of €187 million), relatively in line with employment growth.⁸ The Universal Social Charge (USC) accounted for roughly a third of the fall below profile (€63 million of the €180 million shortfall) and was down year-on-year by 12 per cent (€107 million).^{9, 10}

Possible explanations for the soft performance of USC in the first four months of 2017 are worth considering. First, the revenue-reducing impact of cuts introduced in recent budgets may have been larger than estimated, or the responsiveness of USC receipts to rising incomes has been overestimated. The Revenue Commissioners, however, have indicated that they are “satisfied ... changes of €335 million in 2017, were costed accurately”.¹¹ Second, the Department of Finance and the Revenue Commissioners have also indicated that the poor performance of USC thus far in 2017 is partially due to a misallocation of the *Budget 2017* package between PAYE and Schedule D payers. Although this misallocation would not impact the overall receipts of USC for the year, it may affect the timing of payments and could be a reason for the poor performance in the year to date.¹²

Estimating the impact of USC reductions may still be difficult, and recent work has substantially revised the estimated elasticities applicable for USC.¹³ Acheson *et al.* (2017) estimate an elasticity to earnings in relation to USC of 1.2, which is considerably lower than that used by the Department of Finance for 2017, at 2.15. This reflects a more disaggregated approach, whereby distributional data are used to estimate a separate elasticity for USC.¹⁴ A lower elasticity was also found in

⁷ One potential reason for repayments being lower than expected could be a decrease in stock building.

⁸ PAYE was below profile by 2 per cent (€49 million) in Q1 2017.

⁹ PQ [22380/17] <https://www.kildarestreet.com/wrans/?id=2017-05-10a.198.q>

¹⁰ This fall year-on-year is in part due to the revenue reducing discretionary tax measure introduced in relation to USC.

¹¹ PQ [22540/17] & [22539/17] <https://www.kildarestreet.com/wrans/?id=2017-05-11a.168.r>

¹² PQ [22540/17] & [22539/17] <https://www.kildarestreet.com/wrans/?id=2017-05-11a.168.r>

¹³ Some work has been produced recently by the ESRI estimating the elasticity of tax revenues to specific macro drivers. This is reflected in Deli *et al.* (2016).

¹⁴ It is important to note also that USC was introduced fairly recently and so analysis is improving as more information is available. However, frequent changes to rates will make estimating the cost of changes more difficult to predict.

relation to Income Tax for both PAYE and non-PAYE workers. These elasticities were used in determining the *SPU* tax forecasts for 2018 onwards, but were not factored into the 2017 forecasts, which remain unchanged from *Budget 2017*.¹⁵ Had the lower elasticity been used, forecasts in 2017 would have shown a lower level of revenue in 2017, as additional employment and earnings would not generate as much extra tax revenue as estimated with the old elasticities.¹⁶

While the new elasticities would suggest lower receipts, all else equal, the macro drivers have been revised up slightly since *Budget 2017* and recent employment and incomes data have been strong. There is therefore some remaining uncertainty as to the extent to which the weaker-than-expected performance of income tax in the first four months of 2017 will persist or whether it will be offset by a stronger-than-expected performance in macro drivers. This is further supported by PRSI data. PRSI revenues for the first 4 months of 2017 have seen an increase, year-on-year, of 7 per cent, which is higher than employment growth of 3.5 per cent in Q1 2017.

Overall, the poor tax revenue performance to date against profile, and relatively soft performance in year-on-year terms may raise some concerns, although it is still relatively early to ascertain the persistence of recent weaknesses in receipts. If the relationship between these macro drivers and revenues has changed, the elasticities used in producing the tax forecasts will need to be updated. Given the uncertainties involved, the Department has decided to leave the 2017 forecasts unchanged in *SPU 2017*. Nonetheless, these trends in revenues should be closely monitored and the reasons for any divergence from expectations should be determined.

Expenditure 2017

Total General Government expenditure forecasts for 2017 have been revised down in the *SPU* from budget-day forecasts by €0.15 billion. This revision is due largely to methodological issues, including base effect changes following official CSO outturns, rather than substantial revisions to expected expenditure. *SPU 2017* notes that the *Revised Estimates for Public Services (REV) 2017* outline the allocations for all government departments for 2017.

The decision to bring forward pay increases related to the Lansdowne Road Agreement will increase pay costs across departments in 2017. The costs of this decision, estimated at €0.12 billion, are to be met within current allocations at present, although, *SPU 2017* notes that the ability of departments to meet this cost will be assessed later in the year.

¹⁵ PQ [22240/17]

¹⁶ Using the data on macro drivers and the estimated impact of policy changes available at the time of *Budget 2017* the impact of these new elasticities on forecasts for 2017 can be estimated. Estimating the expected tax yield for 2017 using the new elasticities suggests, in absence of other judgement factors, PAYE would be estimated as €11 million higher and USC €80 million lower than estimates using the old elasticities.

Budget 2017 included a 2016 provision for a Christmas Bonus measure of €220 million, which represented an 85 per cent bonus for people in receipt of long term social protection payments.¹⁷ The measure, which was abolished in 2009, has seen a phased reintroduction since 2014; yet in none of these years has such a payment been budgeted for. Unless the Government intends not to pay this in future, spending estimates should make an allowance for it. No provision has been made for the payment of a Christmas bonus in 2017.

In-year spending increases during 2015 and 2016 saw a far looser-than-planned budgetary stance and came on the back of revenue surprises. In-year gross voted spending increases of €1 billion in 2016 and €0.7 billion in 2015, compared to budget-time projections, absorbed the majority of better-than-expected tax revenues during the two years. Such a policy is especially risky when the source of the additional revenue is, to a large extent, Corporation Tax. For 2017, spending is within plans to date. Total gross voted expenditure had grown 3 per cent year-on-year, as compared to a projected growth rate for 2017 as a whole of 3.9 per cent.

Spending Reviews provide an opportunity to examine the level of ongoing baseline expenditure separately from incremental changes. This process can inform expenditure prioritisation. *Budget 2017* announced a Spending Review to take place before *Budget 2018* this autumn. This provides an opportunity for the Government to examine existing schemes in terms of rationale, efficiency and effectiveness, and to identify areas of expenditure pressure and areas for potential savings. This can also help with expenditure planning and reducing cost pressures. *SPU 2017* notes that the review process will change from previous iterations, as the 2017 review will begin a rolling system that focuses on a selective set of reviews.

Box E: Spending Reviews¹⁸

This Box discusses the approach to spending reviews in the Irish context and the lessons to be learned from international best practice. Spending reviews are a mechanism by which savings can be achieved through examination of baseline expenditure (Robinson, 2013). An effective spending review provides a means of assessing ongoing expenditure to assess sustainability in view of increasing spending pressures due to demographic pressures and the increasing cost of provision of public services (Baumol's disease) (IMF, 2014, Howlin et al., 2016).¹⁹

Recent Spending Reviews in Ireland

Three spending reviews have been conducted in Ireland since 2008: the 2009 *Report of the*

¹⁷ Of social protection or pensions payments.

¹⁸ This box draws largely on analysis from the OECD Working Party of Senior Budget Officials document on Spending Reviews, GOV/PGC/SBO(2013)6, 3rd Annual Meeting of OECD Senior Budget Officials, Paris 3-4 June 2013. Available at: [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=GOV/PGC/SBO\(2013\)6&doclanguage=en](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=GOV/PGC/SBO(2013)6&doclanguage=en)

¹⁹ Baumol's disease refers to the phenomenon whereby costs of government services may tend to disproportionately increase relative to the average price of goods in the economy.

Special Group on Public Service Numbers and Expenditure Programmes (Department of Finance, 2009); the *Comprehensive Review of Expenditure (CRE) 2012-2014* (Department of Public Expenditure and Reform, 2011); and the *CRE 2015-2017* (Department of Public Expenditure and Reform, 2014). The *CRE 2012-2014* established that spending reviews should take place on a periodic basis to support the Medium Term Expenditure Framework and to inform resource allocation, by examining baseline expenditure (Howlin *et al.*, 2016). In addition to departmental submissions, the *CRE 2012-2014* published six thematic evaluations, as follows:

- Enterprise support,
- Labour Market Activation and Training,
- Overview of Legacy Expenditure Programmes and Policy Reforms including opportunities for rationalising State Agencies,
- Publically-Funded Local Transport Systems,
- Rationalising Multiple Sources of Funding to Not-for-Profit Sector,
- Social Housing Supports.

Comparatively few analytical papers were published with *CRE 2015-2017*, these included:

- Behavioural Economics,
- Future Risks Associated with Climate Change Finance,
- The Cost of Public Services.

Budget 2017 announced plans for a spending review to take place in advance of *Budget 2018*, and background analysis for this is currently being undertaken.

The Design of Spending Reviews

Spending reviews have become increasingly used in public expenditure management internationally. The design and parameters of spending reviews may differ depending on economic context and fiscal objectives. The OECD (2013) undertook an examination of spending reviews and best practices internationally. The study outlined two of the dimensions under which reviews may differ: the nature of the savings, and the scope of the spending review.

1. The Nature of Savings

Spending reviews can be broadly categorised under two headings: (i) efficiency and (ii) strategic reviews:

- (i) An efficiency review seeks to achieve savings by altering the way in which public services are delivered while still producing the same output. It does not assess the rationale for existing expenditure.
- (ii) A strategic review on the other hand examines expenditure with a view to assessing its continued relevance. Savings are achieved by altering the quantity or quality of outputs or transfers where the scheme is deemed no longer relevant.

