FFS

# Reflections on Ireland’s Fiscal Framework


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A TRADITION OF INDEPENDENT THINKING

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# Outline

**1 Ireland's Fiscal Framework**
- Whistle Stop Tour, 1922-1992
- Maastricht Treaty, SGP 1.0 and SGP 2.0
- SGP 3.0: Six-Pack, Fiscal Compact and Two-Pack
- Fiscal Responsibility Act (2012)

**2 Fiscal Advisory Council**
- Assessment of Fiscal Stance
- Endorsement of Macroeconomic Projections
- Budget Recommendations 2017-2019
- Operation of the Fiscal Council
  - Media, Oireachtas, FOI, C&AG, Budget

**3 Possible Changes**
- SGP 4.0
- Costings

**4 Conclusion**

# Fiscal Policy in Ireland

The first five decades of fiscal policy after Independence are typically characterised by:

- a soft commitment to **match current expenditure with current revenue**,
- the explicit intention to **borrow limited to capital expenditure**,
- (with debt repayments to be notionally made via current expenditure to a "**sinking fund**").

The move to **active fiscal management** can be shown to have begun with the Autumn Financial Statement in October 1970.

# George Colley, October 1970

***Budgetary Policy***

"Up to now**, budgetary policy has aimed at balancing current expenditure and current revenue** rather than deliberately producing a surplus or a deficit."

"But the intense and growing inflation of recent years, and the extent to which money incomes have been racing ahead of national output, may make it necessary to reconsider our former attitude.

While, as I have already explained, a surplus could not now be achieved in 1970-71 without severely disrupting the economy, this does not rule out the possibility that **we shall in future aim at a surplus on current account in conditions of inflation or at a deficit when economic activity is depressed**."

# George Colley, April 1972

***Budgetary Policy***

“When introducing the supplementary budget in October, 1970, I indicated that,…, the Government would in future aim at a deficit when economic activity was depressed and at a surplus in conditions of inflation.”

“Faced with these competing requirements*, the Government have opted for growth rather than stability. The level of Government expenditure this year will, therefore, be determined by reference to our economic requirements and will not be cut back to the estimated yield of revenue.

There will not be any increases in taxation, and **the resultant deficit in the current budget will be financed mainly by borrowing.**”

(*high inflation and high unemployment)

# Sean T. O'Kelly, May 1944

"As Deputies will see by turning to the first of the tables issued in connection with the Financial Statement, the deficit for the year just closed worked out at £529,000…"

"It may be objected that **we are increasing expenditure without any serious increase in taxation**. This is exactly what is happening, and it should please the expansionists if it does not satisfy anyone else."

"These additions result in … the estimated deficit for the year 1944-45 to £3,375,000."

"…I think our financial structure is **capable of bearing the strain.** Not that I wish to see inaugurated here a policy of deficit economy which finds favour in some quarters."

# Active Fiscal Management

- The expansionary stance in 1972 may not have been appropriate but **expansions subsequent to the 1973 oil crisis** were.
- As the economy recovered significant **efforts to reduce the budget deficit** were introduced by Richie Ryan in 1976.
- Then came the general election of 1977 and the **manifesto promises of fiscal expansion** were unfortunately delivered on.
- This left Ireland vulnerable to recession, which came and was exacerbated by the need to **restore order to the public finances** (which took most of the 1980s)

# 1990s: Maastricht Criteria

**<u>Maastricht Treaty (1992): Article 104c</u>**

1 . Member States shall **avoid excessive government deficits**.

2. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to **identifying gross errors**. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria :

(a) whether the ratio of the planned or actual **government deficit** to gross domestic product **exceeds a reference value** unless…,

(b) whether the ratio of **government debt** to gross domestic product **exceeds a reference value**, unless…,.

# Protocol 12

**<u>Protocol on the Excessive Deficit Procedure</u>**

Article 1

The **reference values** referred to in Article 104c(2) of this Treaty are:

— **3%** for the ratio of the planned or actual government **deficit** to gross domestic product at market prices;

— **60%** for the ratio of government **debt** to gross domestic product at market prices.

# 1997: Stability and Growth Pact

- The ‘Corrective’ Arm: Regulation 1467/97
- The ‘Preventative’ Arm: Regulation 1466/97

**Article Two**
A stability programme shall present the following:
(a) the medium-term objective for the **budgetary position of close to balance or in surplus** and the adjustment path towards this objective for the general government surplus/deficit and the expected path of the general government debt ratio;

**Recital Four**
Whereas adherence to the medium-term objective of budgetary positions close to balance or in surplus will allow Member States to **deal with normal cyclical fluctuations** while keeping the government deficit within the 3% of GDP reference value ;

# 2005: SGP 2.0

Preventative Arm amended by Regulation 1055/05

**Article 2a**
Each Member State shall have a differentiated medium-term objective for its budgetary position.

These **country-specific medium-term budgetary objectives** may diverge from the requirement of a close to balance or in surplus position. They shall provide a safety margin with respect to the 3% of GDP government deficit ratio;

Taking these factors into account, … the country-specific medium-term budgetary objectives shall be specified within a defined range between –1% of GDP and **balance or surplus, in cyclically adjusted terms**, net of one-off and temporary measures.

