Chapter 3

Assessment of Budgetary Forecasts

3. Assessment of Budgetary Forecasts

Key Messages

- The general government deficit (excluding one-off items) for 2018 is forecast at 0.5 per cent of GNI*, slightly deteriorating compared to 2017. This comes despite several favourable factors such as strong revenue growth, falling unemployment and declining interest payments. The deterioration in the budget balance is driven by non-interest spending growing at a faster pace (6.4 per cent) than total revenue (4.7 per cent).

- Spending in 2018 was higher than budgeted for, with overruns in the Department of Health and, to a lesser extent, the payment of the Christmas bonus (which had not been budgeted for) mainly responsible. For 2019, primary expenditure is forecast to increase by €4.5 billion. This is to be partially funded by discretionary tax changes.

- In recent years, there has been a persistent pattern of large overruns in health spending. These long-lasting pressures have been largely absorbed through temporary gains from sources like cyclical revenues, unexpected corporation tax receipts or interest savings. Unrealistic health spending forecasts have undermined the credibility of ceilings, leading to higher-than-planned spending.

- Corporation tax receipts as a share of tax revenue in 2018 are estimated to reach record levels, aided by €700 million one-off receipts. This tax head is very volatile and is strongly concentrated in a small number of companies. This, together with changes in the international tax environment, leaves government revenue exposed to shocks.

- For 2019–2023, the general government balance is forecast to improve very gradually, with a surplus of 0.5 per cent of GNI* in 2020, followed by increasing surpluses thereafter. The expenditure forecasts are based on technical assumptions, which are unlikely to reflect actual policy. These assumptions imply an implausible slowdown in expenditure growth and overstate the likely budget balance.

3.1 Introduction

This chapter assesses recent outturns and the latest set of fiscal forecasts produced by the Department of Finance in *Budget 2019*.

The general government balance is forecast to remain in deficit in 2018 and 2019. For 2018, the balance (excluding one-off items) is forecast to deteriorate by €465 million, after excluding once-off payments of €700 million in corporation tax receipts. Expenditure projections after 2019 are based on technical assumptions, the application of which leads to a significant slowdown in expenditure growth, which results in surpluses in later years. These assumptions are unlikely to reflect actual policy.

Strong general government revenue growth is forecast to continue in the coming years. Over 2019–2023, revenue (excluding one-off items) is projected to grow by 4.7 per cent on average, the same rate as in 2017 and 2018. However, primary expenditure (excluding one-off items) is forecast to grow even stronger than revenue in 2018 and 2019 (6.4 and 5.9 per cent, respectively).

The *Budget 2019* plans allocate €0.5 billion each year from 2019 to 2023 to a Rainy Day Fund (also known as the National Surplus Reserve Fund), along with an initial allocation of €1.5 billion from the Ireland Strategic Investment Fund (ISIF). Although these amounts will count as Exchequer spending, they will not impact the general government balance, because these are transfers that remain within the general government sector.

Table 3.1: Summary of Fiscal Outturns and Forecasts (2017–2023)

€ billion, unless stated

	2017	2018	2019	2020	2021	2022	2023
General Government Balance	-0.7	-0.3	-0.1	1.1	2.6	4.2	5.8
General Government Balance (excluding one- offs) [1]	-0.6	-1.0	-0.1	1.1	2.6	4.2	5.8
Total revenue	76.5	80.8	85.2	88.9	92.6	96.6	100.7
Total revenue excl. one-offs [1]	76.5	80.1	85.2	88.9	92.6	96.6	100.7
Total revenue excl. one-offs (% change) [1]	4.7	4.7	6.4	4.3	4.2	4.4	4.2
Total Expenditure	77.3	81.1	85.3	87.8	90.0	92.5	94.9
Total Expenditure excl. one-offs [1]	77.1	81.1	85.3	87.8	90.0	92.5	94.9
Total Expenditure excl. one-offs (% change) [1]	2.9	5.3	5.1	3.0	2.4	2.8	2.6
Interest Expenditure	5.8	5.3	5.0	4.7	4.5	4.8	5.1
Primary Expenditure	71.5	75.9	80.3	83.1	85.5	87.6	89.8
Primary Expenditure excl. one-offs [1]	71.3	75.9	80.3	83.1	85.5	87.6	89.8
Primary Expenditure excl. one-offs (% change)[1]	3.6	6.4	5.9	3.5	2.8	2.6	2.4
Primary Balance	5.1	5.0	4.9	5.8	7.2	9.0	10.9
Primary Balance excl. one-offs [1]	5.3	4.3	4.9	5.8	7.2	9.0	10.9
Nominal GNI* Growth (% change)	3.0	8.1	6.0	5.2	4.2	4.3	4.4

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: [1] One-off items/temporary measures are as assessed by the Council to be applicable, as per Table 1.1, Chapter 1. These one-offs are removed from variables to get a sense of the underlying fiscal position. Rounding can impact on totals. Figures in grey indicate that the Council assesses these forecasts as largely the result of technical assumptions on expenditure, which may be unrealistic. Expenditure amounts in 2021 are adjusted to take account of a capital transfer expected to be reclassified to general government.

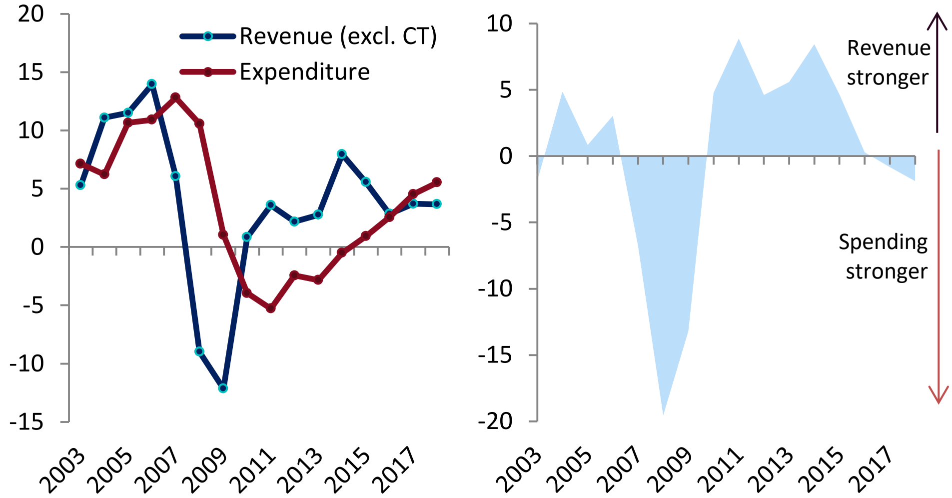
The figures in Table 3.1 differ somewhat from those presented in *Budget 2019*. After *Budget 2019*, Eurostat reviewed the classification of the Eircom No. 2 pension fund and concluded that it should be classified to the general government sector. As a result, a €1 billion capital transfer in 2021, which had been included in *Budget 2019* forecasts, is removed. Removing this distortion implies a smoother path for fiscal projections. As a result of this alteration, the general government surplus and primary surplus are €1 billion higher than presented in *Budget 2019*, as general government expenditure and primary expenditure is €1 billion lower than in *Budget 2019*. This capital transfer relates to pensions of employees of the disbanded Department of Posts and Telegraphs.

3.2 Outturns and Estimates in 2018

The **general government deficit** for 2018 is now forecast to be €0.3 billion, an improvement of €0.4 billion from 2017. However, excluding one-off payments of €0.7 billion in corporation tax, the deficit for 2018 is €1.0 billion and represents a deterioration of €0.5 billion from 2017. This comes despite strong cyclical revenue growth, declining unemployment, and falling interest payments (€0.5 billion lower than last year). The €0.7 billion one-off corporation tax receipts are driven by two elements. First, the adoption of new accounting standards, which affect the timing of the payments of the receipts. Second, non-recurring improvements in profitability / trading conditions from other Revenue clients.

Excluding one-off items, the deficit is €0.2 billion larger than forecast in *SPU 2018* in April. Forecasts of both revenue and expenditure have been revised up since *SPU 2018* (by 0.8 billion and €1.1 billion, respectively). These revisions are mainly due to: (i) higher-than-expected corporation tax receipts (even after a one-off payment is accounted for); (ii) overruns in health spending; and (iii) the payment of the Christmas bonus (which, once again, had not been budgeted for).

Figure 3.1: Revenue (Excluding Corporation Tax) and Expenditure



Sources: Department of Finance; and internal IFAC calculations.
Note: Expenditure is expressed in total gross voted terms; revenue is shown in Exchequer revenue terms excluding corporation tax. Figures for 2018 are as per *Budget 2019.*

Figure 3.1 shows underlying revenue and expenditure trends. In the past 15 years, Exchequer revenue growth—excluding the highly volatile corporation tax revenue—has generally outpaced gross voted spending. The two periods where this has not been the case are the crisis years (2007–2009) and the current period (2017–2018, see Figure 3.1B). This does not seem to match a strong cyclical upswing in the economy in recent years. The lack of improvement in the budget balance in the last three years partly reflects the fact that expenditure growth has accelerated since 2016, while revenue growth (excluding corporation tax) has been relatively flat.

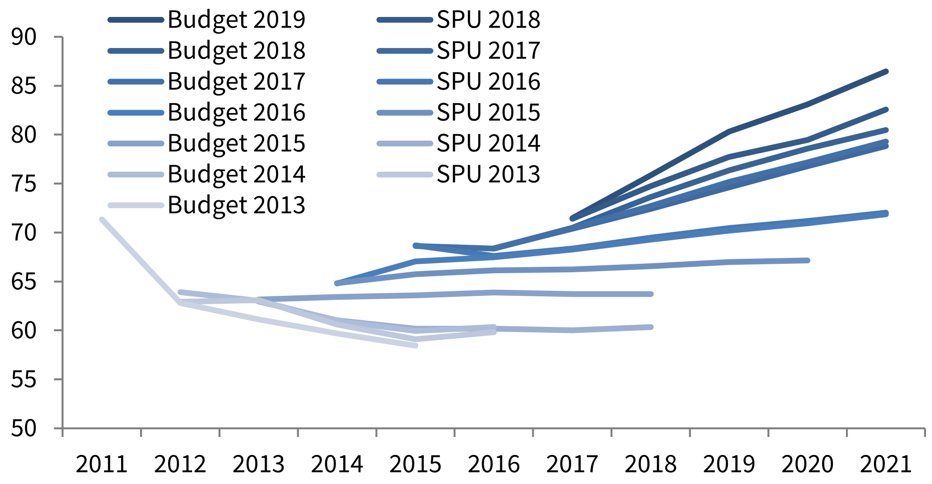
The **primary balance** (excluding one-off items) is forecast to deteriorate in 2018 (surplus of 2.2 per cent of GNI*) relative to 2017 (2.9 per cent of GNI*). This is a consequence of non-interest spending growing at a faster pace (6.4 per cent) than total revenue (4.7 per cent).

General government **primary expenditure** (excluding one-off items) is set to grow by €4.6 billion in 2018. The main items driving this growth are gross fixed capital formation (€1.4 billion), compensation of employees (€1.3 billion) and intermediate consumption (€1.1 billion). This estimated growth is faster than anticipated in *SPU 2018* forecasts, and is mainly accounted for by stronger growth in current spending. This upward revision to primary spending is consistent with the pattern of revisions to spending seen in recent years. Figure 3.2 shows various vintages of forecasts of primary spending; one can see there has been a tendency for spending to drift up as the cyclical recovery takes hold.[1]

[1] Forecasts for spending at the end of the forecast horizon may have been somewhat unrealistic (i.e., low) prior to *Budget 2016* which may exaggerate the extent of upward revisions somewhat.

