

Appendix G: Assessment of the Budgetary Rule under the EU Methodology⁸³

This appendix examines the consistency of the projections outlined in the *SPU 2019* with Ireland’s Domestic Budgetary Rule and with the preventive arm of the SGP. In particular it examines compliance in relation to the Medium-term Budgetary Objective (MTO).

The assessment in this appendix is based on the Council’s interpretation of the *Vade Mecum* using the Department’s CAM-based estimates of potential output and the output gap and considering the same one-off items as outlined in Chapter 4. As the assessment in this appendix is based on, *inter alia*, different estimates of potential output and the output gap, the assessment in this appendix may at times give contradictory signals about compliance with the Budgetary Rule when compared to the assessment in Chapter 4. It is the assessment that is presented in Chapter 4—not the assessment in this appendix—that represents the Council’s view on compliance with the Budgetary Rule. Table G.1 provides a summary of the assessment of the compliance with the fiscal rules.⁸⁴

⁸³ See Appendix F for a comparison of the Council’s new principles-based approach and Council’s old approach.

⁸⁴ This assessment is in line with Column 3 (IFAC Old Approach) of Appendix F, Table F.1.

Appendix Table G.1: Assessment of fiscal rules under the EU methodology^{1, 2, 3, 4}

Per Cent of GDP, unless stated. For deviations, negative values = non-compliance

	2017	2018	2019	2020	2021	2022	2023
Corrective Arm							
General Government Balance Excl. One-Offs	-0.2	0.0	0.2	0.4	0.7	1.0	1.3
General Government Debt	68.5	64.8	61.1	55.8	55.4	53.2	51.6
1/20th Debt Rule Limit	81.9	71.5	67.9	64.2	60.0	60.0	60.0
Debt Rule met?	Y	Y	Y	Y	Y	Y	Y
Preventive Arm & Domestic Budgetary Rule							
Structural Balance Adjustment Requirement							
MTO for the Structural Balance	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
CAM Structural Balance	-1.1	-1.8	-1.1	-0.5	0.1	0.7	1.3
MTO met?	N	N	N	Y	Y	Y	Y
Minimum Change in Structural Balance Required	-	0.4	-	0.7	0.0	0.0	0.0
Change in CAM Structural Balance	0.9	-0.7	0.6	0.7	0.6	0.6	0.6
1yr Deviation (€bn)	-	-3.4	2.0	0.0	2.2	2.2	2.5
1yr Deviation (p.p.)	-	-1.1	0.6	0.0	0.6	0.6	0.6
2yr Deviation (€bn)	-	-	-0.7	1.0	1.1	2.2	2.3
2yr Deviation (p.p.)	-	-	-0.3	0.3	0.3	0.6	0.6
Expenditure Benchmark							
(a) Reference Rate of Potential Growth (% y/y)	3.3	3.4	4.5	4.7	4.6	4.5	4.2
(b) Convergence Margin	0.0	1.7	0.0	2.9	0.0	0.0	0.0
(a-b) Limit for Real Net Expenditure Growth (% y/y)	3.3	1.8	4.5	1.8	4.6	4.5	4.2
GDP Deflator used	1.2	1.3	1.3	1.9	1.7	1.6	1.6
Limit for Nominal Net Expenditure Growth (% y/y)	4.5	3.1	5.9	3.7	6.4	6.1	5.9
Net Expenditure Growth (% y/y)	4.1	5.3	2.9	3.4	3.1	3.1	2.8
Net Expenditure Growth (Corrected for one-offs) (% y/y)	3.9	5.3	3.2	3.4	3.1	3.1	2.8
1yr Deviation (Corrected for one-offs) (€bn)	-	-1.6	2.0	0.2	2.7	2.5	2.7
1yr Deviation (Corrected for one-offs) (% GDP)	-	-0.5	0.6	0.1	0.7	0.7	0.7
2yr Deviation (Corrected for one-offs) (€bn)	-	-	0.2	1.1	1.4	2.6	2.6
2yr Deviation (Corrected for one-offs) (% GDP)	-	-	0.1	0.3	0.4	0.7	0.7
Limit for Nominal Net Expenditure Growth (€bn)	3.1	2.2	4.5	2.9	5.2	5.2	5.1
Net Expenditure Increase (€bn)	2.8	3.8	2.2	2.7	2.5	2.6	2.4
Net Expenditure Increase (Corrected for one-offs) (€bn)	2.6	3.7	2.4	2.7	2.5	2.6	2.4
Current Macroeconomic Aggregates							
Real GDP Growth (% y/y)	7.2	6.7	3.9	3.3	2.4	2.5	2.6
CAM Potential GDP Growth (% y/y)	7.9	4.9	4.7	4.4	3.5	3.4	3.3
CAM Output Gap	1.6	3.3	2.5	1.6	1.0	0.5	0.0
GDP Deflator Used (% y/y)	1.2	1.3	1.3	1.9	1.7	1.6	1.6