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# Ireland's MTO

- "The underlying (structural) budget balance […] respects the terms of the Stability and Growth Pact, and is consistent with a medium-term objective of keeping the budget close to balance."

Ireland, Stability Programme Update, December 2005

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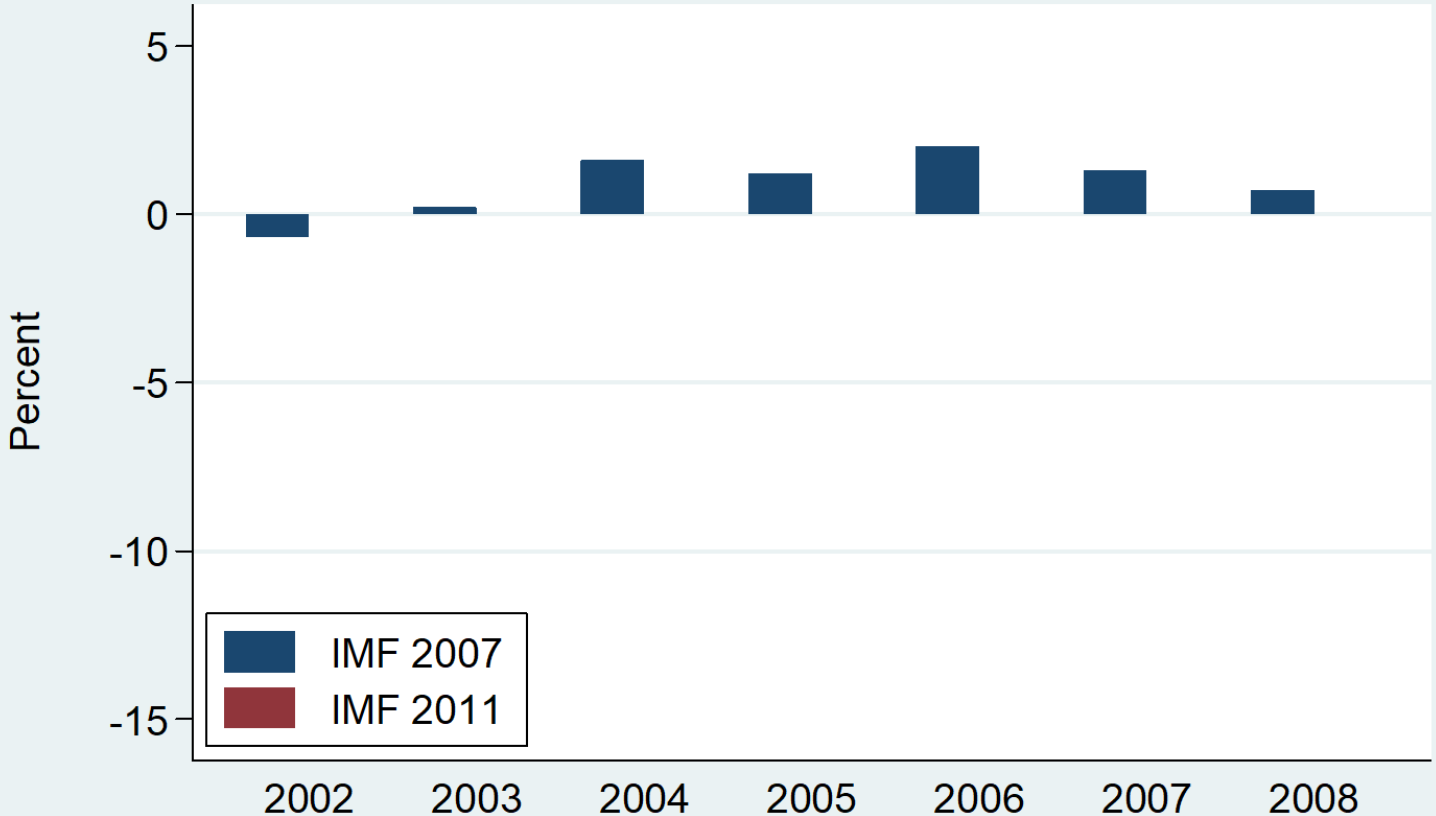
# Structural Balances