Figure 3.2: Vintages of General Government Primary Spending

€ billion



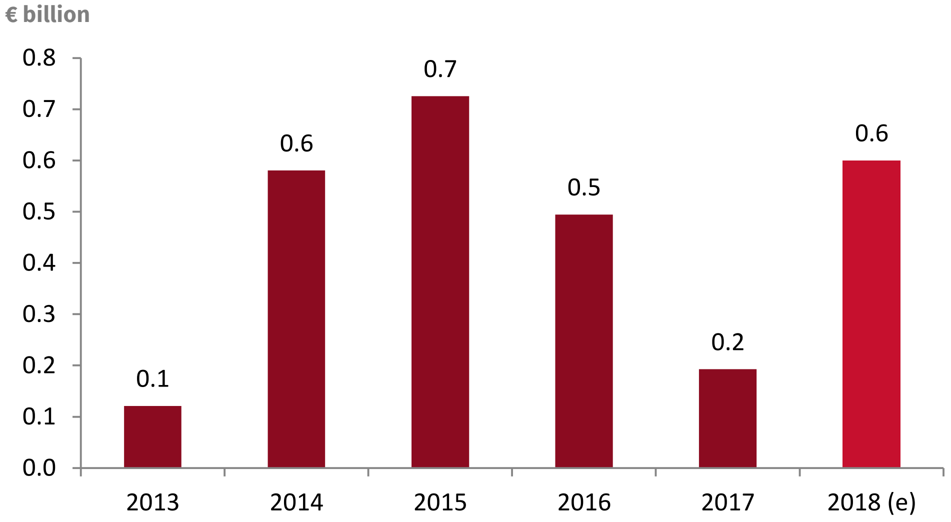
Sources: Department of Finance.
Note: Primary expenditure excludes interest payments. Prior to *Budget 2016*, spending forecasts were made on the unrealistic assumption of fixed nominal spending for most items. Since then, forecasts have been made on a realistic basis, and so upward revisions to spending more clearly show the upward drift in spending plans.

The main contributor to higher-than-expected expenditure in 2018 to date is current expenditure in the Department of Health. To the end of October, gross voted current spending in the Department of Health is €368 million above profile. On Budget day, the Minister confirmed that a €700 million supplementary estimate would be needed for the Department.[2,3] This comes in addition to an increase of €685 million for 2018 that had originally been budgeted for as part of *Budget 2018*. Higher-than-budgeted spending has been a recurring issue for the Department of Health, resulting in "within-year" increases and supplementary estimates (Howlin, 2015). A combination of unrealistic forecasting and an anticipated relaxation of health spending ceilings is likely to have reinforced the "soft budget constraint" (see Box D for more details). Figure 3.3 shows the persistent current spending overruns in the Department over the past six years. Of these, the expected €600 million overspend this year is among the largest in recent years (Figure 3.3).

[2] "This year I will allocate an additional €700 million by way of a supplementary estimate, bringing the total additional 2018 investment to €1.2 billion." As well as overspending, revenue from private patients is set to be lower than anticipated. Financial statement, available at: http://budget.gov.ie/Budgets/2019/Documents/Financial%20Statement_C.pdf

[3] As well as overspending, revenue from private patients is set to be lower than anticipated.

Figure 3.3: Health Overruns



Sources: Department of Public Expenditure and Reform, Analytical Exchequer Statements; and internal IFAC calculations.
Note: Overruns are shown in terms of gross voted current spending and are derived from end-December Analytical Exchequer Statements outturns less profiles. The 2018 figure shows the expected overrun for the year.

Other than the Department of Health, current spending is broadly on profile for the first ten months of the year. Gross voted capital spending is €345 million lower than profile for the first ten months, with underspends in Housing, Planning and Local Government; Transport, Tourism and Sport; and Education and Skills mainly responsible for this underperformance.

Box D: Health Overruns

In recent years, there has been a persistent pattern of large overruns in health spending. A combination of unrealistic forecasts and repeated relaxation of ceilings have repeatedly led to uncontrolled increases in spending, which can put the public finances at risk. Over the period 2014–2017, these overruns have averaged €0.5 billion per year (in current spending terms). In 2018, the Government expects a health spending overrun of €0.6 billion, one of the largest overspends in recent years.[4] This implies that the 2018 outturn is now expected to be 9.3 per cent higher than the ceiling set in the previous Budget. In light of previous experience, the *Budget 2019* forecasts for 2019–2021 may not be realistic.[5]

This box highlights important issues with health overruns, namely: (i) the way these long-lasting increases in expenditure have been generally absorbed by unexpected, transient gains from the cycle; (ii) the budgetary implications of spending peaks taking place late in the year; and (iii) the underlying deficiencies that are driving this pattern of large overruns.

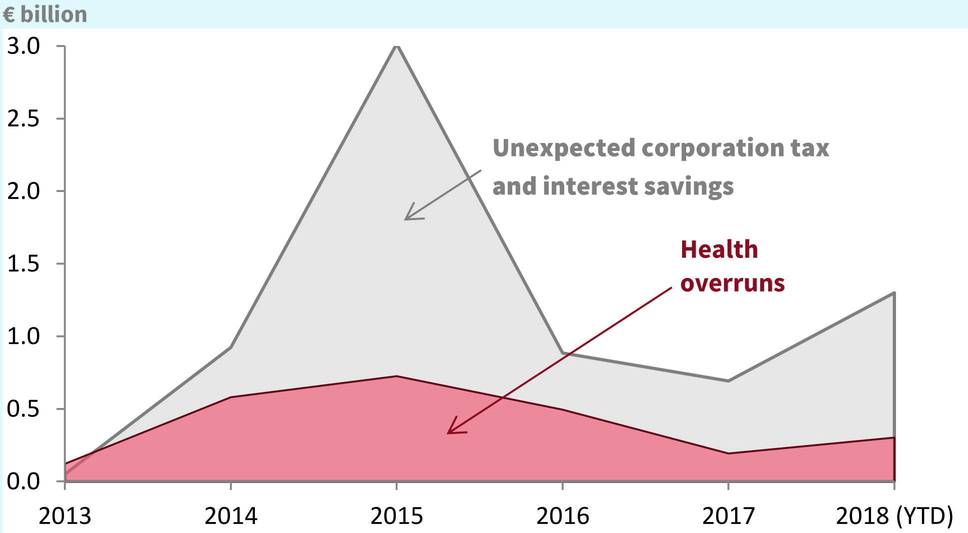
[4] The expected total overrun for 2018 is €0.7 billion, of which €0.6 billion relates to current spending, and the remaining €0.1 billion relates to capital expenditure and a shortfall in Departmental receipts.

[5] For 2019, the current health ceiling is forecast to growth by 5.8 per cent. For 2020–2021, current health spending is forecast to grow by less than 1.0 per each year, which appears too modest compared with the trends in the last years.

Long-lasting health pressures are being masked by temporary gains

Since 2013, the impact of health overruns on the deficit has been masked by unexpected gains from corporation tax and interest savings, both of which may well be temporary. Figure D.1 shows that, in 2013–2017, the current health overspends (averaging €0.4 billion per annum) were outweighed by unexpected corporation tax receipts (averaging €0.8 billion) and unexpected interest savings (averaging €0.3 billion).

Figure D.1: Health Overruns Masked by Unexpected Corporation Tax and Interest



Sources: Department of Finance, Analytical Exchequer Statements; and internal IFAC calculations.
Note: Overruns are shown in gross voted current spending terms. All figures are derived from the end-December Analytical Exchequer Statements outturns less profiles. 2018 shows data to end-October.

The volatility and strong concentration of corporation tax in Ireland—where the top 10 companies account for roughly 40 per cent of all corporation tax receipts—implies that unexpected revenues from this source should be deemed as transient.[6] Similarly, unanticipated interest savings over the last years are a result of changes in the external environment, which may prove temporary in nature.

To the extent that gains are temporary or cyclical, these should not be used to mask ongoing health overruns. Doing so risks a repeat of the pro-cyclical policy mistakes of the past. Instead, pressures in the health sector should be absorbed through sustainable tax revenues or decreases in spending categories elsewhere.

Overruns late in the year imply higher carryover costs

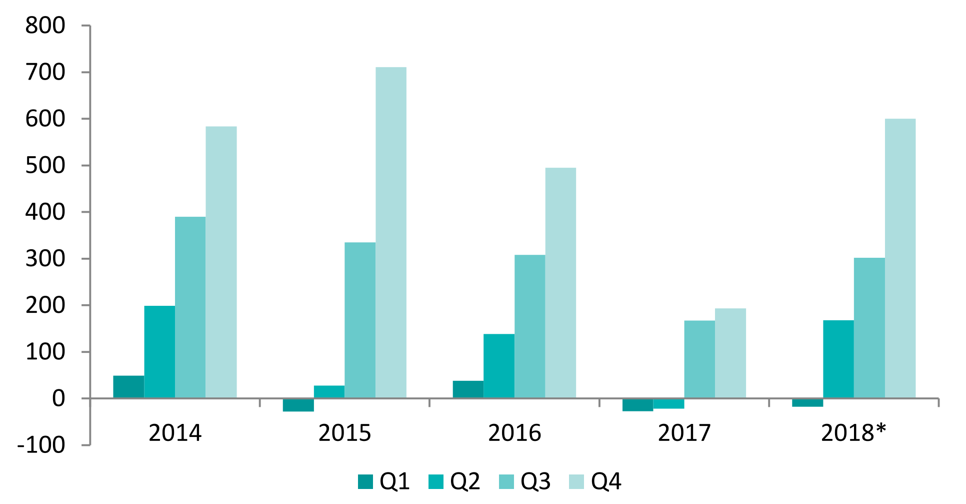
Recent trends have shown health spending ramping up in the second half of the year, especially in the last quarter (Figure D.2). This is the case, yet again, in 2018, when half of the expected current spending overrun in 2018 is to take place just in the last quarter.[7] However, it is worth noting that the later the overrun occurs within the year, the less time there is to adjust spending in the remainder of the year. This also triggers larger spending carryovers in the following year.

[6] The June 2018 *Fiscal Assessment Report* (IFAC, 2018c) provided a stylised scenario on the direct impact of a large firm leaving Ireland. This exit was estimated to trigger a reduction of government revenues by over €330 million, close to half a per cent of total revenue in 2016 (and higher than the current health overspend of 2017).

[7] While the first three quarters of 2018 have seen an overrun of €0.3 billion in current terms, the expected overrun for the last quarter is €0.3 billion.

Figure D.2: Health Overspends Tend to Ramp Up Late in the Year

€ million (cumulative), per quarter



Sources: Department of Finance Analytical Exchequer Statements; and internal IFAC calculations.
Note: Overruns are shown in terms of gross voted current spending and are derived from the monthly Analytical Exchequer Statements outturns less profiles. * The 2018 figure for Q4 is an IFAC estimate.

A key driver of this pattern in the timing of overspends is related to staff recruitment. As noted in Connors (2018a), recruitment in each of the last quarters of 2015–2017 by the Health Service Executive has averaged 1,432. This represents 40 per cent of the annual increase in employment over just a three-month period. As in previous years, an important part of the 2018 overrun is likely to be unplanned increases in staff.[8] As new recruits have commenced work at different stages in 2018, the full-year cost of employing them will only be realised in full in 2019. This means that the overrun will imply carryover costs into 2019, more so because of the late timing. The Department currently estimates that these carryover costs into 2019 will amount to €0.3 billion, implying a €1.1 billion full-year cost of the overruns this year.

