Irish Fiscal Advisory Council

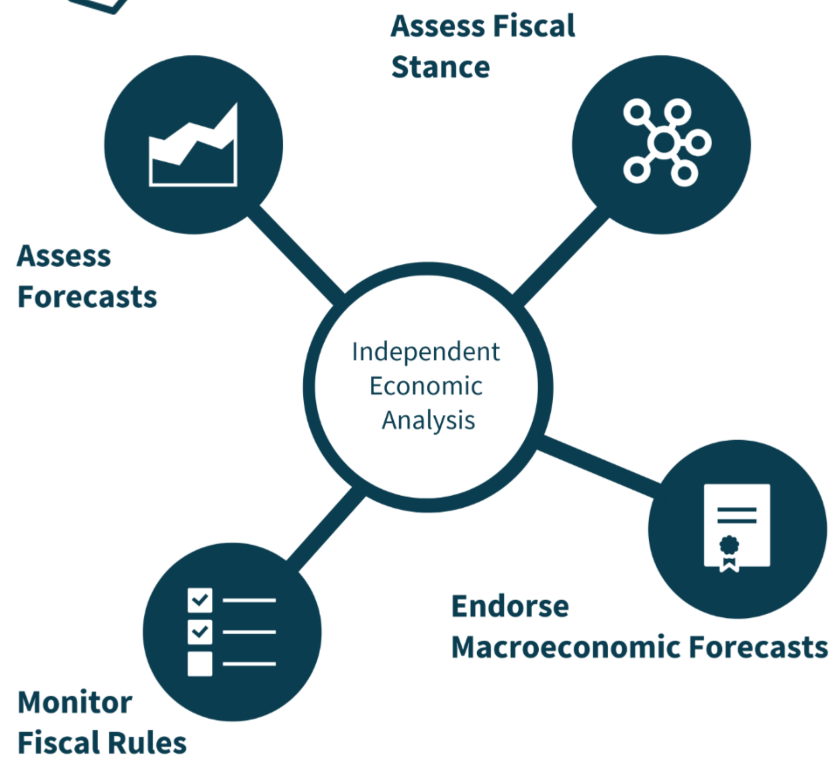
Fiscal Assessment Report November 2019

Briefing,

27th November 2019

The Fiscal Council

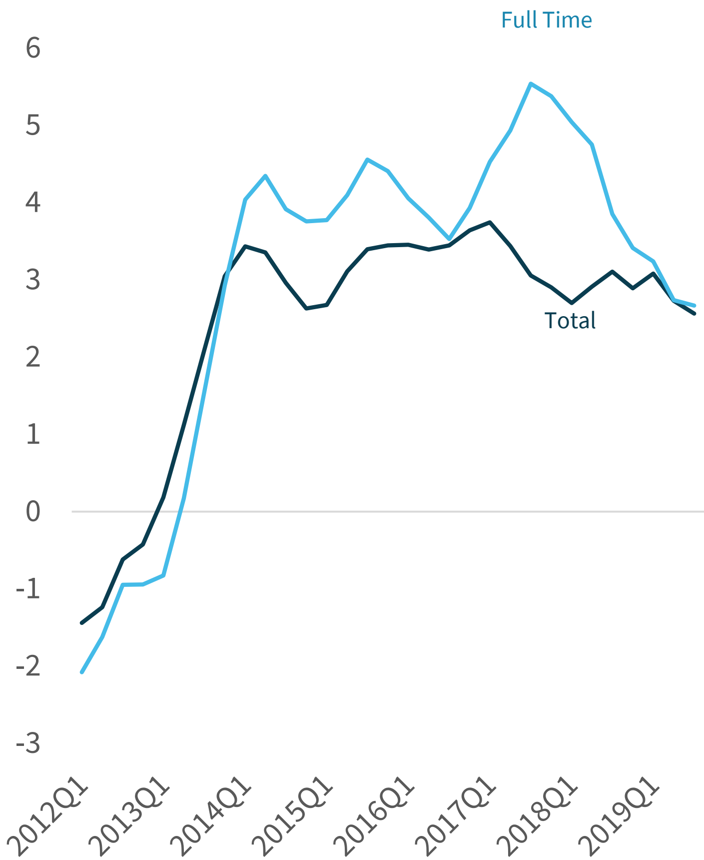
- First established in July 2011
- Five-Member Council
- Seven-Member Secretariat
- Fiscal Assessment Report is our main publication. This report looks at Budget 2020.



