Assessment of Compliance with the Domestic Budgetary Rule in 2018

May 2019

Irish Fiscal Advisory Council

Background

The *Fiscal Responsibility Act* (FRA), which came into effect in December 2012, established the Irish Fiscal Advisory Council (IFAC) as a statutory body and legislated for the implementation of national fiscal rules. These reforms were part of a wider agenda of budgetary reform, set out in the National Recovery Plan 2011-2014, the Programme for Government 2011 and the EU-IMF Programme of Financial Support for Ireland.

Under the *FRA,* part of the mandate of IFAC is to monitor and, at least once in each year provide an assessment of compliance with the domestic Budgetary Rule.[1] Independently, the European Commission will make their own assessment of compliance with the EU fiscal rules for 2018, and that assessment is the legal basis for compliance with the EU fiscal rules.

Previously, the Council's assessment of compliance with the Domestic Budgetary Rule was broadly in line with the EU fiscal rules as set out in the *Vade Mecum on the Stability and Growth Pact 2019* (European Commission, 2019) and as implemented by the European Commission.[2]

However, the Council has identified a number of issues with this approach and is now opting to take a more "principles-based approach" to assessing compliance with the Domestic Budgetary Rule. This principles-based approach is based on the same underlying framework as the EU fiscal rules, but makes a number of adjustments, that make it simpler and more relevant for an Irish setting.

This principles-based approach, and the reasons for applying it, is outlined in Box A. This note primarily assesses compliance with the Domestic Budgetary Rule using

[1] FRA Section 8(2) specifies the Council's role as to "monitor, and at least once in each year, provide an assessment of, whether any obligation under section 2(1)(a) or 6(1), or to do things specified in a plan under section 6(1), is being complied with". Section 2(1)(a) relates to the Budgetary Rule and notes: "the Government shall endeavour to secure that—(a) the requirement imposed by section 3 (the budgetary rule)…are complied with". Section 6(1) covers the "Correction Mechanism", that sets plans to secure compliance with the Budgetary Rule when not met: "if the Commission addresses a warning to the State under Article 6(2) of the 1997 surveillance and coordination Regulation or if the Government consider that there is a failure to comply with the budgetary rule which constitutes a significant deviation for the purposes of Article 6(3) of that Regulation, the Government shall, within 2 months, prepare and lay before Dáil Éireann a plan specifying what is required to be done for securing compliance with the budgetary rule".

[2] Available at: https://ec.europa.eu/info/sites/info/files/economy-finance/ip101_en.pdf

this principles-based approach, but also includes an assessment based on the previous methodology in the appendix (Appendix A).

This publication outlines the Council's assessment for the previous year, 2018, based on data available as of spring 2019 including the Maastricht returns (i.e., the first official outturns for the previous year's annual general government statistics) and preliminary GDP data for the previous year (Q4 *Quarterly National Accounts*).

Summary Assessment Table

Table 1 outlines the main information relevant for assessing compliance with the Domestic Budgetary Rule in 2018. Initially, the Budget Condition is assessed (i.e., whether the structural balance is at the Medium-Term Objective (MTO) requirement). Then, if the MTO has not been reached, the Adjustment Path Condition is assessed (i.e., whether the required pace of convergence towards the MTO is achieved).

IFAC assesses that the MTO was achieved for 2018 on the basis of the Department's preferred GDP-based estimates of the output gap.[3] The Expenditure Benchmark limit was not complied with for 2018, although technically this does not apply when the MTO is achieved.

Table 1: Summary Assessment of Compliance for 2018

	Required/ Limit	Actual	Compliant	Deviation (% GDP)	Deviation (€bn)	Significant Deviation
A. Budget Condition						
Structural Balance (% GDP)	**-0.5**	**0.2**	**Yes, At MTO**			
B. Adjustment Path Conditions						
I. Change in Structural Balance						
One-year change (p.p.)						
Two-year avg. change (p.p.)						
II. Expenditure Benchmark (Limit)[a]	**Technically no longer applies once the MTO is achieved**					
One-year growth rate (%)						
Two-year avg. growth rate (%)						

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: All fiscal outturns are taken from the CSO's April 2019 *Annual Government Finance Statistics* publication. One-offs and discretionary measures are as reported by the Department of Finance unless the Council assesses these classifications to be inapplicable (Appendices B and C). Estimates of the output gap are as reported in Table A9 of the *SPU 2019.* The budgetary semi-elasticity used is 0.588 as estimated in IFAC Analytical note 12. Overachievement of the MTO is not required and so the structural balance adjustment is not assessed. Member States that have exceeded their MTO do not need to be assessed for compliance with the Expenditure Benchmark. [a] The Expenditure Benchmark requirement is set as a growth limit in nominal terms.