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

Note: ¹ All figures presented on General Government basis. Assessments of SPU 2019 revenue and expenditure projections using Department of Finance's latest CAM potential output estimates and considering Council's views on one-off/temporary measures. A one-off windfall of €0.35bn in corporation tax revenue for 2018 is included in the Council's assessment of the structural balance as well as a €0.2 billion expenditure one-off in 2018 in relation to a pay arrears settlement for medical consultants. The treatment here differs to that applied in the appendix of "Assessment of Compliance with the Domestic Budgetary Rule in 2019" (IFAC, 2019a), which used the Commission's Spring 2019 output gap estimates for the structural balance as these are the legal basis of ex-post assessments of compliance. The outlier for "CAM Potential GDP Growth" for 2015 is replaced by the 2014 and 2016 rate average in the expenditure benchmark (IFAC, 2017c).² The 2018 adjustment requirement was reset to 0.4 per cent of GDP based on the Commission's Spring 2019 output gap estimates. The Council assesses Expenditure Benchmark compliance without a negative convergence margin. The 2019 adjustment requirement is frozen by the European Commission at zero meaning the Commission will apply a negative convergence margin for 2019. The Expenditure Benchmark limits here therefore differ to those in the European Commission's opinion on Ireland's Draft Budgetary Plans.³ The 1/20th Debt Rule requires that the debt-to-GDP ratio make progress towards 60 per cent of GDP. A transition period applies until end-2018. ⁴ Figures in grey indicate that the Council assesses these forecasts to be the result of technical assumptions on expenditure, which may be unrealistic (Chapter 3).

G.1 Ex-post Assessment of 2018

There have been substantial revisions to the CAM-based output gap, particularly for the 2018 estimate (see Figure 4.3).⁸⁵ These revisions have had a detrimental impact on the structural balance as estimated using the CAM.

MTO and Structural Balance Adjustment Requirements

The MTO of a structural balance of -0.5 per cent of GDP was not achieved for 2018. The structural balance deteriorated to -1.8 per cent of GDP in 2018. 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 $t+1$, provided that these vintages imply a more favourable adjustment requirement in terms of compliance. The adjustment requirement for 2018 has now been updated, to 0.4 per cent of GDP, based on the European Commission's Spring 2019 estimates of the structural balance showing a more favourable initial distance from the MTO, than the previously frozen requirement. Despite this, a significant deviation, of 1.1 per cent of GDP, occurred for 2018. However, this deviation is largely as a result of an unrealistic output gap estimate, with the output gap estimate for 2018, of 3.3 per cent of GDP, now similar to the output gap, currently estimated under the same methodology, for 2007.

