Fiscal Rules

Exceptional circumstances set to end

4 Fiscal Rules

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In this section, the Council assesses whether the budgetary forecasts published in *Budget 2024* comply with Ireland's Domestic Budgetary Rule, as set out in the Fiscal Responsibility Act 2012 (FRA), and the EU fiscal rules, as set out in the Stability and Growth Pact (SGP). In addition, the Council assesses compliance with the National Spending Rule. However, this rule lacks a statutory footing.

The "exceptional circumstances" and general escape clauses of the domestic and EU fiscal rules were activated at the onset of Covid-19 in 2020. They have remained in effect into 2023, allowing Ireland to temporarily depart from the requirements under both the domestic and EU fiscal rules during this time.[48]

However, the Council assesses that "exceptional circumstances" will no longer apply as of 2024. Furthermore, the European Commission (2023a) has confirmed that the general escape clause will be deactivated at the end of 2023.[49] It noted that the European economy has recovered beyond its pre-pandemic level and navigated the acute phase of the energy price shock caused by Russia's invasion of Ukraine. However, uncertainty remains high.

The Council has a mandate to monitor and assess compliance with the Domestic Budgetary Rule on at least an annual basis. Legal compliance with the fiscal rules continues to be assessed against GDP. However, GDP-based measures do not give an accurate picture of Ireland's fiscal position.

The Council has previously assessed broad compliance with the Domestic Budgetary Rule (N°66).[50]

[48] For an overview of these dispensations, see Box K from the *May 2020 Fiscal Assessment Report*.

[49] The Commission's Fiscal policy guidance for 2024 discusses the ending of the general escape clause in more detail.

[50] Ireland's Domestic Budgetary Rule was set requires that the general government budgetary position be in balance or in surplus, or on an appropriate path to meet this condition. In practice, the Budgetary Rule is deemed to be achieved if the structural balance meets a specified structural balance target, the so-called medium-term objective (MTO), or is on an appropriate path towards it. Compliance is assessed using the Council's principles-based approach to the Domestic Budgetary Rule. For further information see Table 8 in the supporting information section.

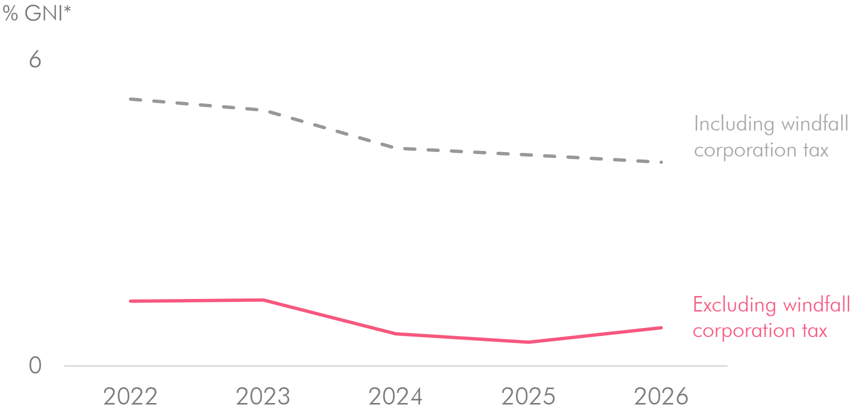
Nº66 **Exceptional circumstances in place since 2020**

	2017	2018	2019	2020-2023
Expenditure Benchmark	Breach	Significant breach	Compliant	Exceptional Circumstances
Structural Balance Rule	Compliant	Compliant	Compliant	
Overall Assessment	Compliant	Compliant	Compliant	

Source: Fiscal Council workings.
Notes: The structural balance rule requires that the structural balance be above the medium-term budgetary objective (MTO) (set at minus 0.5% of GDP for 2016–2019) or moving towards the MTO at an adequate pace. The Expenditure Benchmark requires that the net government expenditure be below the average medium-term potential growth rate of the economy. Significant deviation means that the limit for the corresponding rule was exceeded by more than 0.5% of GNI* for the Expenditure Benchmark, or 0.5% of GDP for the structural balance rule. A "breach" means that the limit for the corresponding rule was exceeded by less than 0.5% of GNI* or 0.5% of GDP. From 2024, the Expenditure Benchmark will be replaced by a maximum growth rate of net primary expenditure (Box J).