[3] The European Commission's Commonly Agreed Methodology (CAM) output gap estimates (Spring 2019) are used by the Commission in formal legal assessments of compliance with the EU fiscal rules. The Council (and the Department of Finance) have raised repeated concerns regarding the usefulness of these estimates in determining the cyclical position of the Irish economy and the Council are therefore assessing compliance with the Domestic Budgetary Rule based on the Department's preferred GDP-based estimates of the output gap.

1. Budget Condition

The Budget Condition set out in the *FRA* requires that the budgetary position of the general government be in balance or in surplus. This condition is deemed to be met if the general government structural balance is at the MTO, which is set under the Preventive Arm of the *Stability and Growth Pact*. If the Budget Condition requirement is not met, the structural balance is subject to the Adjustment Path Conditions discussed in Section 2. If failure to meet the requirement is the result of exceptional circumstances, and provided that it does not endanger medium-term fiscal sustainability, it is permitted.

Current estimates suggest that the Budget Condition was met in 2018. The structural balance for 2018 was 0.2 per cent of GDP, above the MTO of a structural balance of -0.5 per cent of GDP.

Table 2: Budget Condition

	Requirement (MTO)	Actual	At MTO?
A. Budget Condition			
Structural Balance 2018	-0.5	0.2	Yes

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: All fiscal outturns are taken from the CSO's April 2019 Annual *Government Finance Statistics* publication. One-offs and discretionary measures are as reported by the Department of Finance unless the Council assesses these classifications to be inapplicable (Appendices B and C). Estimates of the output gap are as reported in Table A9of the *SPU 2019.* The budgetary semi-elasticity used is 0.588 as estimated in IFAC Analytical note 12.

The Council assess that achievement of the MTO was not due to windfall revenues under the standard definition. Achievement of the MTO should be assessed taking into account revenue windfalls. If overachievement of the MTO were due to revenue windfalls, the Expenditure Benchmark would still apply. While the Council assesses that these revenues are not deemed to be windfalls as per the methodology outlined in the *Vade Mecum*, considerable concerns remain about the long-run sustainability of these receipts, in particular corporation tax.

2. Adjustment Path Condition and Expenditure Benchmark

The Adjustment Path Condition of the Domestic Budgetary Rule does not apply in 2018. The Adjustment Path Condition is a requirement which applies when the MTO is not met. The Adjustment Path Condition is a means of ensuring the structural balance is on a suitable path towards the MTO and it incorporates the Expenditure Benchmark. As the MTO was achieved in 2018, and this achievement is not deemed contingent on windfall revenues, the Adjustment Path Condition, technically, no longer applies.

While the Adjustment Path Condition does not formally apply the Council still assesses the Expenditure Benchmark. The Expenditure Benchmark limit for 2018 was an expenditure growth rate of 5.0 per cent. Net expenditure grew by 6.0 per cent in 2018, 1 percentage point above the limit (Table 3). This Expenditure Benchmark limit is based on the Council's new principles-based approach to the Budgetary Rule and was not available at the time policy was set. However, the limit for the Expenditure Benchmark based on the EU methodology, which was available at the time policy was set, was also exceeded (Appendix A). On this basis, the Council assesses that the Expenditure Benchmark was not complied with in 2018.

Table 3: Adjustment Path Condition

	Required/ Limit	Actual	Compliant	Deviation (% GDP)	Deviation (€bn)	Significant Deviation
B. Adjustment Path Conditions						
I. Change in Structural Balance						
One-year change (p.p.)	0.0	-1.2	**N/A**	-1.2	-3.9	**N/A**
Two-year avg. change (p.p.)	0.0	-0.1	**N/A**	-0.1	-0.4	**N/A**
II. Expenditure Benchmark (Limit)[a]						
One-year growth rate (%)	5.0	6.0	**N/A**	-0.2	-0.7	**N/A**
Two-year avg. growth rate (%)	4.4	5.4	**N/A**	-0.2	-0.7	**N/A**

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: All fiscal outturns are taken from the CSO's April 2019 Annual *Government Finance Statistics* publication. One-offs and discretionary measures are as reported by the Department of Finance unless the Council assesses these classifications to be inapplicable (Appendices B and C). Estimates of the output gap are as reported in Table A9of the *SPU 2019.* The budgetary semi-elasticity used is 0.588 as estimated in IFAC Analytical note 12. N/A's refer to when rules do not technically apply. Overachievement of the MTO is not required and so the structural balance adjustment is not assessed. Member States that have exceeded their MTO do not need to be assessed for compliance with the Expenditure Benchmark. [a] The Expenditure Benchmark requirement is set as a growth limit in nominal terms.