A cyclical upswing since about 2013

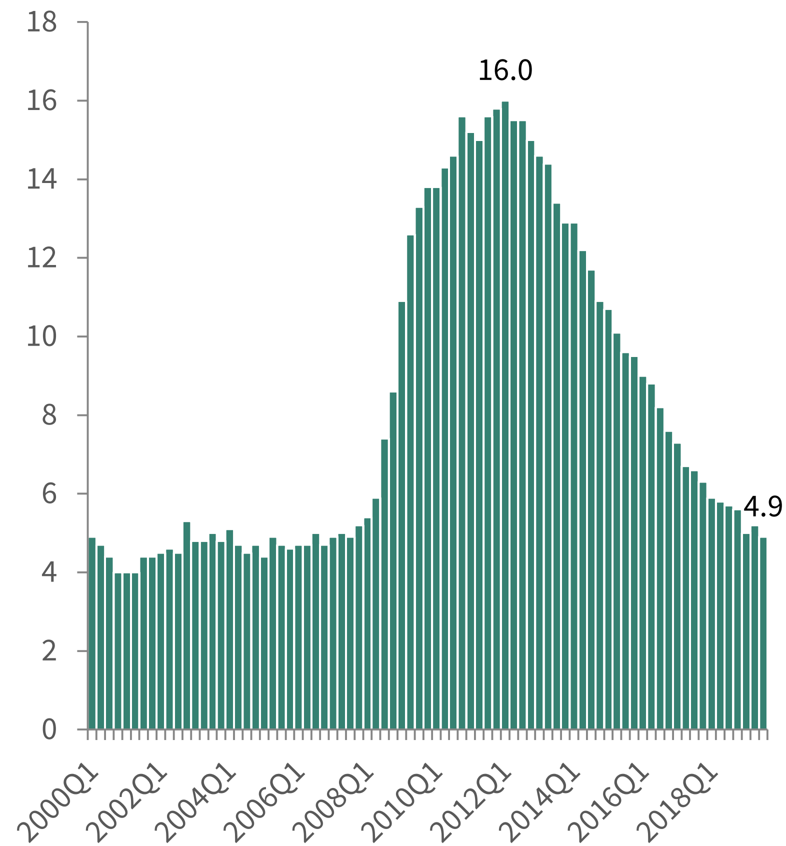
Employment growth

% change year-on-year



Unemployment rate

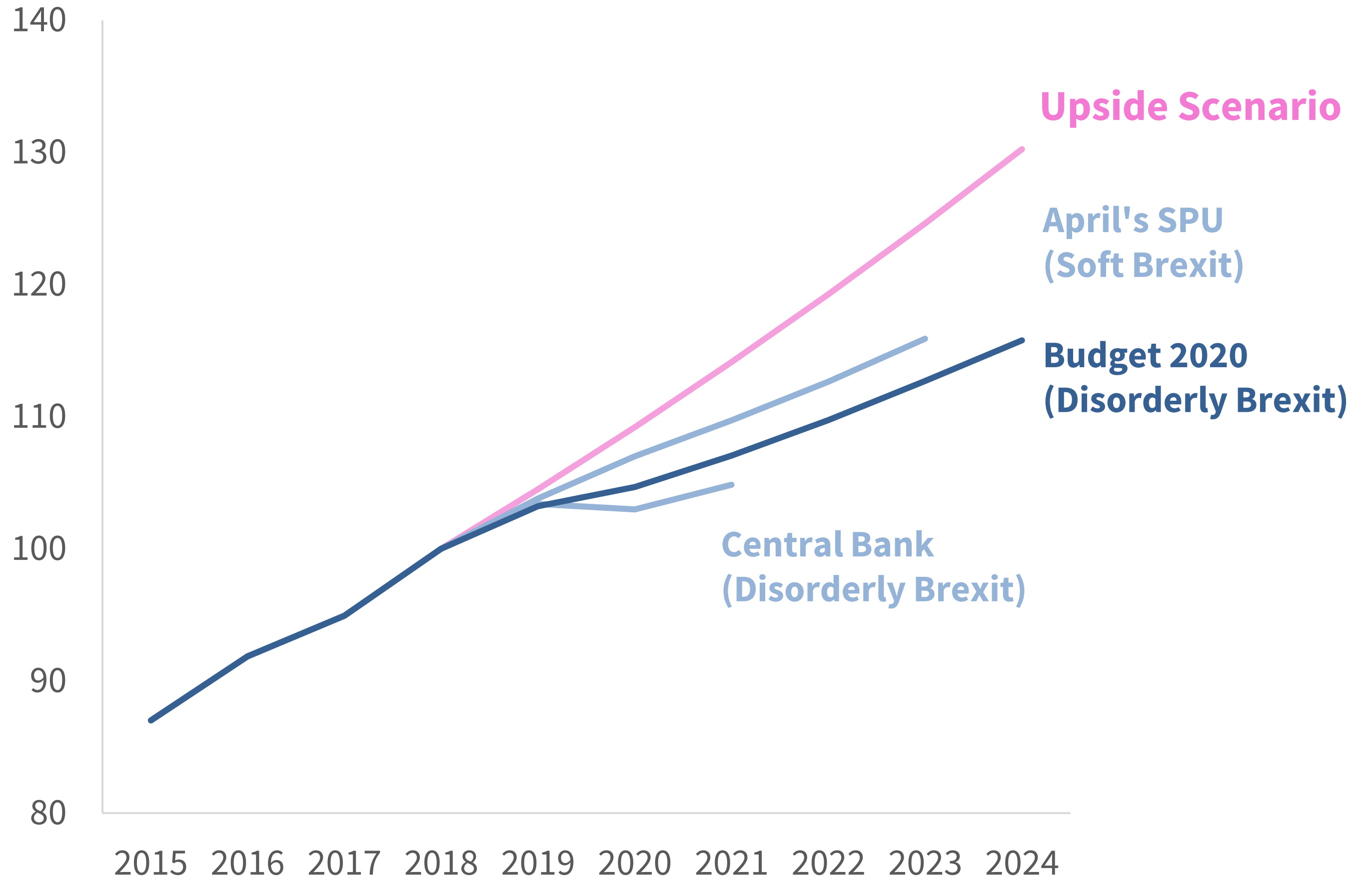
%



Irish Fiscal Advisory Council

Economic outlook exceptionally uncertain for the budget

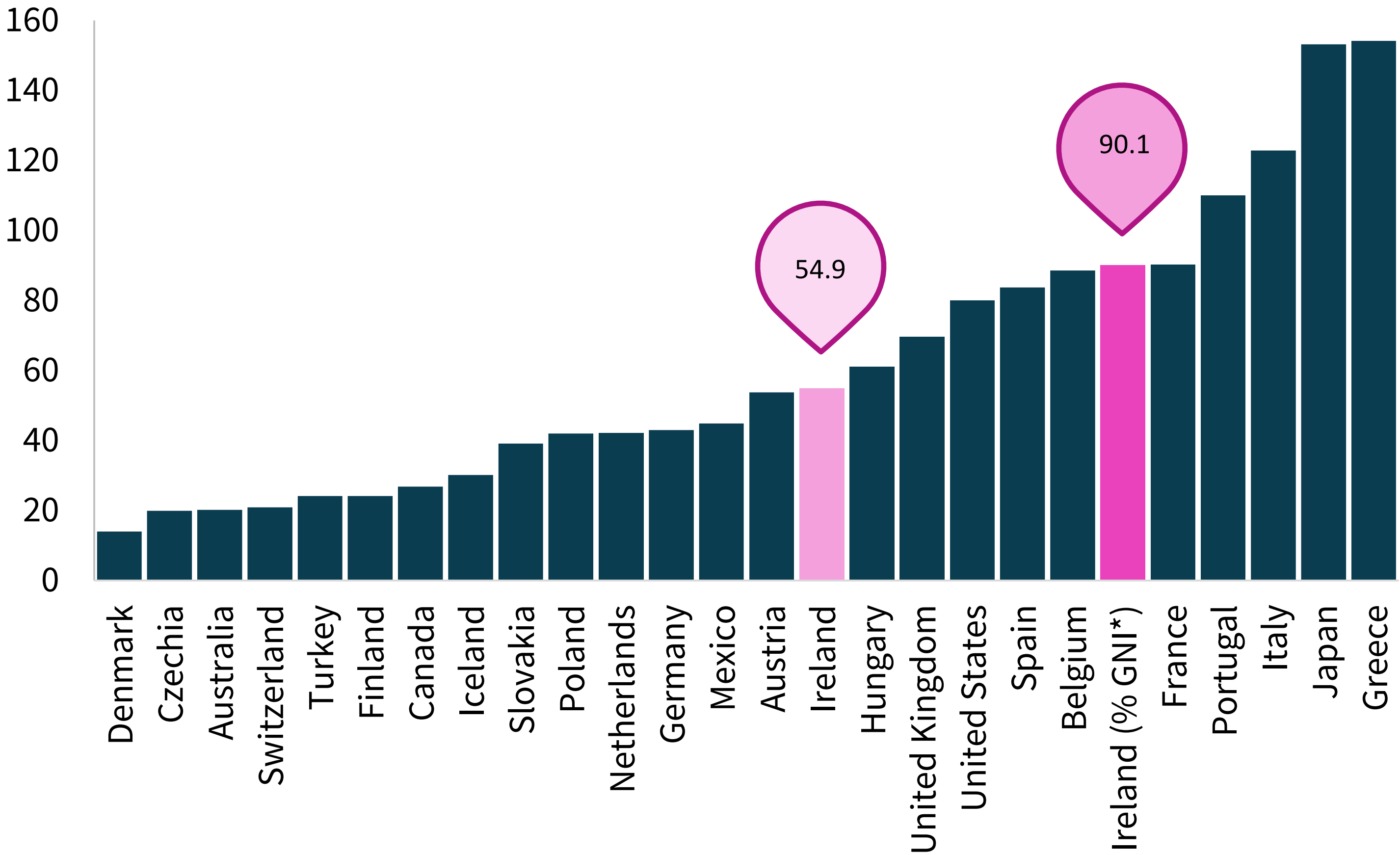
Index (2018 =100), real underlying domestic demand



Sources: CSO; Department of Finance; Central Bank of Ireland; and Fiscal Council workings.
Note: The “Upside” scenario assumes that growth stays constant at its average pace over 2014–2018 at 4.5 per cent per annum and that adverse Brexit impacts are limited.