The UK 2010 Comprehensive Spending Review provides an example of an efficiency and strategic review which aimed to decrease public expenditure to achieve fiscal consolidation. In contrast the Netherlands 2010 Comprehensive Expenditure Review predominantly sought to achieve strategic savings. Reviews of efficiency and overall strategy in relation to expenditure provide a key input for the achievement of Government fiscal and macro objectives. This requires persistent analysis of baseline expenditure identifying key areas of underlying demand pressure in the medium and longer term. Therefore, a spending review should seek to achieve both efficiency and strategic savings.

2. The Scope of Spending Reviews

In terms of scope, spending reviews may be comprehensive or selective. A comprehensive review, in contrast to what may be inferred by the name, does not examine all expenditure programmes. Rather, the term “comprehensive” refers to how the topics chosen to be reviewed are selected. In a comprehensive review, topics are not selected prior to the review process and

all departments are examined to identify the most important areas where savings can be made. In contrast, a selective review is one where a list of topics for review is drawn up *ex-ante*. Selective reviews focus more on sustainability of expenditure than on expenditure reductions. Topics may be selected on an automatic rolling basis, or a discretionary basis.

Recently there has been a resurgence in popularity of comprehensive expenditure reviews internationally, with a focus on fiscal consolidation. However, international best practice suggests a selective review, which is more targeted, and is a more effective means of assessing sustainability and expenditure management. This selective approach is common among the established spending reviews conducted internationally, such as the '*Comprehensive Review of Expenditure*' in The Netherlands and the '*Special Studies*' in Denmark (Blöndal and Ruffner, 2004).²⁰ A more selective approach should make more efficient use of the evidence available. Aligning the three year round of Value for Money Reviews to the selective review topics list could improve the evidence base for decision making.²¹ *SPU 2017* indicated that the next Spending Review will move to a rolling selective review process.

Spending Reviews in the Budgetary Process

Spending reviews act as a complementary tool to the budgetary process for expenditure management. They provide a mechanism to combat incrementalism (i.e., an excessive focus on new expenditure items as opposed to existing expenditure) by

- Presenting an analysis of the baseline expenditure,
- Ensuring that the whole of government expenditure is considered in policy decisions,
- Providing an input into the estimates process where new expenditure can be considered,
- Providing opportunities for the efficient reallocation of spending across and within sectors (Marcel, 2012).

Thus, spending reviews improve the budgetary process by separating the generation of fiscal space, and through the evaluation of existing spending, from the allocation of resources and consideration of new expenditure.

In line with good public expenditure management the MTEF sets the provisions for Multiannual Expenditure Ceilings. The *CRE 2012-2014* and *CRE 2015-2017* notionally set multiannual expenditure ceilings for the next three-year period. However, these ceilings are being consistently revised upwards in the budget estimates process, which highlights their inefficiencies as credible ceilings and their propensity to incentivise incrementalism.

As outlined in Box I, Ministerial Expenditure Ceilings should be set to take account of underlying demand pressures while also encouraging efficient expenditure management and prioritisation within these ceilings. Spending review evaluations can inform these ceilings. A selective expenditure review, supported by an evidence base of evaluations such as the Value for Money Reviews, will provide important information on efficiency and strategic savings to facilitate prioritisation within expenditure ceilings.

²⁰ Although this review is called a Comprehensive Review it is more selective in approach with a list of policy areas to be reviewed chosen *ex-ante*. http://ec.europa.eu/economy_finance/events/2014/20140211-meeting/documents/session3tim_en.pdf

²¹ Under the Public Spending Code all Departments are required to carry out Value for Money Policy Reviews (VfM) and Focused Policy Assessments (FPAs). These reviews examine specific areas of expenditure and address the rationale and objectives, efficiency and effectiveness of the scheme. Departments are required to carry out three VFMs/FPAs in a three year cycle. The topics selected are brought to Government before the cycle begins.

3.4 SPU 2017 Medium Term Forecasts (2018-2021)

General Government Balance 2018-2021

Turning to the medium term, *SPU 2017* outlines a slight revision to the General Government Balance from the *Budget 2017* forecast. For 2018, an improvement in the deficit of 0.3 percentage points relative to 2017 is indicated, with a projected deficit of 0.1 per cent of GDP. A surplus of 0.1 per cent is projected in 2019, increasing to 0.6 per cent in 2020 and 1 percent in 2021. The improvement is at a slightly weaker pace than outlined in *Budget 2017*, and partly reflects reduced Central Bank capital gains that more than offset an increase in the Social Investment Fund surplus.

Total revenues, excluding one-offs, are expected to grow over the forecast period (2018-2021) at an average rate of 3.8 per cent, whereas total expenditure, excluding one-offs, is growing at an average of 2.4 per cent over the period 2018 to 2021. Primary expenditure shows higher growth at an average of 2.9 per cent. This slows marginally in the later forecast years from 3 per cent in 2018 to 2.7 per cent by 2021. Combined with increasing revenue growth in later years (averaging 4 per cent over 2020 to 2021), this leads to an improving General Government Balance relative to preceding years. The Government's stated policy of fully using projected fiscal space under the EU rules implies that, on average, spending will grow at a slower rate than revenues by about 1.3 percentage points.²²

Expenditure 2018-2021

Expenditure is planned to increase over the medium term, while complying with the fiscal rules. *SPU 2017* notes the establishment of a Rainy Day Fund following the achievement of a balanced budget in 2018, and sets aside €1 billion each year 2019-2021 for the Fund. This €1 billion is counted as Exchequer spending, but does not affect the General Government Balance as the amounts allocated remain within the General Government sector. This will drive a wedge between Exchequer and General Government spending.

Following the period of consolidation of the public finances, expenditure has begun to increase again since 2015. The average annual growth rate of total expenditure planned in *SPU 2017* for the period 2018 to 2021 is 2.4 per cent. Figure 3.9a shows the growth in gross voted expenditure over the period 2002 to 2017 using *SPU 2017* forecasts for the period 2017 to 2021.

²² Excluding one-offs (see Box H in Chapter 4).

Figure 3.9a: Gross Voted Expenditure % Change (Year-on-Year)

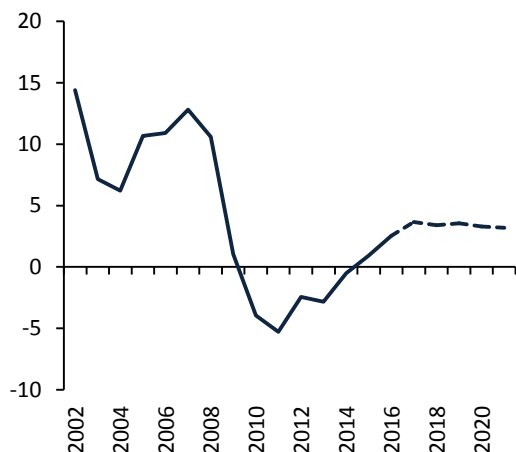
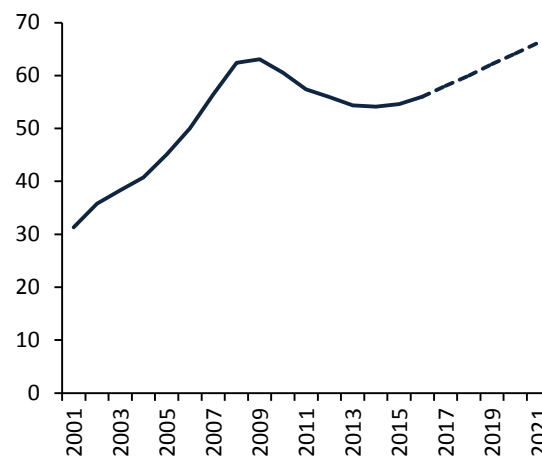


Figure 3.9b: Gross Voted Expenditure € Billion

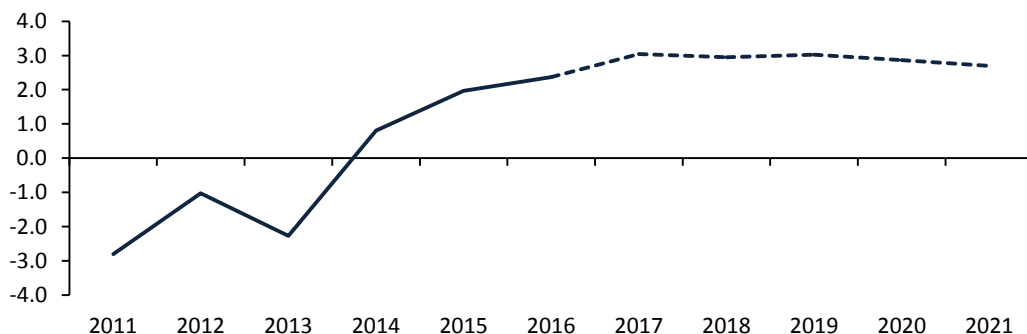


Sources: Department of Finance; Department of Public Expenditure and internal IFAC calculations.
 Note: Gross voted expenditure as per DPER databank. Data are 2016-2021, as per SPU 2017.