3. Fiscal Stance as Indicated by the Structural Primary Balance

As set out in the *FRA*, the Council's mandate also requires an assessment of the fiscal stance. The fiscal stance is defined in the *FRA* as the change in the annual structural primary balance. The structural primary balance is the general government balance, excluding one-off items and interest costs, which are largely outside the government's control, adjusting for the economy's cyclical position.

While there is considerable uncertainty about point estimates of the level of the structural primary balance, changes in this estimate can provide a more accurate picture of the change in the underlying fiscal position of the state.

Table 4: Indicators of Fiscal Stance

Per cent of GDP unless otherwise stated

	2016	2017	2018
Primary Balance (Excluding one-offs)			
Level	1.5	1.8	1.6
Change (p.p)		0.3	-0.1
Structural Primary Balance			
Level	2.7	3.4	1.9
Change (p.p)		0.7	-1.6

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: All fiscal outturns are taken from the CSO's April 2019 Annual *Government Finance Statistics* publication. One-offs and discretionary measures are as reported by the Department of Finance unless the Council assesses these classifications to be inapplicable (Appendices B and C). Estimates of the output gap are as reported in Table A9of the *SPU 2019.* The budgetary semi-elasticity used is 0.588 as estimated in a forthcoming IFAC Analytical Note 12.

The structural primary balance deteriorated significantly in 2018, falling by 1.6 percentage points (Table 4). This indicates that there was a considerable worsening in the fiscal position in 2018. This is notwithstanding the considerable overperformance of corporation tax in 2018, which is unlikely to be linked to the performance of the underlying domestic economy (IFAC, 2018b). Risks to the sustainability of corporation tax receipts are growing. If not for the overperformance of corporation tax, the underlying fiscal position would have been far worse.

A more detailed discussion of the fiscal rules and an assessment of the fiscal stance will be provided in the Council's forthcoming *Fiscal Assessment Report*, which will be published in June.

Box A: Principles-Based Approach to the Budgetary Rule

The Council's mandate includes assessing compliance with Ireland's domestic Budgetary Rule as set out in the *Fiscal Responsibility Act 2012.* The Budgetary Rule requires that the general government budgetary position be in balance or in surplus, or on an appropriate path to meet this condition. In practice, the Budget Rule is deemed to be achieved if the structural balance meets a specified structural balance target, the so-called Medium-Term Objective (MTO), or is on an appropriate path towards it.

Until recently, the Council has followed the European Commission's approach to assessing compliance with the EU fiscal rules as set out in the *Vade Mecum.* However, the Commission's approach has a number of shortcomings: first, calculating structural deficits for Ireland on the basis of output gap estimates produced under the Commonly Agreed Methodology (CAM) is highly problematic. The CAM estimates are excessively procyclical and are often implausible, particularly for Ireland, thus giving rise to estimates of the structural balance that are also implausible. Second, the application of the fiscal rules has a number of aspects that introduce excessive complications with questionable merit, as explained below.

In light of these issues, the Council has decided to follow a "principles-based approach" to assessing compliance with the domestic Budgetary Rule.[4,5] The Council's new approach is based on the framework of the EU fiscal rules, but implements and interprets some aspects differently to make it simpler and more relevant for Ireland. The differences in the Council's approach, relative to the Commission's approach, are outlined below, along with the reasons for doing so. Table A.1 summarises the Council's principles-based approach, differences with the Council's previous approach, and the Commission's Approach.[6]

Potential Output and the Output Gap

CAM-based estimates of potential output and the output gap have a number of shortcomings, which can lead to implausible results, particularly for small open economies such as Ireland. As far back as December 2003, the Department of Finance has highlighted the unsuitability of CAM-based estimates of the output gap for Ireland (Department of Finance, 2003). The Council has on a number of occasions, also highlighted their shortcomings.[7]

Recognising these shortcomings, the Council and the Department have both developed suites of supply-side models to estimate alternative output gaps. The Department's preferred estimate of the output gap is the mid-point of their suite of GDP-based estimates, and it is these estimates of the supply-side of the economy around which the Government set their fiscal policy. As these supply-side estimates provide a more appropriate representation of the position of the economy in the cycle than the CAM-based estimates, the Council will use these estimates in assessing compliance with the Budgetary Rule.[8] These GDP-based estimates will be used when calculating the structural balance and the reference rate for the Expenditure Benchmark.