## Structural Budget Balance, % GDP




**Source:** IMF, World Economic Outlook

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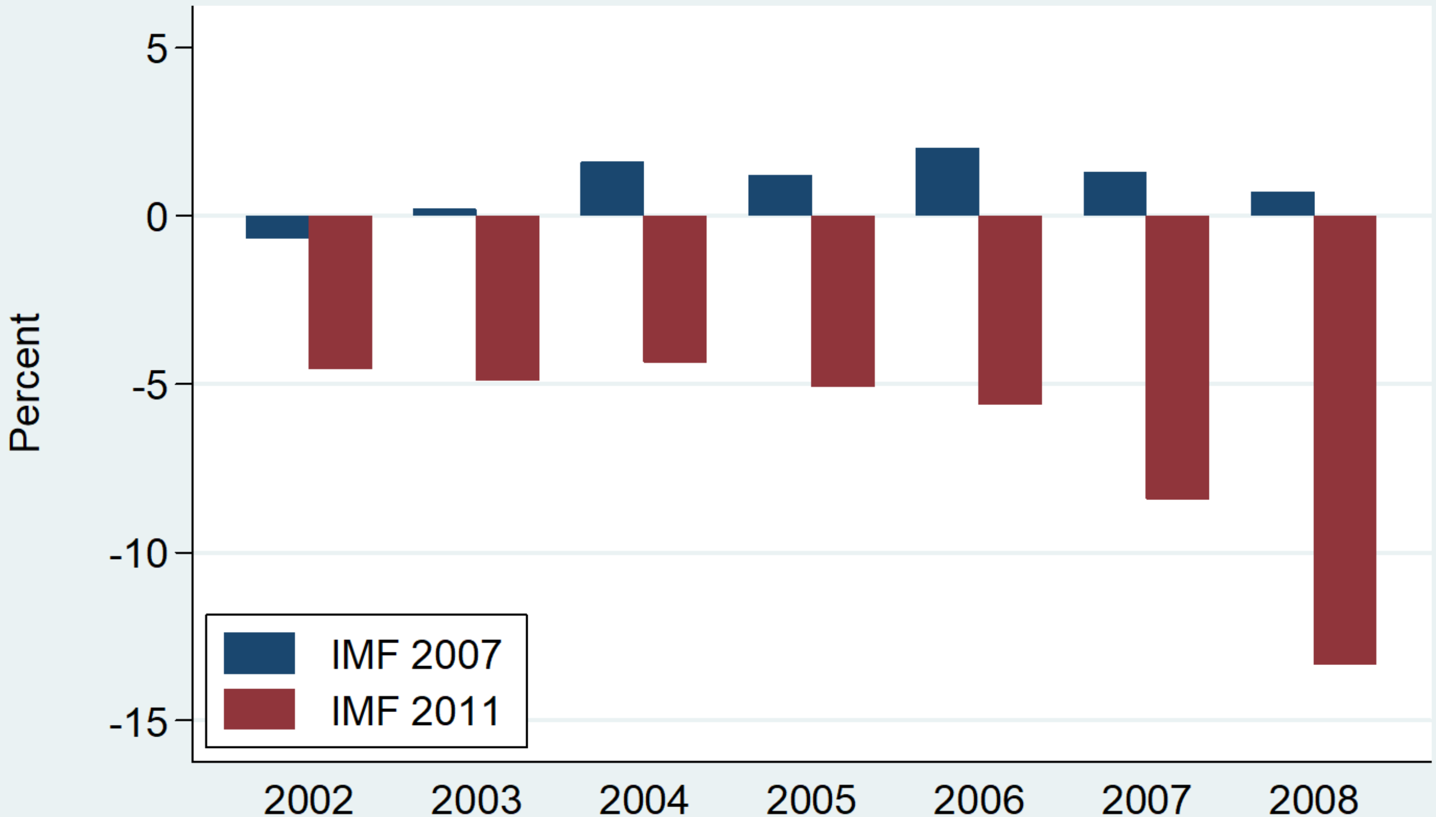


**Source:** IMF, World Economic Outlook

# 2011-13: SGP 3.0

**Six-Pack (2011)**
• One Directive & Five Regulations

Six-Pack Directive:
• Put (some of) the SGP fiscal rules into **national law.**

Six-Pack Regulations:
• **Increased monitoring** of balanced-budget rule and increased involvement with EDP countries to correct excessive deficits,
• Allow entry to EDP because of non-reducing debt ratio - **the 1/20th rule**,
• Establish **Macroeconomic Imbalance Procedure**,
• Introduce **Government Expenditure Rule**.

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# SGP 3.0

**Fiscal Compact (2012)**

- Part of the Treaty on Stability, Coordination and Governance
- Put (some of) the SGP rules on a **constitutional footing**.

**Two-Pack (2013, EMU)**

- Two regulations
- Further increased **monitoring and surveillance** of EDP and ‘Programme’ countries
- Establish **independent fiscal council**

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# Nov 2010: National Recovery Plan

Reformed arrangements will also include:

- a **Budget Advisory Council** to provide an independent commentary on the Government's budgetary planning, by means of assessing the appropriateness of the budgetary stance and aggregate budgetary targets being adopted; and,
- a **Fiscal Responsibility Law** to put key reform measures on a statutory basis and to ensure that the principle of keeping the public finances on a sustainable footing is binding in law.

# 2012: Fiscal Responsibility Act

**<u>Part Two: Section Three</u>**

(1) The **budgetary rule** is that for each year either—
(a) the budget condition, or
(b) the adjustment path condition is satisfied.