Gross voted expenditure growth in 2016 reached 2.5 per cent. Figure 3.9b shows the level of gross voted expenditure over the period 2001 to 2016 and the SPU forecast for period 2017 to 2021. In 2016, gross voted expenditure was equivalent to 89 per cent of peak expenditure levels in 2009. Expenditure is planned to surpass this peak in 2020.

Stripping out expenditure in relation to interest payments and excluding one-off expenditure items, primary expenditure began to rise in 2014 and is projected to continue to grow at roughly 3 per cent per annum over the forecast period (2017 to 2021) (Figure 3.10).²³ This represents a fall, as a share of GDP, from 25.7 per cent in 2016 to 23.5 per cent in 2021.

Figure 3.10: Growth in Primary Expenditure (excluding one-offs) Percentage change (year-on-year)



Sources: CSO; Department of Finance; and internal IFAC calculations.
 Note: Primary Expenditure equals total expenditure less interest repayments on government debt and one-offs. One-offs are examined in Box H of Chapter 4 and relate to those identified by the Council as applicable.

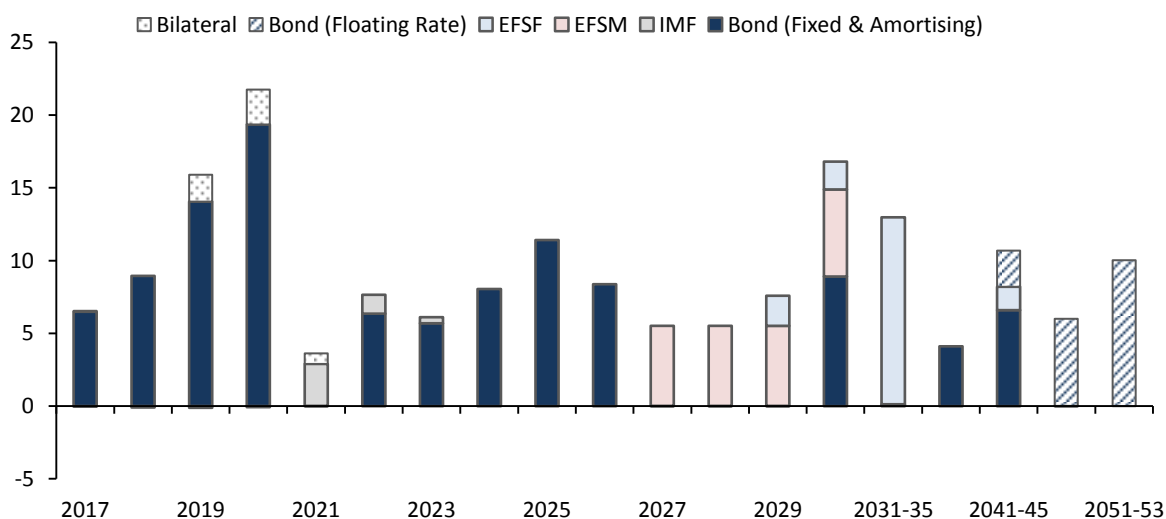
²³ One-offs are examined in Box H of Chapter 4 and relate to those identified by the Council as applicable.

Given the pattern of upward revision to expenditure in recent years, it may be expected that current spending plans will be revised up. However, considering the limited fiscal space available, the scope for additional spending increases over and above amounts already allocated will be somewhat constrained, especially in view of planned discretionary revenue measures.

Interest payments on government debt also form an important part of expenditure over the medium term. The stock and maturity profile of debt, along with interest rates, will determine this expenditure. Figure 3.11 shows the National Treasury Management Agency (NTMA) maturity profile of Ireland’s long-term and marketable debt as at end-March 2017. This profile has been adjusted to take account of the extensions of the European Financial Stabilisation Mechanism (EFSM) loans which have been agreed. Although some of the EFSM loans have yet to be refinanced, these data provide an indicative profile of maturity, including this extension.

Figure 3.11: Maturity Profile of Ireland’s Long Term Marketable and Official Debt as at End-March 2017

€ Billions



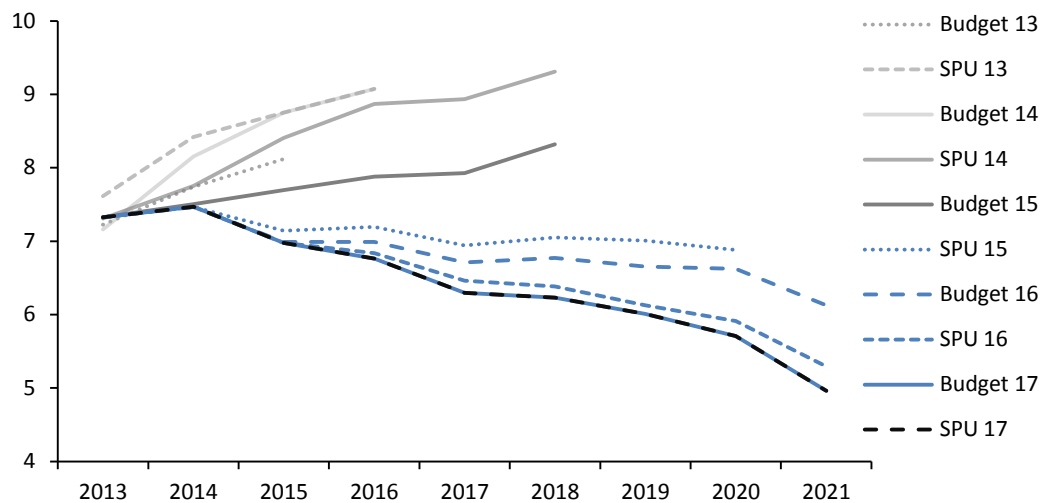
Sources: NTMA; Department of Finance; and internal IFAC calculations.

Note: Data are adjusted to provide an indicative profile given the seven year extension of the EFSM loans, to bring the weighted average maturity from 12.5 years to 19.5 years. Ireland is not expected to refinance these loans before 2027. Therefore, the indicative maturity of the EFSM loans has been placed in the years 2027-2031, but may be subject to change.

Interest costs on government debt have been on a declining trend in recent years and this is projected to continue over the forecast period (2017 to 2021). Figure 3.12 shows the improvement in forecast and actual interest costs due to low interest rates globally; agreed reductions in interest rates on official borrowing; expansionary monetary policy by the ECB, including the Public Sector Purchase Programme; and the early repayment of IMF loans and other debt restructuring. *SPU 2017* keeps interest cost projections unchanged from those forecast in *Budget 2017*, with interest expenditure forecast to fall over the forecast horizon (2017-2021).

Figure 3.12: National Debt Cash Interest Projections

€ Billions

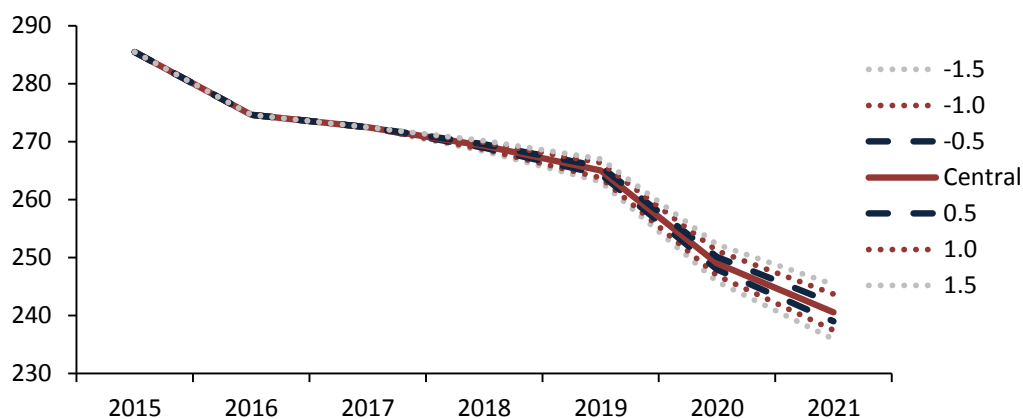


Sources: Department of Finance; internal IFAC calculations

Interest rate shocks pose less of a risk to the public finances following recent maturity extensions and interest rate reductions (Figure 3.13). At high debt levels, however, there are still risks that self-reinforcing fears in bond markets might take hold and there are substantial maturities to be rolled over during 2018-2021 (some €50 billion; 16 per cent of GDP). As noted in the *November 2016 FAR* (IFAC 2016c), risks may arise from external shocks, while developments in relation to international monetary policy could negatively impact Irish borrowing costs.

Figure 3.13: Gross Debt Paths

General Government Basis (% Total Revenue)



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

Note: Lines depict how far the debt-to-revenue would be pushed away from the baseline scenario under different shocks to marginal interest rates in each year. Changes in EDP debt instrument assets for forecast years are assumed to be in line with projected changes in cash balances.

Expenditure on public sector pay will impact on the dynamics of total spending over the medium term. Negotiations in relation to an extension to the pay agreement have been entered into by the Department of Public Expenditure and Reform, following the recent publication of the *Report of the*

Public Service Pay Commission (2017).²⁴ Given existing pay pressures, public sector pay forecasts are likely to rise over the medium term. Any resulting increases in pay expenditure will exert some upward pressure on overall spending plans, in the absence of additional efficiency or other savings from other non-pay expenditure. Any such costs would likely take effect over the medium term (i.e., from 2018 at the earliest as opposed to from 2017). The gross public sector pay bill net of the pension-related deduction was €15.6 billion in 2016 (Public Service Pay Commission, 2017). A one per cent increase in pay would – all other things being equal – lead to an approximate €0.15 billion additional expenditure annually.