Debt remains among highest in advanced economies

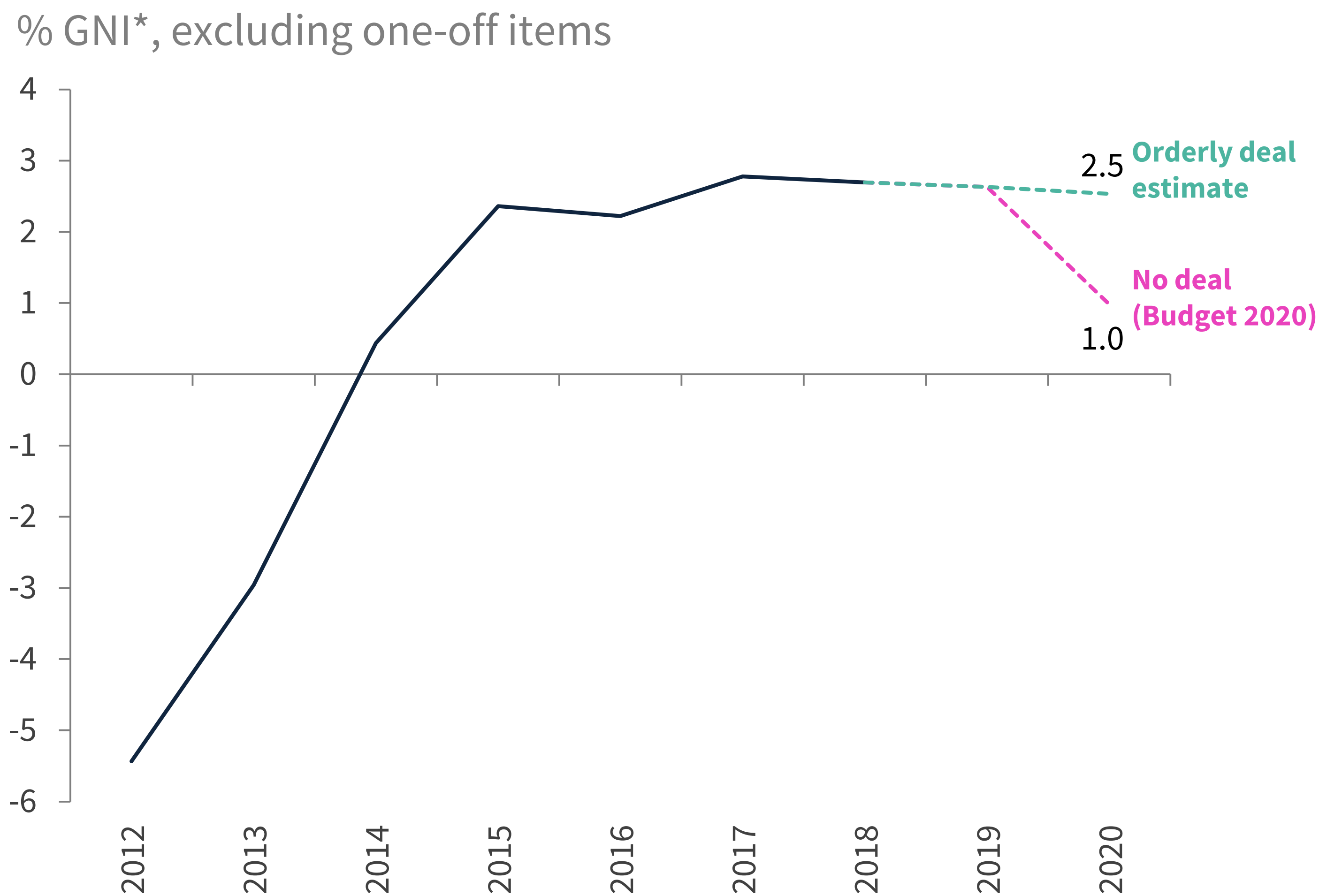
% GDP (and % GNI* for Ireland), end-2018, general government net debt



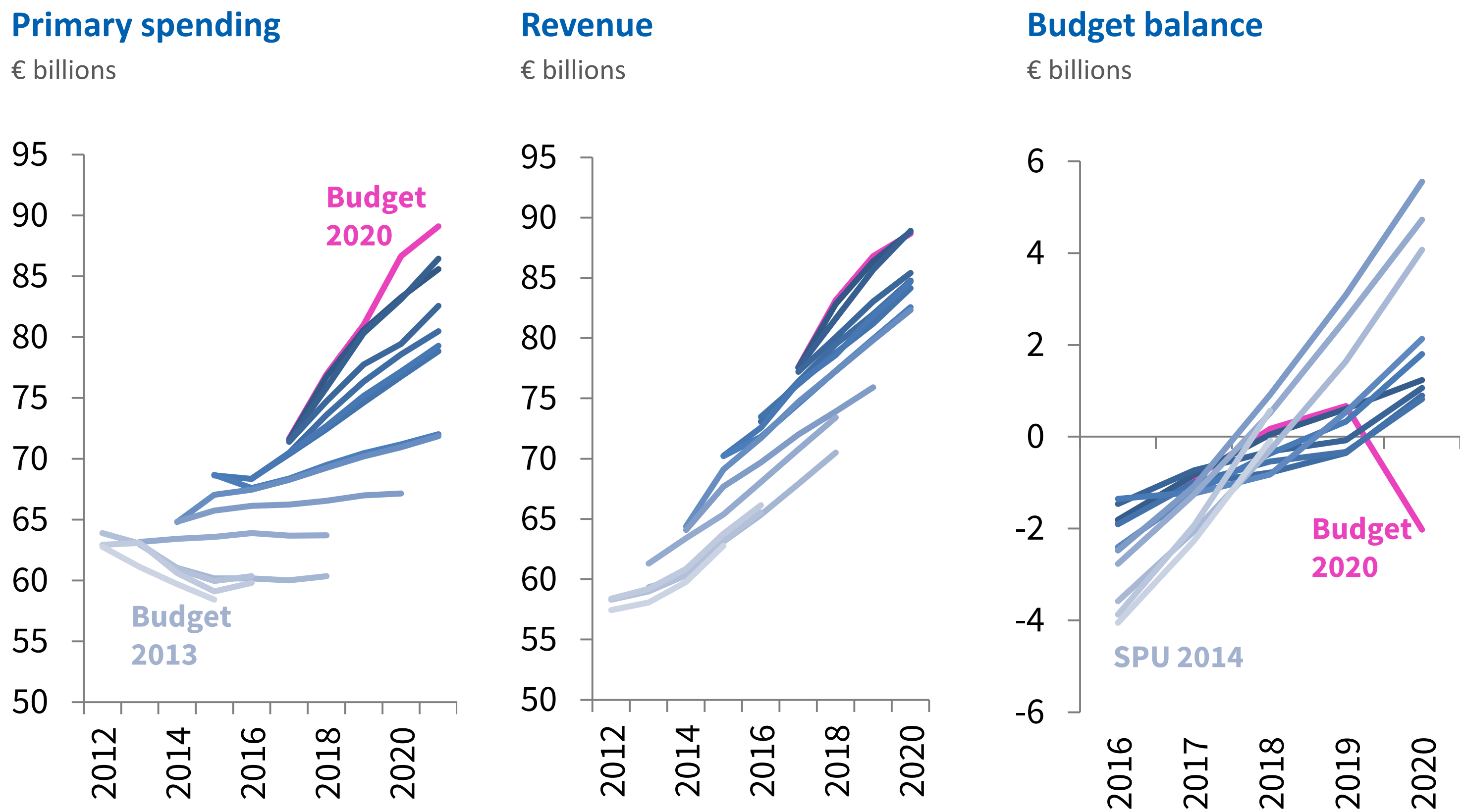
Sources: IMF (October 2019 WEO); CSO; Eurostat; and Fiscal Council workings.

Notes: The Stability and Growth Pact criterion of a 60 per cent ceiling for government debt is set in gross terms rather than in net terms. Net debt does not include the State's bank investments.

