Chapter 4

Assessment of Compliance with the Fiscal Rules

4. Assessment of Compliance with the Fiscal Rules

Key Messages

- A substantial deterioration of the structural balance occurred in 2018, and this trend continued into 2019. The structural balance for 2019 is now forecast to be -0.4 per cent of GDP marginally above the Medium-term Budgetary Objective (MTO) of a structural balance of no less than –0.5 per cent of GDP. Conditional on a no-deal Brexit and considering the proposed expenditure on sectoral supports to be temporary, the structural balance is forecast to improve slightly to -0.2 per cent of GDP for 2020. However, the compliance with the MTO is, again, flattered by excess corporation tax receipts that may prove unsustainable. Excluding some of these receipts from the assessment, the MTO would not be achieved in 2019 and 2020 (Box N).

- Net expenditure is currently forecast to grow by 3.6 per cent in 2019, below the Expenditure Benchmark limit of 3.9 per cent for 2019. In 2020, net expenditure is currently forecast to grow by 4.5 per cent, below the Expenditure Benchmark limit of 5.1 per cent.

- The debt ratio is currently forecast to fall below the 60 per cent of GDP threshold set in the Stability and Growth Pact (SGP). However, this is largely as a result of distortions in Ireland's GDP figures relating to the activities of multinationals. Were the Debt Rule based on a more appropriate ratio of debt-to-GNI*, as opposed to GDP, there is a possibility that non-compliance would occur over the medium-term.

- Over the medium-term, there is a risk of non-compliance with the MTO. Forecasts for 2021–2023 show the structural balance fails to achieve the MTO. Furthermore, the Expenditure Benchmark is forecast to be breached in 2024. This is despite the fact that expenditure figures for later years, 2021–2024, are based on technical assumptions that may not be realistic.

4.1 Introduction

The Council's mandate includes assessing compliance with Ireland's Domestic Budgetary Rule, as set out in the Fiscal Responsibility Act 2012 (FRA), and the EU fiscal rules as set out in the *Stability and Growth Pact* (SGP). This chapter assess the consistency of the projections laid out in *Budget 2020* with Ireland's Domestic Budgetary Rule and with the preventive arm of the SGP. In particular it examines compliance with the Medium-term Budgetary Objective (MTO), the Expenditure Benchmark and the Debt Rule.

The assessment in this chapter examines compliance with Ireland's Domestic Budgetary Rule based on the Council's "principles-based approach" to the budgetary rule, using the Department of Finance's GDP-based estimates of potential output in *Budget 2020* and considering the Council's own assessment of one-off/ temporary measures.[72] While legal compliance with the EU fiscal rules is assessed based on the Vade Mecum on the Stability & Growth Pact—using the EU's Commonly Agreed Methodology (CAM) for estimating the output gap—the Council and the Department of Finance have identified a number of shortcomings with this methodology. Therefore, the Council has opted to base its assessment of the Domestic Budgetary Rule on a framework that is more appropriate for Ireland.[73]

As *Budget 2020* was framed on the basis of a no-deal Brexit, which would be a permanent shock to the economy, this necessitates a discussion around the classification of the proposed supports to affected sectors, be they permanent or temporary, and how these impact on the assessment of the fiscal rules. Box H of the June 2017 FAR outlines what is required for a measure to be considered a one-off/temporary measure (Fiscal Council, 2017c):

> "Deliberate policy actions that increase the deficit do not, as a rule, qualify as one-offs. In order to give policymakers the right incentive to fully

[72] See Appendix F for a summary of the Council's "principles-based approach". For a more detailed outline of the Council's "principles-based approach" to the Domestic Budgetary Rule, and the Council's reasoning for taking this approach, see Box A of Ex-Post Assessment of Compliance with the Domestic Budgetary Rule 2018 (Fiscal Council, 2019a).

[73] For an outline of some of the shortcomings of the EU's CAM for estimating the output gap and potential output, see among others, Box B and Box E of the November 2017 Fiscal Assessment Report (Fiscal Council, 2017e) and Barnes & Casey (2019).

> recognise permanent budgetary impacts, there is a strong presumption that deliberate policy actions that increase the deficit are of a structural nature. These measures should only exceptionally be classified as one-offs, in cases where it can be unambiguously demonstrated that they have an intrinsic temporary nature."

On the basis of information provided by the Department of Finance, the above definition, and the exceptional and exogenous nature of a no-deal Brexit, the Council is of the view that €0.65 billion of Brexit sectoral supports can be classified as one-off/temporary measures and should therefore be excluded from the Council's assessment of compliance with the fiscal rules. However, this classification is preliminary and is subject to change in the *ex-post* assessment of 2020 should these supports—if introduced—not prove temporary, or alternatively, should more supports prove to be temporary.

Table 4.1 provides a summary assessment of compliance with the Domestic Budgetary Rule and the Debt Rule. *Budget 2019* incorporated a one-off windfall of €0.3 billion for corporation tax in 2018, relating to a change in International Financial Reporting Standards, and this continues to be incorporated in the Council's assessment of the fiscal rules. Additionally, *SPU 2019* incorporated a one-off expenditure of €0.2 billion for 2018 relating to the payment of arrears to medical consultants following the settlement of a court process.