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[4] The Council will continue to assess the Budgetary Rule under the Council's previous approach. However, this assessment will be included as an appendix in the Council's reports.

[5] The Commission's CAM-based estimates are used for legal compliance with the EU fiscal rules.

[6] These changes to the Council's approach to the Budgetary Rule have been communicated to the Department of Finance. While the fiscal rules are continuously evolving, any future changes to the Council's approach, and the rationale for changing the Council's approach, will be communicated clearly both to the Department and to the public.

[7] See, for example, Box E of the November 2017 FAR (IFAC, 2017).

[8] The *Fiscal Responsibility Act*, which sets out Ireland's domestic Budgetary Rule, does not specify the method by which the output gap is to be calculated in arriving at a structural balance estimate. This is part of the reason why the Department use their own version of the CAM to estimate the output gap.

Table A.1: Outline of Principles-Based Approach to the Budgetary Rule

Criteria	IFAC (New Approach)	IFAC (Old Approach)	European Commission Approach
Potential Output and the Output Gap	The Department's GDP-based estimates of potential output and the output gap.	The Department's CAM-based estimates of potential output and the output gap were used in all previous *Fiscal Assessment Reports*. For the *ex-post* Assessment, the European Commission's own CAM-based estimates were used.	The European Commission's own CAM-based estimates of potential output and the output gap.
Reference Rate for Expenditure Benchmark	Based on the Department's latest estimates of GDP-based potential output growth (i.e. not frozen).	Reference rate frozen by the Commission in spring of year *t-1*, for assessment of year *t.* The same reference rate is used for the *ex-post* assessment. For later years (e.g. years *t+2* onwards) IFAC uses the Department's CAM-based estimates of potential output.	Based on the European Commission's CAM-based estimates of potential output, frozen in spring of year *t-1.* No reference rate is set for *t+2* or later years.
Deflator for Expenditure Benchmark	Based on the Department's latest estimates of the demand-side GDP deflator (i.e. not frozen).	Based on the European Commission's estimates of the GDP deflator, frozen in spring of year *t-1.*	Based on the European Commission's estimates of the GDP deflator, frozen in spring of year *t-1.*
Adjustment Requirement and Convergence Margin	Based on the latest estimates of distance from the MTO in year *t-1* (i.e. not frozen). No negative convergence margin applied.	Compliance assessed based on the most favourable of the adjustment requirements and convergence margins in the spring or autumn of year *t-1*, or spring of *t+1* for the *ex-post* assessment (all based on the Commission's estimates of the output gap). No negative convergence margin applied.	Based on the European Commission's estimates of distance from the MTO that are frozen in either spring or autumn of year *t-1* (whichever is more favourable). For ex-post assessment, requirements can be unfrozen in spring of year *t+1* if these are more favourable in terms of compliance. Negative convergence margin allowed.
NAWRU	Assumed constant at 5.5%.	The Department's latest CAM-based estimates of the NAWRU.	The Commission's latest CAM-based estimates of the NAWRU.
Margin of Tolerance	No margin of tolerance.	No margin of tolerance.	0.25% of GDP from the MTO.
Budgetary Semi-Elasticity	0.588	0.522	0.522

Reference Rate and the Deflator used for the Expenditure Benchmark[9]

The Council's previous approach to setting the reference rate and the deflator used for assessing the Expenditure Benchmark closely followed the approach taken by the Commission. The Commission's approach uses reference rates and deflators that are frozen based on the Commission's estimates in spring of year *t-1*. The Commission's freezing approach to setting the reference rate and the deflator is inconsistent with the Commission's approach to freezing the adjustment requirement and the convergence margin; while the reference rate and the deflator are frozen based on estimates in spring of year *t-1* and cannot be updated, the adjustment requirement and convergence margin can be reset in autumn of year *t-1*, or in spring of year *t+1*. For example, these may be reset in cases where later estimates of the output gap prove more favourable in terms of compliance. In practice, this adds additional layers of complexity and means that a number of different vintages of potential output are required in order to assess compliance with the Expenditure Benchmark. Furthermore, estimates of potential output are often subject to end-point bias, and using estimates that are based on information from a number of years prior to the present day will exacerbate this problem. Additionally, more up-to-date estimates are closer to the true parameter values than previous estimates.

With these issues in mind, the Council has decided to simplify its approach to assessing compliance with the Expenditure Benchmark. It will use the Department's latest available GDP-based estimates of potential output when assessing compliance. While latest estimates provide a more accurate picture of where the economy is in the cycle, these estimates may be different to the estimates available at the time policy is set. As a result—in the event that the latest estimates show non-compliance with the Expenditure Benchmark—the Council will determine to what degree, if any, the non-compliance is as a result of changes in estimates between the time policy was set and the latest available estimates.