The medium-term expenditure forecasts (2018 to 2021) in *SPU 2017* are undertaken on an *ex-post* basis, taking account of the fiscal space that will be available for allocation in the coming years. The Council welcomes this improvement to the projection methodology. The forecasts allow for growth in expenditure to account for some demographics pressures, the Lansdowne Road Agreement, and capital spending contained in the Infrastructure and Capital Investment Plan 2016 to 2021. Some €5.14 billion additional capital expenditure is due to be allocated under the Review of the Infrastructure and Capital Investment Plan 2016-2021 which is due to take place in 2017. Therefore, it may be expected that the capital expenditure departmental ceilings will be revised; however, the General Government Gross Fixed Capital Formation, as forecast in *SPU 2017*, has taken account of the additional funding. As such there is some inconsistency between the expenditure ceilings and the forecasts, which should be resolved to improve the credibility of the ceilings.

Box F: Public Capital and Investment Expenditure

This Box examines recent trends in public capital and investment expenditure in Ireland on a gross and net basis. *SPU 2017* plans for an increase of €5.14 billion in capital expenditure, consistent with the review of the *Infrastructure and Capital Investment Plan 2016-2021*. This expenditure should increase the stock of public infrastructure in Ireland somewhat after a period of consolidation in the face of estimated depreciation. However, net fixed capital formation will still remain below average levels over the 2000 to 2008 period.

Recent trends in Gross Fixed Capital Formation

In the lead-up to the crisis investment in public capital, as a share of primary expenditure, was consistently over 10 per cent in the period 2000 to 2008, with a peak of 13.5 per cent in 2001 (Figure F.1). The consolidation of the public finances saw public investment roughly halved, as a share of primary expenditure, over the following years, with gross fixed capital investment in 2016 approximately half of its peak level in 2008. It is important to note that although investment levels fell sharply over the crisis period, considerable capital investment in the years running up to 2008 did much to address infrastructural deficits in the State (Kennedy, 2016).

SPU 2017 plans an increase in investment as a share of primary expenditure over the period 2017-2021, reaching 9.4 per cent in 2021. This proportion includes the additional €5.14 billion to

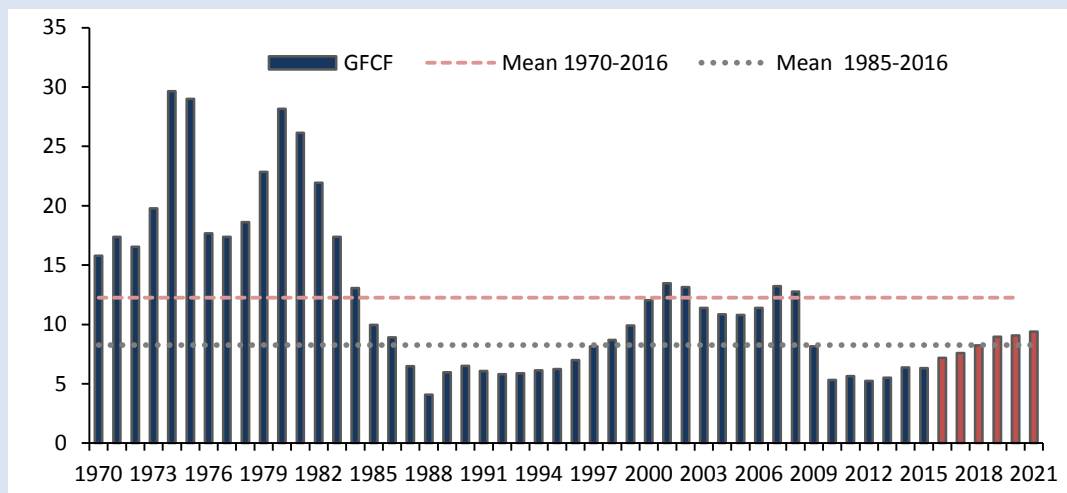
²⁴ <http://www.per.gov.ie/en/minister-donohoe-welcomes-report-of-the-public-service-pay-commission/>

be allocated in the review of the *Infrastructure and Capital Investment Plan 2016-2021*.

Figure F.2 shows Ireland’s public capital stock per capita in contrast to select comparator countries. Ireland’s public capital stock was above all the comparator countries, bar the UK, for most of the period (1998-2014).

Figure F.1: Public Investment

General Government GFCF as a Share of Primary Expenditure (1970-2021)

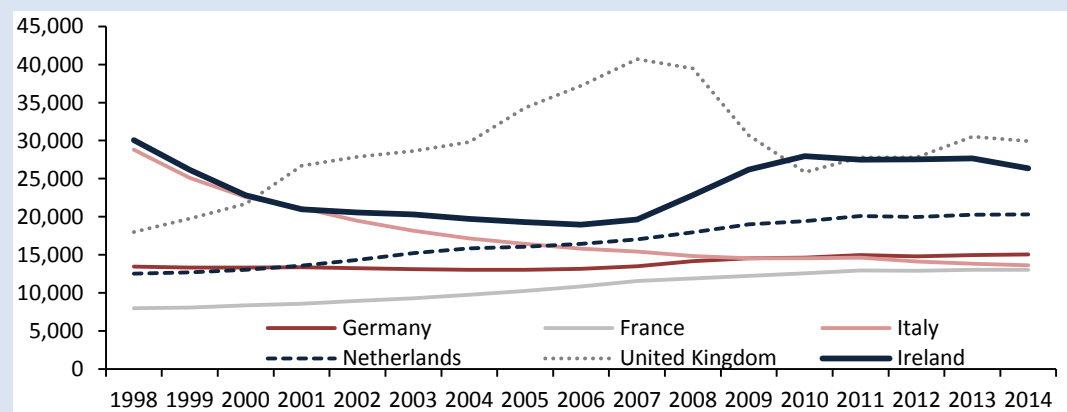


Sources: CSO; Department of Finance; and internal IFAC calculations.

Note: Primary Expenditure equals total expenditure less interest repayments on government debt. Red bars indicate SPU 2017 forecasts, which take account of the planned allocation of €5.14 billion under the Review of Capital Plan.

Figure F.2: International Comparison Public Capital Stock

Real Non-Financial Assets, € per capita



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

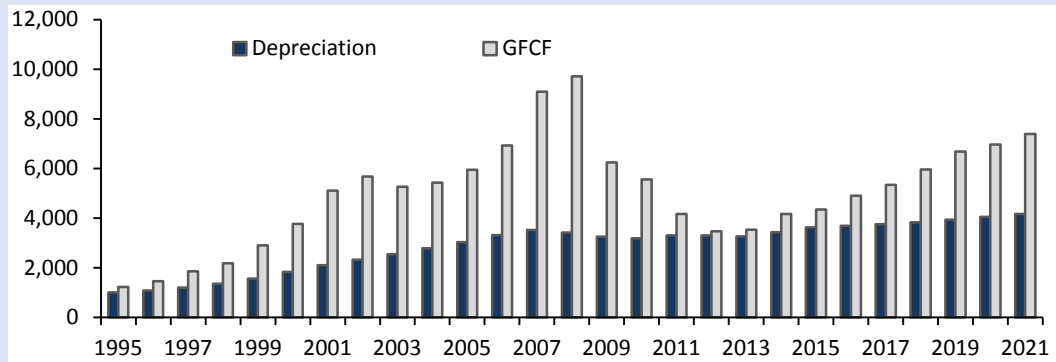
Note: Irish Non-Financial Assets computed using the Perpetual Inventory Model (PIM) method (see Kennedy, 2016); population is as of 1 January. In practice, stock estimates are comprised of fixed assets in public administration and defence, education, health and local authority housing.

Net Fixed Capital Investment

Net fixed capital investment describes public investment in capital, less depreciation of assets. To increase the level of the public capital stock, gross investment would have to exceed depreciation. Figure F.3 shows the trends in gross investment and estimated depreciation in Ireland for recent years and the forecast period covered by SPU 2017 (2017-2021).

Figure F.3: Gross Public Investment and Depreciation

€ Millions (1995-2021)



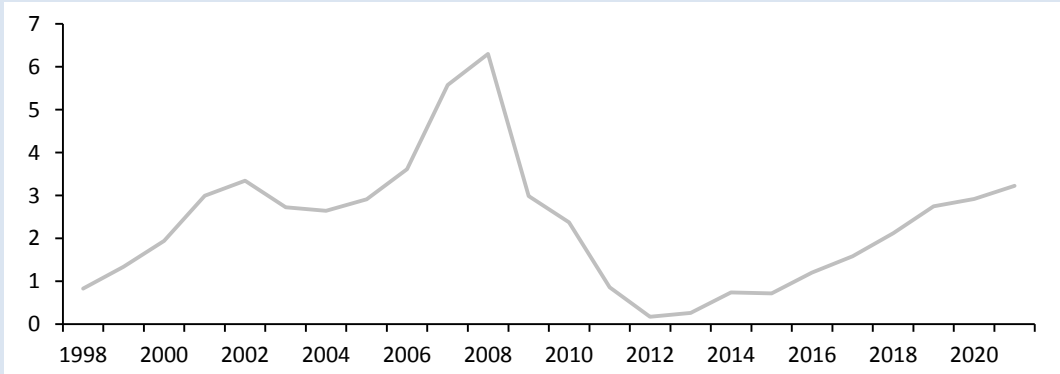
Sources: CSO, SPU 2017 Internal IFAC calculations

Note: Depreciation (GG Consumption of Fixed Capital (CFC)) is assumed to be 4 per cent per annum over the period 2016-2021. GFCF forecasts 2017-2021 as per SPU 2017.

