IFAC: Some Background

Mandate of the Council:

12th Fiscal Assessment Report

Five-member Council
Five-member Secretariat
Key Messages

- Strong cyclical recovery expected to continue in near term so further fiscal stimulus is unwarranted. Further ahead, risks from a harder Brexit impact. Long-run sustainable growth could be lower than previously thought.

- Should the economy begin to overheat (even with a hard Brexit), fiscal policy may play an important role in “leaning against the wind” and proposed Rainy Day Fund could be a useful tool.

- Considerable success in stabilising the public finances and new budgetary framework put in place. Should help re-build capacity to withstand future shocks and help avoid overheating.

- But, slowing improvements in primary balance, given within-year increases in spending, leave public finances more exposed to risks and have contributed to limited compliance with the fiscal rules in first two years of operation of the new framework.
Key Messages

- Minimalist approach to compliance with rules carries risks:
  - Rules help limit risks of cyclical/transitory revenues funding permanent expenditure increases
  - Breach in 2016 and planned breach in 2017
  - Unexpected revenues and lower-than-expected interest payments followed by within-year increases in spending (2015 and 2016)
  - Increases raise base level of spending for future years (increasing risk exposure)
  - Especially risky when source of additional revenue is, to a large extent, Corporation Tax, given high volatility and concentration

- 45% GDP debt target not necessarily a low/prudent debt burden. Equivalent to 65% when methodological issues and more appropriate hybrid measure is considered. Need to consider alongside other factors: pension commitments, spending pressures, etc.

- Looking beyond 2018, scope under the rules for government spending to increase in line with sustainable economic growth, while gradually reducing debt levels.
Substantial Progress Has Been Made

Unemployment Rate (%)

10 Year Government Bond Yields (%)

- Germany
- Ireland
Strong cyclical recovery in near-term
Expected to moderate to lower growth rates

Real GDP, % change (year-on-year)
Debt levels remain high following the crisis

**GENERAL GOVERNMENT DEBT-TO-REVENUE RATIOS, 2016 Q3 (%)**

Sources: Eurostat; and internal IFAC calculations.
Note: Net debt from Eurostat Government Finance Statistics calculated as gross consolidated debt less excessive debt procedure (EDP) debt instrument assets (F2: currency and deposits; F3: debt securities; and F4: loan assets). Total General Government revenue = 4 quarter sum.
Improvements have slowed since 2015 achievement of 3% deficit
Within-Year Spending Increases Absorb Majority of Better-than-Expected Corporation Tax receipts and Interest savings

Sources: Department of Finance; and internal IFAC calculations.
Without these Increases, Debt and Deficit Would Be Lower

Debt level would have been estimated to be just over €8 billion lower by 2021 (or €4 billion lower at end-2018, just in advance of the expected conclusion of Brexit negotiations).
Ireland Achieves Deficit <3% GDP Enters Preventive Arm

- After finally achieving deficit below 3% in 2015, preventive measures take effect
- Challenge is to prevent repeat of past policy mistakes contributing to multiple economic crises. Re-build capacity to withstand future shocks, ensure economy does not overheat.
- Preventive Arm requirements and the domestic Budgetary Rule help prevent repeats of past mistakes:

**Twin Pillars:**

1. Achieve annual improvements in structural budget balance until a -0.5% GDP “Medium Term Objective” is reached
2. Stay within Expenditure Benchmark – limits pace of net primary expenditure growth reflecting economy’s sustainable growth rate (additional revenue measures allow equivalent excess expenditure growth relative to benchmark rate set by fiscal rules).
Minimalist approach to compliance

- Rules breached in 2016 (not sufficient to trigger sanctions)

- Within year increases absorbed most of higher-than-expected revenues (corporation tax) and lower interest costs.

- Department of Finance *SPU 2017* forecasts indicate plans to breach again in 2017

- Further in-year increases like those in 2015 and 2016 could risk a “significant deviation” and possible triggering of sanctions so there is a need to manage the public finances carefully.

- Government policy of minimum compliance is inherently risky and leaves minimal scope for overruns or within-year spending increases.
Change in structural balance in 2016 was just 0.3 percentage points, thus short of 0.6pp requirement (difference equates to between €0.7bn and €0.8bn).

Expenditure Benchmark complied with due to one-off AIB transaction in 2015 (+€2.1bn boost to base level of spending). Excluding this would have seen a breach of €1bn.

Breach of rules, but not sufficient to trigger potential sanctions
Plans suggest risk of breach in 2017

2017

- Structural Balance to improve by 0.2 percentage points, short of required 0.6pp.
- Expenditure benchmark to be breached by €0.6bn (0.2% GDP).
- On a two-year basis, risks that relatively modest changes in plans could lead to “significant deviation” and potential trigger of sanctions under both pillars:
  - Structural balance (0.35% GDP)
  - Expenditure Benchmark (0.3% GDP).

Suggests that public finances should be managed carefully as room for manoeuvre under current plans is very limited.
Public finances should be managed carefully

- In 2017, fiscal space is already allocated to spending and tax cuts. Any further increases in expenditure will have to be offset by lower spending in other areas or higher taxes.

- In 2018, €0.7 billion will be required to meet the carry-over cost of tax cuts and expenditure increases introduced in *Budget 2017*. This absorbs over ½ of fiscal space for 2018.
Looking forward to beyond 2018

- Medium Term Objective expected to be met.

- Maintaining this is the objective.

- Means more scope under the rules for government expenditure to expand in line with the economy’s sustainable pace of growth, while gradually reducing debt levels.

- Adhering to Expenditure Benchmark thereafter – a position that goes beyond the formal requirements of the SGP – would go some way towards avoiding fiscal policy that aggravates the boom-bust cycle.
Recap of Key Messages

- **Strong cyclical recovery** expected near term so further fiscal stimulus unwarranted.
- **Risks further ahead** from a harder Brexit impact.
- Fiscal policy could play important role in “leaning against the wind” and proposed Rainy Day Fund a useful tool.
- **Considerable success in stabilising public finances**, with new budgetary framework now in place helping re-build capacity to withstand future shocks and avoiding overheating.
- **But, slowing primary balance improvements**, within-year spending increases, minimalist approach to rules carries risks.
- **45% GDP debt target (equivalent to 65%)** not necessarily a low/prudent debt burden.
- **Scope beyond 2018**, scope to increase spending in line with sustainable economic growth & gradually reduce debt.