Improvements in the primary balance stopped after 2015

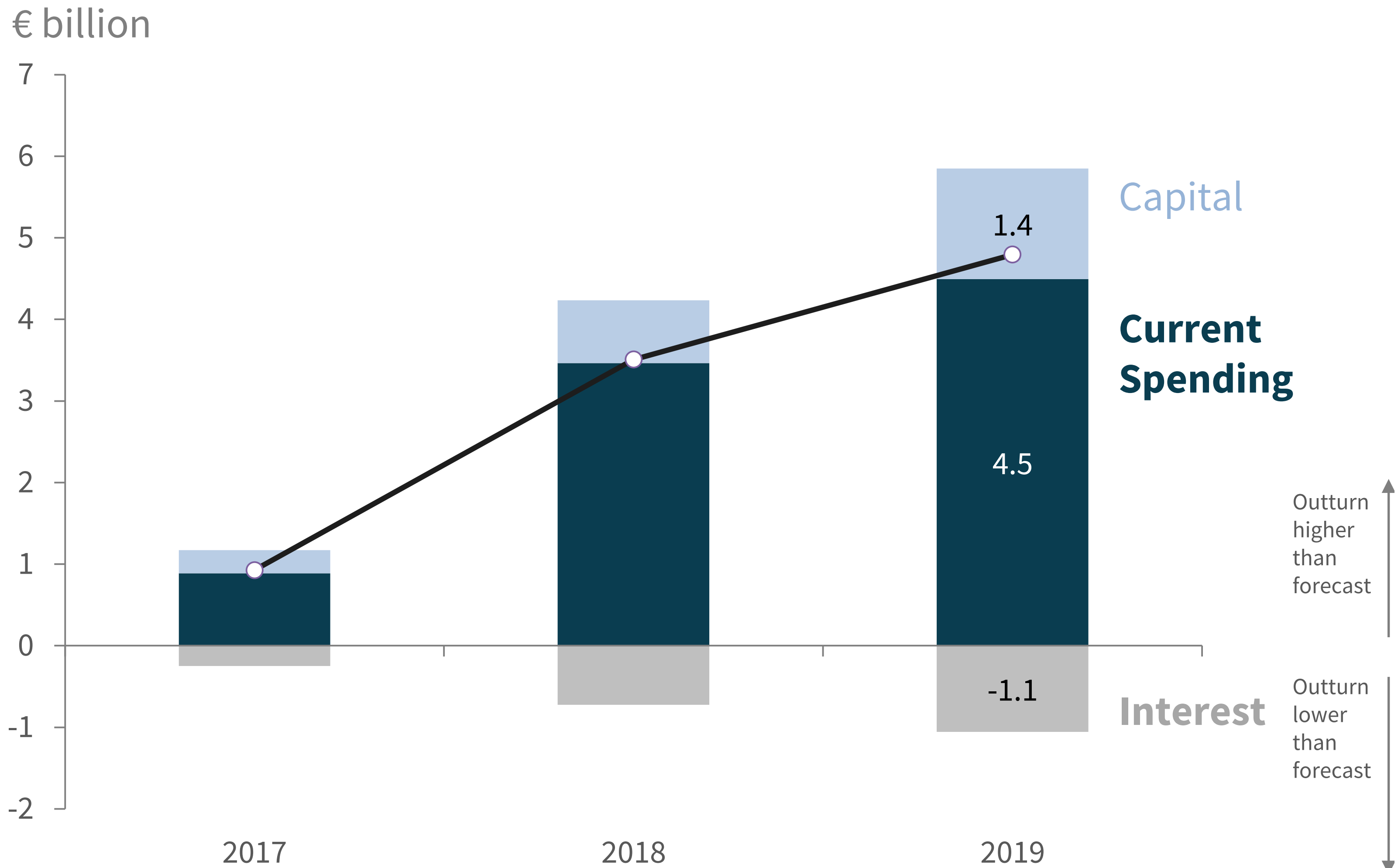


Spending has been revised up more than revenue



Sources: CSO; and Department of Finance.
€ billion (light blue = older vintages; darker blue = more recent vintages)
Primary expenditure excludes interest payments. Prior to Budget 2017, spending forecasts were made on the unrealistic assumption of fixed nominal spending for most items. Since then, forecasts have been made on a more realistic basis, and so upward revisions to spending more clearly show the upward drift in spending plans. General government revenue data are adjusted to account for discretionary tax policy changes (not including the impact of non-indexation of tax bands and credits). The slope of the general government balance lines shows the expected improvement in the public finances. Older vintages generally show a more rapid improvement in the balance.

Three quarters of spending overruns due to current spending



Sources: Budget 2017; CSO; Budget 2020; and Fiscal Council calculations.

Spending overruns compared with *Budget 2017* plans. Current spending excludes interest.

Fiscal Rules: Commission assessments

	2016	2017	2018	2019	2020
Spending rule	✗	✗	✗	✓	✓
Structural deficit rule	✗	✓	✗	✓	✓
Overall Assessment	✗	✓	✗		

✓ **Compliant**

✗ **Some deviation**

✗ **Significant deviation**

Fiscal Rules:
Council's "Principles-Based Approach"

	2016	2017	2018	2019	2020
Spending rule	✓	✗	✗	✓	✓
Structural deficit rule	✓	✓	✓	✓	✓
Overall assessment	✓	✓	✓		