Table 4.1: Assessment of compliance with the fiscal rules[1, 2, 3]

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

	2018	2019	2020	2021	2022	2023	2024
Corrective Arm							
General Government Balance Excl. One-Offs	0.0	0.2	-0.4	-0.2	0.1	0.4	0.7
General Government Debt	63.6	59.3	56.5	56.4	54.4	53.8	53.0
1/20th Debt Rule Limit	71.4	67.4	60.0	60.0	60.0	60.0	60.0
Debt Rule met? (Y/N)	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**
Structural Balance	0.1	-0.4	-0.2	-0.5	-0.7	-0.7	-0.5
MTO met? (Y/N)	Y	Y	Y	N	N	N	Y
Minimum Change in Structural Balance Required	**–**	**–**	**–**	**–**	**0.0**	**0.2**	**0.2**
Change in Structural Balance	-1.1	-0.5	0.2	-0.3	-0.2	0.0	0.2
1yr Deviation (€bn)	–	–	–	-1.1	-0.7	-0.9	0.0
1yr Deviation (p.p.)	–	–	–	-0.3	-0.2	-0.2	0.0
2yr Deviation (€bn)	–	–	–	-0.2	-0.9	-0.8	-0.5
2yr Deviation (p.p.)	–	–	–	-0.1	-0.2	-0.2	-0.1
Expenditure Benchmark							
(a) Reference Rate of Potential Growth (% y/y)	3.3	3.4	3.4	3.3	3.2	3.2	2.6
(b) Convergence Margin	0.0	0.0	0.0	0.0	0.1	0.8	1.0
(a-b) Limit for Real Net Expenditure Growth (% y/y)	3.3	3.4	3.4	3.3	3.1	2.4	1.6
GDP Deflator used (% y/y)	0.8	0.4	1.6	1.4	1.4	1.4	1.4
Limit for Nominal Net Expenditure Growth (% y/y)	**4.2**	**3.9**	**5.1**	**4.8**	**4.5**	**3.8**	**3.0**
Net Expenditure Growth (% y/y)	6.0	3.4	5.3	3.6	3.8	3.1	3.4
Net Expenditure Growth (Corrected for one-offs) (% y/y)	6.0	3.7	4.5	4.4	3.8	3.1	3.4
1yr Deviation (Corrected for one-offs) (€bn)	-1.3	0.2	0.5	0.3	0.6	0.6	-0.3
1yr Deviation (Corrected for one-offs) (% GNI*)	-0.7	0.1	0.2	0.2	0.3	0.3	-0.1
2yr Deviation (Corrected for one-offs) (€bn)	-0.8	-0.6	0.3	0.4	0.5	0.6	0.1
2yr Deviation (Corrected for one-offs) (% GNI*)	-0.4	-0.3	0.2	0.2	0.2	0.3	0.1
Limit for Nominal Net Expenditure Growth (€bn)	**2.9**	**2.9**	**4.0**	**4.0**	**3.9**	**3.4**	**2.8**
Net Expenditure Increase (€bn)	4.2	2.5	4.2	3.0	3.3	2.8	3.2
Net Expenditure Increase (Corrected for one-offs) (€bn)	4.2	2.7	3.5	3.7	3.3	2.8	3.2
Current Macroeconomic Aggregates							
Real GDP Growth (% y/y)	8.2	5.5	0.7	2.5	2.8	2.7	2.6
Department's alternative Potential GDP Growth (% y/y)	5.3	4.0	2.0	1.6	2.1	2.0	2.4
Department's alternative GDP Output Gap	-0.2	1.0	-0.3	0.5	1.3	1.9	2.1
GDP Deflator Used (% y/y)	0.8	0.4	1.6	1.4	1.4	1.4	1.4

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

Notes: [1] All figures are presented on a General Government basis. Assessments examine the Budget 2020 revenue and expenditure plans, using the Council's principles-based approach to the Domestic Budgetary Rule and considering the Council's views on one-off/temporary measures. Deviations from the Expenditure Benchmark are assessed on the basis of GNI* instead of GDP (a significant deviation from the benchmark is 0.5 per cent of GNI*, on a one-year basis, and 0.25 per cent of GNI* on a two-year basis). For the rationale behind assessing deviations on the basis of GNI* see Box M. For more information about the Council's principles-based approach see Appendix F of this report and Box A of Fiscal Council's *Ex-post* assessment of compliance with the Domestic Budgetary Rule 2018 (Fiscal Council, 2019a). A one-off windfall of €0.3bn in corporation tax revenue for 2018 is included in the Council's assessment of the structural balance as well as a one-off expenditure of €0.2 billion, in 2018, due to a settlement in relation to pay arrears for medical consultants. For 2020, Brexit sectoral supports of €0.65 billion are considered temporary measures by the Council and are therefore excluded from the assessment. The outlier for Potential GDP Growth for 2015 is replaced by the average of the 2014 and 2016 rates in the Expenditure Benchmark, as discussed in the June 2017 FAR (Fiscal Council, 2017c). [2] The 1/20th Debt Rule requires that the debt-to-GDP ratio should make annual progress toward the reference value of 60 per cent of GDP. A transition period applied until the end of 2018. [3] Figures in red indicate a significant deviation from the limit. Figures in amber indicate some deviation from the limit.