These timing effects, if not accounted for properly, can have important implications. For example, the 2018 carryover costs narrow the budgetary resources available for 2019. This is partly reflected in the increased ceiling forecast for 2019 since July's *Mid-Year Expenditure Report 2018* (estimated at €15.0 billion) relative to the latest ceiling established in *Budget 2019* (€16.4 billion, in gross current terms). This implies a revision in the ceiling of €1.4 billion for next year in just three months.

Health budgets should be well-founded and credible

The budget overruns in recent years largely reflect significant deficiencies in health spending management, including:

1. **Weak planning**: spending plans are not accurately accounting for increasing cost pressures and demand for health services; and
2. **Weak spending controls:** day-to-day health spending is not sufficiently constrained throughout the year.

[8] Connors (2018b) notes that the Health Service Executive is required to produce a Pay and Numbers Strategy every year including detailed information on the number of staff to be hired along the year. However, these reports have tended to be submitted very late in the year. For example, a revised version of the document for 2016 was submitted in December 2016, which looked to significantly increase the end-2016 staffing number. This was done despite not having the resources to undertake such increases. In 2017 and 2018, submissions took place in November and August, respectively.

The combination of weak planning and weak spending controls has led to a "soft budget constraint" problem. That is, providers of health services anticipate that yearly spending ceilings will be relaxed at a later stage with little opposition, and this weakens the incentive to stay within initial spending targets (Howlin, 2015). When this happens persistently, it can lead to uncontrolled increases in spending and budget plans can lose credibility. If spending overruns are likely to be long-lasting (e.g., when permanent staff are unexpectedly recruited), but are funded by temporary revenues, the sustainability of public finances can be put at risk. When temporary revenues disappear, the long-lasting spending overruns will remain and will lead to deteriorations in the government balance, unless those costs are offset by new tax-raising measures or savings elsewhere.

Turning to **general government revenue** for 2018, this is estimated to amount to €80.8 billion. This is €1.5 billion higher than in *SPU 2018*, largely driven by taxes on income and wealth arising from higher-than-expected corporation tax receipts. In light of recent revenue growth, it is worth exploring what has driven growth in general government revenue.

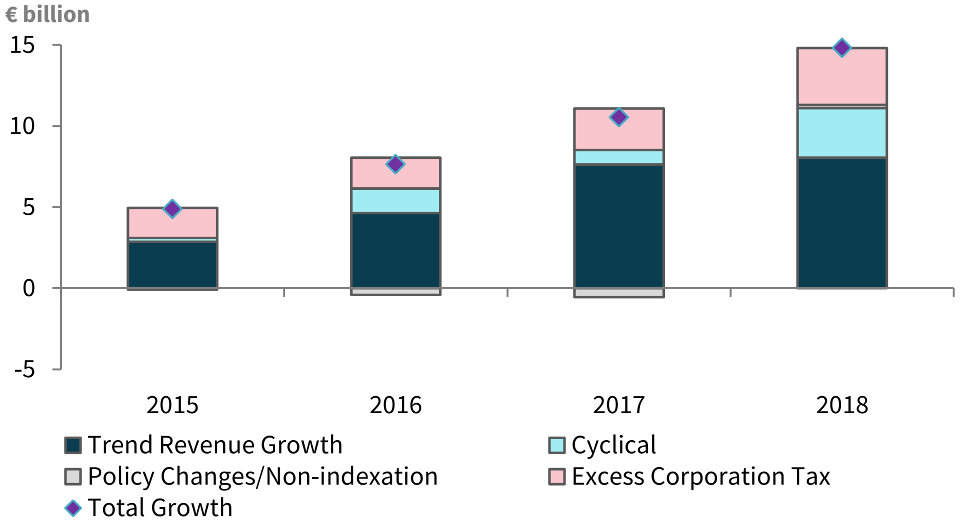
Examining the sources of recent changes in revenue

As an illustrative example, Figure 3.4 attempts to quantify the various contributors to revenue growth since 2014. *Budget 2019* forecasts of general government revenue for 2018 are almost €15 billion above 2014 levels. The increases in revenue are broken into four categories:

1. Trend revenue growth: this refers to increases in revenue driven by normal trend growth, rather than cyclical growth, corporation tax surprises or tax policy changes. It is calculated as a residual after accounting for the three other factors described below.
2. Cyclical revenue: this refers to the extra revenue collected due to the growth in activity associated with the cyclical upturn experienced over these years. This is calculated using the Department's preferred alternative output gap estimate.
3. Policy changes/non-indexation: this refers to the direct impact of tax policy changes on revenue over these years. Estimates are taken from Budget documentation. This also includes non-indexation of tax bands and credits, which increases revenue relative to a scenario where these bands and rates are raised in line with inflation.
4. Excess corporation tax: this refers to corporation tax in excess of what might have been anticipated. To calculate what might have been

anticipated, the 2014 outturn is taken as given, with the subsequent years assumed to grow in line with nominal GNI*.

Figure 3.4: Contributions to Changes in Revenue since 2014



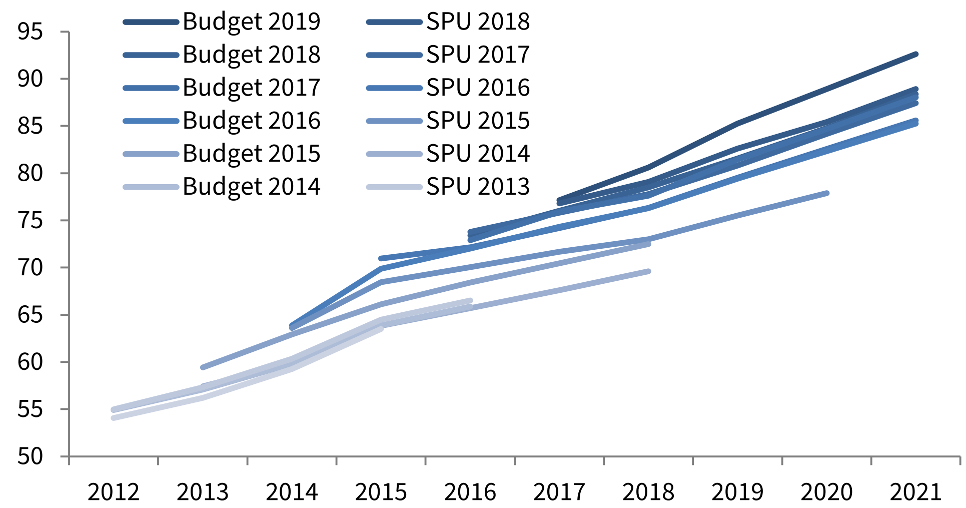
Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: Cyclical revenue is calculated using changes in the output gap. Policy changes/non-indexation reflects tax policy changes introduced over the period, as described in Budget documentation as well as the extra revenue generated from not indexing tax bands and credits. Excess corporation tax is measured as corporation tax receipts minus what would be expected if they were to grow in line with GNI*.

The €15 billion revenue increase from 2014 to 2018 can be attributed to the following components. Trend growth in revenue accounts for just over half of the overall change in revenue (€8 billion). Cyclical revenues contribute €3 billion, with excess corporation tax receipts contributing €3.5 billion to revenue growth. Policy changes/non-indexation contributed positively (€0.2 billion) to revenue also over the period. So while trend growth has accounted for over half of the change in revenue in this period, there have been significant contributions from the cyclical upturn and surprise corporation tax receipts. Tax policy changes made a small positive contribution to revenue over the period.

One concern is that estimates of medium-term revenue get revised procyclically as revenue comes in. This implies that revenue forecasts get revised up in good times. But correspondingly, it implies that revenue forecasts would be revised down in bad times. Looking at budget and SPU publications in recent years, there is evidence of general government revenue forecasts being revised up (Figure 3.5) as cyclical conditions improve and as surprise corporation tax receipts are received. For 2019, revenue projections—adjusted for discretionary revenue changes—are now some

€9.7 billion stronger than first forecast in *SPU 2015*. Even for 2021, revenue projections are around €7 billion higher than forecast in *Budget 2016*. This underlines the likely cyclical characteristics of some part of forecast revenue growth.

Figure 3.5: Vintages of General Government Revenue



Sources: Department of Finance; and internal IFAC calculations.
Note: Data are adjusted to account for discretionary tax policy changes (not including the impact of non-indexation of tax bands and credits).

Exchequer Tax Revenue and PRSI Developments

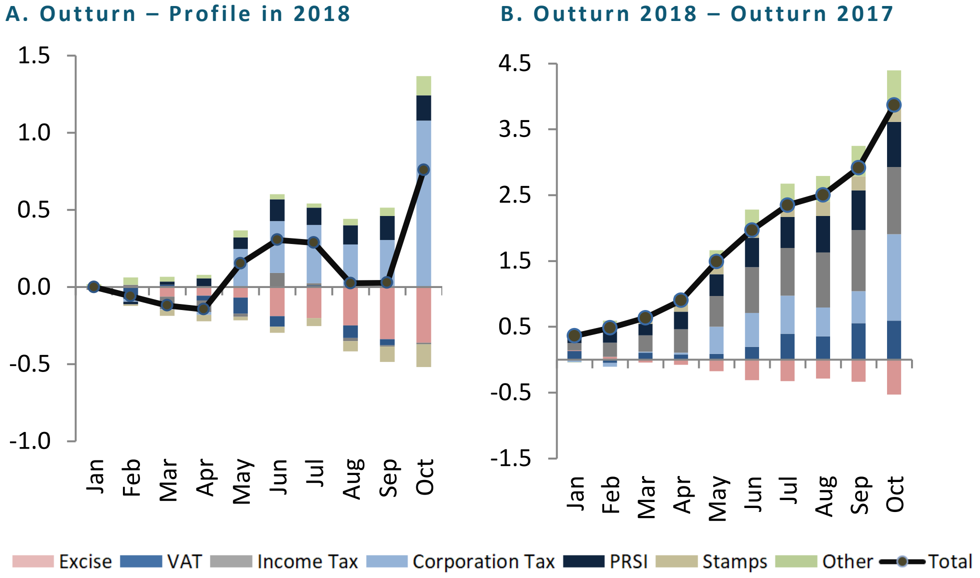
In terms of **Exchequer tax revenue**, this is estimated at €55.1 billion in 2018, €0.9 billion higher than estimated in *SPU 2018.* This boost arises from the substantial overperformance of corporation tax revenue, mainly driven by unexpected one-off receipts of €0.7 billion. Separately, **PRSI** contributions, which are paid into the Social Insurance Fund, are expected to amount to €10.2 billion in 2018.

For the first ten months of the year, cumulative receipts including PRSI are €0.8 billion above target (Figure 3.6A). The main drivers of this outperformance are corporation tax and PRSI contributions, which have more than offset underperforming excise duties and stamp duties. Figure 3.6B shows that the outturns for the year to end-October are cumulatively €3.9 billion higher than in end-October 2017, with excise duties being the only tax head with annual negative growth.[9]

[9] The main driver of this annual increase is corporation tax (+1.3 billion), followed by income tax (+€1.0 billion), PRSI (+€0.7 billion) and VAT (+€0.6 billion).

Figure 3.6: Tax Revenue and PRSI

€ billion (cumulative)



Sources: Department of Finance; and internal IFAC calculations.
Note: Data as per the monthly Analytical Exchequer Statements. Other includes capital taxes, motor tax and other unallocated tax receipts.

