Pact (SGP)". The SGP allows for temporary deviations from the adjustment path which are not regarded as significant before applying EU procedures.[100,101]

Future Implications of the MTO

By 2015 and the scheduled closing of the Excessive Deficit Procedure (EDP), the structural balance is estimated to reach -1.6 per cent of GDP. Ireland's MTO for the structural balance was revised in 2013 from -0.5 per cent of GDP to a balanced budget in structural terms in line with EU procedures (Box H). The main reason for the stricter MTO resulting from this exercise is the higher debt-to-GDP ratio since the previous estimate was made in 2009 (based on data for 2008). This tightening in the required structural balance – other things equal – would require additional consolidation of close to €0.8 billion at some point to reach the new standard compared with the previous MTO.

Box H: The Medium-Term Budgetary Objective (MTO)

The Medium-Term Budgetary Objective (MTO) and progress towards it, is one of the conditions underpinning the Irish Budgetary Rule, as well as forming the cornerstone of the "preventive arm" of the EU Stability and Growth Pact. It is set at the EU-level for each country using a formula. This box provides an overview of how the MTO is set and how progress towards it is measured.

Setting The MTO

The MTO is set in terms of the structural budget balance (i.e. the cyclically-adjusted General Government balance net of one-off and temporary measures.)

MTOs are set for all countries in an EU-wide exercise at regular three year intervals, most recently in 2009 and then again in 2013. The MTO is determined by a formula taking into account a number of considerations as set out below. Until 2013, this formula was not made fully public.

The MTO can never be lower than a deficit of -1 per cent of GDP in structural terms for any Euro Area country. Countries, such as Ireland, that signed the EU Fiscal Compact have committed to MTOs no lower than -0.5 per cent of GDP until their debt ratio is significantly below 60 per cent of GDP and the risks in terms of long-term sustainability of public finances are low.

Subject to these constraints, the MTO is set to meet three objectives:

- A safety margin with respect to the 3 per cent of GDP deficit limit. This is based on

[100] Temporary deviations from the adjustment path of 0.5 percentage points in one year or cumulatively over two years from the MTO are allowed *ex post*.

[101] Exceptional circumstances are defined in the *Fiscal Responsibility Act 2012 and 2013* as "…a period during which an unusual event outside the control of the State has a major impact on the financial position of the General Government, or …a period of severe economic downturn".

achieving the lowest percentile of country-specific output gap estimates over the historical sample, given the estimated elasticity of the budget to the output gap.

- Ensure sustainability or rapid progress towards sustainability of public debt, taking into account the economic and budgetary impact of ageing. This is set as the sum of:
  - The budget balance needed to stabilise the debt-to-GDP ratio at 60 per cent given long-term growth and interest rate projections.
  - An additional 2.4 basis points for each additional percentage point by which the debt to GDP ratio exceeds 60 per cent.
  - One-third of the budget balance required to meet the present value of future age-related expenditure.[102]
- Allow room for budgetary manoeuvre, in particular taking into account public investment needs.

For Ireland, the upward revision to the MTO since it was previously set in 2009 (which tightened the MTO from a structural deficit of 0.5 per cent of GDP to balance) arises from a combination of the major changes of circumstances since the crisis, along with some minor methodological changes. The main driver is the higher debt-to-GDP ratio.

Measuring Progress Towards The MTO

Until the MTO is met, the EU rules require improvement in the structural balance each year with 0.5 per cent of GDP as a benchmark. A greater effort can be sought in good times with effort more limited in bad times. Progress is assessed on the basis of plans for the current and the next year (*ex ante* assessment) and also for the previous year (*ex post* assessment).

If there is "significant deviation" *ex post* from this path, this can open the way to a recommendation from the EU and sanctions.

Signification deviations are assessed using two complementary indicators:

- The size of the deviation in the structural balance from the adjustment path to the MTO.
- An expenditure benchmark that public spending grows below the medium-term potential growth rate of the economy (see Box I).

In both cases, a deviation of 0.5 percentage points of GDP in one year or 0.25 percentage points in each of two consecutive years is considered significant.

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[102] Formally, this can be expressed as:

$$\mathrm{MTO}^{*} = -\left({(60\% * \mathrm{g})}/{(1+\mathrm{g})} \right) + (0.024\mathrm{b} - 1.24) + 0.3\dot{3} * \mathrm{S2E},$$

where *g* is the long-run nominal growth rate, *b* is the debt-to-GDP ratio and *S2E* is an EC indicator of future ageing costs.

(***Note:*** *This footnote was amended 12 December 2013.)*