4.2 In-year assessment of 2019

This section assesses whether the Department's plans for 2019, based on forecasts in *Budget 2020*, are compliant with the fiscal rules. However, a brief recap of the assessment of 2018 is warranted at this point given the nature of fiscal policy in 2018.[74] The estimated structural balance deteriorated by 1.1 percentage points in 2018 to 0.1 per cent of GDP. Net expenditure in 2018 grew by 6.0 per cent, above the Expenditure Benchmark limit of 4.2 per cent. This was a deviation of €1.3 billion over the limit set by the Expenditure Benchmark. It is given this context that the in-year assessment of 2019 is carried out.

The Debt Rule will apply in full for the first time in 2019, following the end of a three-year transition period from 2016–2018.

The MTO is forecast to be achieved for 2019; however, there is minimal room for slippage in 2019 and this achievement of the MTO is heavily reliant on excess corporation tax (see Box M). Net expenditure is forecast to grow below the Expenditure Benchmark for 2019 and the debt-to-GDP ratio is currently forecast to fall below 60 per cent of GDP for the first time since 2008.

MTO and Structural Balance Adjustment Requirements

As the MTO was achieved for 2018, there was no adjustment requirement for 2019. A structural balance of -0.4 per cent of GDP is now forecast for 2019, above the MTO of a structural balance of no less than -0.5 per cent of GDP (Figure 4.1).[75] However, the structural balance is forecast to deteriorate by 0.5 percentage points in 2019 and any further slippage in 2019 would put the achievement of the MTO at risk.

There was an upward revision to the estimate of the output gap for 2019 of approximately 0.9 percentage points relative to *SPU 2019* (Figure 4.2). As the structural balance adjusts for the effects of the cycle on the general government balance, an upward revision to the output gap makes the estimated structural

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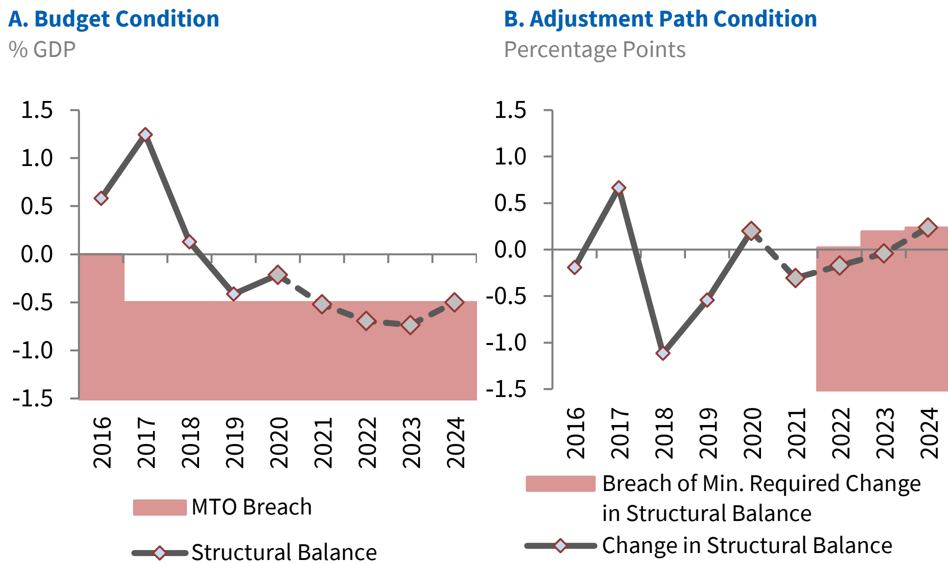
[74]The Council's formal assessment of 2018 was carried out in *Ex-post assessment of compliance with the Domestic Budgetary Rule 2018* (Fiscal Council, 2019a).

[75] On budget day, the Department of Finance published the paper "*Addressing Ireland's Fiscal Vulnerabilities*" which highlighted the fact that if the formula used to calculated the MTO was adjusted for the distortions in Irish GDP figures by using GNI* instead of GDP, the minimum required MTO for Ireland would instead be a structural balance of 0.5 per cent instead of –0.5 per cent (Department of Finance, 2019c).

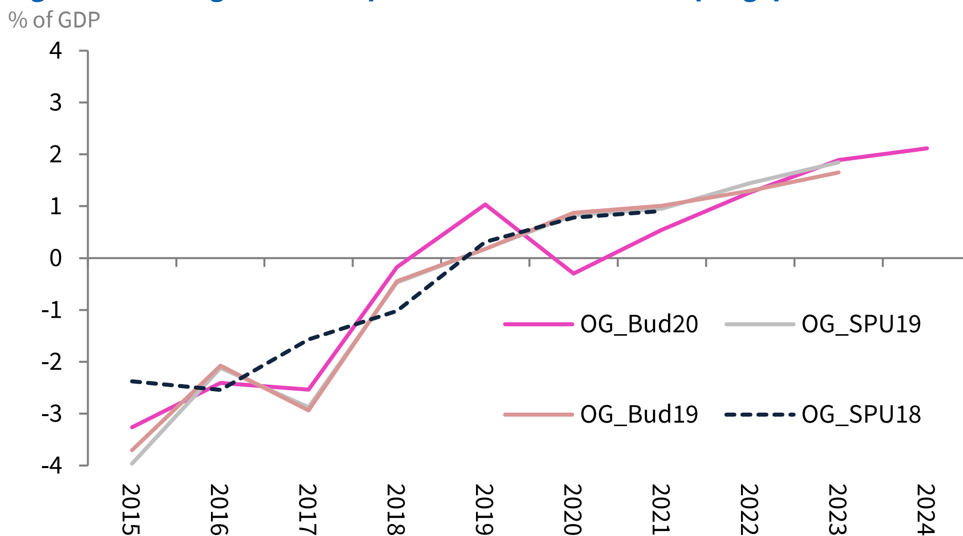
balance more negative (cyclical budgetary component, Figure 4.3). The forecast improvement in the general government balance is not of a sufficient magnitude to prevent a deterioration in the structural balance.