The structural balance is projected to be in surplus in 2023 and in subsequent years. However, windfall corporation tax revenues continue to flatter Ireland's budgetary position. But even when these excess revenues are excluded, the structural balance is expected to remain in surplus for the remainder of the forecast horizon. Figure Nº67 shows these surpluses as a share of GNI*, a more appropriate measure for the Irish economy.

Nº67 **Structural balance in surplus with or without windfalls**



Sources: Department of Finance and Fiscal Council workings. Get the data.
Note: The structural balance is measured on a top-down basis using the Council's estimates of one-off items together with the Department of Finance's alternative estimates for the output gap, its GNI* forecasts, and its estimates of windfall corporation tax receipts.

Ireland's debt-to-GDP ratio is projected to stand at 41.4% by year-end 2023 and decline each year for the remainder of the forecast horizon. In 2026, the debt-to-GDP ratio is expected to be 33.3%.[51] These forecasts are well below the 60% limit imposed by the Stability and Growth Pact.

Therefore, Ireland would be on track to comply with domestic and EU fiscal rules, assuming these rules are reinstated in their current form in 2024. However, in

[51] The Council advocates using GNI* as a more appropriate benchmark for assessing Ireland's fiscal position. Ireland's debt-to-GNI* ratio is forecast to be 79% at the end of 2023 and fall to 65% by the end of 2026.

April, the Commission tabled legislative proposals to reform the EU's fiscal framework from 2024. At the time of writing, no agreement has yet been reached on these potential reforms. Discussions remain ongoing at an EU level, with a view to coming to an agreement on the reforms by year-end 2023 (Box J).

Supporting Information Section S.5 provides a full overview of compliance with the fiscal rules based on the Council's principles-based approach.

Ireland's medium-term expenditure framework

Ireland's Medium-term Expenditure Framework was established in 2013 as part of an extensive package of budgetary reform measures. Its purpose is to encourage Governments to plan further ahead than they had previously tended to do. Rather than concentrate solely on the next year, the framework seeks to adopt a more forward-looking approach, with a strong emphasis on realistic medium-term planning.

The framework legally requires the Government to set ceilings for how much each department will spend annually over the next three years. However, for the fourth year in a row, the Government failed to publish these spending ceilings on Budget Day. Instead, it seems likely that they will again be released in December. The repeated failure to fix these expenditure ceilings as part of the budgetary process implies that they are set, not with a view to imposing credible spending controls, but as a separate box-ticking exercise to meet legal requirements.

Furthermore, the medium-term estimates produced by the Department of Public Expenditure and Reform for individual department ceilings have tended to be highly unrealistic in recent years. In many areas, including health, they ignore demographic, price, and wage pressures and assume essentially constant levels of current spending in nominal terms. The Department leave large unallocated amounts that are then allocated where needed at a later stage. This approach to applying the ceilings undermines their credibility and is a backwards step in terms of transparency and the overall functioning of the fiscal framework.

The National Spending Rule

The National Spending Rule aims to limit core spending growth to 5% each year, in line with the estimated trend growth rate of the Irish economy.[52] The rule seeks to anchor core expenditure growth over the medium term.

The rule is not legally binding; it does not have a statutory footing. However, the Council considers it useful to assess the rule given its importance as a tool to help

[52] This trend growth rate is the sum of the Department of Finance's preferred estimates for medium-term potential output growth of 3% and steady-state price inflation of 2%. Sticking to the 5% path implies a broadly sustainable pace of expenditure growth, given revenues typically grow at this rate.

ensure the public finances are managed sustainably. Its importance is magnified by the fact that the EU rules are likely to prove less binding for Ireland in future, since GDP remains their main metric of reference (Casey and Cronin, 2023).