For the year to October, **corporation tax** receipts are €1.1 billion (or 19.1 per cent) higher than previously forecast, and €1.3 billion (or 24.3 per cent) higher than in the same period last year. For the end of 2018, *Budget 2019* projects an overperformance of €1.1 billion in corporation tax receipts (relative to *Budget 2018* and *SPU 2018*). This is cited as being driven by one-off receipts (€700 million) and other unexpected, yet recurring, receipts related to improved profitability / trading conditions (€400 million). The one-off revenue is mainly related to two components: (i) timing issues in some payments, particularly in relation to the adoption of new accounting standards by some firms (€300 million); and (ii) non-recurring improved profitability / trading conditions from other Revenue clients (€400 million).[10,11]

If the projections for 2018 materialise, corporation tax receipts as a share of total Exchequer tax revenue will be at a record level of 17.4 per cent in 2018. As shown in Figure 3.7, this is well above the previous peak of 16.4 per cent in 2002. However, the Council notes that receipts from this tax head are very volatile and highly

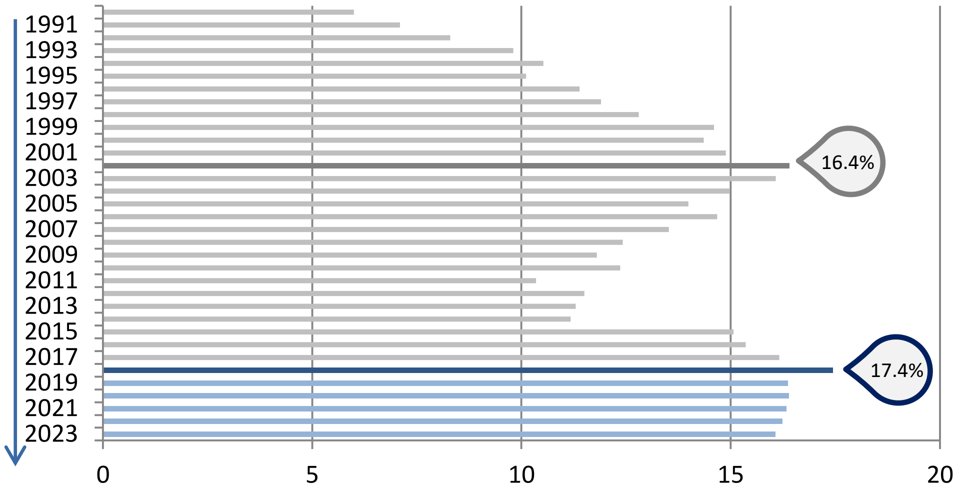
[10] The new accounting standards relate to the International Financial Reporting Standard (IFRS 15). Over time, the impact is expected to be cash-neutral (i.e., the surge in revenues in 2018 is expected to be offset by lower revenues in future). Of the cumulative outperformance to date, €0.3 billion relates to the IFRS 15 received in May.

[11] Receipts for the month of October are €773 million higher than profiled, which the Department of Finance attributes to improvements in profitability / trading conditions.

concentrated in a small number of companies. This, together with changes in the international tax environment, can leave government revenues exposed to shocks.

Figure 3.7: Corporation Tax (% Revenue) in 2018 at Record Levels

% of total Exchequer tax revenue (horizontal axis)



Sources: Department of Finance; and internal IFAC calculations.
Note: The shares for 2018–2023 are based on *Budget 2019* estimations/projections.

Income tax receipts to end-October are cumulatively strong in annual terms—higher than in 2017 by €1 billion or 6.7 per cent—and are broadly in line with *Budget 2018* forecasts. In terms of **PRSI**, receipts since March are higher than initially forecast (+€163 million in cumulative terms to end-October). This reflects a strong labour market, where employment and earnings growth are estimated to amount to 3.0 per cent and 2.4 per cent, respectively, this year.[12] Compared to the first ten months of 2017, PRSI contributions are now €688 million (8.1 per cent) higher. Since last year, PRSI revenue has been higher than forecast for almost all months.

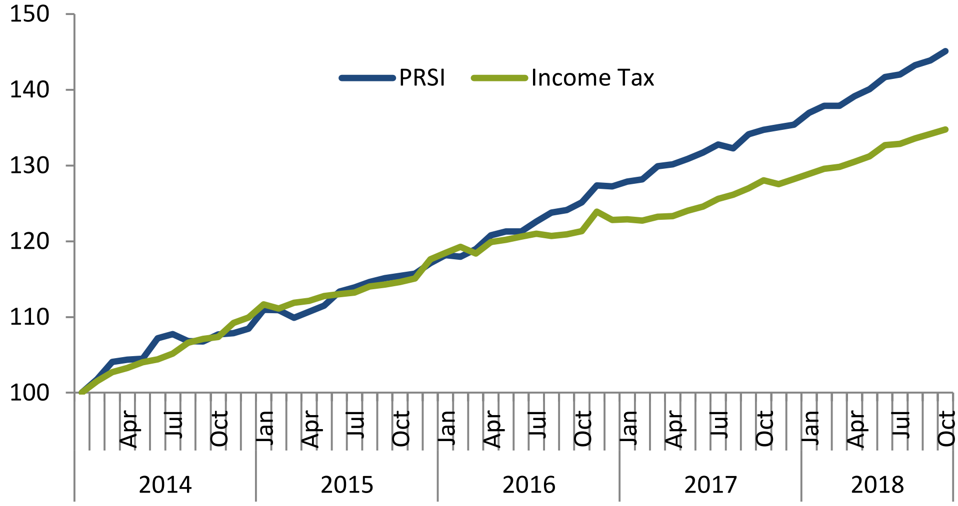
Figure 3.8 shows that the gap in growth between PRSI and income tax has widened since mid-2016. Income tax is comparatively weaker given a number of recent discretionary changes (including rate cuts and changes in tax bands), which have triggered revenue being foregone from this tax head.[13] As a result of this, PRSI gives a better indication of the recent strength in the labour market.

[12] Employment growth for 2018 has been revised up from 2.7 per cent in *SPU 2018* to 3.0 per cent in *Budget 2019.* Compensation per employee, however, showed more moderate growth in *Budget 2019* (2.4 per cent) relative to *SPU 2018* (2.6 per cent).

[13] In *Budget 2019*, the new measures include an increase of €750 in the income tax standard rate band for all earners, from €34,550 to €35,300 for single individuals and from €43,550 to €44,300 for married one earner couples. In addition, an increase in the Home Carer Tax Credit has been

Figure 3.8: PRSI Growth Outstripping Income Tax Growth

Index of 12-month-rolling sum, January 2014 = 100



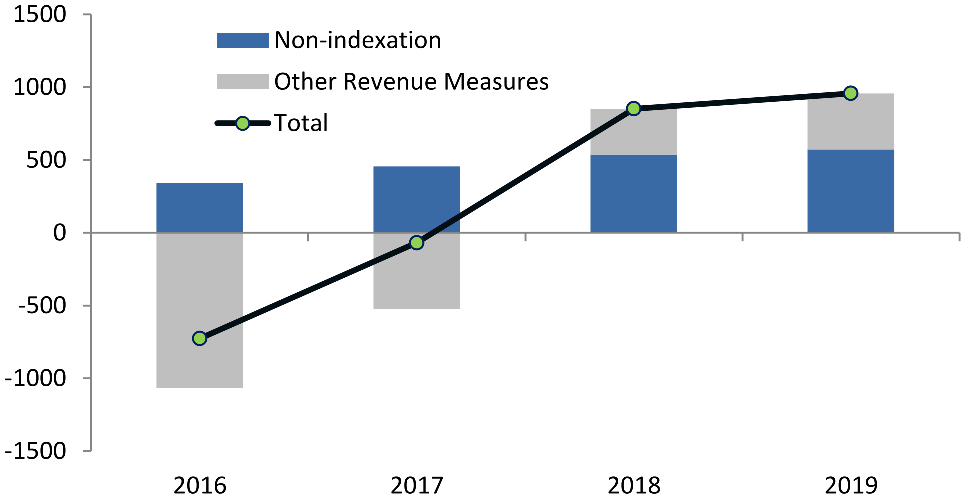
Sources: Department of Finance; and internal IFAC calculations.
Note: Data shown up to end-October 2018.

Recent years have seen a number of policy measures introduced on the revenue side. These include: (i) non-indexation of tax thresholds (additional tax revenues that are generated as people move into higher rate bands); and (ii) other measures. Figure 3.9 shows that the net impact of such measures reduced revenue in 2016 (by €700 million), while the figures for 2018–2019 show that these measures will increase revenue (by €850 million and €960 million, respectively). While the positive contribution of non-indexation has remained relatively stable at roughly €500 million since 2016, the impact of other discretionary revenue measures only became positive in 2018. This positive impact of discretionary revenue measures other than non-indexation is also projected to remain in 2019.

introduced from €1,200 to €1,500, together with an increase in the Earned Income Credit from €1,150 to €1,350.

Figure 3.9: The Impact of Revenue Policy Measures

€ million



Sources: Department of Finance; and internal IFAC calculations.
Note: Non-indexation reflects the increase in tax revenues due to tax thresholds not being indexed so that, as income rises, additional tax revenues are generated. Other Revenue Measures shown include both discretionary revenue measures introduced that year as well as the carryover impact of measures introduced in previous years. The 2018 estimate and 2019 projections are as per *Budget 2019*.

Excise duty receipts to end-October are €361 million (or 7.6 per cent) lower than expected, and 10.7 per cent lower than in the same period last year. This is, in the main, driven by previously anticipated purchases of tobacco products in advance of the introduction of the plain-packaging in 2017.[14] This poor performance has triggered a €0.2 billion downward revision in *Budget 2019* relative to *SPU 2018.*[15]

Figure 3.10A shows how excise duty forecasts have compared to actual outturns since 2005. The two most recent peaks, in 2016 and 2017, are related to new packaging regulations on tobacco products. The 2016 boost largely reflects EU requirements to modify the design of tobacco packages to discourage tobacco consumption.[16] Stocks were built up in anticipation of the measure, which explains the downward trend that followed after that (Figure 3.10). After this measure, the Domestic Plain-Packaging Initiative was introduced in end-September 2017.[17]

[14] To a lesser extent, the Department of Finance also attributes this shortfall to lower-than-expected excise duties arising from a decreasing petrol demand. This is partly the result of improved efficiencies in cars and an increased demand of hybrid or electric cars.

[15] It is worth noting that the downward revision since *SPU 2018* is lower than the cumulative underperformance to end-October. This relies on the Department of Finance's assumption that lower-than-expected receipts to date, mainly related to tobacco products, will unwind by the end of the year.

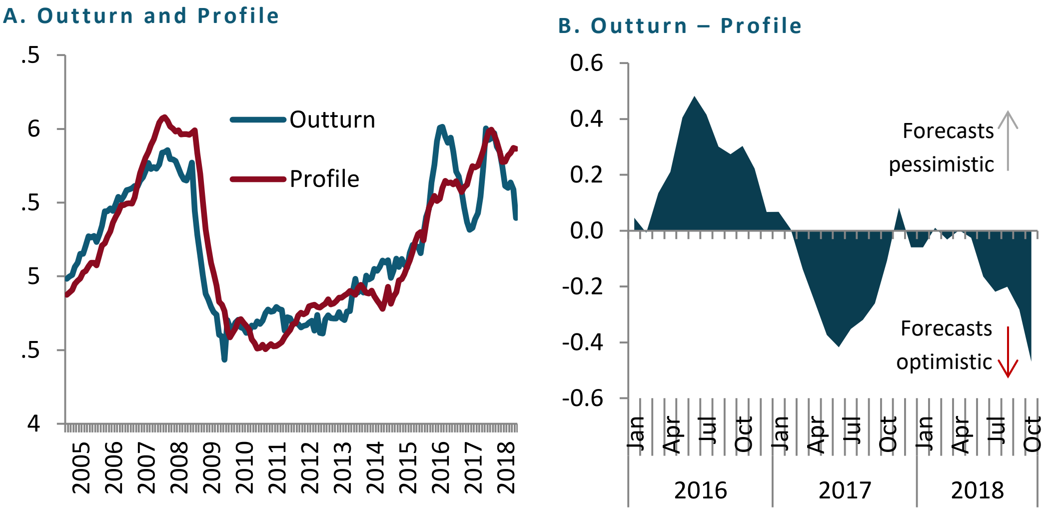
[16] This refers to the EU Tobacco Warning Directive. While this regulation came into force in May 2016, manufacturers and retailers had one year to replace non-compliant stock items.