Figure 4.1: Assessment of compliance with the Budgetary Rule



Sources: CSO; Department of Finance; and internal Fiscal Council calculations.
Notes: The MTO for 2017–2022 for Ireland is set at –0.5 per cent of GDP. When the MTO is achieved the adjustment path condition is not assessed, so no breach can occur.

Figure 4.2: Vintages of the Department's GDP-based output gap



Sources: CSO; Department of Finance; and internal Fiscal Council calculations.
Note: The Department's GDP-based estimates of the output gap are based on the mid-point of its suite of GDP-based models. The *SPU 2018* vintage of the output gap for the Department's GDP-based estimates was at the early stage of the development of these estimates and included an additional model not included in the Department's suite of models in subsequent vintages.

Expenditure Benchmark

The Council recommends that the Expenditure Benchmark should be considered as an upper limit, and may, sometimes, be beyond what the Council would deem appropriate. While the Expenditure Benchmark has its flaws (see, for instance, Barnes & Casey, 2019), it can provide a better indication of the prudence of fiscal policy than the structural balance.

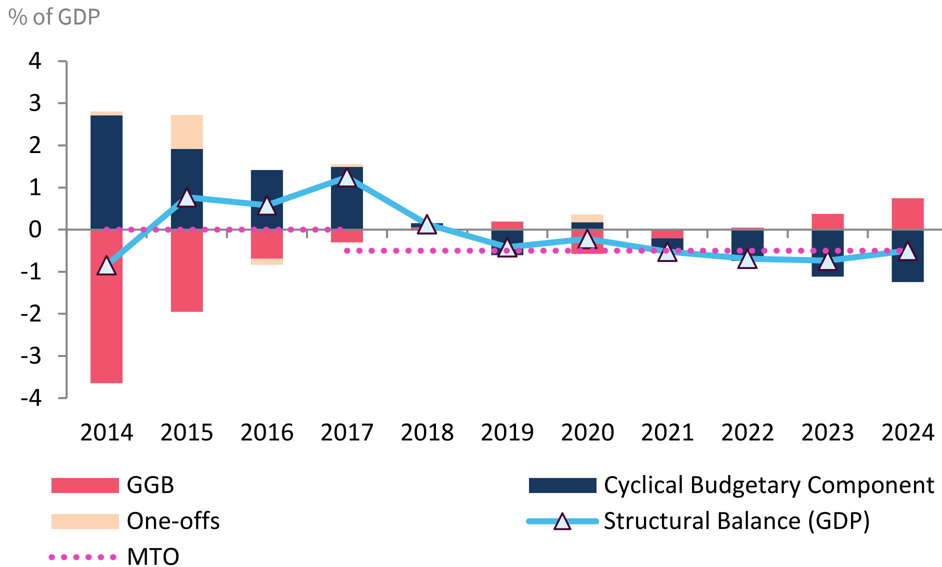
Based on *Budget 2020* forecasts, net expenditure is set to grow by 3.6 per cent in 2019, below the limit of 3.9 per cent growth. However, further expenditure overruns in 2019, and a potential underestimation of social payments for 2019 (see chapter 3), could jeopardise compliance with the Expenditure Benchmark.

Based on current forecasts, taking 2018 and 2019 together and, assessing deviations from the Benchmark using GNI* (see Box M), there is a risk that a significant deviation will occur over the two years (expenditure of more than 0.25 per cent of GNI* above the Benchmark limit). This is largely as a result of a significant deviation occurring in 2018, on a one-year basis (0.5 per cent of GNI* from the Benchmark), and no corrective measures being taken in 2019.[76]

[76] However, this is based on the Council's principles-based approach, which was not in place at the time policy was set and as such, the Government could not have formulated policy in order to be compliant with this limit. The Council adopted its principles-based approach to the Domestic Budgetary Rule in May 2019 (Fiscal Council, 2019a). However, the expenditure limit that was in place at the time policy was set was also breached in 2018 (See Appendix G).

Figure 4.3: Structural balance decomposition

% of GDP



Sources: CSO; Department of Finance; and internal Fiscal Council calculations.
Note: GGB is the General Government Balance. The cyclical Budgetary Component is estimated as: -0.588 × output gap, where the output gap is the Department of Finance's GDP-based output gap.