The Council assesses compliance with the rule on a net basis. That is, a rise in core net spending is offset by tax-raising measures but is added to by tax cuts.[53] This approach is in line with the Government's description of the rule (Department of Finance, *SPU 2023*, p. 30).

Budget 2024 continues a pattern in which the Department's forecasts lack transparency. Once again, no assessment of core spending is provided that adjusts for tax measures. In addition, the Department makes no reference to the original ceilings for core spending first set out in *Budget 2022*. This is bad for transparency and further highlights the need to strengthen the fiscal framework.

In *SPU 2023*, the Government revised up its ceiling for 2023, taking spending to a level beyond what would be implied by a 5% growth path. This decision was made to allow spending to adapt to high levels of inflation. *Budget 2024* goes further again and takes core net spending to an even higher level in 2023.

Nº68

Government plans breach the 5% limit in 2024 and 2025

€ billions

	2021	2022	2023	2024	2025	2026
Core net spending assessment (% year-on-year growth)						
5% limit		5.0	5.0	5.0	5.0	5.0
Budget 2024		5.4	7.0	5.8	5.1	4.9
Cumulative assessment						
5% path	75.9	79.7	83.7	87.9	92.2	96.9
Budget 2024	75.9	80.0	85.7	90.7	95.4	100.2
What goes into the Budget 2024 cumulative assessment?						
Total spending		88.8	93.4	96.6	96.9	102.0
less one-offs *		8.8	7.2	5.1	0.4	0.2
Core spending		80.0	86.2	91.5	96.5	101.8
less revenue measures (net)		0.0	0.5	0.3	0.3	0.5
Core net spending		80.0	85.7	90.7	95.4	100.2

Sources: Department of Finance and Fiscal Council workings.
*One-offs for this assessment assume all Covid-19 expenditure, Ukrainian supports, cost of living measures, and other expenditure, such as EU-funded spending for the Brexit Adjustment Reserve and the National Recovery and Resilience Plan are one off, as well as other provisions such as the Temporary Business Energy Support Scheme (TBESS).
Notes: Core net spending refers to core spending, adjusted for the impact of tax measures, and includes the expected yields arising from the non-indexation of the income tax system. Revenue-raising measures (such as tax increases) can be used to offset bigger spending increases, whereas revenue-reducing measures (such as tax cuts) would lower the scope for spending increases. Estimates of revenue-reducing and revenue-raising measures are those judged by the Fiscal Council.

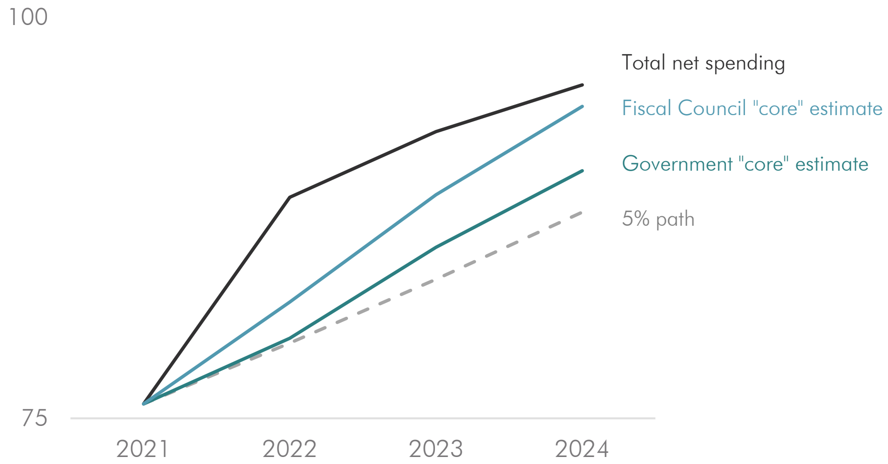
[53] These include the expected yields that would be raised from not indexing the income tax system.