Adjustment Requirement and Convergence Margin

The Commission's freezing approach (which uses different vintages of potential output being used to freeze reference rates and adjustment requirements) is inconsistent and adds complexity to the assessment of the Budgetary Rule. In light of this, the Council will use the latest estimates of the distance of the structural balance from the MTO in year *t-1* for estimating the adjustment requirements and the convergence margins for year *t*. The Council will not apply a negative convergence margin once the MTO has been overachieved in year *t-1*.[10]

NAWRU

The natural rate of unemployment or "NAWRU" is used as a key input for the CAM-based estimates of potential output.[11] It is also used in determining the level of government expenditure on unemployment benefits that can be attributed to the cyclical conditions (that is, more cyclical-unemployment expenditure is estimated as unemployment rates rise relative

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[9] The reference rate for any year, *t,* is calculated as an average of the estimated potential output growth rates from year *t-6* to year *t+3*.

[10] The Commission calculates allowed net spending growth rate limits that are compatible with Member States returning to their MTO, on the basis of the initial distance from the MTO, but regulations do not envisage any specific negative convergence margin.

[11] NAWRU is an acronym for "non-accelerating wage rate of unemployment". Previously, the Commission had estimated a non-accelerating wage rate of unemployment for Ireland by empirically estimating the relationship between changes in wages growth and unemployment. However, the Commission have recently begun estimating the "NAWRU" for Ireland by using a HP filter to detrend the unemployment rate. As estimation no longer takes into account wage dynamics, this "NAWRU" can no longer be truly considered as a non-accelerating wage rate of unemployment, and is simply a trend unemployment rate.

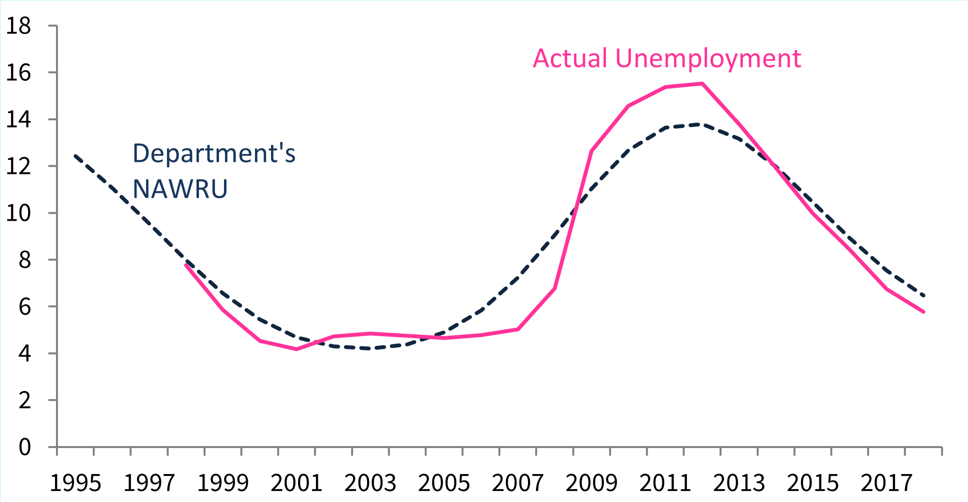
to their natural rate). This amount is deducted from the measure of spending assessed in the Expenditure Benchmark in calculating underlying spending levels not attributed to the cycle.

However, there are a number of issues with the CAM-based estimates of the NAWRU. Ideally, the estimated natural rate of unemployment would be relatively stable overtime, and one would not expect to see large fluctuations in the estimates of the natural rate from year to year. This is not the case with the CAM-based estimates of the NAWRU, as can be seen in Figure A.1. NAWRU estimates produced using the CAM track the actual unemployment rates very closely and both are evidently cyclical. These estimates are implausible. For instance, in 2012, the actual unemployment rate was 15.5 per cent, while the Commission and the Department estimated the NAWRU at 13.2 per cent. These estimates would imply that, if the actual unemployment rate fell below 13.2 per cent, then wages should grow at an increasing rate. However, this would not have been expected to happen, given the actual degree of slack in the labour market at the time.

As a result, the Council has decided to use a constant NAWRU to estimate the cyclical component of unemployment. In the absence of more plausible estimates of the natural rate of unemployment, the Council will use the rate that the Department's forecasts tend to converge to over the medium-term as a proxy for the natural rate of unemployment. This is in the region of 5.5 per cent. Note that this approach does not have to be precise about the actual *level* of the natural rate. Seeing as the measure focuses on changes in cyclical unemployment expenditure, what matters is how actual unemployment changes relative to any constant level (e.g., the assumed natural level, if constant, will tend to lead to similar estimates of cyclical unemployment costs regardless of the level chosen).