From 2000 to 2008 investment far exceeded depreciation of fixed capital. However, since 2008, the fall in investment has led to a substantial decrease in this gap, with investment and depreciation approximately equal in 2013. This implies that investment was only enough to maintain the existing stock, rather than to increase it. Increased public investment over the forecast period (2017-2021) is expected to lead to an increase in net fixed capital formation. However, by 2021, net fixed capital formation is expected to reach 91 per cent of the average level over the period 2000 to 2008 (a period in which considerable capital investment took place addressing previous infrastructural deficits). Figure F.4 shows net public investment over the period 1998 to 2021.

Figure F.4: Net Fixed Capital Formation

€ Billion, 1998-2021



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

Note: Depreciation (GG Consumption of Fixed Capital (CFC)) is assumed to be 4 per cent per annum over the period 2016-2021. GFCF forecasts 2017-2021 as per SPU 2017.

Gross fixed capital formation is forecast to grow at an average of 9 per cent per annum over the forecast period (2017 – 2021). After a prolonged period of negative growth (an average of -5 per cent 2008-2016) it may be expected that a certain degree of unmet demand is present. Given this limited level of investment since 2008, maintaining such low growth in capital expenditure may be difficult in view of expected economic growth and demographic projections. For example, the Department of Transport, Tourism and Sport (2015) estimated a €300 million gap to maintain the land transport system.²⁵ One area where investment pressures might be expected to arise is in relation to the housing sector where supply is understood to have fallen short of estimated annual demand in recent years (see Chapter 2).

²⁵ <http://igees.gov.ie/wp-content/uploads/2015/04/Transport-Trends-2015-Final.pdf>, Department of Transport Tourism and Sport (2015), Transport Trend, An Overview of Ireland's Transport Sector.

Budget plans and projections will be more robust if built on a good understanding of the drivers of expenditure and how they are expected to evolve over the medium term. The *Mid-Year Expenditure Report 2016* noted progress of work in developing a methodology to “separately model the evolution of volume/demand and price impact” on public expenditure. This methodology along with any findings of the upcoming spending and capital reviews could provide a valuable input to future medium-term expenditure forecasts and improve the basis on which fiscal forecasts can be assessed.

While the recent progress in the presentation of budgetary forecasts on an *ex-post* basis is welcome, further improvements could enhance the quality the medium-term expenditure forecasts presented in the budget and expenditure reports. The Council maintains, as noted in previous *Fiscal Assessment Reports*, that an estimate of the cost of maintaining today’s level of public services and benefits in real terms in future years should serve as an important input into the expenditure planning process. Producing such a scenario would enrich the evidence base for budgetary decisions. The Council’s Stand-Still expenditure scenario (Box G) provides an example of such an exercise. The Stand-Still scenario aims to provide an estimate of the bottom-up pressures, taking account of demographics, inflation and the Lansdowne Road Agreement.

Box G: The Council's Stand-Still Medium Term Expenditure Scenario

This Box updates the medium-term scenario for government expenditure contained in IFAC's November 2016 *Fiscal Assessment Report* (IFAC 2016c). The Stand-Still approach is intended as an illustrative exercise and should not be seen as an alternative expenditure forecast to that outlined in *SPU 2017*. The exercise outlines the cost of maintaining today's level of public services and benefits in real terms, given demographic costs and price changes. It is important to note that the Council is not suggesting that automatic or semi-automatic indexation should be adopted as a policy. Instead the scenario provides information as an input into the policy decision process through which the ultimate expenditure forecasts are produced.

In constructing the medium-term Stand-Still scenario, government expenditure is split into five headline components: health; education; social payments (including social welfare pensions); national debt interest; and other. The methodology used in each case is described in Box E of the June 2016 *Fiscal Assessment Report* (IFAC, 2016a).

The Stand-Still approach does not consider possible efficiency gains or Government policy changes that could lead to expenditure savings over the timeframe. Rather, the scenario illustrates the cost of maintaining today's level of public services in the absence of such efficiency measures and/or policy changes.

Table G.1 provides a comparison between the fiscal space allocated to current expenditure (including pre-committed amounts) implicit in *SPU 2017* and the Council's Stand-Still scenario for current expenditure.²⁶

The Council's Stand-Still scenario shows the estimated increases in current spending if demographic pressures were fully accommodated for and if spending moved in line with inflation as forecast in *SPU 2017* by the Department of Finance. In this scenario, gross voted current spending would increase by €5.96 billion over the period 2018 to 2021.

For the same period (2018 to 2021), the Government has pre-committed €2.27 billion for the cost of: (i) public sector pay arrangements under the Lansdowne Road Agreement (2018); (ii) some estimated demographic pressures; and (iii) to cover other pre-committed spending measures (amounting to €0.16 billion).²⁷

Comparing total pre-committed expenditure increases (before any indicative allocations of fiscal space are considered) with the Stand-Still estimates implies that €3.69 billion of the available fiscal space would be required to fully account for demographic pressures and the additional costs of maintaining real services and benefits, should it be decided these are to be maintained. The *SPU* indicatively allocates some €3.6 billion of fiscal space to current spending over the same period (2018-2021). This implies that – in the absence of policy changes, or changes to macroeconomic spending drivers – fully accommodating estimated demographic pressures and the cost of maintaining real public services and benefits would absorb all of the fiscal space currently budgeted for expenditure increases from 2018-2021, and that an additional €0.09 billion would be required. However, it is important to note that the Stand-Still estimates do not take account of any other pre-committed expenditure increases included in *SPU 2017* and are only based on the estimated cost of fully accommodating demographic changes and price increases. Additionally, live register savings noted in *Expenditure Report 2017* could offset the pre-committed gross voted current expenditure increases noted should these savings be realised.

Relative to the Council's previous Stand-Still scenario (IFAC 2016c), the estimated increase in gross voted spending required to stand still is €0.36 billion higher, primarily because of higher price inflation, as forecast in *SPU 2017*. This is offset, in part, by lower demographic pressures, given new Census data, which show changes in the composition of the population.

²⁶ Note that the Stand-Still scenario assumes the same levels of capital expenditure for all periods as allocated by the Department.

²⁷ This relates to pre-committed EU programme funding covered under the Rural Development Fund.

Table G.1: Comparison of Estimated Stand-still Current Expenditure and Allocated Fiscal Space

€ Billion

	2018	2019	2020	2021	Total (2018-2021)
Gross Voted Current Spending - IFAC Stand-still (A)	1.00	1.49	1.71	1.76	5.96
of which: Demographics	0.38	0.47	0.61	0.62	2.09
Prices	0.62	1.02	1.10	1.14	3.88
Budget 2017 Net Pre-Committed Gross Voted Current Expenditure (B)	0.77	0.50	0.50	0.50	2.27
of which: Demographics	0.41	0.46	0.46	0.46	1.79
Lansdowne Road Agreement	0.32	0.00	0.00	0.00	0.32
Other	0.04	0.04	0.04	0.04	0.16
Amount of Net Fiscal Space Needed to Stand Still C=(A-B)	0.23	0.99	1.21	1.26	3.69
Net Fiscal Space Allocated to Current Expenditure (Budget 2017/SES 2016) (D)	0.60	1.00	1.00	1.00	3.60
Difference Between Net Fiscal Space Needed to Stand Still and Net Fiscal Space Allocated to Current Expenditure Increases E=(D-C)	0.37	0.01	-0.21	-0.26	-0.09

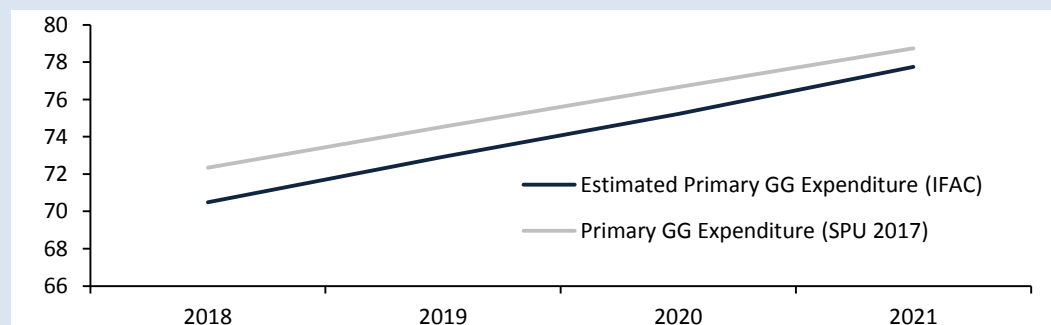
Sources: Department of Finance; DPER; and internal IFAC calculations.

Note: (A) IFAC stand-still gross voted current spending is attained using a bottom up approach based on the latest expenditure estimates for 2016, a cohort component demographics model and the latest macroeconomic and inflation forecasts from *SPU 2017*. (B) *Budget 2017* pre-committed spending takes the demographics and pre-committed spending figures as in *Budget 2017* (held constant from 2019-2021) which remained unchanged in *SPU 2017*. The net fiscal space allocated to current expenditure (D) takes the fiscal space allocated in *SES 2016* and updates it for the *Budget 2017* package.