The Government now intends to breach the National Spending Rule in 2024 and 2025 (N°68). Compared to *SPU 2023*, additional capital spending, labelled "windfall capital investment" has been introduced.[54] In addition, current spending plans were revised up, as were cuts to income tax. The pace of the core net spending increase is currently projected at 5.8% for 2024 and 5.1% for 2025. Core net spending is expected to grow 4.9% in 2026, within the 5% limit.

Cumulatively, the breaches of the National Spending Rule are substantial. The Government's estimate for core net spending is €2.6 billion above what a 5% path would imply in 2024 (N°69).

Nº69 **Different estimates for net spending exceed the 5% path**

€ billions



Sources: Department of Finance and Fiscal Council workings. Get the data.
Notes: The 5% path takes the total spending allocated for 2021 and grows it by 5% each year. The Government "core" estimate includes all core spending, adjusted for the net impact of new tax measures. The Fiscal Council "core" estimate begins with the Government "core" estimate but also factors in additional spending measures. These include the portion of Covid spending likely to be permanent, all spending related to supporting Ukrainian refugees, and windfall capital investment. "Total net spending" equals gross voted expenditure, adjusted for the net impact of new tax measures. Estimates of the net impact of new revenue measures are those judged relevant by the Fiscal Council.

However, there are a large number of measures which the Government classifies as temporary. Adding all these on would take total net spending to a far higher level. Total net spending includes all expenditure treated as "core" by the Government, as well as all expenditures related to Covid-19, Ukrainian supports, windfall capital investment and cost of living measures. Total net spending is forecast to reach €95.8 billion in 2024, €7.9 billion above a hypothetical 5% path from 2021.

Ultimately, the truth probably lies somewhere in between. The Council's own assessment of core net spending begins with the Government's estimate for core

[54] The Council treats the additional capital spending termed "windfall capital investment" as core spending. This is because this extra spending is included in the Department's spending forecasts each year from 2024 to 2026, and it rises over time. See Box D on fiscal gimmickry for more details.

expenditure. It then adds on all spending related to supporting Ukrainian refugees and the share of Covid-related spending likely to continue indefinitely.[55] It also includes windfall capital investment (N°70). This Council estimate for net spending is €6.6 billion (7.5%) above what a 5% path would imply in 2024.

Nº70 **Walk to total net spending**

€ billions

	2022	2023	2024
Government "core" estimate	80.0	85.7	90.4
add potentially permanent Covid spending *	1.3	1.3	1.3
add Ukrainian supports	1.0	2.0	2.5
add windfall capital investment			0.3
Fiscal Council "core" estimate	82.3	88.9	94.5
add temporary Covid spending	3.2	0.2	
add other **	3.3	3.7	1.3
Total net spending	88.8	92.9	95.8

Sources: Department of Finance, Fiscal Council workings.
*Some amount of Covid-19 related expenditure is likely to become permanent or "core" spending. *Budget 2024* allocates €1.3 billion for Covid-related expenditure for 2024. The Fiscal Council "core" estimate considers this to be permanent spending and, therefore, treats it as "core" in 2024. The Council's estimate also retrospectively treats €1.3 billion of the Covid-related spending in 2022 and 2023 as "core" too, given it has transpired to be long-lasting. **Other here includes all expenditures related to the cost of living measures, as well as EU-funded spending for the Brexit Adjustment Reserve and the National Recovery and Resilience Plan, and other provisions such as the Temporary Business Energy Support Scheme (TBESS).

The latest developments towards EU fiscal rules reform

In April, the European Commission (2023b) published a package of legislative proposals to reform the EU fiscal rules. Box J provides an update on how talks among Member States are progressing.

Pending an agreement on the reforms, the existing rules will be reinstated, albeit with some new features. A maximum growth rate in nationally financed net primary spending will now form the operational part of the rules.