Figure A.1: Procyclicality of the NAWRU

Per Cent of Labour Force



Sources: CSO; Department of Finance; and AMECO database.
Note: The Department's estimates of the NAWRU are based on the Commission's current methodology for estimating the NAWRU for Ireland, which uses a HP filter.

Margin of Tolerance

The Council does not consider a margin of tolerance when assessing whether the structural balance is at the MTO. It is important that the fiscal rules are complied with, although any assessment should take into account the degree of non-compliance and the reasons why it occurred. The Commission apply a margin of tolerance—essentially, a degree of flexibility or a margin of error— of 0.25 percentage points of GDP from the MTO when assessing whether the MTO has been met or not.[12] The Council will continue to not apply the margin of tolerance in assessing whether the MTO has been achieved.

Budgetary Semi-Elasticity

The budgetary semi-elasticity is used in calculating the structural balance. Formally the structural balance, $\boldsymbol{SB_t}$, at time t, is:

$$\boldsymbol{SB_t = GGB_t - one\_offs_t - \varepsilon * OG_t}$$

where $\boldsymbol{GGB_t}$ is the general government balance as a percentage of GDP, one_offs_t are temporary or one-off items as a percentage of GDP, which affect the general government balance in a given year, $\boldsymbol{OG_t}$ is the output gap, and $\boldsymbol{\varepsilon}$ is the budgetary semi-elasticity. In essence, the budgetary semi-elasticity is a measure of how responsive the budget balance is to a change in the cyclical position of the economy. The budgetary semi-elasticity was previously estimated by the Commission, and is currently set at 0.522. However, the budgetary semi-elasticity is estimated based on the Commission's CAM-based estimates of potential output. In order to be consistent with the choice of potential output used by the Council, the Council has re-estimated the budgetary semi-elasticity based on the Department's GDP-based estimates of potential output. The new budgetary semi-elasticity that the Council will use is 0.588.[13]

Principles-based approach in practice

In practice, this principles-based approach will mean that the Budgetary Rule will be assessed on more appropriate estimates of the underlying cyclical position of the economy. However, there are trade-offs. When using the latest estimates to evaluate compliance with the Budgetary Rule, there is a trade-off between simplicity in the rules and fairness in assessing compliance with the rules. The latest estimates of potential output and the output gap may not be the same as the estimates that were available at the time at which policy was set. This may mean that, in hindsight, policy may have been set inappropriately in relation to the position of the economy in the cycle. However, based on estimates at the time policy was set, this inappropriate stance may not have been evident. In light of this trade-off, the Council has opted for simplicity. In the event that the latest estimates show non-compliance with the Budgetary Rule, the Council will make a determination as to what degree, if any, the non-compliance is due to changes in the estimates between when policy is set and the latest estimates.

It is likely that there will, on occasion, be differences between the Council's principles-based assessment of the compliance with the Budget Rule and the Commission's assessment of compliance with the EU rules, despite the fact that they are based on the same underlying framework for fiscal policy. While any divergence would not be ideal, the Council's principles-based approach should offer a simpler and less distorted framework for assessing fiscal policy. The EU framework will likely continue to play an important role given the possibility of sanctions for non-compliance in the Stability and Growth Pact.

[12] An example of this would be that if the MTO were -0.5 per cent, then the margin of tolerance would allow a Member State to run a structural deficit of 0.74 per cent while still meeting its MTO.

[13] See Carroll, K. (2019) for details on the estimation of the budgetary semi-elasticity.

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Appendix A: Assessment of compliance with the Domestic Budgetary Rule, using the Commonly Agreed Methodology.

This Appendix outlines the Council's assessment for the previous year, 2018, based on data available as of spring including the Maastricht returns (i.e., the first official outturns for the previous year's annual general government statistics) and preliminary GDP data for the previous year (Q4 *Quarterly National Accounts*) using the EU's CAM for estimating the output gap.[14]

However, it is the assessment that is presented in the main text of this note that represents the Council's view on compliance with the Budgetary Rule, not this appendix.

[14] The EU's CAM-based output gap estimates are the legal basis for assessing the EU fiscal rules.

Main Assessment Table

Table 1 outlines the main information relevant for assessing compliance with the domestic Budgetary Rule in 2018. Initially, the Budget Condition is assessed (i.e., whether the structural balance is at the Medium-Term Objective (MTO) requirement). Then, if the MTO has not been reached, the Adjustment Path Condition is assessed (i.e., whether the required pace of convergence towards the MTO is achieved).

