# Fiscal Rules

## Exceptional circumstances continue

# 4. FISCAL RULES

## Exceptional circumstances continue

Due to the ongoing public health and economic crisis, the "exceptional circumstances" clause continues to apply in the domestic fiscal and EU rules. This allows for deviation from the requirements under both the domestic and EU fiscal rules for the years 2020-2021. Table 4.1 shows a summary of the Council's recent assessments, based on the Council's principles-based approach to the fiscal rules.[67]

**Table 4.1: The Council's assessment of compliance with the Domestic Budgetary Rule**

| | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|
| Spending Rule | Breach | Significant Deviation | Compliant | Exceptional Circumstances |
| Structural Balance Rule | Compliant | Compliant | Compliant | |
| Overall Assessment | Compliant | Compliant | Compliant | |

Sources: Fiscal Council workings.
Note: The structural balance rule requires that the structural balance be above the medium-term budgetary objective (MTO) (set at minus 0.5 per cent of GDP for 2016-2019) or moving towards the MTO at an adequate pace. The spending rule requires that net government expenditure be below the average medium-term potential growth rate of the economy (the Expenditure Benchmark). Significant Deviation means that the limit for the corresponding rule was exceed by more than 0.5 per cent of GNI* for the spending rule, or 0.5 per cent of GDP for the structural balance rule. Breach means the limit for the corresponding rule was exceeded by less than 0.5 per cent of GDP or 0.5 per cent of GNI*.

The Council assessed in its May 2020 *Fiscal Assessment Report* that "exceptional circumstances" existed for 2020. "Exceptional circumstances" is a provision included in the Fiscal Responsibility Act, 2012, that allows for a temporary deviation from the requirements set out under Ireland's Domestic Budgetary Rule. The Council's assessment was made in light of the ongoing Covid-19 pandemic, and the effect it has had on the economy and the public finances. Subsequently, the Council assesses that exceptional circumstances continue to exist in 2021.[68] This will allow the government to provide the appropriate fiscal response to the continuing Covid-19 crisis.

Separately, in March 2020 the European Commission activated the general escape clause in the *Stability and Growth Pact* (SGP), which allows for temporary deviation from the EU fiscal rules. The European Commission has

[67] See supporting information section S13 for further details on the Council's principles-based approach.

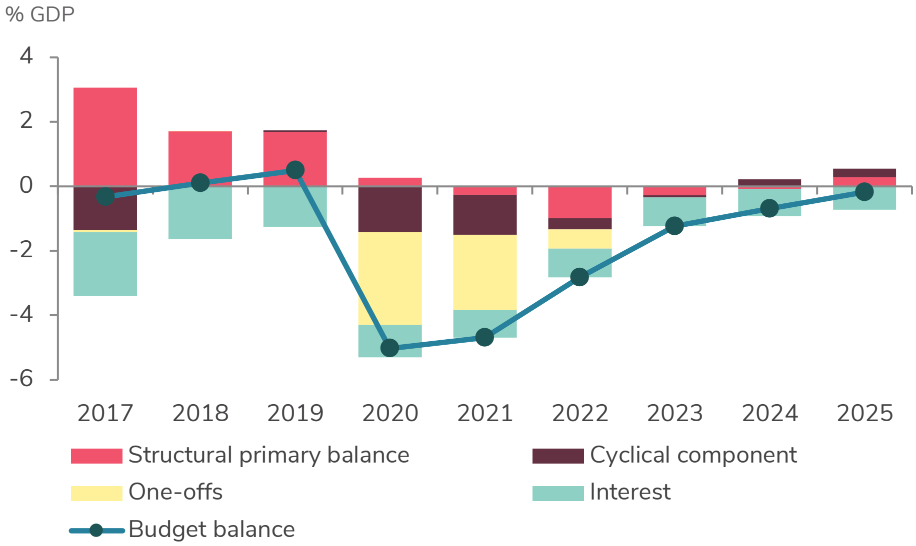
[68] The Council has not yet made a determination as to whether exceptional circumstances will continue to exist in 2022.

indicated that the general escape clause is likely to be in place until the end of 2022.[69]