[17] This measure established that non-plain tobacco products could be marketed for a period of one year (i.e., until 30th September 2018).

Purchases of tobacco products then followed a similar pattern as in 2016, with excise duties reaching roughly the same amount as in the 2016 peak (see 12-month-rolling sum outturns in Figure 3.10A). After this, forecasts for the vast majority of 2017 and 2018 to date have been overly optimistic (in full-year rolling-sum terms). Figure 3.10B suggests that forecasts for 2018 did not capture the similar behavioural patterns that had been seen in 2016 and in part of 2017.

Figure 3.10: Excise Duties

€ billion (12-month-rolling sum)



Sources: Department of Finance; and internal IFAC calculations.
Note: Data shown up to end-October 2018.

VAT receipts are broadly in line with expectations for the year to end-October. In year-on-year terms, solid growth of 5.3 per cent (or €592 million) has been recorded for the first ten months of the year. This reflects strong personal consumption expenditure, estimated to grow at 5.1 per cent in 2018 in nominal terms (see Appendix E).

Stamp duties have performed substantially worse than forecast. The cumulative underperformance to end-October amounts to €149 million (or 10.9 per cent), with monthly receipts being persistently lower than profile. This largely reflects the overoptimistic yield expected to take place in 2018 as a result of a measure introduced in *Budget 2018* to increase the stamp duty rate on non-residential property. The Department of Finance notes that the "non-linear" nature of this tax source—where delays in completing major transactions such as property sales or merger and acquisitions have an impact on the timing of the receipts within the year—hinders the accuracy of the monthly forecasts. While the year-on-year performance is very strong (23.3 per cent higher than for the same period last year), there is a revenue shortfall. As previously signalled by the Council, well-founded costing analysis should serve as the basis of realistic forecasts, and these should be subject to independent scrutiny.

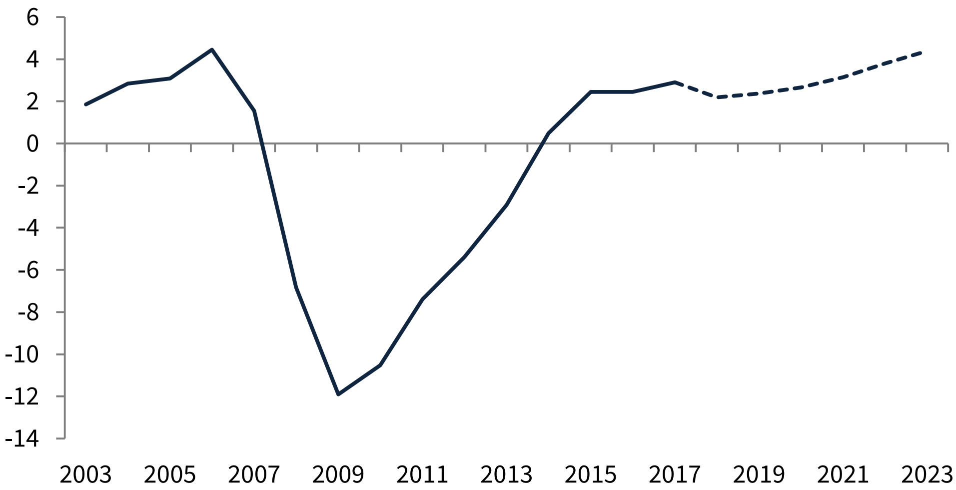
3.3 Forecasts for 2019–2023

2019 – 2023 general government balance

Budget 2019 forecasts the general government balance to improve in 2019 (by €240 million in headline terms, and €940 million after correcting for one-off items). This improvement is aided by falling interest payments (down by €305 million compared to 2018). However, the underlying primary balance forecast for 2019 (2.4 per cent of GNI*) is the same as in 2015 (Figure 3.11). This comes despite several factors which would typically lead to an improvement in the intervening years, with strong recent economic growth set to continue, and with the unemployment rate forecast to fall further in 2019.[18] Rapid growth in expenditure—only partially funded by revenue-raising tax changes and the non-indexation of tax bands and credits—is mainly responsible for the lack of improvement in the budget balance in recent years.

Figure 3.11: Primary Balance

Percentage of GNI*, excluding one-off items



Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: Dashed line indicates forecasts from *Budget 2019*.

In the later years of the projections (2020–2023), the general government balance and the primary balance are projected to improve significantly. However, this is based on expenditure figures which rely on technical assumptions. These assumptions are unlikely to reflect actual policy and are described below. Revenue forecasts for the same years are much more informative as they are based on continuing existing policies in a way that is likely to broadly reflect reality.

[18] *Budget 2019* forecasts indicate the unemployment rate will fall by 0.6 percentage points in 2019.

Based on these assumptions, the general government balance is projected to move into surplus in 2020 (€1.1 billion), with increasing surpluses thereafter. Forecasts of the general government surplus in 2020 and 2021 have been revised up slightly since *SPU 2018*. Both revenue and expenditure have been revised up for 2019–2021 relative to *SPU 2018*, both in terms of levels and growth rates.

2019 expenditure

In 2019, general government expenditure is forecast to increase by €4.2 billion. This comes despite interest payments falling by €0.3 billion. This means that primary expenditure (i.e., expenditure net of interest payments) is forecast to grow by €4.5 billion (5.9 per cent). In addition to this very large increase in planned expenditure, there are factors which could push this figure even higher than forecast. For example, health spending has exceeded expenditure forecasts for the past number of years. While significant increased funding has been provided for in the latest set of forecasts, previous experience suggests overruns are likely (see Box D).[19]

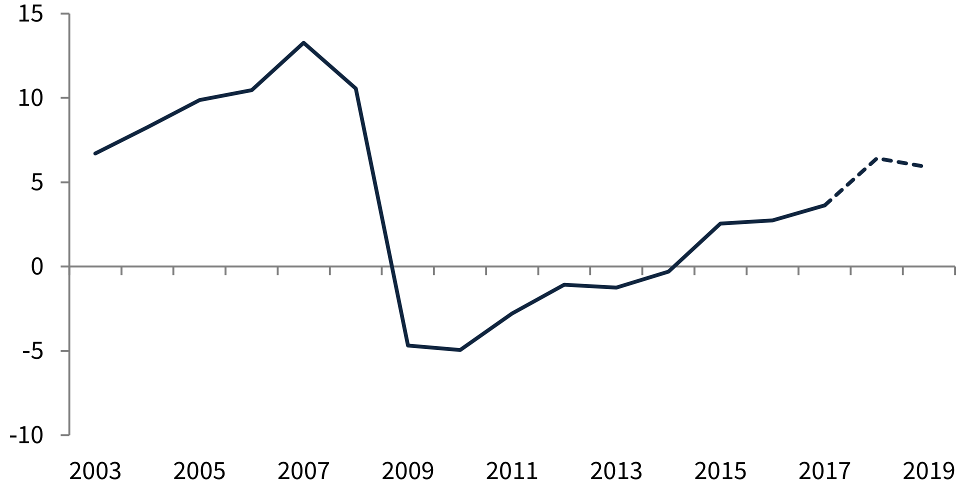
The Christmas bonus has, again, not been budgeted for in 2019, despite this payment having been made to varying degrees over the past five years. Throughout this period, the payment has not been budgeted for, with a decision on the scale of the payment being made late in the year. This year, the bonus is to be paid for a full week, with a cost of €265 million. In the interest of good budgetary planning and to avoid a pattern of spending decisions based on cyclical developments (as occurred in the past), budget estimates should account for the payment of the bonus unless the Government genuinely does not intend to pay it.

Compensation of employees is set to increase by €1.1 billion in 2019, driven by increased headcount and pay increases. Intermediate consumption (€1.9 billion) and public gross fixed capital formation (€0.9 billion) are both set to contribute strongly to expenditure growth next year.

[19] The latest gross current expenditure ceiling for the health group in 2019 is €896 million higher than the 2018 figure, which itself has been revised up by €666 million due to the anticipated supplementary estimate.

Figure 3.12: Primary Expenditure Growth

Percentage change (year-on-year), excluding on-off items



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 those defined by the Council as applicable.

Strong expenditure growth forecast for 2019 comes after substantial increases forecast for 2018. Primary expenditure growth is set to be 12.4 per cent higher in 2019 than in 2017. Gross fixed capital formation is forecast to record the strongest growth (44.5 per cent), and large contributions from intermediate consumption (30.6 per cent) and compensation of employees (11.4 per cent) are also projected. Figure 3.12 shows primary expenditure growth accelerating in recent years, getting closer to rates last seen in the early 2000s.

2020 – 2023 Expenditure

For the years 2020–2023, expenditure forecasts in *Budget 2019* are based on the following technical assumptions. Voted current expenditure is assumed to grow by 2.5 per cent per annum for 2020–2023. Previously, the Department of Finance had improved its medium-term expenditure forecasts by moving from simply assuming no nominal growth in spending to a more realistic basis that was consistent with stated government policy. *Budget 2019* took a step backwards in this regard, by assuming a fixed (and implausibly low) growth rate in the outer years with little basis. Non-voted current expenditure is forecast to grow by only 1.2 per cent on average over the period, mainly due to falling interest costs. There is limited information value in these forecasts as they are based on assumptions rather a medium-term policy path or the costs of sustaining existing policies.

Forecasts for voted capital expenditure are in line with the National Development Plan, with growth averaging more than 6.5 per cent over 2020–2023. As this is part of stated policy, this forecast is more informative than the other assumptions for spending forecasts.

Table 3.2: General Government Expenditure Forecasts (2018–2023)

Percentage change year-on-year, unless otherwise stated

	2018	2019	2020	2021	2022	2023
General Government Expenditure	5.0	5.1	3.0	2.4	2.8	2.6
Compensation of Employees	6.2	4.9	1.7	1.0	0.1	0.1
Intermediate Consumption	11.0	17.6	3.0	3.1	2.6	-0.5
Social transfers	0.3	1.8	1.9	1.1	0.3	0.5
Interest Expenditure	-8.9	-5.8	-5.0	-4.2	6.8	5.0
Subsidies	0.7	-0.3	1.1	-0.5	-2.4	4.5
Gross Fixed Capital Formation	27.0	13.8	3.2	4.4	4.4	6.8
Capital transfers	-8.6	13.3	15.1	8.9	9.9	3.5
Other	19.7	-4.9	8.9	3.7	2.6	3.0
Primary Expenditure	6.1	5.9	3.5	2.8	2.6	2.4
Primary Expenditure, % of GNI*	38.7	38.7	38.0	37.5	36.9	36.2
Resources to be allocated, € billion	0.0	0.0	0.6	1.3	2.4	3.6

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: Figures in grey indicate that the Council assesses these forecasts as largely the result of technical assumptions on expenditure, which may be unrealistic. Expenditure amounts in 2021 are adjusted to take account of a capital transfer expected to be reclassified to general government. Resources to be allocated represents expenditure which is yet to be allocated to a specific item, with a decision as to where this is to be allocated to be made closer to the time.