Regardless of the outcome of the discussions, Ireland appears set to face less scrutiny under the new rules. In particular, the new rules look set to be underpinned by GDP-based measures, where distortions help to achieve compliance. A more appropriate assessment on a GNI* basis and reflecting excess corporation tax would signal greater risks (Casey and Cronin, 2023). The Council assesses that the National Spending Rule should be further developed as a "first line of defence" to ensure sound management of the economy and public finances at home.

[55] *Budget 2024* allocates €1.3 billion for non-core Covid-related expenditure in 2024. The Fiscal Council "core" estimate regards this as permanent. Moreover, the Council estimate also treats €1.3 billion of the Covid-related spending in 2022 and 2023 as core too, given it has transpired to be long-lasting.

Box J: The latest developments towards EU fiscal rules reform

In April 2023, the Commission (2023b) tabled legislative proposals to reform the EU fiscal rules. These build on the Commission's initial set of ideas from November last year (European Commission, 2022). They reflect discussions since then among EU Member States. We have previously discussed the outline of the new reforms in detail.[56] Here, we take a look at the latest state of play.

Agreement progressing but hangs on "safeguards"

At the time of writing, Member States have yet to reach an agreement on the Commission's proposed reforms. Most of the discussions have centred on what are labelled "numerical safeguards". Some Member States are seeking minimum requirements for debt and deficit adjustments that would apply regardless of a country's debt risks. They argue that medium-term country-specific fiscal plans could lack sufficient ambition and give countries too much fiscal leeway. However, other Member States regard the addition of these numerical requirements on top of the risk-based assessment as being too onerous. They argue these requirements would undermine a key tenet of the reforms, which is to tailor a country's fiscal adjustment path to its debt risks.

Member States are continuing to explore a potential compromise. It is hoped that an agreement will be reached by both the European Council and the European Parliament by year-end 2023, given parliamentary elections will take place in June 2024. Such an agreement would allow the new rules to come into effect in early 2024.

In the meantime, the rules will apply a mix of old and new elements

Pending an agreement on the reforms, the current rules still apply. The general escape clause will be deactivated at the end of 2023. As a result, the Commission has set country-specific recommendations for fiscal policies as part of its guidance for 2024.

The Commission's current guidance includes elements of both the new and old fiscal frameworks. For example, the structural balance rule remains in place for now. It sets a minimum annual requirement for the structural balance — the budget balance adjusted for the cycle and one-offs. Such a rule would be eliminated under the new proposals.

However, some parts of the latest proposals are incorporated in the guidance for 2024. The guidance focuses on a maximum growth rate for nationally financed net primary expenditure.[57] This spending limit is broadly consistent with the relevant Member State achieving its required improvement in the structural balance in 2024. In addition, these spending ceilings take account of a country's medium-term debt sustainability challenges.

Ireland will face little scrutiny under the EU fiscal rules in 2024

Some Member States, such as Ireland, are expected to achieve their medium-term objective in 2023.[58] Therefore, there is no guidance on a fiscal adjustment, although the Commission will continue to note the growth in nationally financed net primary expenditure.

All other Member States are expected to ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024. This would cap net spending increases at a slower rate than might otherwise be considered sustainable.[59]

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[56] Box F of the *June 2023 Fiscal Assessment Report* explored these proposals in greater detail.

[57] Nationally financed net primary expenditure is defined as general government expenditure excluding interest, one-offs, EU-funded spending, and temporary spending on unemployment related to the cycle. It adjusts for the net impact of tax measures; tax-raising measures would allow for larger spending increases, whereas tax cuts would reduce the scope for spending increases. Unlike the Expenditure Benchmark it replaces under the current guidance, it does not smooth out investment costs over a four-year period.

[58] In its assessment of *SPU 2023*, the Commission forecast Ireland's structural deficit to be -0.1% of GDP in 2023 (European Commission, 2023c). Ireland's medium-term objective is set as a structural deficit of no more than -0.5% of GDP for 2023. Consequently, Ireland is expected to comply with the structural balance rule in 2023, given its structural balance is expected to be greater than the medium-term objective.

[59] In this instance, sustainable means in line with usual — or "potential" — economic growth, and, by extension, revenue growth.