(2) The budget condition is that either—
(a) the budgetary position of the general government is **in balance or in surplus**, or
(b) [exceptional circumstances]

(3) The requirement in subsection (2)(a) shall be deemed to be respected if the **annual structural balance of the general government is at the medium-term budgetary objective**.

(4) The adjustment path condition is that...

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# Fiscal Responsibility Act

**<u>Section Four</u>**

When the ratio of **general government debt** to gross domestic product at market prices **exceeds 60 per cent**, the ratio **shall be reduced** in accordance with the 1997 excessive deficit Regulation until the ratio reaches 60 per cent.

# Definitions

“**annual structural balance of the general governme**nt”, 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;

“**fiscal stance**” means the change in the annual structural balance of the general government, excluding interest payments on the general government debt expressed as a percentage of gross domestic product at market prices, for a year relative to the preceding year;

# Fiscal Council

Part Four (as amended)

8.—(2) **The Fiscal Council** shall monitor, and at least once in each year **provide an assessment of**, whether any obligation under… [**the budgetary rule**]… is being complied with.

8.—(4) The Fiscal Council shall—

(*a*) **endorse**, as it considers appropriate, the macroeconomic forecasts prepared by the Department of Finance on which the Budget and stability programme will be based,

(*b*) provide an **assessment of the official forecasts**, and

(*c*) in relation to each Budget and stability programme, provide **an assessment of whether the fiscal stance** for the year or years concerned is, in the opinion of the Fiscal Council, **conducive to prudent economic and budgetary management**, including by reference to the provisions of the Stability and Growth Pact.

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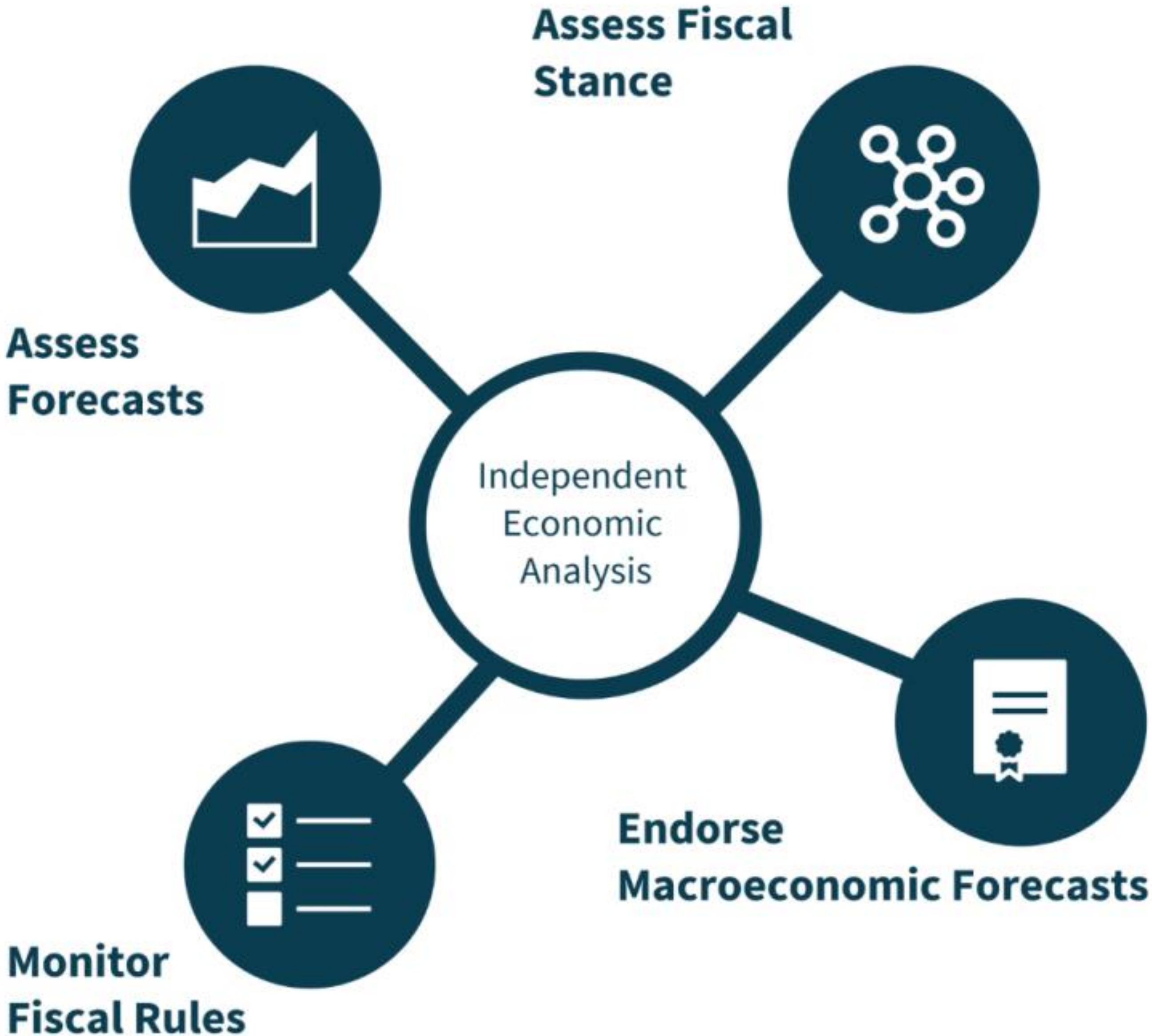


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# The Endorsement Function

• Largely takes place “behind closed doors”.
• The Council approves a set of internal *benchmark* forecasts in advance.*
• Most significant direct interaction between the Council and the Department of Finance.
• The process is set out in a Memorandum of Understanding.
• Can contribute to significant, if understated, changes, e.g. production and publication by the Department of alternative supply-side estimates of the economy.