In IFAC (2018b), IFAC presented the Stand-Still scenario, which estimates the cost of maintaining today's level of public services and benefits (in real terms) over the medium term. A preliminary update to these estimates suggests that these costs are relatively unchanged since May. Including unallocated spending, the level of non-interest spending assumed in *Budget 2019* marginally exceeds the updated Stand-Still estimate for the period 2020–2023. This means that the assumed level of expenditure could accommodate demographic and price pressures, assuming no change in policy or macro drivers. The implication is that there would be no room for other improvements in public services or additional welfare increases based on these projections, unless there were significant efficiency gains. In a growing economy, this is likely to be extremely challenging.

The technical nature of the projections means that some expenditure items show limited growth. Compensation of employees sees a significant slowdown in growth in 2020 and 2021, and is projected to remain flat in 2022 and 2023. Given the likely increases in staff numbers and wage growth in the economy, it would seem highly unlikely that compensation of employees would stay almost constant in 2022 and 2023. IFAC Stand-Still estimates would indicate that if public sector pay rates were to increase in line with agreed pay deals and private sector wages thereafter, this would imply cost pressures of over €600 million per year.

The Department has left a significant amount of unallocated expenditure in the forecasts. A better practice would be to give an indication of where these resources would be employed.

Budget 2019 saw a return to forecasting fiscal and macroeconomic variables five years ahead. The Council welcomes this and highlights that the practice ought to continue as part of multi-annual budgeting. The Alternative Presentation in the Budget, setting out spending and revenue forecasts in a disaggregated way over a five-year horizon, would be a potentially useful tool but is undermined by the implausible assumptions used for Departmental spending.

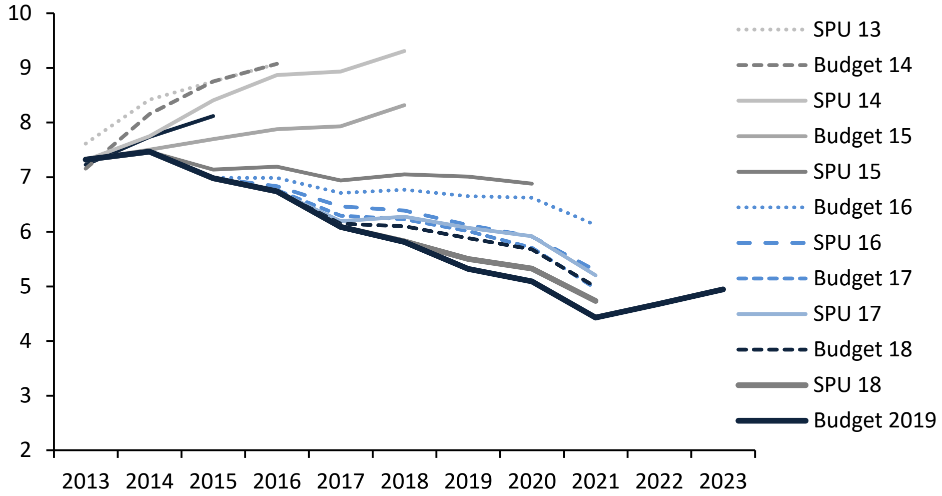
Interest expenditure

Interest costs on government debt have declined in recent years, and this is forecast to continue until 2021. Figure 3.13 shows the improvement in forecast and actual interest costs due to: (i) low global interest rates; (ii) agreed reductions in interest rates on official borrowing; (iii) expansionary monetary policy by the ECB, including the Public Sector Purchase Programme; and (iv) the early repayment of IMF loans and other debt restructuring. *Budget 2019* has once again seen a fall in expected interest payments over the period 2018–2021. Interest costs are forecast to rise somewhat after 2021, due to a forecasted rising average interest rate and a rising level of debt (in absolute terms). The average interest rate is forecast to rise because the bonds due to be refinanced in 2022 have very low rates; hence they are expected to be refinanced at higher rates.

Budget 2015 forecasts suggested interest expenditure of close to €8.5 billion and corporation tax receipts of close to €5 billion for 2018. The latest forecasts suggest interest expenditure will be just over €5.5 billion and corporation tax receipts of close to €10 billion in 2018. This is a positive swing approaching €8 billion for the public finances which was not forecast four years ago. Despite this, the general government balance is now forecast to be in deficit in 2018, compared to a surplus forecasted in *Budget 2015.*

Figure 3.13: Revisions to National Debt Cash Interest Payments

€ billion



Sources: Department of Finance.

2019–2023 revenue

The outlook for 2019 points to **general government revenues** of €85.2 billion, with annual growth forecast at 5.4 per cent (Table 3.3). The main drivers of a total increase of €4.4 billion are social contributions (€1.4 billion), followed by taxes on production and income, and current taxes on income and wealth (€1.3 billion each).[20] Over 2020–2023, revenue is projected to average €94.7 billion, representing an average increase of €3.9 billion per year (or 4.3 per cent).[21] As a share of GNI*,

[20] Compared to *SPU 2018,* general government revenue for 2019 has been revised up. In particular, *Budget 2019* includes revisions of +€1.0 billion in social contributions; +€0.9 billion in current taxes on income and wealth; and +€0.5 billion in other. Over the medium term (2020–2023), growth is forecast at a slower average rate of 4.3 per cent per year, with current taxes on income and wealth being the main contributor to this increase.

[21] For 2020–2021, *Budget 2019* has included upward revisions of social contributions (averaging €1.3 billion each year); current taxes on income and wealth (+€1 billion per year); and other (averaging +€0.9 billion per year). The revision in social contributions is predominantly due to the latest estimates of PRSI receipts in the Social Insurance Fund and the National Training Fund. The revision of current taxes on income and wealth partly reflects the fact that the €0.6 billion income tax reductions included on an indicative basis in earlier forecasts is not to be fully utilised in 2019 (which impacts 2019 and subsequent years).

general government revenue is projected to be over 41 per cent in 2019, and 40.7 per cent on average in 2020–2023 (Table 3.3).[22]

Table 3.3: General Government Revenue Forecasts

€ billion, unless stated

	2018	2019	2020	2021	2022	2023
General Gov. Revenue	80.8	85.2	88.9	92.6	96.6	100.7
Taxes on production and imports	25.2	26.5	27.6	28.6	29.6	30.6
Current taxes on income, wealth	34.2	35.6	37.4	39.2	41.2	43.5
Capital taxes	0.5	0.5	0.5	0.5	0.5	0.6
Social Contributions	13.3	14.7	15.5	16.3	17.1	17.9
Property income	1.5	1.5	1.3	1.1	1.1	1.0
Other	6.2	6.6	6.7	6.9	7.1	7.1
Macro indicators						
% GNI*	41.3	41.1	40.7	40.7	40.7	40.6
% GDP	25.1	25.0	24.7	24.6	24.6	24.6

Sources: Department of Finance; and internal IFAC calculations.

Exchequer tax revenue for 2019 is forecast to amount to €57.9 billion, 5.2 per cent higher than in 2018. Strong income tax and VAT revenues are expected to account for the highest part of this increase (Table 3.4 and Figure 3.14). Separately, **PRSI** contributions are forecast to reach €11.2 billion in 2019.

In terms of **income tax**, growth of 6.8 per cent reflects “the assumed continuation of strong employment and earnings growth” in 2019 (projected at 2.8 per cent and 3.0 per cent, respectively). Relatedly, the unemployment rate is forecast to remain low at 5.2 per cent in 2019. *Budget 2019* notes that the full €0.6 billion that had been previously included on an indicative basis to income tax measures in 2019 was not fully used in this Budget (see Figure 3.15 and Appendix E). This gave space for additional spending measures beyond the level previously set out.

Another expected source of income tax revenue for 2019 relates to a compliance measure introduced in *Budget 2019*. This refers to Revenue’s updated PAYE system, which is projected to bring in a yield of €50 million. An analysis of compliance measures introduced in *Budget 2017* was included with the budget documentation (Revenue Commissioners, 2018b). This is welcome, and it is important that

[22] This higher share for 2019–2021 relative to *SPU 2018* (where the last projected year is 2021) is the result of an upward revision of general government revenue—averaging +€1 billion—and a downward revision of GNI*—averaging –€16 billion (see Chapter 2).

estimated yields from revenue measures are based on sound and detailed forecasts, as also highlighted in the *November 2017 Fiscal Assessment Report* (Box F). The Revenue analysis of compliance measures indicates that the compliance target established in *Budget 2017* for 2017 was exceeded. However, the document notes that it is not possible to clearly identify how much is raised from compliance measures due to the improved efforts at tax compliance as opposed to from general economic activity or behavioural changes. While this breakdown might not be easy to undertake, it is crucial that a robust analysis is made to evaluate the impact of such measures.

Table 3.4: Tax Revenue and PRSI Forecasts

€ billion, unless stated

	2018	2019	2020	2021	2022	2023
Tax Revenue	55.1	57.9	61.0	63.8	66.8	70.2
Income tax	21.4	22.9	24.2	25.6	27.1	28.8
VAT	14.1	15.1	16.0	16.7	17.5	18.4
Corporation tax	9.6	9.5	10.0	10.4	10.8	11.3
Excise duties	5.6	5.9	6.1	6.3	6.4	6.6
Stamp duties	1.6	1.7	1.8	1.8	1.8	1.9
Other	2.7	2.8	2.9	3.0	3.1	3.2
PRSI	10.2	11.2	11.9	12.5	13.2	14.0

Sources: Department of Finance; and internal IFAC calculations.
Note: Tax revenue in Exchequer terms. Other includes motor tax, customs, capital gains tax and capital acquisitions tax.

As regards **VAT**, a strong yield for 2019 is supported by a solid growth of personal consumption volume (3.0 per cent) and of the personal consumption deflator (2.0 per cent), as covered in the “macro” driver of Appendix E. In addition, a policy impact is estimated by the Department of Finance to further support an increasing VAT yield for 2019. This refers to an increase of VAT rate on “tourism” activities—though this goes beyond what can be strictly considered as “tourism”, e.g., an increase of VAT in restaurants affects both tourists and non-tourists—expected to bring in a yield of €560 million for the full year (€466 million for 2019).[23,24]

[23] The measure applies to goods and services related to tourism activities, with the exception of newspapers and sporting facilities. The increased rate will be applied from January 1st 2019 onwards. The reason why the full-year yield is higher than the 2019 yield is because VAT is paid in arrears. In January 2019, businesses will pay VAT for sales made in November and December 2018, which for the tourism sector will be at the 9 per cent rate. The next November and December’s sales will be at the 13.5 per cent rate, but the VAT will not be paid until January 2020.

[24] The “Review of the 9% VAT Rate” (Department of Finance, 2018b) notes that an increase in the VAT rate is not expected to trigger a fall in the demand of goods and services, “given the positive

A simple cross-check, using accommodation and food service activities data from the CSO, suggests that this estimate is reasonable. The rationale for choosing this category is that it covers information related to both tourists and non-tourists, who are also liable for this measure. Assuming a 2-per-cent growth of accommodation and food services per annum (close to the long-term average growth, and still substantially lower than the recently observed growth) and assuming no further behavioural changes suggests that increasing the rate to 13.5 per cent might bring in a yield of around €500 million from these specific sectors in 2019.[25]

In terms of **corporation tax**, the 2019 projections point to slightly lower receipts than in 2018 (1.3 per cent lower), largely due to a base-year effect as a consequence of the 2018 windfall. In particular, Appendix Figure E1 shows that this negative growth is the result of the one-off impact that has taken place in 2018, which is not expected to be offset by the strong gross operating surplus forecast for 2019.[26] However, after accounting for the one-off revenue of €0.7 billion, the Department of Finance still expects strong growth of 6.5 per cent for 2019. Corporation tax as a percentage of Exchequer tax revenue is forecast to amount to 16.4 per cent in 2019. This is equal to the second highest peak of the last decades, reached in 2002 (see Figure 3.7 in Section 3.2), but still lower than the expected record share of 2018.