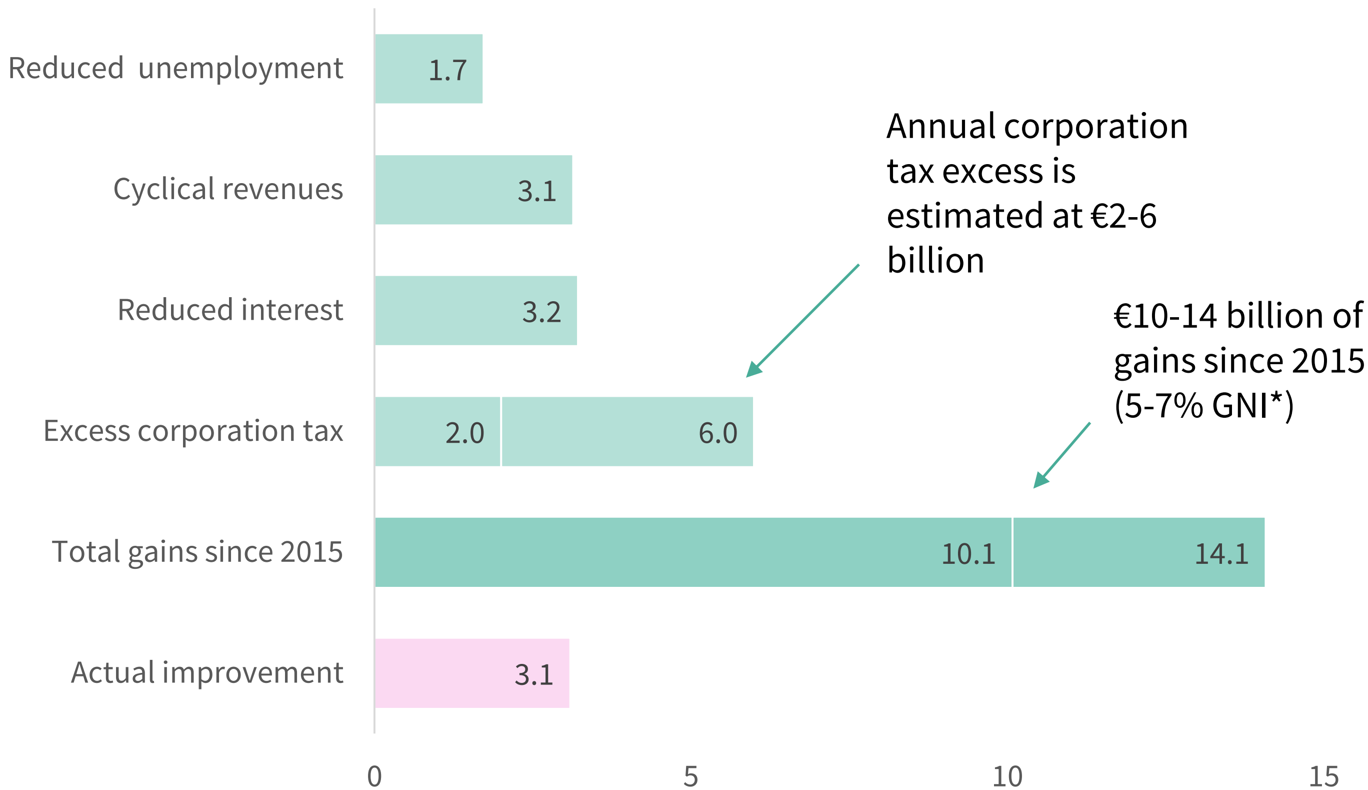
✓ Compliant

✗ Breach

✗ Significant Breach

Tailwinds have not resulted in corresponding improvements in balance

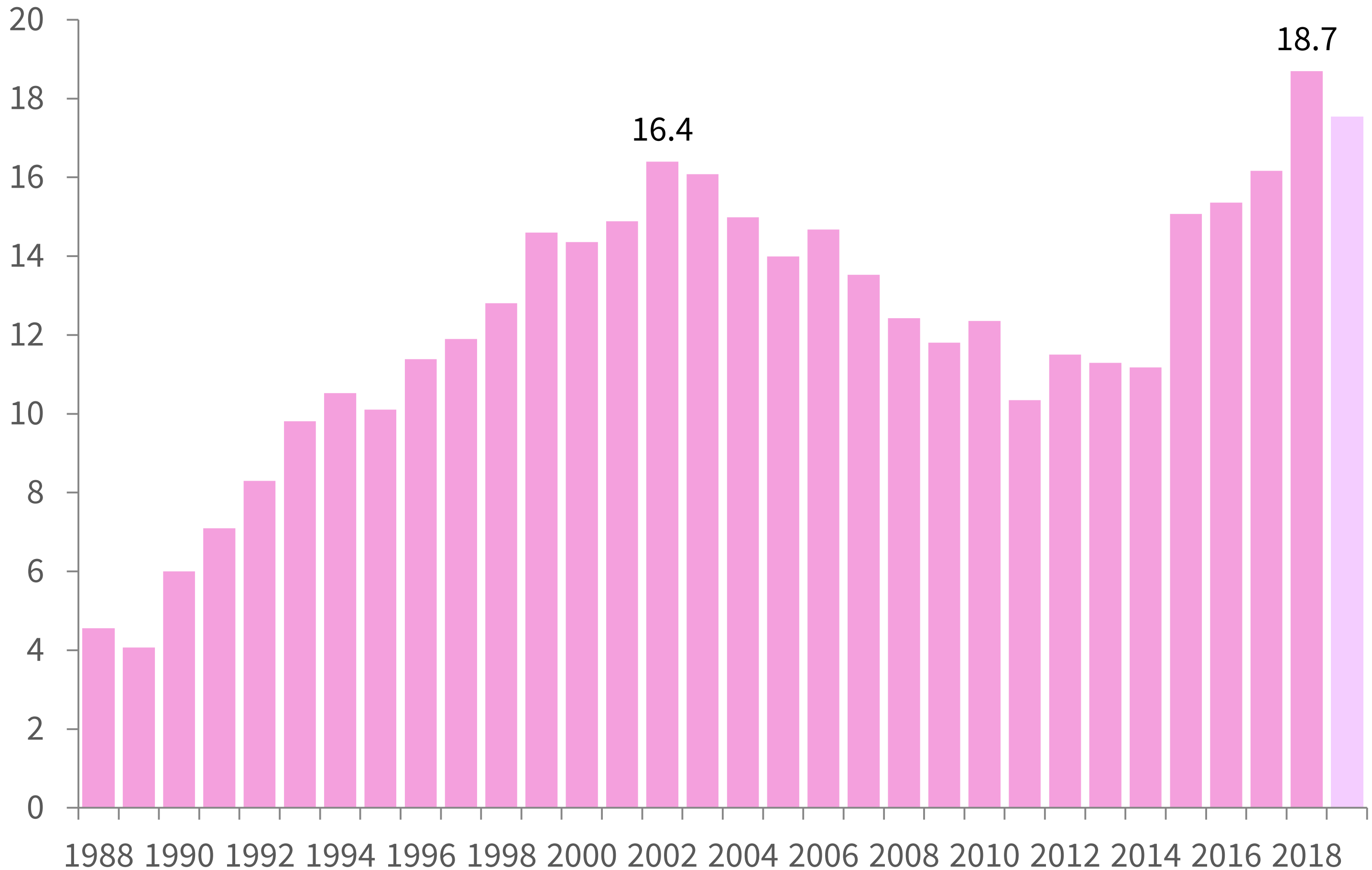
€ billions (estimated annual gains since 2015)



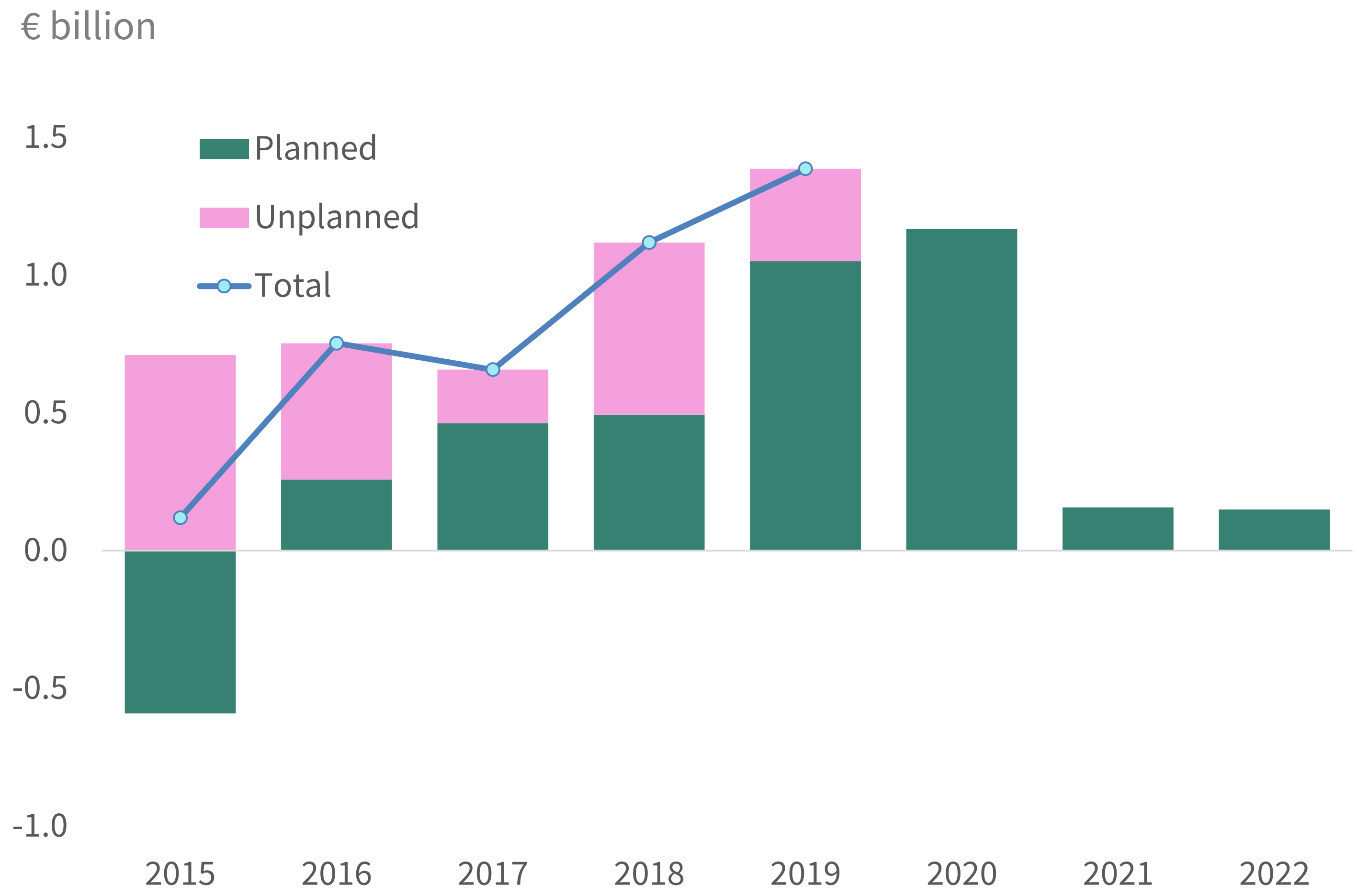
Sources: CSO; Eurostat; Department of Finance; and Fiscal Council workings.
Notes: "Excess corporation tax" estimates are based on updates of Box B (*June 2019 Fiscal Assessment Report*). Interest gains are based on the difference between the *Budget 2015* forecast of interest and the actual outturn. Unemployment-related cost gains are based on the Council's principles-based approach (Chapter 4) and relate to the estimated reduction in associated expenditure due to the recovery in the cycle. Cyclical revenue gains are based on the Department's preferred estimate of the output gap and the elasticity of expenditure to the output gap as outlined in Carroll (2019). Actual improvement is based on the change in the actual budget balance excluding one-offs between 2015 and 2018.