*While not published at the time they are included in the subsequent Fiscal Assessment Report.

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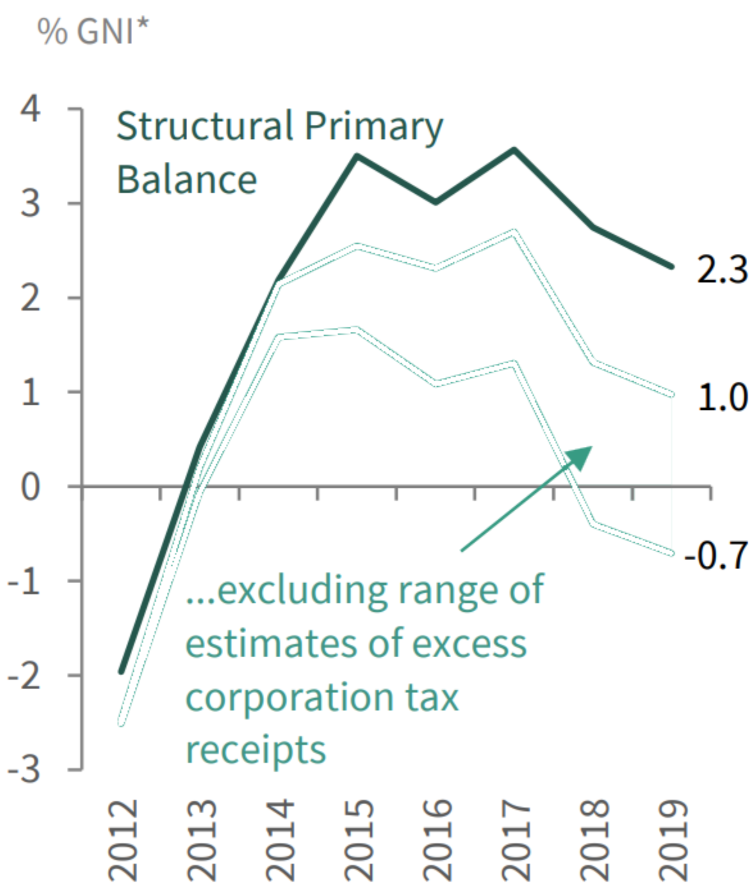
# Assessing the Fiscal Stance




Taking liberties?

- GNI* instead of GDP
- Based on DoF alternative estimates rather than CAM.
- Does ‘excess’ equal one-off or windfall?

Source: Fiscal Council, Fiscal Assessment Report, November 2019.