Box M: Using GNI* to assess compliance with the Expenditure Benchmark

The Council has recently begun assessing Ireland's Domestic Budgetary Rule using its principles-based approach.[77] This new approach makes the assessment simpler and more appropriate for Ireland, including by measuring potential output using the Department of Finance's alternative method rather than the EU's Commonly Agreed Methodology (CAM). This Box outlines a further innovation to the Council's principles-based approach, and that is to assess the severity of deviations from the Expenditure Benchmark using Modified Gross National Income (GNI*) instead of using GDP.[78]

Under the EU fiscal rules, what constitutes a significant deviation from the Expenditure Benchmark is assessed on the basis of GDP. The Vade Mecum on the Stability & Growth Pact states that a "*significant deviation on each indicator* [Structural Balance and Expenditure Benchmark] *will look at whether the difference between the two is forecast/planned to be equal to or more than 0.5% of GDP for the year under consideration, or will result in an average deviation of 0.25% of GDP over two years.*"[79]

While GDP is an appropriate estimate of the size of the domestic economy in most EU countries, due to well-documented issues relating to the multinational sector, GDP is not an appropriate measure of the size of Ireland's domestic economy.[80] Figure M.1 shows the ratio of

[77] See Appendix F for a summary of the Council's "principles-based approach". For a more detailed outline of the Council's "principles-based approach" to the Domestic Budgetary Rule, and the Council's reasoning for taking this approach, see Box A of Ex-Post Assessment of Compliance with the Domestic Budgetary Rule 2018 (Fiscal Council, 2019a).

[78] GNI* is an indicator produced by the CSO designed to "exclude globalisation effects that are disproportionally impacting the measurement of the size of the Irish economy". It excludes from gross national income, factor income from redomiciled companies, depreciation on aircraft leasing and depreciation on R&D service imports and trade in IP. More information available here: https://www.cso.ie/en/releasesandpublications/ep/p-nie/nie2017/mgni/.

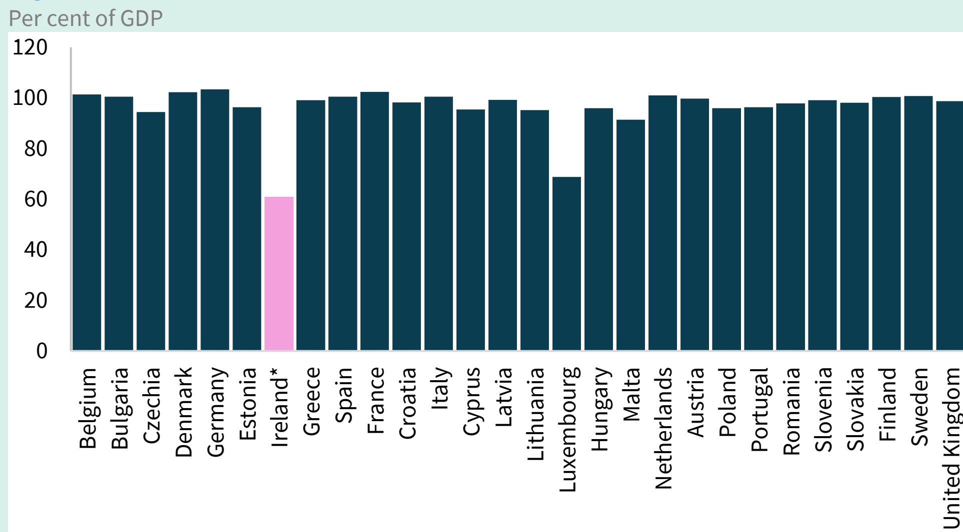
[79] https://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2019-edition_en

[80] See, for instance, Box D of the June 2017 Fiscal Assessment Report (Fiscal Council, 2017c).

GNI (GNI* for Ireland) to GDP for EU countries in 2018. For most EU countries, the ratio is close to 100 per cent of GDP, whereas for Ireland, the ratio of GNI* to GDP was 61 per cent in 2018.

Figure M.1: Ratio of GNI (GNI* for Ireland) to GDP in 2018 for EU countries

Per cent of GDP

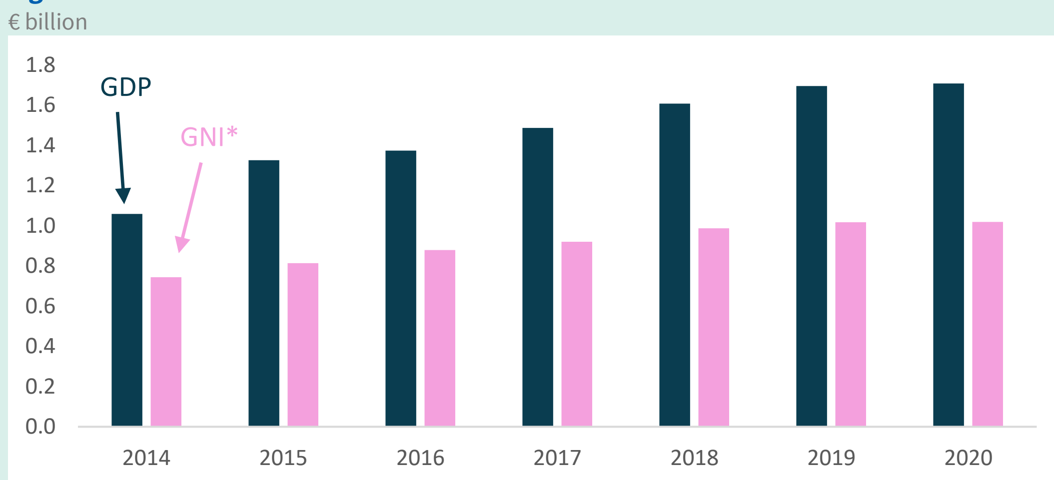


Sources: Eurostat for GDP; AMECO for GNI; CSO for GNI*; and internal Fiscal Council calculations.