IFAC assesses that the MTO was not achieved for 2018 on the basis of the EU Commission's CAM-based output gap estimates. IFAC assesses that a significant deviation from the MTO occurred for 2018. However, this occurred largely as a result of substantial revisions to the CAM output gap estimates.

IFAC assesses that the Expenditure Benchmark was breached in 2018. However, a significant deviation from the Expenditure Benchmark did not occur.

Table A.1: Summary Assessment of Compliance for 2018

	Required/ Limit	Actual	Compliant	Deviation (% GDP)	Deviation (€bn)	Significant Deviation[a]
A. Budget Condition						
Structural Balance (% GDP)	**-0.5**	**-1.5**	**No, Not at MTO**	**-1.0**	**-3.1**	**Yes**
B. Adjustment Path Conditions						
I. Change in Structural Balance						
One-year change (p.p.)	**0.4**	**-0.6**	**No**	**-1.0**	**-3.2**	**Yes**
Two-year avg. change (p.p.)	**–**	**–**	**N/A**	**–**	**–**	**N/A**
II. Expenditure Benchmark (Limit)[b]						
One-year growth rate (%)	**3.1**	**5.3**	**No**	**0.5**	**1.6**	**No**
Two-year avg. growth rate (%)	**–**	**–**	**N/A**	**–**	**–**	**N/A**

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: All fiscal outturns are taken from the CSO's April 2019 Annual *Government Finance Statistics* publication. One-offs and discretionary measures are as reported by the Department of Finance unless the Council assesses these classifications to be inapplicable (Appendices B and C). Estimates of the output gap are as outlined in the European Commission's Spring 2019 forecasts. N/A's refer to when these rules do not technically apply. Two-year deviations are not assessed if the preceding year was deemed at the MTO at the time of the *ex-post* assessment for that year (as was the case on this occasion). [a] A "significant deviation" is the term for the threshold that determines potential triggering of sanctions in the domestic and EU fiscal rules. It equates to a threshold of ≥0.5 per cent of GDP for one-year or an average of ≥0.25 per cent of GDP for two years.
[b] The Expenditure Benchmark requirement is set as a growth limit in nominal terms.

A.1 Budget Condition

The Council assesses that the Budget Condition was not met based on the EU's methodology. The MTO of a structural deficit of no more than 0.5 per cent of GDP was not met for 2018, with an estimated structural deficit of 1.5 per cent of GDP (Table A.2).

However, this is largely as a result of substantial revisions to the EU Commission's CAM-based output gap. The EU's previous Autumn 2018 estimate of the structural balance for 2018, was a structural deficit of 0.2 per cent of GDP. The output gap of 0.2 per cent of GDP, for 2018, in the Autumn 2018 estimates has since been revised up to 2.8 per cent in the EU Commission's latest Spring 2019 estimates. This revision is largely as a result of methodological changes between the two vintages.[15]

Table A.2: Budget Condition

	Requirement (MTO)	Actual	At MTO?
A. Budget Condition			
Structural Balance 2018	-0.5	-1.5	No

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: All fiscal outturns are taken from the CSO's April 2019 Annual *Government Finance Statistics* publication. One-offs and discretionary measures are as reported by the Department of Finance unless the Council assesses these classifications to be inapplicable (Appendices B and C). Estimates of the output gap are as outlined in the European Commission's Spring 2019 forecasts.

[15] For more information on this revision see the Council's forthcoming June *Fiscal Assessment Report*.

A.2 Adjustment Path Condition

As the MTO was not achieved for 2018, the Adjustment Path Condition of the domestic Budgetary Rule applies. The Adjustment Path Condition is a means of ensuring the structural balance is on a suitable path towards the MTO and it incorporates the Expenditure Benchmark. Adjustment requirements for year *t* are set in the spring of year *t-1.* These requirements can only be reset in autumn of year *t* or spring of year *t+1*, if these vintages have a more favourable adjustment requirement in terms of compliance.

The Adjustment requirement for 2018 was reset based on the European Commission's Spring 2019 forecasts showing a structural balance of –0.9 per cent for 2017, meaning the adjustment required to meet the MTO for 2018 was +0.4 per cent of GDP. The structural balance deteriorated in 2018 by 0.6 per cent of GDP (Table A.3). As a result, a significant deviation occurred from the required adjustment path.

The Expenditure Benchmark limit of 3.1 per cent was breached in 2018, with net expenditure growing by 5.3 per cent. This represents a deviation from the Expenditure Benchmark limit of 0.49 per cent of GDP, marginally below what is classified as a significant deviation (of 0.5 per cent of GDP) under the rules.