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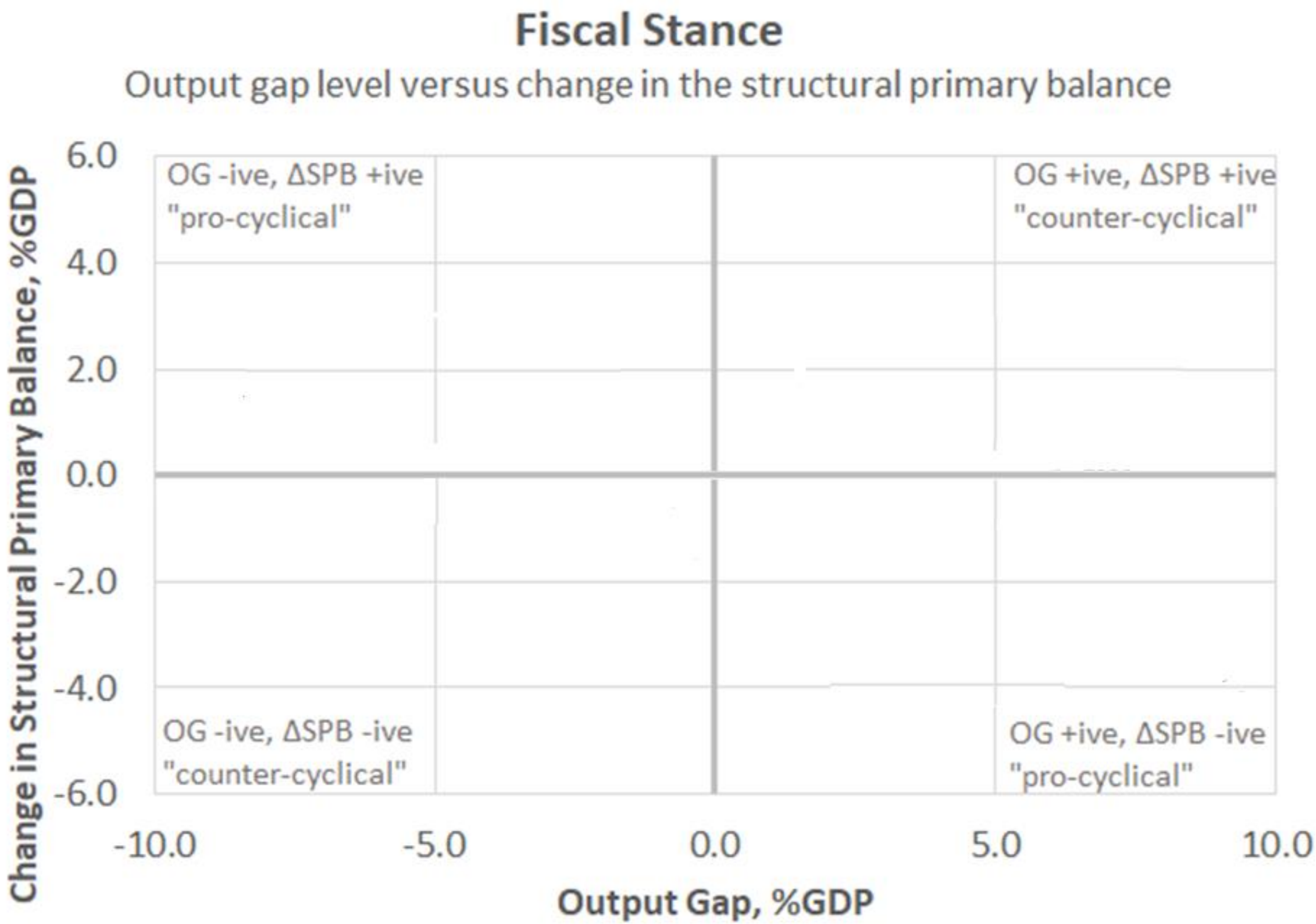


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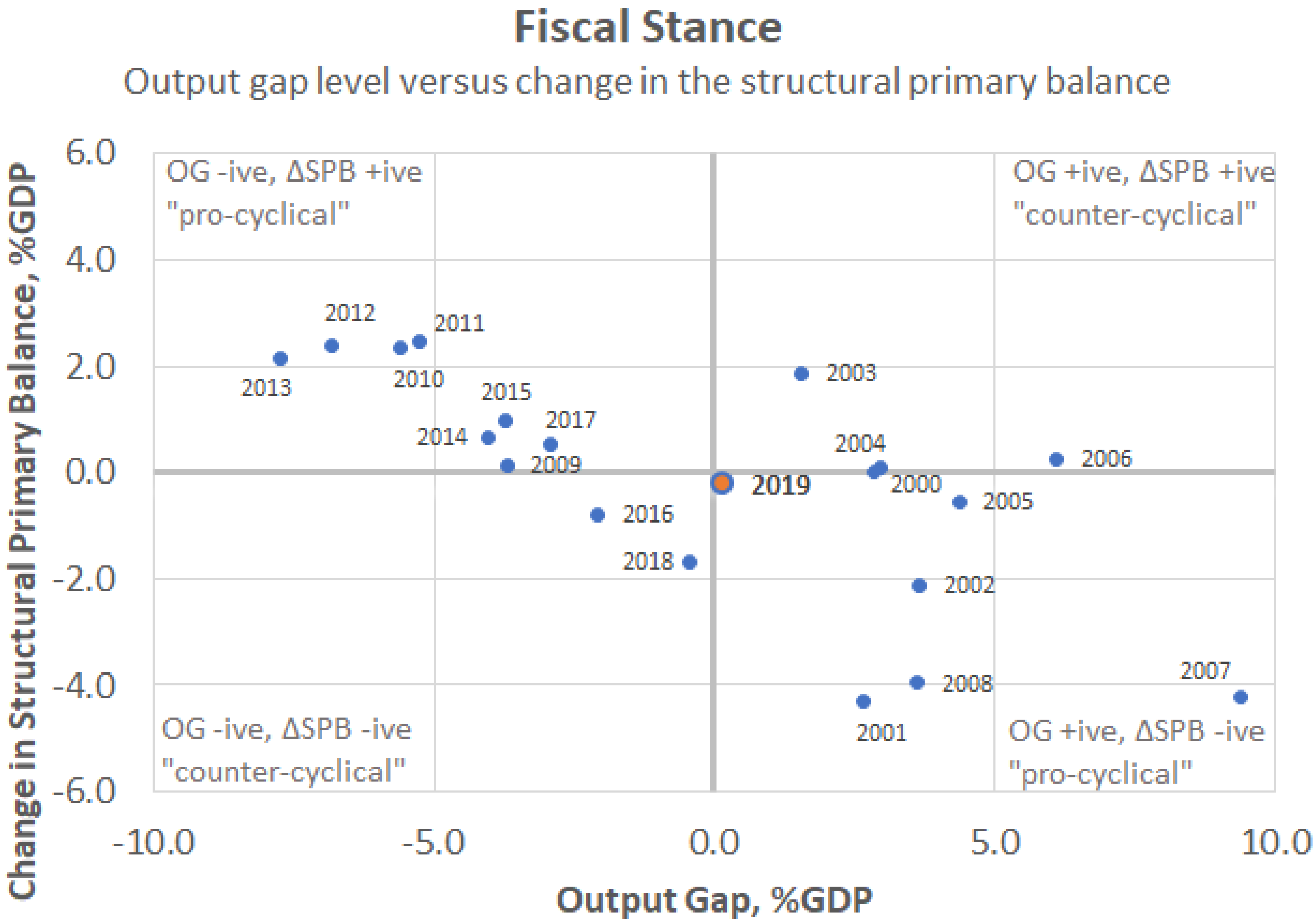