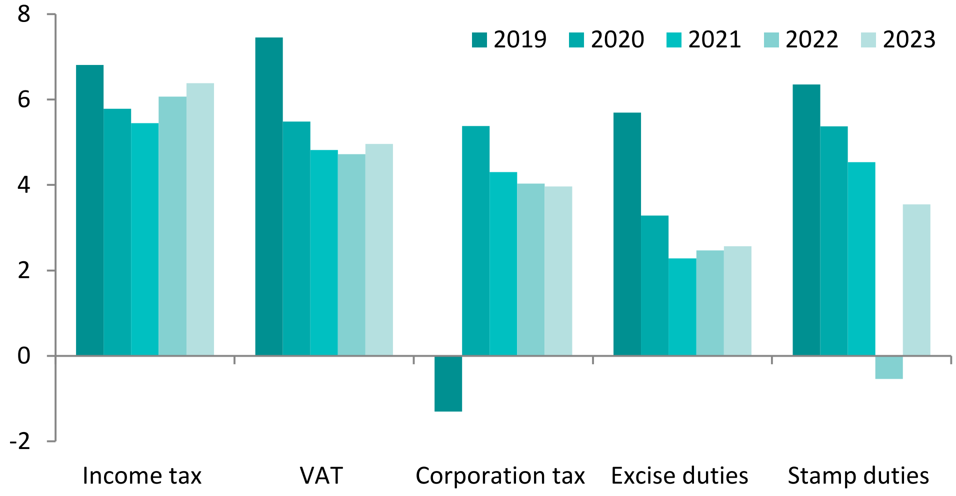
outlook for both household incomes and consumer demand […] and given that demand is considerably more sensitive to changes in income than price".

[25] This exercise is shown on an indicative basis. The elasticity of changes in demand to this modified rate should be properly accounted for in order to provide a more accurate estimate.

[26] In particular, the gross operating surplus projected for 2019 is 6.1 per cent, the highest rate of the whole projection horizon.

Figure 3.14: Tax Forecasts

Percentage change (year-on-year)



Sources: Department of Finance; and internal IFAC calculations.

Excise duties are forecast to grow by 5.7 per cent in 2019. This relies on the assumption that the distortionary impact from tobacco health measures will unwind by 2019. The excise duty projection for 2019 partly reflects an expected policy impact of €90.4 million (Appendix E) related to three tax-raising policy measures introduced in *Budget 2019*: (i) tobacco products tax (€48.9 million); (ii) betting tax (€39.5 million); and (iii) raise in the minimum excise duty on cigarettes (€2.0 million).

In relation to the tobacco products tax, the Revenue Commissioners' estimates (which attempt to partially reflect the change in behaviour of smokers to higher prices) suggest that an equivalent increase should yield between –€44 million to +€57 million (Revenue Commissioners, 2018). While the analysis notes that the upper limit of these estimates is likely to be most accurate, choosing this rather than the mid-point of estimates (€6.5 million, in this case) is an unusual statistical practice. The assumptions underpinning this range of estimates are not referenced, which is paramount for assessing the adequacy of this estimate.

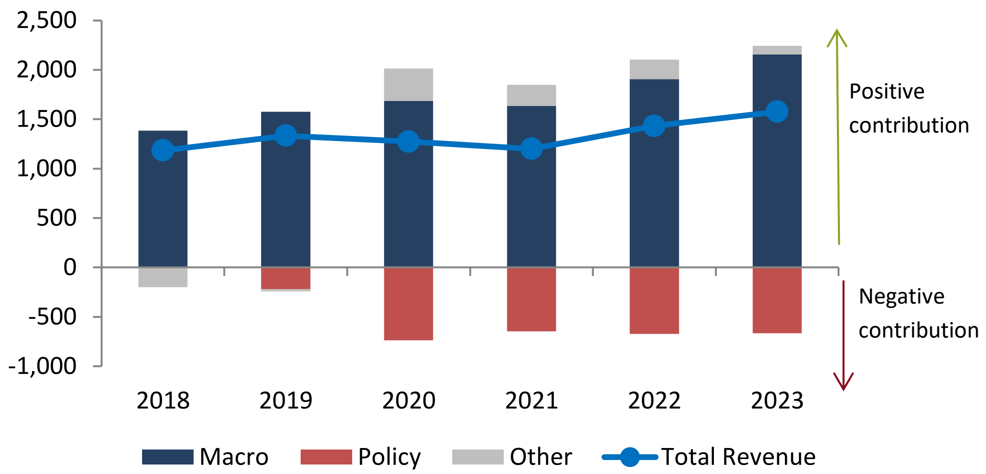
Stamp duties are expected to follow relatively strong growth of 6.3 per cent in 2019 to moderate thereafter and become negative in 2022, before again turning positive in 2023. The expected drop in 2022 is because the banking levy is due to cease after 2021, hence triggering a structural fall in revenues for 2022.

Over **2020–2023**, Exchequer tax is forecast to average €65.4 billion. This implies strong growth of 4.9 per cent, on average, annually. Income tax is expected to register the strongest growth of all the main tax heads, averaging 5.9 per cent over this period.

Figure 3.15 and Appendix E identify the factors that contribute to the annual changes in USC and PAYE forecasts of income tax produced by the Department of Finance. Both USC and PAYE are expected to grow strongly, aided by strong non-agricultural earnings and employment prospects—as covered in the “macro” driver—but policy changes will partly mitigate this. These policy impacts largely reflect the assumption that an income tax package of over €0.6 billion will be allocated each year between 2020 and 2023. This is a technical assumption, which will depend on the Government in advance of each respective Budget. Another important source of revenue is PRSI, which is not often recognised in revenue analyses. Receipts from this source are forecast to be equivalent to almost half of income tax revenues over the whole period 2020–2023.

Figure 3.15: Income Tax (USC and PAYE) Forecasts Decomposed

€ million, year-on-year change



Sources: Department of Finance; and internal IFAC calculations.
Note: Graphs show the Pay-As-You-Earn (PAYE) and Universal Social Charge (USC) components of income tax (see Appendix E for more detail on the calculations). Other includes carryover effects, one-offs and other factors/judgement applied by the Department of Finance.

VAT and corporation taxes are also forecast to grow strongly (5.0 and 4.4 per cent on average, respectively), while the growth of excise duties will remain more moderate (averaging 2.7 per cent). The growth in corporation tax is fully driven by relatively strong macroeconomic forecasts (gross operating surplus is projected to grow by 4.4 per cent on average over 2020–2023). In terms of VAT, solid forecasts of personal consumption expenditure and of the deflator support an average VAT growth of over €800 million per annum. Regarding excise duties, the estimated yields over

2020–2023 are partly the result of strong macro drivers, including personal consumption expenditure (excluding cars), the projected increase in the price of new cars, and, to a lesser extent, the volume of new car sales (with average growth projected to slightly moderate relative to 2018–2019).

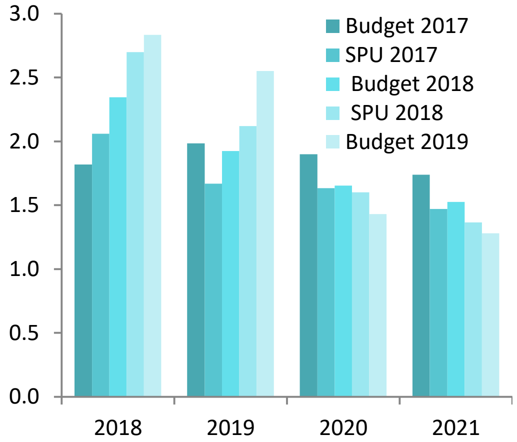
Non-tax revenues are projected to reach €2.6 billion in 2019 (Figure 3.16). This is €0.7 billion higher than the *SPU 2018* forecast and is mainly driven by expectations of increased non-tax revenue through higher Central Bank of Ireland surplus income, as well as other dividend income. Taking previous forecasts, this is the highest yield projected for 2019, as shown in Figure 3.16A. For 2020–2021, non-tax revenues are assumed to decrease to €1.4 billion and €1.3 billion respectively. These lower estimates arise from an assumption of decreased Central Bank surplus income payable to the Exchequer.[27] For 2022 and 2023, non-tax revenue (largely arising from the Central Bank surplus income, besides dividend income) is forecast to remain relatively stable at roughly to €1.2 billion (Figure 3.16B). It is worth noting that, over the whole projection horizon, around half of total non-tax revenues (on average) will have no general government impact, although they will impact the Exchequer position.

[27] Given the current negative interest rate environment, the Central Bank charges credit institutions for holding their deposit balances and receives income which, in more normal times, would represent a cost of holding such funds. As interest rates turn positive, the Central Bank will have to pay to hold such balances and the profit outlook reflects this as part of a general assumption that post-crisis conditions continue to normalise. This, combined with expected increases in operating costs, is expected to reduce the Central Bank’s profit and surplus payable to the Exchequer.

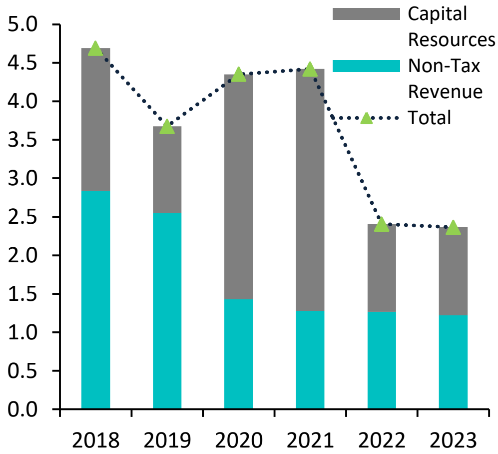
Figure 3.16: Non-Tax Revenues and Capital Resources

€ billion

A. Non-tax revenue vintages



B. Non-tax revenue, capital resources



Sources: Department of Finance; and internal IFAC calculations.
Note: Almost all of the revenue from capital resources is estimated to not impact the general government balance (since it is treated as a financial transaction under current accounting rules), while the Exchequer cash position will be impacted. For non-tax revenue, this is the case only for half of the yearly revenue over 2019–2023.

Capital resources for 2019 are expected to amount to €1.1 billion before increasing to roughly €3 billion in 2020 and 2021. This boost results from the distribution of a €3.5 billion surplus of the winding-down of the National Asset Management Agency (NAMA) in this period.[28] Capital resources in 2022–2023 are projected to decline due to the cessation of the NAMA.[29] While impacting the Exchequer position, almost all of the projected capital resources (95 per cent, on average) are neutral from a general government perspective.[30]

General government debt

The gross debt-to-GDP ratio has fallen substantially since 2012. Two factors have played a significant role. The first is related to the high level of measured GDP growth in 2015. The second involves the liquidation of the IBRC, which led to lower liabilities being measured on the Government's balance sheet (in 2011, this had led to an increase in government liabilities of €20.9 billion; stripping out these liabilities, gross debt to GDP would have been 4 per cent lower annually). While the Stability

[28] Of the €3.5 billion surplus, €1.5 billion is expected to take place in 2020, and the remaining €2.0 billion, in 2021.

[29] *Budget 2019* notes that these proceeds—along with others related to the resolution of the financial crisis—are to be directed to debt reduction. This aims to "help ensure fiscal sustainability and to reduce the debt servicing burden, particularly as we face a number of potential external challenges, including Brexit".