As the disparity between national income and GDP for Ireland is so large, assessing what is a significant deviation from the Expenditure Benchmark on the basis of GDP would not be appropriate for Ireland. A more appropriate figure from which to assess a deviation from the Expenditure Benchmark is GNI*. Figure M.2 shows the amount of spending—measured as 0.5 per cent of GDP or GNI* for each year—in excess of the Expenditure Benchmark that would have to occur in order to be considered a significant deviation. The disparity between the amounts beyond which a significant deviation occurs has increased in recent years – particularly since the level shift in GDP in 2015. For 2020, if assessed against GDP, spending of €1.7 billion over the Expenditure Benchmark would have to occur before a deviation would be considered significant, whereas, if assessed against GNI*, the corresponding figure would be €1 billion.

Figure M.2: Spending in excess of the Expenditure Benchmark that would result in a significant deviation

€ billion



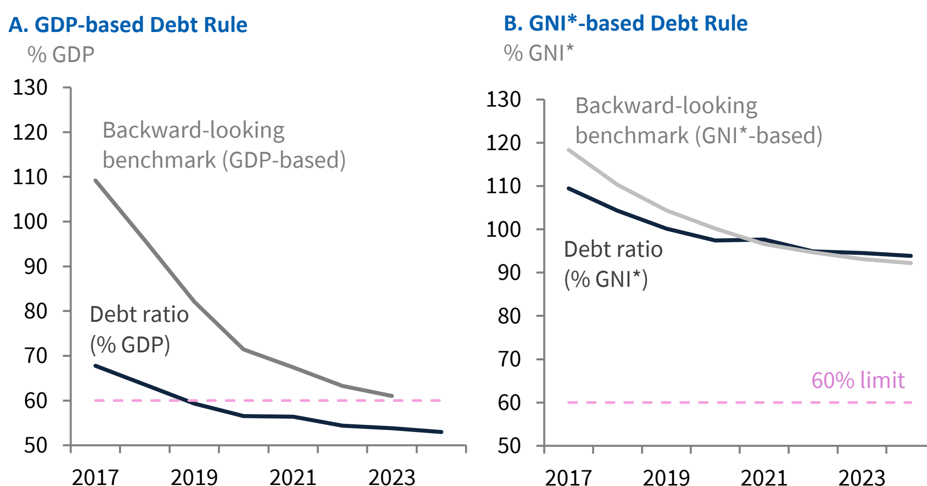
Sources: CSO; and internal Fiscal Council calculations.
As GNI* is a more appropriate indicator to measure Ireland's underlying macroeconomy and its fiscal capacity, the Council has decided to assess deviations from the Expenditure Benchmark on the basis of GNI* instead of GDP.

Debt Rule

The Debt Rule applies in full for the first time in 2019, following the end of a three-year transition period (2016–2018) since Ireland exited the SGP Corrective arm based on 2015 outturns. The debt-to-GDP ratio is the formal basis for the Council's assessment of compliance with the Debt Rule, as specified in the *FRA 2012*. The Debt Rule requires Ireland's debt-to-GDP ratio to be below 60 per cent of GDP or reducing by, on average, $1/20^{th}$ of the gap above 60 per cent.

Forecasts in *Budget 2020* show the debt ratio falling below 60 per cent of GDP at the end of 2019 (Figure 4.4A). However, the recent fall in the debt ratio is largely as a result of level shifts in GDP, the denominator. The distortions in GDP, mainly relating to the globalisation activities of a small number of large multinational firms, mean that the debt-to-GDP ratio is not an appropriate indicator of the sustainability of Ireland's debt levels. The sustainability of Ireland's debt levels should be judged against more appropriate metrics, like a debt-to-GNI* ratio.

Figure 4.4: Compliance with the Debt Rule: backward-looking benchmark



Sources: CSO; Department of Finance; and internal Fiscal Council calculations.
Note: The left panel shows the Debt Rule based on GDP, which is the legal requirement for compliance. The right panel shows compliance with the Debt Rule were it to be based on GNI*.

The debt-to-GNI* ratio is forecast to be above 100 per cent of GNI* at the end of 2019 (Figure 4.4B). Were the Debt Rule to be formulated as a per cent of GNI*, instead of GDP (as specified in the FRA), this would be above the 60 per cent limit. However, in this case, the Debt Rule would be complied with as the pace of reduction in the debt ratio would be below the backward-looking benchmark for 2019 (Figure 4.4B).[81]

[81] The backward-looking benchmark requires that the debt ratio falls by, on average one-twentieth $1/20^{th}$ the excess between the actual debt ratio and 60 per cent.

4.3 *Ex-ante* Assessment of 2020

Budget 2020 was framed on the basis of a no-deal Brexit. As such, €0.65 billion of proposed sectoral supports have—for the time being—been classified as temporary measures and are not forecast to recur in 2021. However, this classification is subject to change, should these measures—if introduced—prove to be permanent, or alternatively, should more supports prove to be temporary.

As the debt-to-GDP ratio is forecast to fall below 60 per cent of GDP in 2019, the legal requirement for the Debt Rule (under the FRA and the SGP) for 2020 is to maintain a debt-to-GDP ratio below 60 per cent.

The structural balance is forecast to meet the MTO for 2020. Net expenditure (corrected for one-offs) is forecast to grow by 4.5 per cent, below the limit set by the Expenditure Benchmark for 2020. There is a risk of further expenditure slippage in 2020 with the Christmas bonus again not budgeted for and a possible repeat of persistent health spending overruns (see Chapter 3).