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# A rule for "good times"?

Sustainable Changes in *Policy Spending*

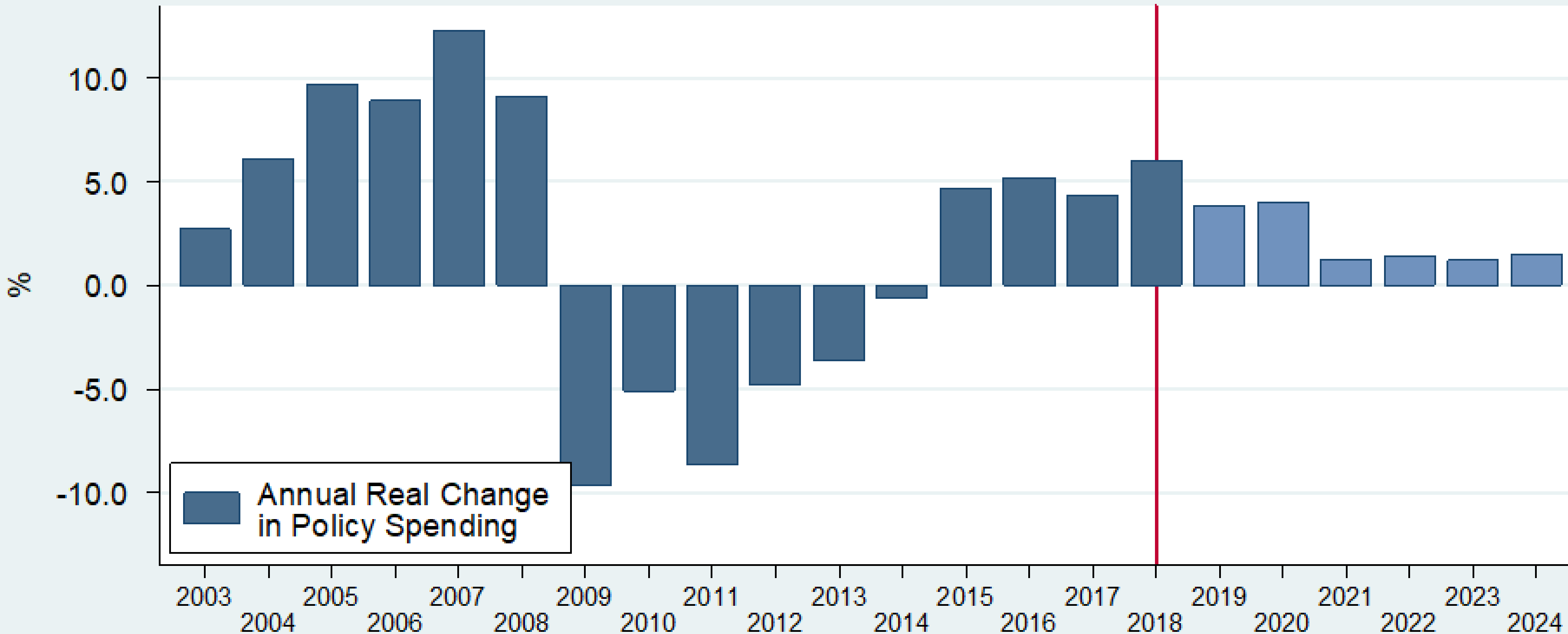
- Introduced in November 2018 FAR
- Similar to Expenditure Rule in the SGP

The increase in **real net policy spending** (expenditure and revenue spending are treated equally) should be limited to the sustainable growth rate of the economy. Faster rates of spending growth can be financed through additional taxes.

Adjustments are made for inflation, one-offs, interest, cyclical unemployment spending and non-indexation of the income tax system.