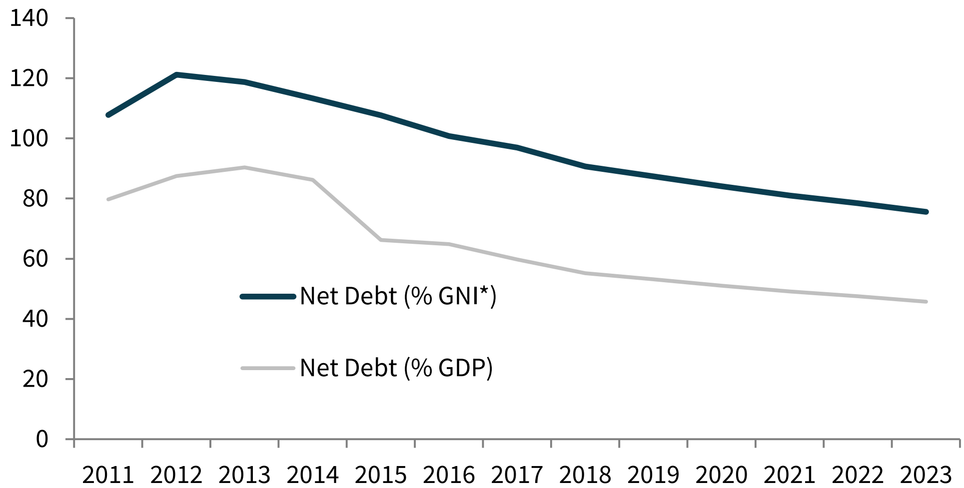
[30] According to the ESA2010 accounting rules, this income is treated as a financial transaction, hence not impacting on general government balance.

and Growth Pact reference value of 60 per cent is set in terms of debt-to-GDP, it is worth remembering that for Ireland this 60 per cent of GDP reference value would be equivalent to 97.4 per cent of GNI* (using 2017 nominal outturns for both variables).[31] Using GNI* or revenue as a denominator, government debt remains high relative to other OECD countries (see Figure 1.6 in Chapter 1). Given some of these distortions and the relatively high cash balances run by the NTMA, net debt to GNI* is a more informative measure. Using this metric, the decline in debt levels is more gradual since 2012, and debt is expected to fall to 90.7 per cent in 2018 before falling to 75.6 per cent in 2023 (Figure 3.17).

The increasing surpluses in 2020–2023—driven by unrealistic forecasts of expenditure growth—contribute to a reduction in the debt burden in those years. Higher forecasts of expenditure in those years would lead to a slower pace of debt reduction in those years.

Figure 3.17: General Government Debt

Percentage of GDP/GNI*



Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: Data for the period 2018–2023 are projections as per *Budget 2019*.

[31] Gross general government debt is forecast to fall below 60 per cent in 2020.

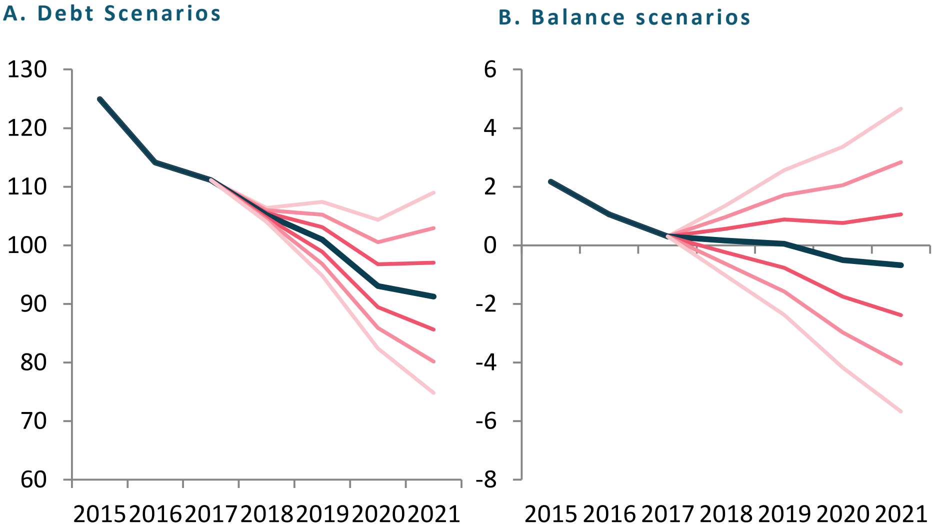
3.4 Risks

While *Budget 2019* forecasts continuing improvements in 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. Volatile bond market conditions as seen recently in Italy and possible changes to the international corporation tax environment could pose significant fiscal risks.

The reliance on potentially transient sources of revenue to fund permanent expenditure increases is a significant fiscal risk. Corporation tax is set to record its highest share of tax revenue in the last decades in 2018 (Figure 3.7). These unexpected corporation tax receipts are being partially used to fund permanent increases in health expenditure and the payment of the Christmas bonus.[32]

Figure 3.18: Debt and Budget Balance Paths under Different Growth Scenarios

%GNI*, general government basis



Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: Central line depicts the central forecasts from the Department of Finance. The outer lines depict how far the budget balance as a percentage of GNI* would be pushed away from the central forecasts under different shocks to real GDP growth in each year. The outer lines, as one moves further away from the central forecast, are for positive/negative growth shocks of 0.5, 1.0, and 1.5 percentage points, respectively. Positive shocks raise the balance; negative shocks reduce it.

Figure 3.18 shows how shocks to growth would impact on the general government balance and general government debt. A shock to GNI* growth of 1.5 percentage

---

[32] The Department of Finance has already stated that €700 million of corporation tax receipts are likely to be one-off receipts. In the financial statement as part of *Budget 2019*, the Minister for Finance stated that a €700 million supplementary estimate for the Department of Health would be required in 2018.

points relative to *Budget 2019* forecasts each year from 2018 to 2023 would result in the general government balance being 5.3 percentage points of GNI* lower by 2023. All else being equal, this means that the public finances would remain in deficit out to 2021, as compared to a central scenario of a surplus of 0.7 per cent of GNI*. In the same scenario, the currently high gross government debt-to-GNI* ratio would remain close to current levels, in the absence of corrective policy action. A shock of this magnitude would not be exceptional given the historic volatility of Irish national income growth, for which a typical current year forecast error is close to 2 percentage points.

Table 3.5: Assessing the *Budget 2019* Fiscal Risk Matrix

Likelihood and Impacts from *Budget 2019* , unless stated:
high in red; medium in pink; low in grey

	Likelihood	Impact

Health overruns (IFAC risk)

Recent years have seen a persistent pattern of large overruns in health spending. A combination of unrealistic forecasts and a repeat of relaxation of ceilings have recurrently led to uncontrolled increases in spending, which can put the public finances at risk. Over the period 2014–2017, current spending overruns have averaged €0.5 billion per year, and are expected to amount to €0.6 billion in 2018 (of the total estimated supplementary estimate of €0.7 billion, the remaining €0.1 billion relates to capital expenditure and a shortfall in Departmental receipts).

EU climate change and renewable energy targets

Ireland seems unlikely to meet its 2020 emissions targets without purchasing more allowances, which could cost between €148 million and €455 million per year (Deane, 2017). Costs associated with missing later targets (2030) could be substantially higher (Curtin, 2016 estimates €2.7 to €5.5 billion).

Corporation tax concentration risks

Corporation tax revenue is forecast to be double its 2014 value this year. Given how quickly this revenue source has grown, there is a significant risk it could fall rapidly also. *Budget 2019* has revised corporation taxes by +€1.1 billion relative to forecasts in *SPU 2018.* Corporation tax (as a share of Exchequer tax revenue) will be at record levels of the last decades (estimated at 17.4 per cent). Given the high volatility and strong concentration of this tax head in very few companies, the Council assesses that a high impact would be more appropriate.

Budgetary pressures

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. In-year spending increases would also exacerbate the problem. The political cycle may also increase near-term budgetary pressures. Given the pattern of overruns in the Department of Health and having not budgeted for the payment of the Christmas bonus in 2019, the Council assess a high likelihood to be more appropriate.

Reliance on transient revenues (IFAC risk)

Failure to recognise the transient nature of certain sources of revenue could, if repeated, reduce the stability of tax revenues. This is particularly risky if transient revenue resources are used to fund long-term expenditure. For example, in 2018, higher-than-expected corporation tax revenue and interest savings, both of which might be deemed as temporary, are largely devoted to funding the high health overrun for the year (see Box D).

Sharper-than-expected growth in tax-rich sectors (IFAC risk)

Pent-up demand in the housing sector is forecast to lead to strong growth in the construction sector. Given the tax-rich nature of housing output, due to its labour intensity, and capacity for tax collection on new homes and housing transactions, rapid growth could imply a substantial increase in revenue.

	Likelihood	Impact

EU Budget contributions

There is continuing uncertainty surrounding the impact Brexit will have on the contributions to the EU budget.

Changes to tax “drivers”

Tax forecasts are dependent upon macroeconomic projections and other components. For example, corporation tax forecasts are driven by forecasts around the Gross Operating Surplus (GOS), and the elasticity associated with this. The GOS forecasts are subject to a high degree of uncertainty, namely that related to international trading conditions and currency markets. Hence, changes in the composition of those macroeconomic components can have important impacts on the tax forecasts.

Litigation risk

This risk refers to an adverse or unexpected outcome of litigation against the State, leading to increased expenditure. Bova *et al.* (2016) estimate that the contingent liability realisations could have an average fiscal cost of 6.1 per cent of GDP.

Tax forecast and payment timeline asymmetry

Timing in relation to certain tax receipts can lead to variation throughout the year. Another concern is posed in the estimation of the cost of tax measures. Although there is a risk of underestimation of the impacts of tax cuts, there is also a risk that estimated yields accruing from revenue-raising measures may be overly optimistic.

Statistical classifications

Ireland’s compliance with the EU fiscal rules is measured under the ESA 2010 statistical framework. When statistical revisions take place, or decisions are made around guidance and classification of different items, including Eurostat, this might pose fiscal risks.

Unexpected one-off revenues (IFAC risk)

This risk refers to large, unexpected one-off government revenues being received. A recent example relates to Apple, which was ordered to pay €13 billion (plus €1.3 billion interest) to an escrow account related to unpaid taxes in Ireland. This is equivalent to 6.6 per cent of GNI* in 2018. Since the announcement, the Minister for Finance stated that this liability “should be taken off the national debt rather than spent on day-to-day expenditure”. Given that this one-off receipt is not budgeted for, it represents a positive fiscal risk.

Receipts from resolution of financial sector crisis

The budgetary projections in *Budget 2019* do not include any assumed proceeds relating to disposals of the State’s shareholding in a number of financial institutions. This provides an upside risk to the fiscal forecasts.

Dividend payments

Budget 2019 identifies risks in relation to lower-than expected payments of dividends from the State’s shareholding in banks and commercial semi-state companies. Such dividends are a function of business performance and outlook, over which the State has little control. If some of these assets are sold, then associated revenue streams would fall.

	Likelihood	Impact
Bond market conditions		
The long maturities and relatively fixed nature of debt (with 94 per cent of gross national debt being at fixed interest rates in June 2017) should insulate the public finances from a typical shock to interest rates on sovereign borrowings. At high debt levels, external shocks such as a harder-than-expected Brexit could lead to self-reinforcing fears in bond markets.		
Contingent liabilities		
Contingent liabilities continued to fall in 2017. Given their reduced level, the Council assesses a low impact to be more appropriate.		

Sources: Department of Finance; and internal IFAC assessment.