Figure G.1 illustrates the scenarios for primary General Government expenditure. The IFAC scenario which illustrates the cost of maintaining today's level of public services in the absence of efficiency measures and policy changes remains below the expenditure scenario as per *SPU 2017* for the entirety of the period (2018 to 2021).

Figure G.1: Scenarios for Government Expenditure (2018-2021)

€ Billions



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

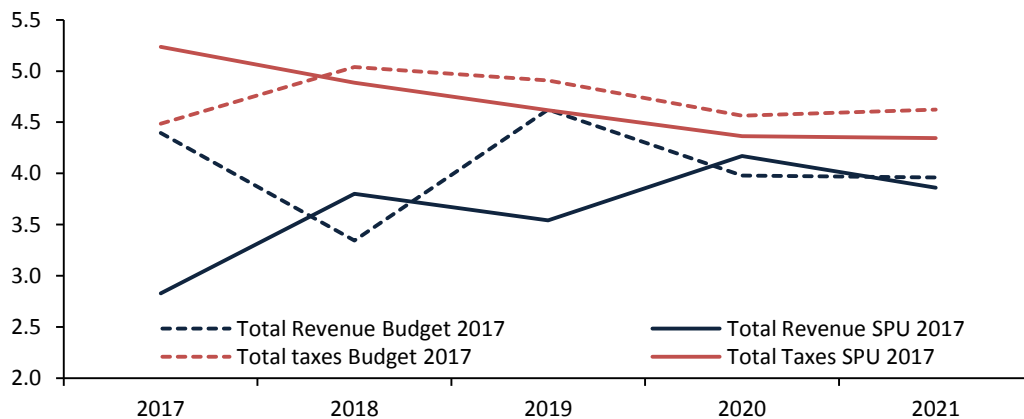
Note: IFAC expenditure scenario illustrates the estimated cost of fully accommodating demographic changes and price changes.

Revenue 2018-2021

Total general government revenues are forecast to grow at an average annual rate of 3.8 per cent from 2018 to 2021. This is primarily driven by total tax revenue growth, which moderates over the medium term (from 4.8 per cent in 2018 to 4.4 percent in 2021).²⁸ Non-tax revenues are expected to fall over the medium term due to lower capital gains from Central bank receipts and reductions in semi-state dividends and other receipts.

General Government revenue forecasts growth rates have been revised slightly from *Budget 2017* (Figure 3.14). Total General Government revenues are forecast to grow at a slightly faster rate in 2018, but on average 0.1 percentage points slower than predicted on budget day, over the period 2018-2021. This reflects downward revisions to both current tax revenue and non-tax revenue over the forecast period. The downward revisions to total tax revenue growth over the medium-term are in line with the downward revisions to GDP growth (Chapter 2).

Figure 3.14: Revenue Growth Forecast *Budget 2017* vs *SPU 2017*
% Growth (2017-2021)



Sources: Department of Finance; and internal IFAC calculations.

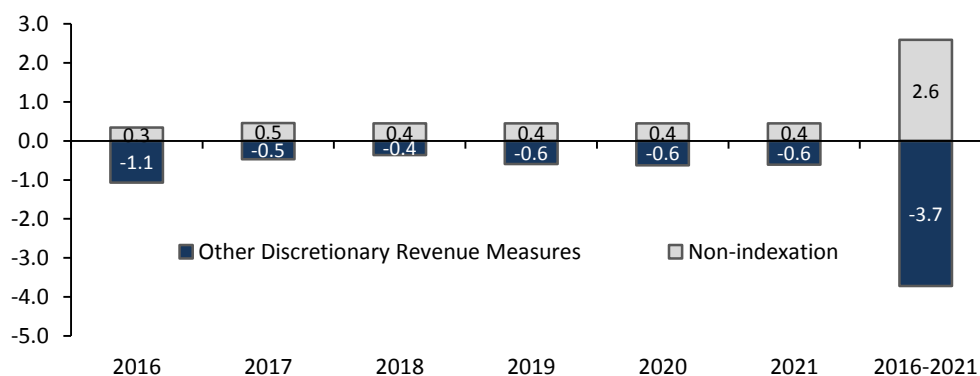
Note: Forecasts as per *Budget 2017* and *SPU 2017*.

Current tax forecasts remain broadly unchanged from *Budget 2017*, although this reflects a downward revision in the predicted annual average growth rate by 0.2 percentage points to 5.2 per cent over the forecast horizon 2018-2021. While Income Tax and VAT are expected to continue contributing the most to total revenue, Corporation Tax will continue to play a considerable role and is expected to maintain approximately 15 per cent of total tax revenues. As outlined in Appendix E over the medium term (2018 to 2021), the macro driver effect plays a positive role in all tax heads, and a negative policy effect is evident for PAYE and USC due to revenue-reducing discretionary measures.

²⁸ Total Tax revenue here refers to General Government receipts and is the sum of Taxes on Production and Imports, Current Taxes on Income, Wealth and Capital Taxes as per *Budget 2017* and *SPU 2017*.

Figure 3.15 shows the estimated impact of discretionary revenue measures introduced in *Budgets 2013 to 2017*, over the period 2016 to 2021 (i.e., carryover effects from earlier years' budgets are reflected). This is an illustrative exercise. The plans outlined in *SPU 2017* are consistent with an assumed use of fiscal space available over the forecast horizon that ultimately will be a matter for decision with each budget.²⁹ Discretionary revenue measures that are not the result of non-indexation are estimated to have a cumulative revenue-reducing impact of €3.7 billion from 2016 to 2021. Non-indexation is estimated to have a cumulative revenue-raising impact of €2.6 billion.

Figure 3.15: Impact of Discretionary Revenue Measures and Non-Indexation
€ Billions



Sources: Department of Finance; and internal IFAC calculations.

Note: Non-indexation reflects the increase in tax revenues due to tax bands not being indexed so that, as incomes rise, additional tax revenues are generated. Other Discretionary Revenue Measures shown include both discretionary revenue measures introduced that year as well as the carryover impact of measures introduced in previous years.

Over the medium term forecast horizon (2018 to 2021), non-tax revenues are expected to fall on average by 5.8 percentage points faster than forecast in *Budget 2017*, with an average growth rate of -14.3 percent (Figure 3.16a). This fall in receipts is due largely to lower Central Bank surplus income, reflected in the falling property income figures in General Government Receipts and also a decrease in dividends and other receipts (Figure 3.16b). Capital resources are expected to fall over the horizon, as a result of lower financial transactions related to the State's support to the financial sector following recent sales.³⁰ Although no assumptions have been made about revenues falling based on future sales, this highlights the inherent trade off between revenues from the potential sale of the State's assets in the financial sector, which may be used to decrease debt, and lower revenue growth thereafter.

²⁹ *SPU 2017* projections are provided on an "ex-post" basis. This means that they are based on an indicative allocation of estimated fiscal space for the forecast period. The indicative allocation is consistent with fiscal policy assumptions contained in *A Programme for a Partnership Government*, which indicates an intention to "introduce budgets that will involve at least a 2:1 split between public spending and tax reductions".

³⁰ Examples of such transactions include contingent capital notes in AIB and PTSB or sale shares in Bank of Ireland.

Figure 3.16a: Non-Tax Revenue
€ Billion

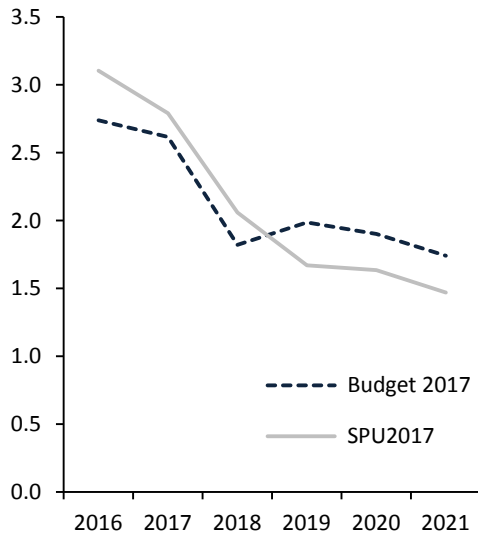
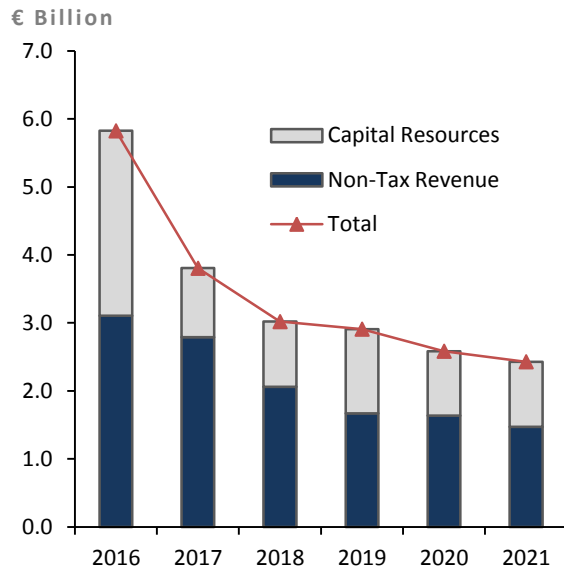


Figure 3.16b: Non-Tax Revenue & Capital Resources (SPU 2017)
€ Billion



Source: Department of Finance.