Corporation tax risks

Corporation tax as % of total Exchequer tax revenue

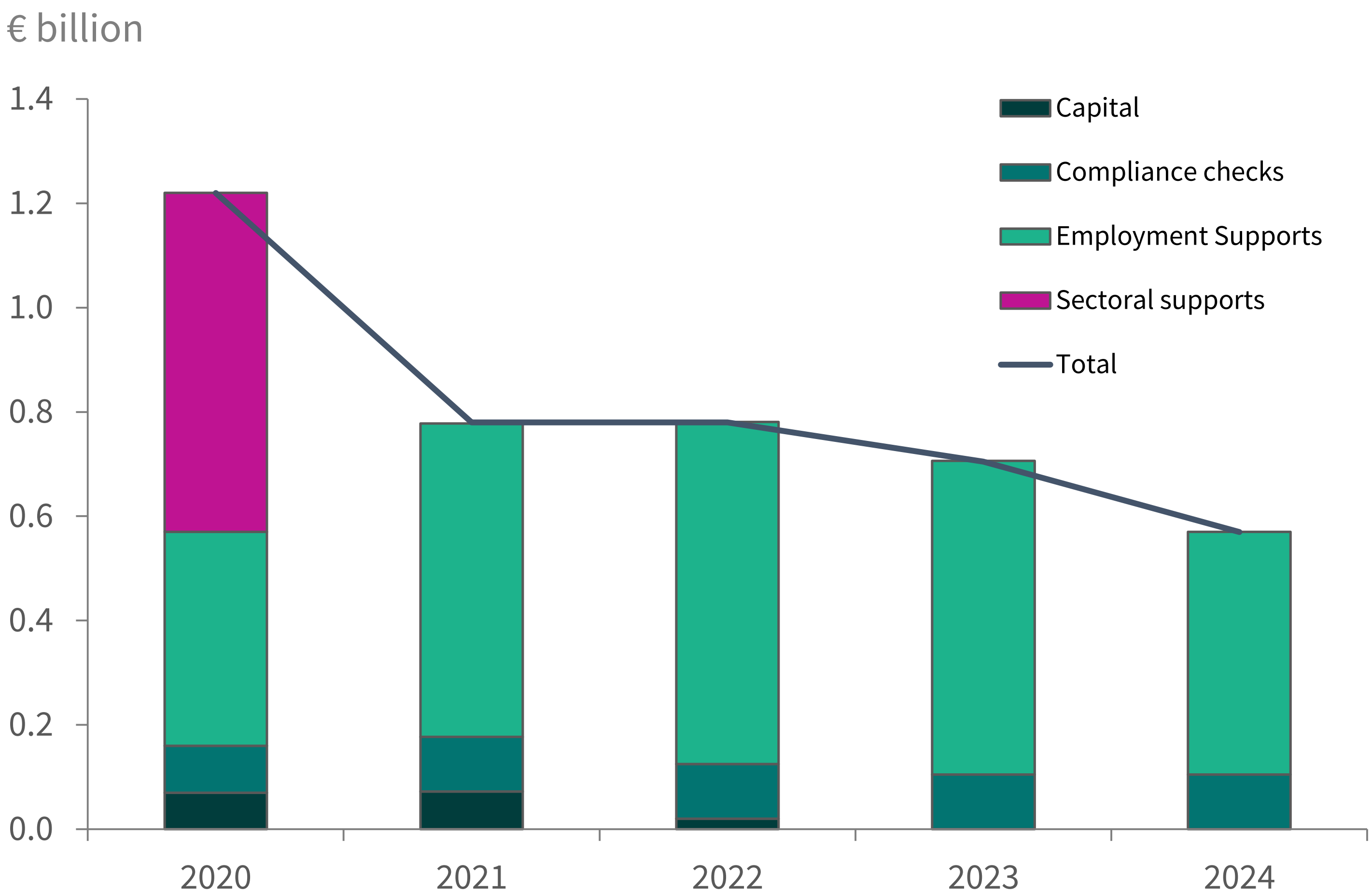


Health overruns since 2016 have been large despite planned increases

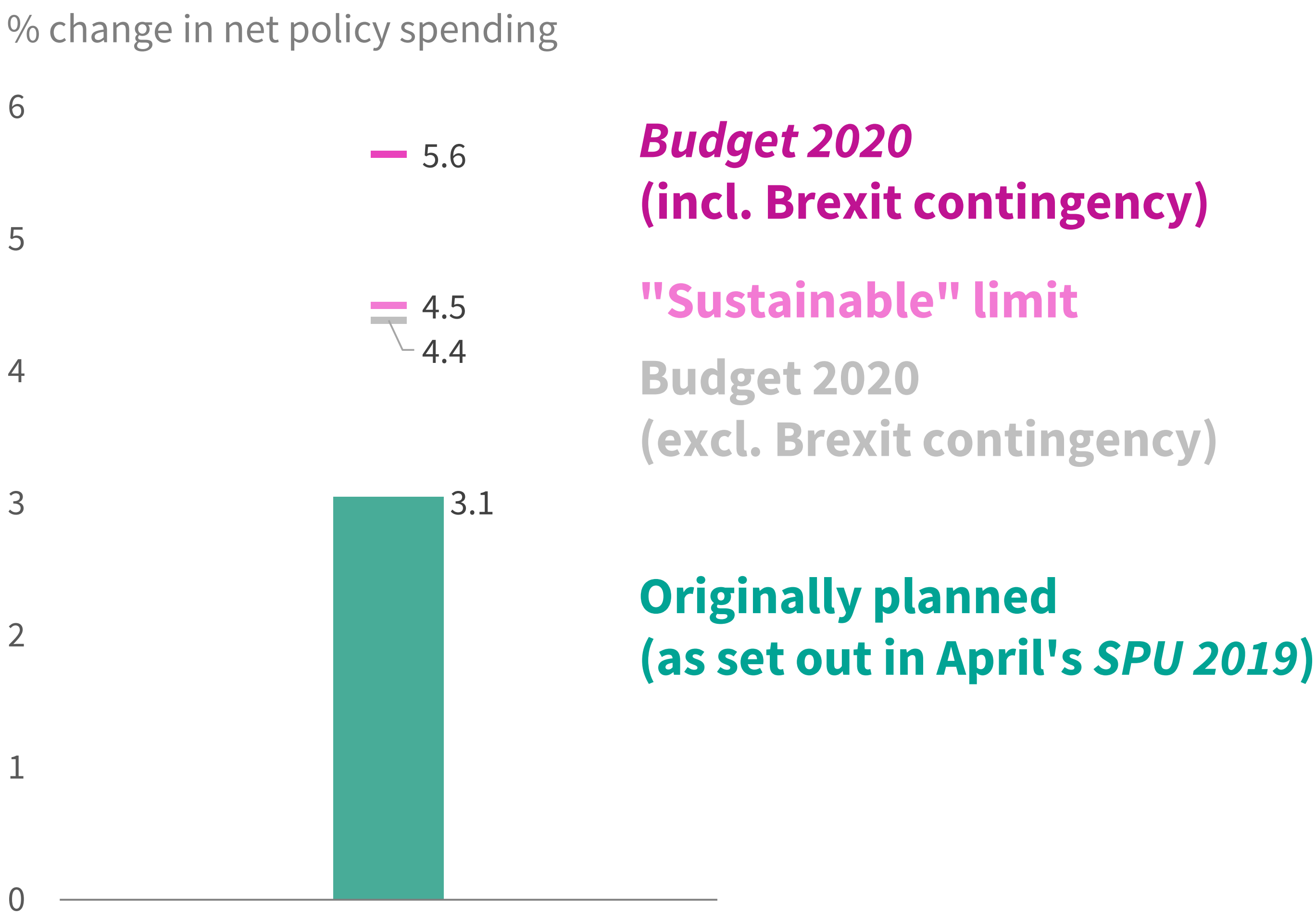


Sources: Department of Finance; and Fiscal Council calculations.
Note: Data shown in gross voted health spending terms. Forecasts are taken from the Revised Estimates. The 2019 overrun is an estimate based on the Expenditure Report 2020 (Department of Finance, 2019d).

Forecasts assume that Brexit sectoral supports completely disappear after 2020



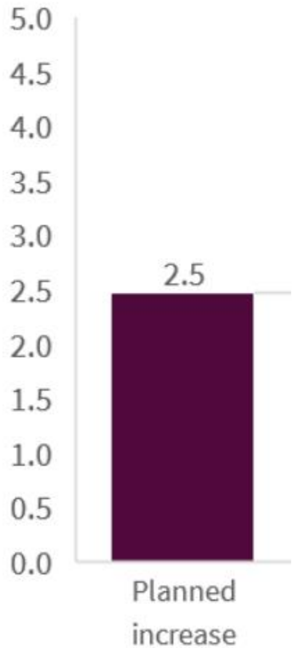
Initial plans were for more moderate net spending growth in 2020



Source: CSO; Department of Finance; and Fiscal Council workings.
Note: "Sustainable" limit refers to the growth rate implied by potential output over the medium term (3 per cent) and forecast inflation for 2020 of 1.5%.
Net policy spending is total expenditure less interest, one-offs, cyclical unemployment costs and the net effect of new tax measures.