For 2020, the Council assesses that, due to exceptional circumstances, the budgetary rule was not complied with. Ireland's deficit-to-GDP ratio, of 5 per cent, was above the 3 per cent reference value in the *Stability and Growth Pact*. The medium-term budgetary objective (MTO) of a structural deficit no greater than 0.5 per cent of GDP was not met. Ireland's structural deficit was 0.7 per cent of GDP in 2020. However, the Council assesses that the failure to comply with the budgetary rule in 2020 was only due to exceptional circumstances and that the failure to comply with the budgetary rule in 2020 does not endanger medium-term fiscal sustainability.[70] The debt-to-GDP ratio increased by 2.2 percentage points, to 59.5 per cent, but remained below the 60 per cent of GDP reference value in the *SGP*.

**The domestic Budgetary Rule was not met in 2020, due to exceptional circumstances.**

**Figure 4.1: The Department forecasts a small underlying deficit**




Sources: CSO; Department of Finance; and Fiscal Council workings.
Note: The cyclical budget component is calculated as 0.588 times the Department's preferred GDP-based output gap estimates. Get the data.

[69] However, a final determination by the European Commission, as to whether the general escape clause will be in place in 2022 has not yet been made. The Commission has outlined that the key criteria for deciding whether the general escape clause will no longer be in place is whether EU-wide GDP is above end-2019 levels. Based on the Commission Winter 2021 forecasts GDP is expected to be above end-2019 levels by the middle of 2022. As such, the Commission has indicated that the general escape clause will likely be in place into 2022, but a final decision will be made after the Commission's spring forecasts. See *Communication from the Commission to the Council: One year since the outbreak of Covid-19*, 3 March, 2021: https://ec.europa.eu/info/sites/info/files/economy-finance/1_en_act_part1_v9.pdf.

[70] This assessment is contingent on the Covid-19 related expenditure proving to be temporary and on the forecast recovery for the economy.

Over the medium-term Ireland's deficit will close, with the deficit-to-GDP ratio forecast to fall below 3 per cent by 2022 (Figure 4.1). With Ireland's deficit-to-GDP ratio forecast to be below 3 per cent by 2022, it is likely that Ireland will be subject to the preventive arm of the *SGP* in 2023. While there is ongoing discussion around the future of the EU fiscal rules, the current requirement for 2023 under the preventive-arm of the *SGP* would be an improvement in the structural balance of 0.5 per cent of GDP based on the *SPU* forecasts. While estimates of the structural balance are subject to considerable uncertainty at this time (see Box I), based on *SPU* forecasts the structural balance is set to improve by 0.7 per cent of GDP in 2023, exceeding what would be required (Table S13.1). However, this is based on expenditure figures that may not fully incorporate Stand-Still costs (see Section 2).

For further information on the Council's assessment of the fiscal rules see Supporting Information S13.

## 4.1 Medium-term Expenditure Framework

**Expenditure ceilings are not working. They are not set to control spending and ignore demographics, price, and pay increases.**

Every year, under the medium-term expenditure framework, the Government is required by law to set expenditure ceilings for the following three financial years.[71] Ceilings are required to be set for overall expenditure and for each department. This framework was introduced in 2013 in order to provide a better mechanism for controlling spending over the medium-term and to ensure the Expenditure Benchmark is complied with.

However, while the Government has, in the past, complied with the letter of the law, it has not complied with the spirit of the law. It has become clear in recent years that these ceilings are set, not with a view to controlling spending by putting in place realistic ceilings, but instead merely to comply with legal requirements. That is, departmental ceilings are often set so as to be constant in nominal terms over the subsequent three years. This provides no realistic control of spending as these do not even factor in price increases or increases in public sector pay.

The Council has also asked the Department, on several occasions, for the current and capital expenditure ceilings for each department, for 2022-2023, that were set in 2020. However, at the time of writing, the Department has not provided these.

For further information on the government expenditure ceilings see Supporting Information S14.

[71] This reform was introduced in the Minsters and Secretaries (Amendment) Act 2013. Once set, the Minister is required to present the ceilings to Dáil Éireann.