Figure 3.17a provides an examination of total tax revenue as a share of Underlying Domestic Demand (UDD), GDP and GNP. Total Tax Revenue as a share of GDP, GNP and underlying domestic demand all show a decreasing trend, although stabilising somewhat over time, until recent years when tax revenue as a share of underlying domestic demand started to increase. This deviation may, in part, reflect a divergence between domestic economic activity (estimated by UDD) and recent surges in tax revenues, which have been disproportionately driven by Corporation Tax receipts.³¹ The *SPU 2017* forecasts imply that tax revenues as a share of all three measures will remain reasonably flat over the forecast period, although the share of underlying domestic demand falls somewhat (2017 to 2021).

³¹ Box C of Fiscal Assessment Report, November 2016 highlights the recent disproportionate effect of growth in CT receipts on total revenues in terms of both variability and forecast error contributions. However, the impact of changes in underlying domestic demand which occurred circa 2009 should also be considered here.

Figure 3.17a: Tax Revenue Share
Percentage of UDD, GDP or GNP

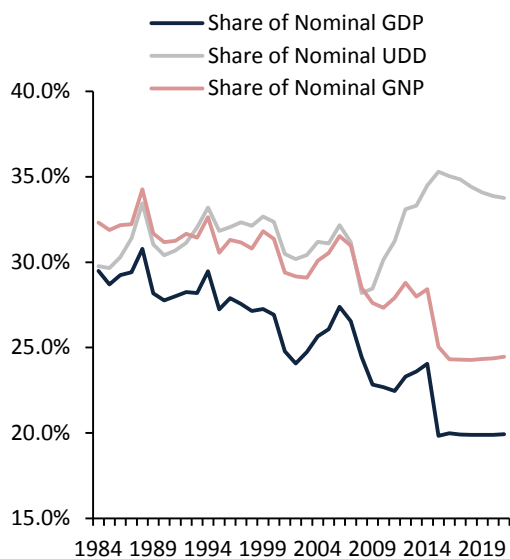
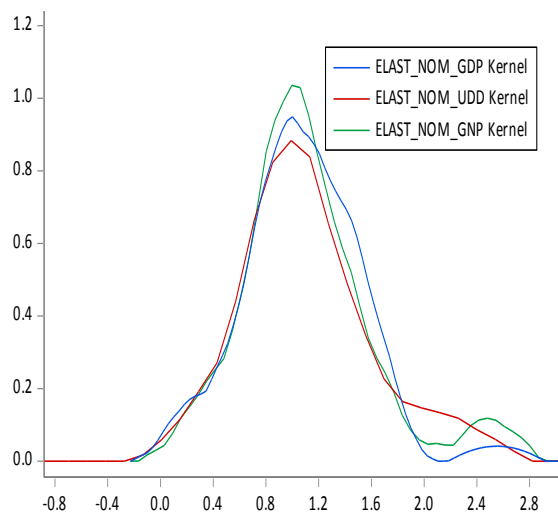


Figure 3.17b: Tax Revenue Elasticities
Density of Annual Elasticities (1984-2021)



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

Note: Data for 2016-2021 forecasts as per *SPU 2017*. Elasticities estimated on the basis of data from 1970-2021 for nominal measures of economic activity. Total Revenue not adjusted for discretionary revenue measures. UDD = Underlying Domestic Demand (Chapter 2).

Figure 3.17b shows the distribution of recent elasticities of tax revenues to nominal underlying domestic demand, GDP and GNP. It suggests that an elasticity in the range of 0.8 to 1.2 may be appropriate, depending on the measure of economic activity used. Underlying domestic demand may be serve as a more informative measure than nominal GDP and GNP for the domestic economy, which tends to be more tax-rich in nature. The modal outturn suggests that tax revenues typically have a lower sensitivity to underlying domestic demand, but this distribution is marginally more positively skewed, which may reflect the disproportionate impact that outsized Corporation Tax changes can have on aggregate elasticities.

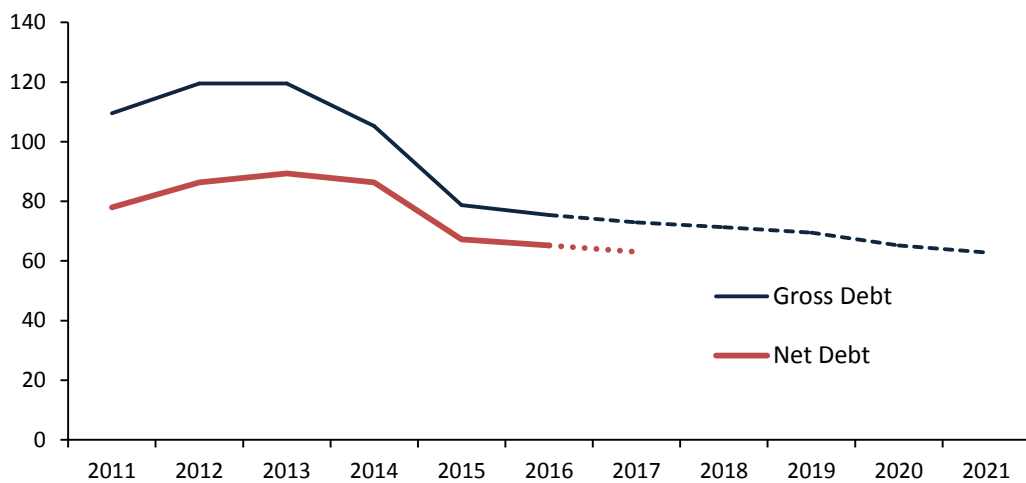
General Government Debt

Figure 3.18 shows the evolution of General Government Debt as a percentage of GDP (2011 to 2016) and the projections for the period 2017 to 2021 as set out in *SPU 2017*. The debt-to-GDP ratio has been falling since 2012, partially due to increased economic growth and partially due to nominal debt reduction following the liquidation of the IBRC. *Budget 2017* outlined a “target” debt-to-GDP ratio of 45 per cent to be achieved in the mid- to late-2020s. This target is lower than the limit of 60 per cent as set out under the Stability and Growth Pact. However the distortions to GDP from 2015 mean that 45 per cent of the new estimate is almost equivalent to 65 per cent when the effect of methodological issues is considered and when using a hybrid measure that more appropriately captures fiscal capacity for Ireland (see Chapter 1). As of end-2016, the debt-to-GDP ratio stood at 75.4 per cent, 0.6 percentage points lower than the budget day projection. This reduction was facilitated by higher-than-expected nominal GDP growth (an increase in the

denominator). Net debt-to-GDP has also fallen over recent years and is expected to reach 63 per cent in 2017.

While the debt-to-GDP ratio is an important measure of the debt position, its reliability as a measure of debt sustainability has lessened in recent years due to large unexpected changes in nominal GDP. As an interim measure, and until alternative denominators such as GNI* become available (Box D), the Council has considered alternatives such as debt-to-revenue ratios (Chapter 1). The stock of debt and the maturity profile also provide an important insight to debt sustainability and funding (Figure 3.11).

Figure 3.18: General Government Debt
% GDP



Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: Data for the period 2017-2021 are projections as per *SPU 2017*.

3.5 Risks

While *SPU 2017* has seen improvements in both the macroeconomic and fiscal outlook, substantial risks to the public finances remain. One of the most prominent risks continues to be uncertainty in relation to the external environment, in particular Brexit and possible changes to international economic and fiscal policy. US economic and fiscal policy changes could have a considerable impact on Ireland. Uncertainty with regards to US Corporation Tax changes means there is a downside risk in relation to Ireland's Corporation Tax receipts from US multinational corporations currently located in Ireland. As outlined in Chapter 2, Brexit could have a significant adverse impact on the Irish economy, with negative consequences for the public finances.

As noted in Section 3.2 the volatility and high concentration of Corporation Tax receipts continues to be a source of potential risk to Ireland's fiscal position. The proportion of Exchequer Tax revenue accounted for by Corporation Tax has increased considerably since the large unexpected increase

in 2015, and is now close to peak levels again. Net receipts in 2016 amounted to €7.4 billion, with 37 per cent of this related to the Top 10 payers (€2.8 billion). Given the scale of volatility in this tax head, there is a high degree of uncertainty with regards to the future trajectory of CT growth.