Net increase in 2020 €1 billion higher even before Brexit spending

€ billions (net policy spending increases)

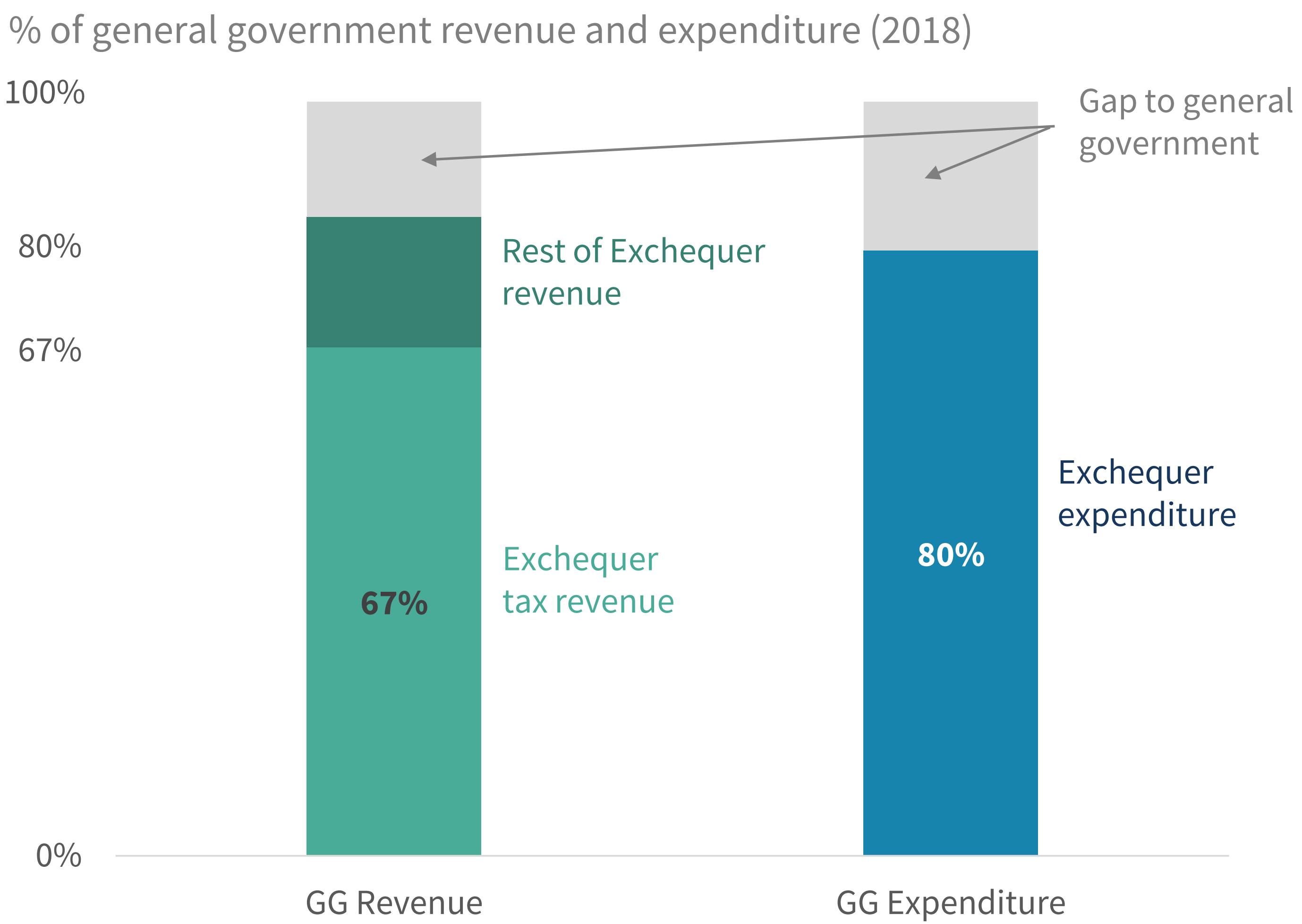


CSO; Department of Finance; and Fiscal Council workings.
Note: Net policy spending is general government expenditure less one-offs, interest, and discretionary revenue measures. The figure compares the original *SPU 2019* plans for spending in 2019 with *Budget 2020* estimates for 2020 to capture the impact of within-year spending revisions in 2019. * Exchequer spending is gross voted current and capital spending plus non-voted current spending (adjusted for the higher EU budget contribution arising from Brexit-related customs duties, which is general government neutral). ** Timing-related costs arise due to extra payment dates in the 2020 leap year. *** The Brexit contingency is adjusted for the estimated cost of cyclical unemployment benefits already removed from net policy spending.

Transparency problems

- *Budget 2020* net policy spending increase of €4.6 billion for 2020 was €2.1 billion more than planned in April.
- Part was Brexit-related costs but close to €1 billion was outside of the Exchequer.
- This is a concern. Increases impact the economy just as much as the Exchequer or central government spending. They should be fully incorporated in budget plans.
  - Department needs to publish more information and comprehensive projections on a general government basis.

Gap to “general government” is large. Traditional measures miss 15-20% or more



Key Messages

1) Failure to stick to plans in recent years, most notably 2018

2) Government took welcome steps to incorporate spending overruns in 2019 in its *Budget 2020* plans.

3) But large upward revisions to spending outside of the Exchequer (local government & housing bodies) push spending to limit of what may be considered sustainable in 2020. Highlights the need for <u>greater transparency</u>.

4) Debt remains high and *Budget 2020* plans remove the safety margin that was planned for in April.

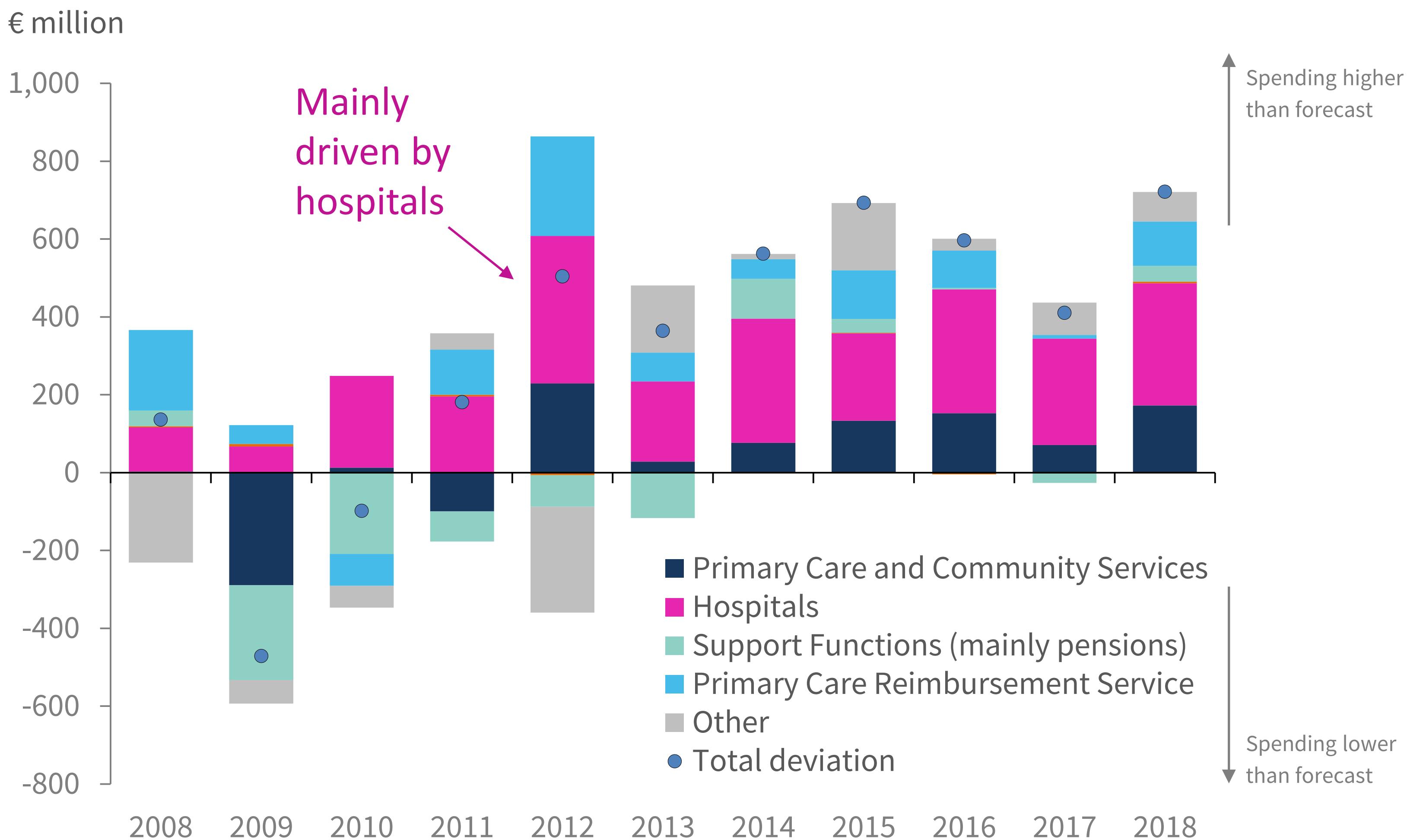
    - narrows scope to cushion adverse shocks (Brexit)
    - adds to activity in an already fast-growing economy
    - Rainy Day Fund contributions also postponed