MTO and Structural Balance Adjustment Requirements

As the MTO is forecast to be achieved in 2019, there is no adjustment requirement for 2020. A structural balance of -0.2 per cent of GDP is forecast for 2020. This is above the MTO of a structural balance of no less than -0.5 per cent of GDP.

Further slippages in expenditure and revenue shortfalls for 2020, potentially arising from a more severe impact of a no-deal Brexit than currently forecast, could jeopardise the achievement of the MTO. Revisions to the output gap could also impact on the assessment of compliance with the MTO for 2020. In addition, the recent surge in corporation tax flatters the estimated structural balance and these revenues may prove unsustainable. Box N shows the structural balance that would have transpired if corporation tax remained at its long run share of tax revenue. If excess corporation tax receipts were removed, the MTO would not be achieved in 2020.

Expenditure Benchmark

Net expenditure for 2020 is set to grow by 4.5 per cent, below the limit of 5.1 per cent set by the Expenditure Benchmark for 2020 (Table 4.2). Were the expenditure

on the proposed sectoral supports arising from a no-deal Brexit to be classified as permanent, and not a one-off, net expenditure would grow by 5.3 per cent, above the Expenditure Benchmark (also shown in Table 4.2).

Notably also, the annual change in public investment in 2020 is now below the change in its four-year average (Table 4.2). While previously the annual change in public investment was greater than the change in its four-year average—and as a result this would have reduced the assessed growth rate figure under the Expenditure Benchmark for 2018 and 2019—this is no longer the case.

Table 4.2: Contributions of adjustments to net expenditure Growth
% of Net Expenditure

		2018	2019	2020	2021
Walk to Net Expenditure Growth (Net of one-offs)					
ΔGGE	**General Government Expenditure Growth**	**6.7**	**4.7**	**6.3**	**2.5**
-ΔInt	Change in Interest	0.9	0.7	0.8	0.4
-ΔEU	Change in EU Co-Financed Current Spending	-0.1	-0.1	0.0	0.0
-ΔGFCF	Change in Public Investment (GFCF)	-1.5	-2.1	-1.1	-0.3
+ΔavGFCF	Change in Four-Year Avg of Public Investment	0.7	1.1	1.2	1.1
-ΔUC	Change in Cyclical Unemployment Expenditure	0.7	0.4	-0.3	-0.1
-DRMs	DRMs	-1.2	-1.3	-1.6	0.0
	Net Expenditure Growth	**6.0**	**3.4**	**5.3**	**3.6**
-ΔOOE	Change in One-Off Expenditure Items	-0.1	0.3	-0.8	0.8
ΔNE	**Net Expenditure Growth (Net of one-offs)**	**6.0**	**3.7**	**4.5**	**4.4**
	Limit for Net Expenditure Growth (% y/y)	**4.2**	**3.9**	**5.1**	**4.8**

Sources: CSO; Department of Finance; and internal Fiscal Council calculations.
Note: Rounding may affect totals. All figures are in nominal terms and are expressed as a percentage of the previous year's net expenditure (less adjustment for DRMs), unless otherwise stated. Δ indicates the change in the variable from year t-1 to year t. Limits presented here are based on the Council's principles-based approach to the Domestic Budgetary Rule.

Debt Rule

As the debt ratio is forecast to fall below 60 per cent of GDP in 2019, the legal requirement for 2020 is to remain below the 60 per cent debt-to-GDP ratio. This is forecast to be the case for 2020, with a debt-to-GDP ratio of 56.5 per cent.

4.4 *Ex-ante* assessment of 2021–2024

This section assesses compliance with the fiscal rules based on the Department's forecasts for 2021–2024 contained in *Budget 2020*. Based on current forecasts, the MTO will not be achieved in 2021–2023, and will only be achieved by a small margin in 2024. The Expenditure Benchmark will be complied with over 2021–2023, but based on current projections, it will be breached in 2024. This comes despite expenditure forecasts for outer years being based on technical assumptions that may not be credible (see Chapter 3).

MTO and Structural Balance Adjustment Requirements

The MTO of a structural balance of no less than -0.5 per cent of GDP will not be met for 2021–2023 based on current forecasts.[82] The structural balance for 2021 is marginally below the MTO but deteriorates further to a structural balance of -0.7 per cent of GDP by 2023 as the output gap turns increasingly positive and is not offset by improvements in the headline balance.

As the MTO will not be met for 2021–2023, there will be an adjustment requirement for 2022–2024. Based on current forecasts, this requirement will not be met in 2022 and 2023. The adjustment requirement will be met in 2024, as the structural balance returns marginally above the MTO.

Expenditure Benchmark

As the MTO is forecast not to be achieved in 2021–2023, there will be a convergence margin applied to the Expenditure Benchmark for 2022–2024. This will reduce the rate by which expenditure is allowed grow at under the Expenditure Benchmark. Based on *Budget 2020* forecasts, the Expenditure Benchmark will be complied with for 2021–2023. The Expenditure Benchmark is forecast to be breached in 2024. This is largely as a result of a convergence margin being applied for 2024, reducing the allowable growth under the Expenditure Benchmark.

