Box N: Fiscal vulnerabilities: assessing compliance with the Department of Finance's suggested alternative fiscal rules

The Department of Finance published, alongside the Budget, a paper assessing Irish fiscal vulnerabilities (Department of Finance, 2019c). The paper highlights the use of potentially temporary windfall corporation tax (CT) receipts to fund permanent expenditure as a key vulnerability. It also outlines an alternative fiscal framework for Ireland. The paper suggested four possible alternative fiscal rules for Ireland:

1) A target for the general government balance that excludes some of the excess CT receipts, which then feeds into structural balance targets;
2) A debt rule stated in terms of a ratio to GNI*;
3) Assessment of the achievement of the MTO on the basis of the Department's preferred estimate of the output gap; and
4) Use of alternative estimates of potential growth rates to determine the maximum permissible expenditure growth.

Under the Council's principles-based approach, the Council has already opted to assess compliance with Ireland's Domestic Budgetary Rule using both the third and fourth recommendations outlined above. The Council has repeatedly called for a more appropriate debt target (second recommendation).[83]

This box assesses the historical and forecasted compliance of the structural balance with the MTO when some of the excess CT receipts are excluded (first recommendation). This has some parallels with the Council's proposal to introduce a Prudence Account, which would address the same issue of possibly excess CT receipts by setting aside excess receipts at the point at which they occur and saving them (Box B, Fiscal Council, 2019c).

Taking the fiscal vulnerabilities paper's definition of excess CT receipts as the receipts above its long-run share of tax revenue (14 per cent), Figure N.1 shows the structural balance for 2015–2024 if the excess CT receipts were excluded.[84] Up to 2017, the difference between the actual structural balance and the structural balance excluding excess CT was relatively small (ranging from 0.2-0.4 percentage points). However, due to the level shift in CT receipts in 2018, the difference more than doubles to 0.8 percentage points in 2018. Had the excess CT been excluded, this would have resulted in a structural balance of –0.6 per cent of GDP in 2018, which would have been a breach of the MTO of a structural balance of no less than –0.5 per cent of GDP. This is compared to an actual structural balance of 0.2 per cent of GDP in 2018. Based on *Budget 2020* forecasts, if excess CT were excluded, the structural balance would not be at the MTO from 2019–2024 either.

Given the difference in the two structural balance estimates in Figure N.1 and the risks posed by funding permanent expenditure by means of potentially temporary tax receipts, setting budgetary targets that excludes excess CT receipts would be a prudent approach to formulating fiscal policy in Ireland. This could be complemented by the use of a prudence account, which sets aside the excess CT receipts so that they cannot be used to fund permanent expenditure.[85]

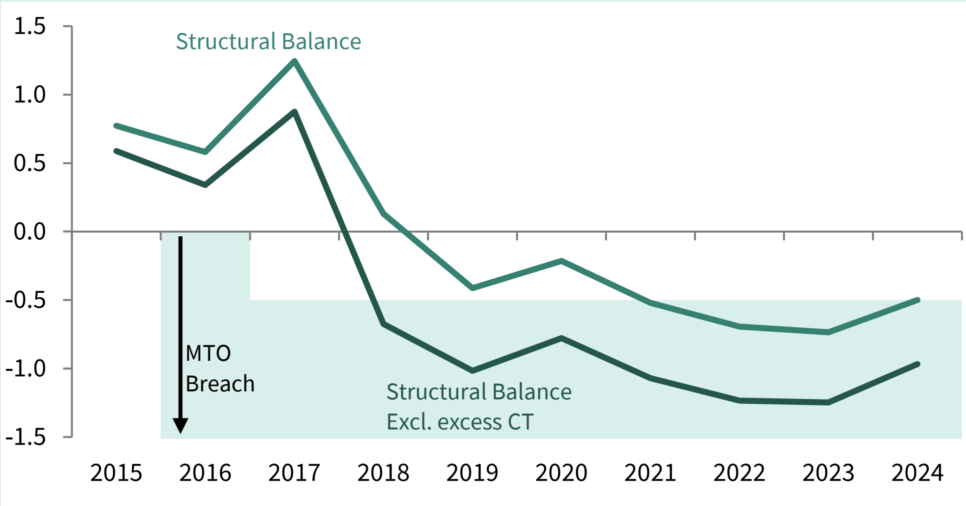
[83] See, for instance, the November 2018 Fiscal Assessment Report (Fiscal Council, 2018e)

[84] The Department of Finance's definition of excess CT receipts, used in the fiscal framework section of the paper, is more modest than the Council's analysis suggests. The Council has estimated that some €3-6 billion of CT can be considered excess (Box B, Fiscal Council, 2019c). The Department has estimated that approximately €2 billion can be considered excess.

[85] For an outline of how a prudence account would work, see Box B of the June 2019 Fiscal Assessment Report (Fiscal Council, 2019c).

Figure N.1: Excluding excess corporation tax receipts from the structural balance would result in non-compliance with the MTO for 2018–2024

Per cent of GDP



Sources: CSO; Department of Finance; and internal Fiscal Council calculations.

Note: Estimates are based on Budget 2020 forecasts. CT receipts in excess of the 14 per cent of total tax revenue are considered excess and are excluded from the structural balance estimate.