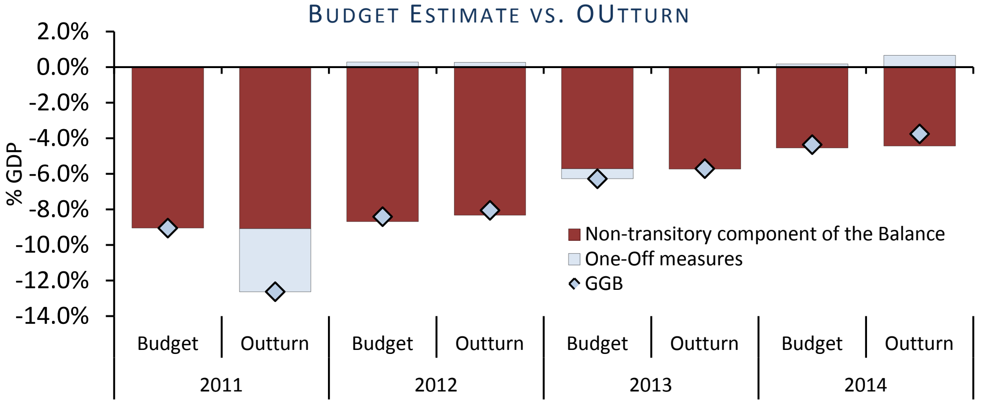
structural balance.[69] The bulk of the structural adjustment to meet MTO in 2018 has been back-loaded into 2017 and 2018. The plan to out-perform the requirement of the EU rules and to make greater efforts in 2017 and 2018, without a clear justification appears to reflect the use of technical assumptions rather than a well developed and detailed medium-term fiscal plan for 2016 to 2018. This issue is discussed in Chapters 1 and 3.

Box D: Treatment of One-Off and Temporary Measures

A key tool in assessing the fiscal stance is the structural balance. This represents the position of the public finances if the economy were to be operating at full potential and when one-off and temporary measures are excluded. A common approach to identifying the structural balance is to adjust the general government balance to remove non-structural elements, particularly those revenues and expenditures driven by the position of the business cycle. There has been much discussion, particularly in Ireland, concerning the problems with identifying the cyclical element of the balance through the estimation of potential output. However, it is also important to analyse the impact of one-off or temporary measures and transactions on the headline balance.[70]

In recent years, one-off and temporary measures have played a significant part in obscuring the movements of the headline deficit position in Ireland and elsewhere. The impact of this is most obvious in the exclusion of one-off and temporary measures in support of the financial system from the assessment of compliance with the EDP. Figure D.1 extends this analysis to exclude all one-off and temporary measures. It is notable that while there is an improvement in the general government balance as a share of GDP in 2013 and 2014 - between budget and outturn - this is driven in part by changes in the estimation of one-off and temporary measures, with much of the remainder from revisions to the forecast of nominal GDP.

Figure D.1 'Non-Transitory' component of the GGB Budget Estimate vs. OUtturn



Source: Budgets (Various years), GFS (CSO) and Department of Finance data.
Note: To aid comparison the Budget estimates of the general government balance (GGB) and the non-transitory component of the balance are adjusted for the impact of the ESA 2010 statistical revisions to the deficit.

[69] The Budget states: "Profiled structural adjustment for 2016-2018 exceeds the minimum correction path prescribed by the Council of the EU" (Ireland's *Draft Budgetary Plan*, Table 7a; CSR Recommendations).

[70] One-off measures typically involve "...large, non-recurrent operations, whose impact on fiscal balance usually falls predominantly in the year when the related operations are recorded with no sustained change in the inter-temporal budget position and hence no implications for fiscal sustainability" (Bornhurst *et al*, 2011).

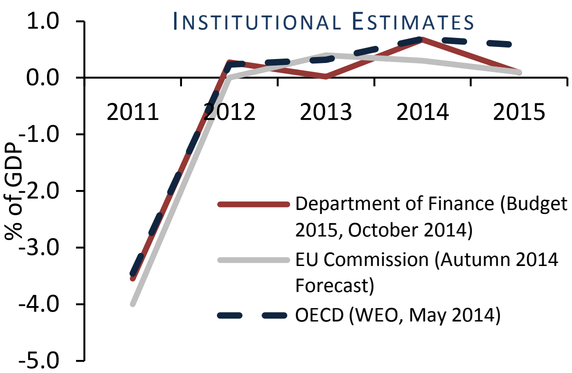
Figure D.1 uses one-offs as identified by the Department of Finance. However, the identification of one-offs and temporary measures can be somewhat subjective. For example, in Budgets 2011 and 2013 a temporary increase in dividends to the State was identified as part of the consolidation package, however, these increases were not classified as one-off. Part of the problem in this instance may be due to the difficulty in identifying the temporary element of on-going transactions.[71]

Identification of One-Off measures

In identifying one-off or temporary measures, both the EU Commission and the IMF employ a 'bottom-up' method, identifying items and adjusting for individual transactions, similar to the Department of Finance. This approach can, however, suffer from information asymmetries between monitoring institutions and the national authorities and requires detailed guidelines on classification.[72]