Expenditure Benchmark

The Expenditure Benchmark limit of 3.1 per cent growth for 2018 was breached, with net expenditure grew by 5.3 per cent. Net expenditure grew by 0.49 per cent of GDP more than the Expenditure Benchmark limit. This is marginally below the limit of what is considered a significant deviation (0.5 per cent of GDP) from the Expenditure Benchmark. In nominal terms, this was €1.6 billion more than the limit. As the MTO was not achieved for 2018, the European Commission will use the Expenditure Benchmark as part of an overall assessment of compliance with the EU fiscal rules.

⁸⁵ See Box J for details on the revisions to the output gap estimates.

G.2 In year Assessment of 2019

MTO and Structural Balance Adjustment Requirements

The MTO of a structural deficit of 0.5 per cent of GDP will not be achieved in 2019. The structural balance is currently forecast to be -1.1 per cent of GDP for 2019. While this estimate of the structural balance partially reflects changes in the output gap estimates between *SPU 2019* and *Budget 2019*, the *Budget 2019* estimates also showed the MTO not being met for 2019.

The adjustment requirement for 2019 was set in autumn 2018 based on the European Commission's Autumn 2018 forecasts, which—at the time—forecast that the MTO would be achieved for 2018.⁸⁶ This means that there will be no adjustment requirement for 2019, despite the MTO no longer shown to be achieved in 2018.

Expenditure Benchmark

The Expenditure Benchmark limit for 2019 is a growth rate of 5.9 per cent of GDP.⁸⁷ Net expenditure is forecast to grow by 3.2 per cent, below the limit set by the Expenditure Benchmark. This low forecasted growth rate is largely as a result of the Expenditure Benchmark being breached in 2018 and this larger than expected level for expenditure becoming the base for 2019. As the MTO is forecast to not be achieved for 2019, the Expenditure Benchmark will be assessed by the Commission as part of an overall assessment of compliance with the fiscal rules.

⁸⁶ The Commission's Autumn 2018 forecasts showed a structural deficit of 0.2 per cent of GDP in 2018.

⁸⁷ The European Commission have set the Expenditure Benchmark limit for 2019 at 7 per cent. The difference between the Council's limit and the European Commission's limit was as a result of the European Commission applying a negative convergence margin for 2019, as the MTO was forecast to be overachieved in 2018 at the time the Expenditure Benchmark limit was set. The Council does not deem it prudent budgetary management to apply a negative convergence margin.

G.3 Ex-Ante Assessment of 2020-2023

The MTO is now set for 2020–2022 as a structural deficit of 0.5 per cent of GDP. Based on current forecasts this will be complied with, although these forecasts are based on expenditure figures which may not be realistic (see Chapter 3).

MTO and Structural Balance Adjustment Requirements

The MTO is currently forecast not to be achieved for 2019. This means that an adjustment requirement of 0.7 per cent will apply for 2020 in order to ensure the structural balance returns to the MTO in 2020. Based on current forecasts, this adjustment requirement will be complied with and the MTO will marginally be achieved for 2020, with a structural deficit of 0.5 per cent of GDP. However, this is based on estimates of expenditure that are unrealistically low. Furthermore, revisions to the output gap may jeopardise compliance further.

Current forecasts show compliance with the MTO for 2021–2023, but again, these estimates are based on dubious expenditure forecasts.⁸⁸

Expenditure Benchmark

As there is an adjustment requirement for 2020, a convergence margin also applies for 2020. This convergence margin reduces the Expenditure Benchmark limit by 2.9 percentage points in 2020. The Expenditure Benchmark limit for 2020 is therefore a growth rate of 3.7 per cent. Net expenditure is currently forecast to grow by 3.4 per cent in 2020, marginally below the limit set by the Expenditure Benchmark. Given the unrealistic expenditure forecasts, there are serious risks of slippage for 2020.

For 2021–2023, net expenditure is currently forecast to be well below the limits set by the Expenditure Benchmark, but these forecasts are unrealistically low (see Chapter 3).

⁸⁸ This is assuming that the MTO will be kept constant at a structural deficit of 0.5 per cent of GDP for 2023. The MTO for 2023–2025 will not be set until 2022.