Irish Fiscal Advisory Council

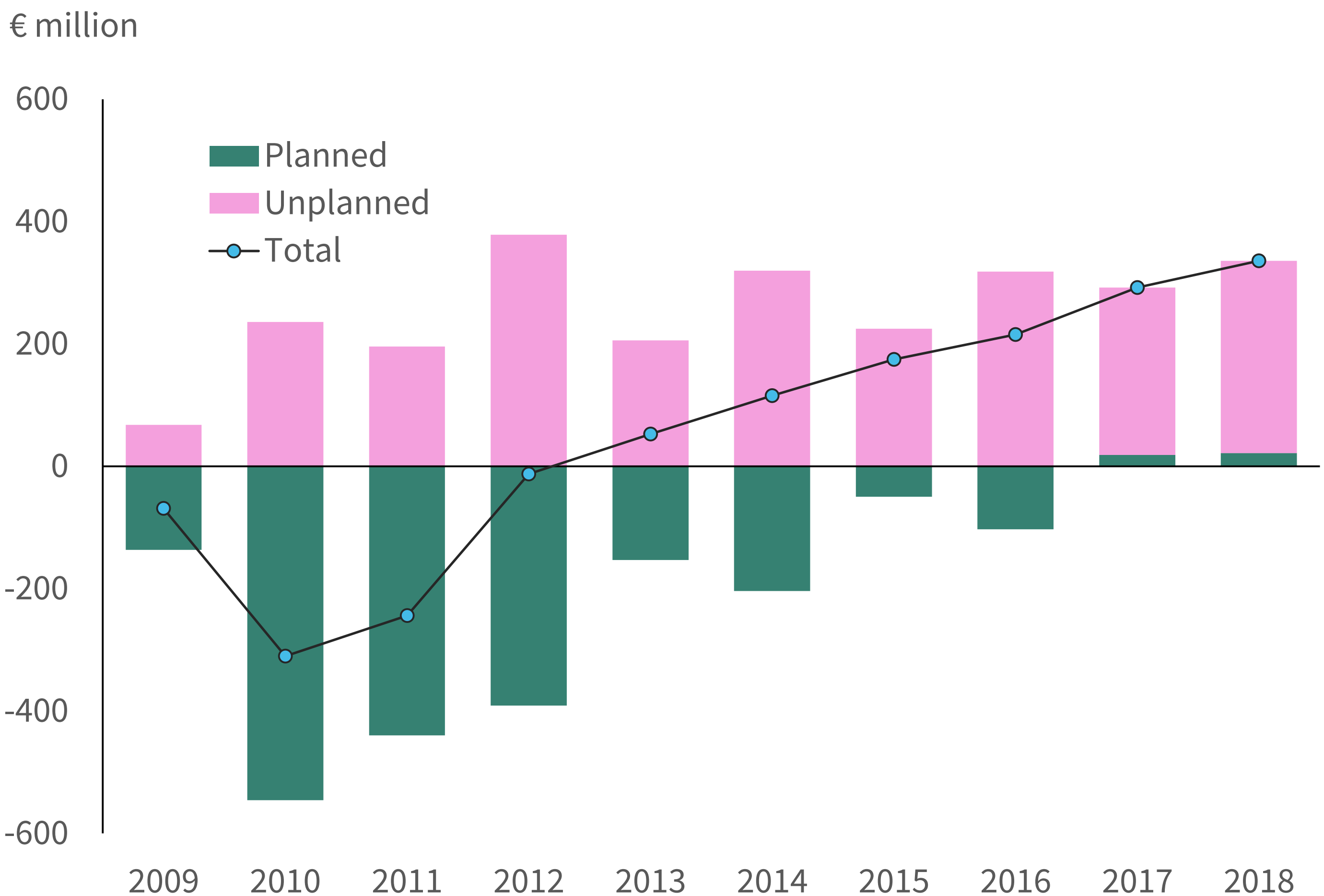
Special Analysis in this Report

Health overruns
(Box I)

Health spending overruns mainly driven by hospitals exceeding their budget



But hospital spending increases largely due to overruns rather than planned spending



Source: HSE Monthly Performance Reports; Howlin (2015); and internal Fiscal Council calculations.
Note: planned growth ($forecast_t$ – $outturn_{t-1}$) + unplanned growth ($outturn_t$ – $forecast_t$) = actual total growth ($outturn_t$ – $outturn_{t-1}$)

Rainy Day Fund
(Box B)

Rainy Day Fund

May 2016

Programme for Government: The Programme announces plans to create a Rainy Day Fund.

Oct 2016

Budget 2017: The budget includes plans to set aside €1 billion every year starting in 2019.

Oct 2017

Consultation paper: The Department of Finance publishes a consultation paper outlining how the fund will operate.

- Annual contributions halved (€1bn to €0.5bn)
- Contributions fixed and pre-determined
- €8bn cap
- “Shock" fund, not a countercyclical fund

June 2019

Rainy Day Fund established: The "National Surplus (Reserve Fund for Exceptional Contingencies) Bill 2018”
is passed into legislation, establishing the Rainy Day Fund.

The first payments into the fund were to take place later in 2019.

Oct 2019

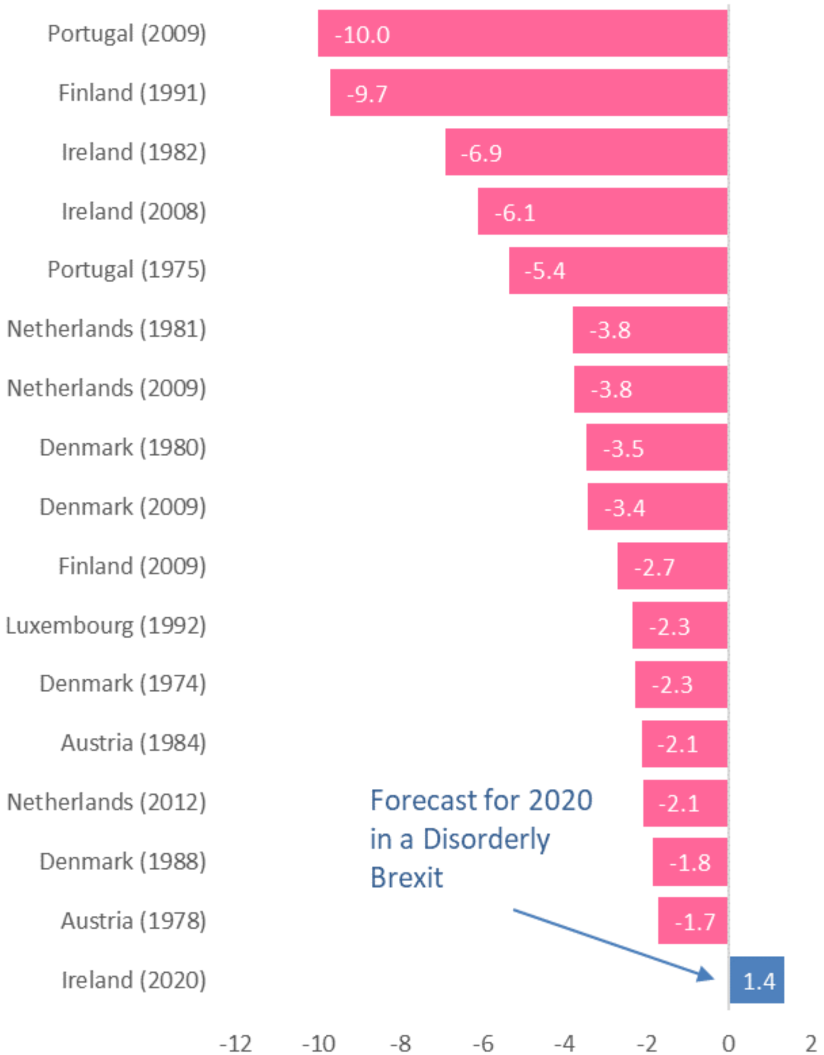
First contributions postponed: The first contributions to the Rainy Day Fund, planned for 2019 and 2020, are cancelled, given risks around Brexit.

The nature of downturns (Box D)

Downturns

Personal consumer spending

Peak-to-trough % change in volume; country and first year of downturn episode



Employment