Table A.3: Adjustment Path Condition

	Required/ Limit	Actual	Compliant	Deviation (% GDP)	Deviation (€bn)	Significant Deviation[a]
B. Adjustment Path Conditions						
I. Change in Structural Balance						
One-year change (p.p.)	0.4	-0.6	**No**	-1	-3.1	**Yes**
Two-year avg. change (p.p.)	–	–	**N/A**	–	–	**N/A**
II. Expenditure Benchmark (Limit)[b]						
One-year growth rate (%)	3.1	5.3	**No**	0.5	1.6	**No**
Two-year avg. growth rate (%)	–	–	**N/A**	–	–	**N/A**

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: Fiscal outturns are taken from CSO's April 2019 Annual *Government Finance Statistics* publication. One-offs and discretionary measures are as reported by Department of Finance unless the Council assesses these classifications to be inapplicable (Appendices B and C). Estimates of the output gap are as outlined in the European Commission's Spring 2019 forecasts. N/A's refer to when these rules do not technically apply. Two-year deviations are not assessed if the preceding year was deemed at the MTO at the time of the *ex-post* assessment for that year (as was the case on this occasion). [a] A "significant deviation" is the term for the threshold that determines potential triggering of sanctions in the domestic and EU fiscal rules. It equates to a threshold of ≥0.5 per cent of GDP for one-year or an average of ≥0.25 per cent of GDP for two years. [b] The Expenditure Benchmark is a growth limit in nominal terms.

A.4 Fiscal Stance as Indicated by the Structural Primary Balance

The structural primary balance is the general government balance, excluding one-off items and interest costs (which are outside the control of government) and adjusted for the cyclical position of the economy.

The structural primary balance, as measured using the CAM output gap, deteriorated in 2018 by 0.9 per cent of GDP (Table A.4). This represents a complete reversal of the improvement in the structural primary balance that occurred in 2017. This indicates that there was a significant deterioration in the fiscal position of the state in 2018, despite a considerable over performance in corporation tax for 2018.

Table A.4: Indicators of Fiscal Stance

Per cent of GDP unless otherwise stated

	2016	2017	2018
Primary Balance (Excluding one-offs)			
Level	1.5	1.8	1.6
Change (p.p)		0.3	-0.1
Structural Primary Balance			
Level	0.2	1.1	0.2
Change (p.p)		0.9	-0.9

Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: All fiscal outturns are taken from the CSO's April 2019 Annual *Government Finance Statistics* publication. One-offs and discretionary measures are as reported by the Department of Finance unless the Council assesses these classifications to be inapplicable (Appendices B and C). Estimates of the output gap are as outlined in the European Commission's Spring 2019 forecasts.

Appendix B: Information on One-offs

This Appendix contains the information on one-offs provided by the Department of Finance to the Council for the purposes of assessing compliance with the domestic Budgetary Rule:

Item	2017 Impact (€m)	2018 Impact (€m)	Rationale
Refund of Domestic Water Charges	-178*		One-off expenditure item
One-off Corporation Tax Receipts		350**	Statement of the Minister for Finance and Public Expenditure and Reform on Budget day 2018: "Corporation tax revenue has been growing strongly and a significant part of the growth for this year is due to changes in international accounting standards (IFRS 15). Around €0.7 billion of the 2018 over-performance is estimated as one-off." The Revenue Commissioners have since clarified that only €0.35 billion of this was related to changes in international accounting standards, and only this component meets the Council's criteria for a one-off.
Medical Consultant's pay settlement		-213*	One-off payment due to a settlement following a court process in relation to pay arrears.
Total Impact on General Government Balance	**-178**	**137**	

*Items with an asterisks are those that are also assessed by the Council as being applicable and equate to a total impact of -€0.18 billion for 2017 and €-0.21 billion for 2018.

**Items with two asterisks are those that were assessed solely by the Council as being applicable and equate to at total impact of €0.35 billion for 2018.

Appendix C: Detail on Discretionary Revenue Measures

This Appendix contains the information on Discretionary Revenue Measures provided by the Department of Finance to the Council for the purposes of assessing compliance with the domestic Budgetary Rule:

Item and Details	2017 Impact (€m)	2018 Impact (€m)
Carryover from previous budgets	71	
Budget 2017 measures	-140	
Carryover from previous budgets		65
Budget 2018 measures		787
Total Impact on General Government Balance	**-68.7**	**852**

Note: DRMs are based on figures contained in *Draft Budgetary Plans.*