4.5 Medium-term compliance with the fiscal rules

As Ireland has been found non-compliant with the deficit criterion of the SGP in 2020, Ireland will likely be placed in an excessive deficit procedure and subject to the corrective arm of the SGP once the general escape clause ceases to be in place. While it is currently uncertain what fiscal requirements will be in place after the general escape clause is no longer active, the current minimum fiscal requirement under an EDP is a fiscal adjustment of 0.5 per cent of GDP in structural terms.[78]

However, based on the Extended Budget 2021 forecasts (Box D and Box G), the deficit is forecast to fall below the 3 per cent deficit limit in the SGP in 2022.[79] Should this transpire, Ireland would be under the Preventive rm of the SGP in 2023.

Box I: Making the domestic fiscal rules more relevant

Ireland's Domestic Budgetary Rule and the Debt Rule are outlined in the *Fiscal Responsibility Act, 2012* (FRA). These largely mirror EU requirements. However, the domestic rules could be made more relevant to Ireland's circumstances and better aligned to the original intentions of the framework.

Under the FRA, the following definition is given for the structural balance:

> "'annual structural balance of the general government', in relation to a year, means the general government deficit or general government surplus for the year, cyclically adjusted and net of one-off and temporary measures, expressed as a percentage of gross domestic product at market prices"

Similarly, the definition for both (1) the debt ratio under the Debt Rule, (2) the lower limit of the Medium-term budgetary objective, are also expressed as a percent of GDP.

However, 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 globalisation activities of the multinational sector, GDP is not an appropriate measure of the size of Ireland's domestic economy (see, amongst others, Fiscal Council (2016b; 2016c; 2017b)).[80]

This was exacerbated in 2015, when real GDP grew by approximately 25 per cent, largely due to the globalisation activities of a few large multinationals. As a result, the CSO developed a new measure of domestic economic activity, modified Gross National Income (GNI*), that strips out many of the components that distort the GDP figures.[81]

This implies that GDP-based rules do not align well to Ireland's situation. By overstating national income, the overstate the size of the tax base. Dividing deficits and debt by GDP means that these ratios are lower than for other countries relative to the true level of national

[78]For further details, see Article 3(4) of Regulation (EC) 1467/97: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:01997R1467-20111213&from=EN.

[79] Indeed, the European Commission's Autumn 2020 forecasts show the same.

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

[81] GNI* is constructed by taking gross national income (GNI) and adjusting for the factor income of redomiciled companies, the depreciation of R&D service imports and Intellectual Property trade, and the depreciation on aircraft leasing.

income. For instance, a deficit of 3 per cent of GDP in 2019 would equate to €10.7 billion, or 5 per cent of GNI*. Similarly, a debt ratio of 60 per cent of GDP in 2019, would equal a debt ratio of 100 per cent of GNI*. This implies that the rules are significantly laxer than intended.

The Council assesses that a more appropriate basis for defining the variables in the FRA would be to define them in terms of GNI* rather than GDP GNI* is now well-accepted and widely used in Ireland. However, putting the FRA on a sounder economic footing, by using GNI* instead of GDP, will require legislative changes to the FRA. Making this change would ensure that the rules are fully relevant for Ireland and based on the most relevant economic measures.

4.6 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 framework requires that, at least once every financial year, the government sets expenditure ceilings for the following three years. The framework requires that ceilings be set for overall expenditure and for ministerial departments.

Typically, these expenditure ceilings are set on Budget Day. However, only expenditure ceilings for 2021 were set out in the Expenditure Report on budget day, instead of the required ceilings for 2021–2023. The Department initially cited the uncertainty surrounding the Covid-19 pandemic and Brexit as a reason for not providing expenditure ceilings for 2022–2023. After the Council highlighted the legal requirement for these ceilings, the Department then indicated that these would be provide in the Revised Estimates for 2021, published in December.[82]

[82] The overall medium-term expenditure ceilings and total ministerial expenditure ceilings for years *t+2* and *t+3* have never before been included in the Revised Estimates.