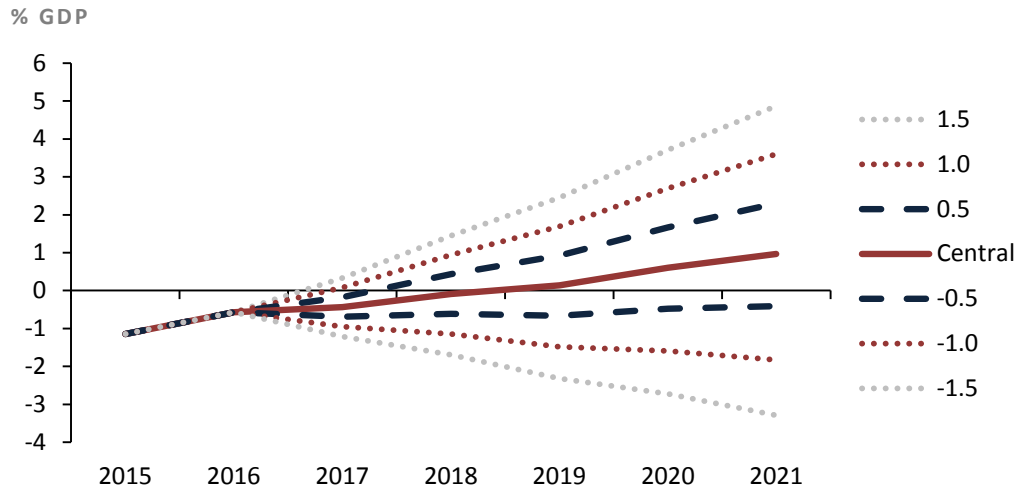
Budget 2017 noted an underestimation of the first-year costs of the reductions in USC in the *Budget 2016* estimates. Although the Revenue Commissioners have indicated that they are satisfied with the estimates of the impact of policy changes to income tax and USC, the first four months of 2017 saw poor performance of income tax returns. If these impacts have been mis-estimated once again, the forecast for Income Tax may be misleading, and it could potentially lead to a less favourable path for the General Government balance than forecast in *SPU 2017*.

Expenditure pressures also pose a risk to deficit projections. As Box I shows, expenditure ceilings have been subject to frequent revisions, weakening their role as an incentive for expenditure management by Departments. In-year expenditure increases aggravate this risk. Should expenditure pressures lead to additional upward revisions of ceilings, it is likely that a disimprovement in the path for the General Government balance projected in *SPU 2017* will result. The addition of new spending measures in the absence of efficiency gains or other savings could exacerbate the problem.

Recent trends in the housing sector also pose a risk. Given the low levels of supply of residential properties in recent years, there is a possibility that significant pent-up demand could emerge. If supply were to rapidly increase to meet any unmet demand, there could be a substantial upswing in revenues from this source, considering the tax-rich nature of housing output.

As shown in Figures 3.19 and 3.20, a shock to GDP growth of 1.5 percentage points relative to *SPU 2017* forecasts each year during 2018 to 2021 would result in the general government balance being over 4 percentage points of GDP lower by 2021. All else being equal, this means that the public finances would remain in deficit out to 2021 as compared to a central scenario where it rises to a surplus of 1 per cent of GDP. In the same scenario, the currently high gross government debt-to-revenue ratio would rise above current levels, in the absence of corrective policy action. A shock of this magnitude would not be exceptional given the historic volatility of Irish nominal GDP growth, for which a typical current year forecast error is close to 2 percentage points.

Figure 3.19: General Government Balance Paths

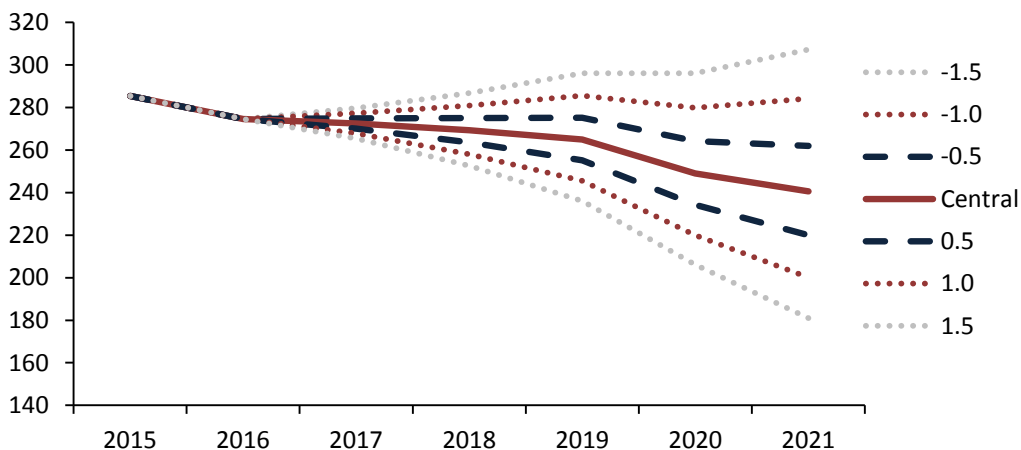


Sources: CSO; Department of Finance; and internal IFAC calculations.

Note: Using the Fiscal Feedbacks Model, the lines depict how far the budget balance would be pushed away from the SPU 2017 forecast under different shocks to growth in each year. The solid red line ("Central") corresponds to the latest official forecast.

Figure 3.20: Gross Debt Paths

% Total Revenue, General Government Basis



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

Note: Using the Fiscal Feedbacks Model, the lines depict how far the debt-to-revenue ratio would be pushed away from the baseline scenario under different shocks to growth in each year. Changes in EDP debt instrument assets for forecast years are assumed to be in line with projected changes in cash balances.

The Environmental Protection Agency (EPA) estimated that Ireland will exceed its obligations for Greenhouse Gas emissions in 2019 and will miss European targets set for 2020.³² Costs in relation to this are not expected to arise until 2020/2021. Ireland's target for non-Emissions Trading Scheme (ETS) sector emissions is a reduction of 20 per cent from the 2005 levels. The EPA has estimated non-ETS emissions to be in the range of 4 to 6 per cent below 2005 levels by 2020. Though no official government costings are currently available, Curtin (2016) estimates a cost of

³² See EPA report available at: http://www.epa.ie/pubs/reports/air/airemissions/ghgprojections/EPA_2017_GHG_Emission_Projections_Summary_Report.pdf

between €60 to €120 million for purchasing compliance with Ireland’s non-ETS targets, using “low” carbon costs of between €5 and €10. Similarly, Ireland will face costs, for failing to attain the Renewable Energy Sources targets for 2020, estimated at between €168 and €490 million. Longer term costs are expected as a result of emissions targets set by the European Commission in July 2016. It is estimated that these costs will be in the region of €2.7 to €5.5 billion, based on a cost of €50-€100 per tonne of CO₂. Therefore, in the medium-term horizon of *SPU 2017*, these costs appear to be a risk with a relatively lower impact, albeit with a higher impact arising over the longer term.

Table 3.3 shows the fiscal risks identified in *SPU 2017* along with the Department of Finance’s assessments of relative likelihoods and impacts. The Council then provides an assessment of each of the risks.

Table 3.3: Assessing *SPU 2017* Fiscal Risk Matrix

	Likelihood	Impact	IFAC Assessment
EU-level Climate Change and Energy Developments	H	H	Ireland is unlikely to meet its 2020 emissions targets without purchasing additional allowances, which could mean a cost of between €228 million to €600 million to the State. In the longer term (based on estimates to 2030 from Curtin, 2016), a failure to meet later targets could lead to additional costs in the region of €2.7 to €5.5 billion. This would suggest that for the forecast horizon, an assessment of high probability and relatively lower impact is appropriate.
Budgetary Pressures	M	H	This pressure refers to the risk of public expectations exceeding budgetary policy. Budgetary pressures may also arise due to demographics, eligibility factors and other demand side pressures. The negotiations in relation an extension of the Lansdowne Road agreement may add to these pressures. Any resulting increase in pay could increase existing expenditure pressures and should be considered in terms of impact on overall public finances.
Concentration of Corporate Tax Receipts	H	M	The increased proportion of tax revenue accounted for by Corporation Tax and the high concentration of revenue among the Top Ten payers makes this source of revenue particularly exposed to ‘idiosyncratic shocks’. Net receipts in 2016 amounted to €7.4 billion, with 37 per cent of this related to the Top Ten payers (€2.8 billion). The uncertainty about future US economic and fiscal policy further adds to this risk.
EU Budget Contribution	M	M	Should national income grow more than expected the EU budget contribution will increase. Additionally, there is uncertainty about budget contributions following the exit of Britain from the EU. However, given the relatively marginal effect that national income growth rates might have on this, the Council do not consider this as likely to have a substantial impact on the public finances.
Changes to Tax ‘Drivers’	M	M	Changes to the macroeconomic tax drivers, which are used for tax forecasting, may have a substantial impact on estimates and receipts. Changes to the elasticity of tax drivers which determine the response of revenues may also pose a risk to estimates and receipts.

	Likelihood	Impact	IFAC Assessment
Financial Sector Developments	L	M	The SPU identifies risks exist in relation to the non-, or lower-than-expected payment of bank dividends to the State. These are a function of ongoing business performance & outlook, regulatory requirements and are subject to bank board and supervisory control over which the State has no control. If some of these assets are sold, then associated revenue streams could fall.
Receipts from Resolution of Financial Sector	L	M	The SPU doesn't incorporate any assumed proceeds in relation to the State's disposal of shareholdings in a number of financial institutions, nor from the termination of NAMA or windup of the Credit Union Restructuring Board. This is due to the difficulty in projecting market conditions, the timing of disposals and any realised surplus funds. These represent an upside risk to the baseline scenario, which will depend on prevailing market conditions at the time of sale.
Contingent Liabilities	L	M	While declining, contingent liabilities remain a risk to public finances should any associated amounts suddenly have to be met with increased expenditure.
Bond Market Conditions	L	M	The long maturities and relatively fixed nature of debt should insulate the public finances from a typical shock to interest rates on sovereign borrowings. However, at high debt levels, there remain risks that external shocks such as a harder-than-expected Brexit could lead to self-reinforcing fears in bond markets.

Sources: Department of Finance; and internal IFAC assessment

Note: Likelihood and impacts from *SPU 2017*: H= High; M = Medium; L = Low.