This is despite the expenditure forecasts for 2021–2024 being based on technical assumptions that may not be credible. If plausible expenditure forecasts were used,

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[82]In *SPU 2019* the MTO was set for 2020-2022 as a structural balance of no less than -0.5 per cent of GDP. As the MTO is currently not set for 2023-2024 it is assumed constant for these years as a structural balance of no less than -0.5 per cent of GDP.

this may have resulted in the structural balance being further away from the MTO than is currently forecast, which would necessitate a larger convergence margin being applied, as well as a higher assessed expenditure growth rate. It is worrying that an Expenditure Benchmark breach is forecast on the basis of expenditure forecasts that typically understate expenditure considerably.

Debt Rule

The Debt Rule is forecast to be complied with over the horizon 2021–2024. The debt ratio is forecast to continue on a downward trajectory and is forecast to be 53.0 per cent of GDP in 2024.

However, if the Debt Rule were based on the more appropriate debt-to-GNI* ratio, then the Debt Rule would not be complied with in 2021–2024. The pace of reduction in the debt-to-GNI* ratio would be close to but marginally above what the backward-looking benchmark requires for these years (Figure 4.4B).

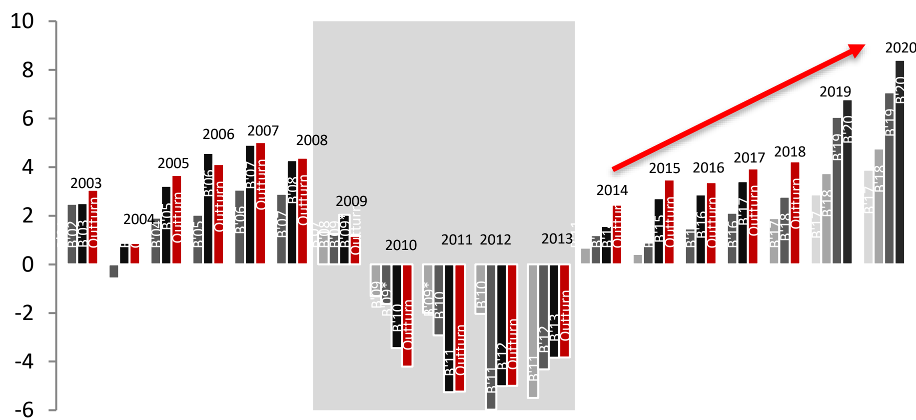
4.5 Medium-term Expenditure Framework

The Medium-term Expenditure Framework (MTEF) was a reform introduced in the Ministers and Secretaries (Amendment) Act 2013 to provide a better mechanism to control spending over the medium-term and to ensure the Expenditure Benchmark is complied with. The MTEF requires that the Government set limits for overall expenditure for the medium-term and that ministerial ceilings be set so that aggregate expenditure stays within the overall limits.

While the goal of the MTEF—to place a constraint on expenditure over the medium-term—is desirable, the MTEF is not working in practice. Procyclical increases in the expenditure ceilings risk repeating the mistakes of the past (Figure 4.5).

The MTEF, as currently instituted, is not a credible framework. The pattern of increases in the expenditure ceilings since 2014 indicates that these ceilings are, in practice, being treated as starting points in Departmental negotiations for resources and are not being used as intended (see Appendix H for graphs of the ceiling revisions for the four largest departments).

Figure 4.5: Change in gross expenditure ceiling relative to initial ceiling
€ billions



Sources: CSO; Department of Finance; and internal Fiscal Council calculations.
Note: Bars show the change in forecasts from various budgets followed by outturns, versus the earliest budget forecast for that year (e.g., B'15 = expenditure forecasts in *Budget 2015* minus the earliest forecast for the specified year). Grey shaded region covers crisis period 2009–2013. Red bars relate to the change in outturn expenditure versus the earliest forecast for expenditure for the year specified above.

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]

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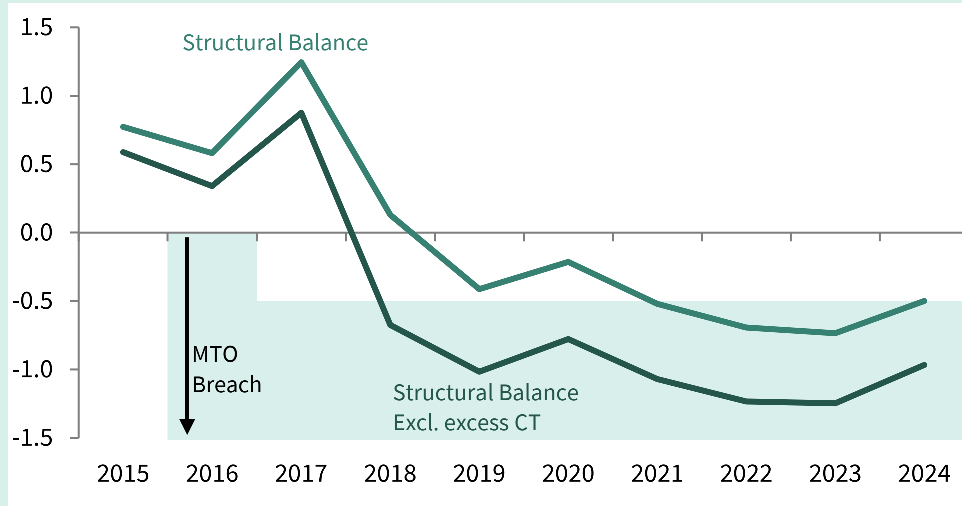
[83] See, for instance, the November 2018 Fiscal Assessment Report (Fiscal Council, 2018e)

[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.