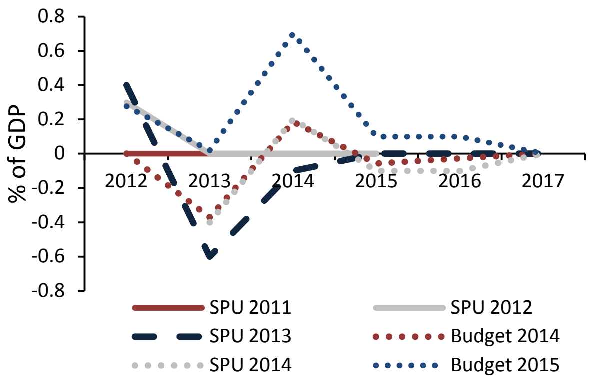
The OECD takes a more 'top down' approach and identifies the presence of one-offs and temporary transactions through deviations in trend net capital transfers (Joumard *et al.*, 2008).[73] This method ensures consistency of treatment across countries. It is transparent as data are freely available in the National Accounts and hence allows for easier review of any *ex post* changes. However, it may omit one-off transactions outside net capital transfers For example, for Ireland it would not account for the treatment of the pension fund levy.[74] Figures D.2A and D.2B compare the latest international estimates for Ireland with those of the Department of Finance and compares different vintages of Department of Finance estimates. The 'bottom-up' method to estimating one-off and temporary measures applied by both the Department of Finance and the EC can lead to differing estimates of the structural balance. However, it is the EC estimate that is ultimately used when assessing compliance with the European rules.

Figure D.2A: Comparison of Institutional Estimates



Note: Budget 2015 and EC Autumn Forecasts are on an ESA 2010 basis.

Figure D.2B: Comparison of Vintages



Note: Budget 2015 is on an ESA 2010 basis.

[71] Similarly, the reduction in the VAT rate on accommodation, restaurants, and certain cultural activities was not included as a temporary measure despite being identified as such when introduced in 2011. However, as it is a deficit increasing measure, it may have been excluded on this basis as these are typically not accounted for as one-off or temporary under the principles applied by the EC.

[72] See Larch and Turrinni (2009) and Bornhurst *et al.* (2011) for an overview of the EC and IMF guidance on the identification of one-off and temporary measures.

[73] The trend is derived using a HP filter approach. The use of this method also raises the issue of the end-point bias in HP filtered estimates.

[74] Such one-offs could be adjusted for individually while preserving the core approach.

Forecasting one-off and temporary measures into the medium term can be challenging. While one-off transactions can arise or change in scale without prior warning, the nature of transactions can also be revised as the ending of a scheme or policy comes close, e.g. the changed treatment of the pension fund levy as a temporary measure in *Budget 2015*.

The use of one-offs transactions in fiscal policy is particularly relevant in Ireland at present given the renewed importance of the budgetary framework. There is evidence that the introduction of a fiscal rules framework based on numerical targets for the headline balance can create an incentive for governments to circumvent it using so-called accounting stratagems, including the use of one-off measures.[75] Consequently, adjustments that may normally be viewed as technical can take on a more strategic role in the budget framework.[76] Koen and Van den Noord (2006) demonstrate that as deficit rules tend to become more binding, recourse to one-offs and other fiscal stratagems is more likely. In the European context, the EU Commission has shown that while in theory one-off adjustments should be both deficit increasing and decreasing, on average they have tended to be deficit-reducing. This analysis also examined the size and incidence of one-offs measures and shows that there is a tendency across Euro Area countries for there to be more - and larger - one-offs when members state are close to the 3 per cent deficit ceiling that applies to the Corrective Arm of the SGP.

While the scope to use one-off and temporary measures will be more limited under both the preventive arm of the SGP and the national Budgetary Rule, the degree of judgement involved in identifying such transactions implies that they require ongoing scrutiny. Even though not all one-off and temporary transactions are under the direct control of Government, there is still sufficient scope for discretionary actions to flatter movements even in key structural fiscal indicators. Given the importance of identifying one-off and temporary measures for both the Corrective and Preventive Arms, a more transparent approach should be taken by both the EC and the Department of Finance. While both institutions have shared their detailed estimates with the Council, these estimates should be published as a matter of course.

Expenditure Benchmark

The EU Expenditure Benchmark (EB) limits growth in general government expenditure, excluding a number of factors.[77,78] As the EB sets a limit on the real growth of this adjusted expenditure aggregate a GDP deflator is used to adjust the nominal growth rate of the aggregate. A further adjustment is made where there is a discretionary change to revenues being collected. This change is symmetrical: a discretionary decrease (increase) in revenues effectively reduces (increases) the growth in the expenditure aggregate that complies with the EB.[79] As the EB forms part of the

[75] These incentives are reinforced in electoral periods (Buti *et al.*, 2006).

[76] This tendency has been associated with Goodhart's law, which is normally formulated as "When a measure becomes a target, it ceases to be a good measure".

[77] The expenditure aggregate used in the assessment of the EB is calculated as general government expenditure excluding interest, cyclical unemployment benefit spending and certain spending on EU programmes and adjusted for exceptional investment costs relating to infrastructure.

[78] While ESA 2010 impacts on general government expenditure, this is mainly a level effect and does not change the annual growth rate substantially of the measured expenditure aggregate.

[79] In relation to the EB, Article 5 of EU Regulation 1466 states, "... the Council and the Commission shall assess whether the growth path of government expenditure, taken in conjunction with the effect of measures being taken or planned on the revenue side, is in accordance with the following conditions [...](c) for Member States that have not yet reached