# Annual Real Change in Net Policy Spending

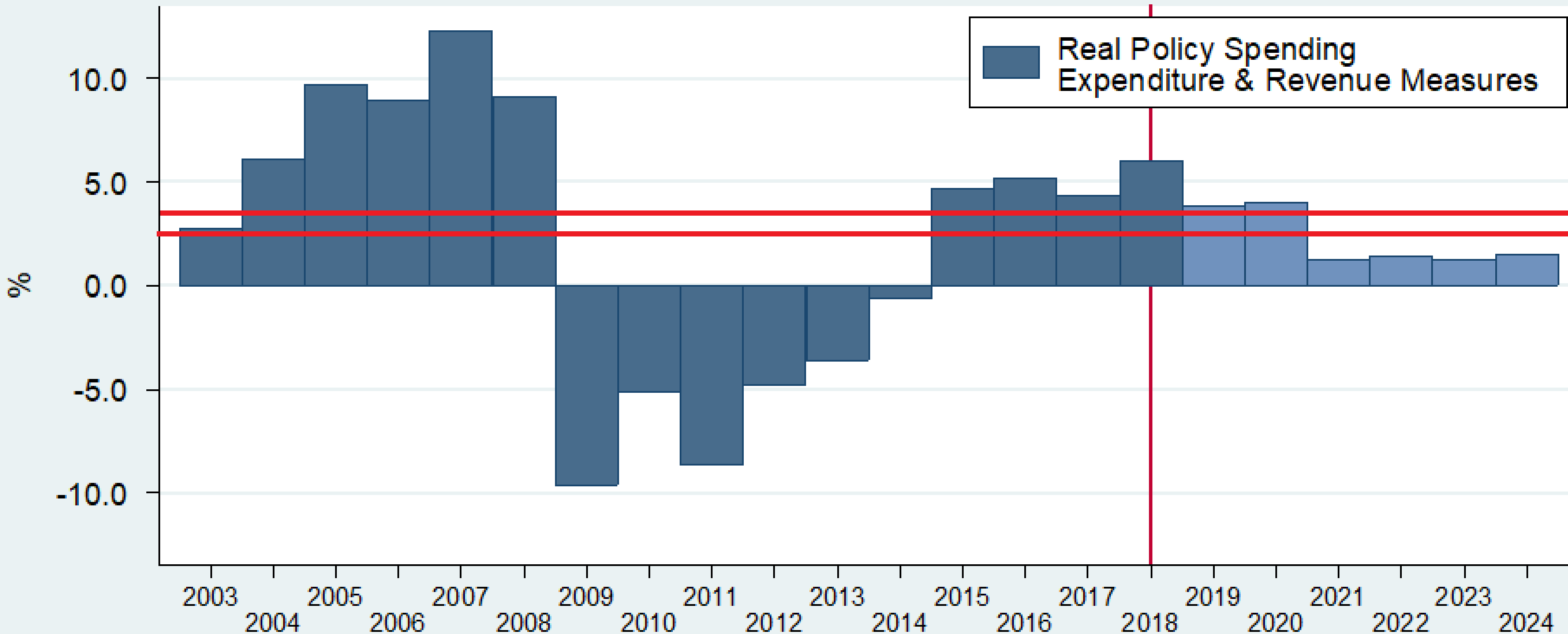
General Government Net Policy Spending, HICP Deflated, Year-on-Year Change, %




**Source:** Fiscal Council

## Annual Change in Real Net Policy Spending

General Government Net Policy Spending, HICP Deflated, Year-on-Year Change, %




**Source:** Fiscal Council

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# Budget Recommendations

Each September the Fiscal Council publishes a ***Pre-Budget Statement*** which sets out it what it considers "prudent" for October's Budget.

***Budget 2018:*** 'stick to existing spending and tax plans'

***Budget 2019:*** 'stick to its existing budget plans for 2019'

***Budget 2020:*** 'the Government should stick to its plans'

# Sticking to Plans?

Real Net Policy Spending by Publication

| Source | Date of Publication | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|
| **SPU** (DoF) | **April** of preceding year | 3.8 | 3.7 | 4.3 | 3.1 |
| **Budget** (DoF) | **October** of preceding year | 4.2 | 4.3 | 5.0 | 3.9 |
| **SPU** (DoF) | **April** of current year | 3.8 | 4.3 | 4.3 | |
| **Budget** (DoF) | **October** of current year | 5.3 | 5.8 | 3.8 | |
| **Outturn** (CSO) | **April** of following year | 4.6 | 6.7 | | |

# Council Criticisms

- In recent years criticisms of budgetary policy have largely been the result of the Government **failing to stick to its own near-term plans** rather than ignoring contradictory advice of the Fiscal Council (implausible medium-term plans have also been criticised).
- A major source of this failure to stick to plans has been **within-year spending increases**, most notably, but not limited to, health spending.
- In a significant improvement in *Budget 2020* the impact of overruns from 2019 was included in the Government's estimates of the size of the overall fiscal package.

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# Operation of the Council

- Media: Reporting and Commentating
- Oireachtas Committees
- The Council's Budget
- Freedom of Information
- The Comptroller and Auditor General

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# Media and Commentary

Newspaper reporting is generally favourable, and usually accurate.

Broadcast media generally include interviews when reports are published – usually one-to-one and non-confrontational.

Limited analysis in opinion and comment pieces with almost no negative commentary.

- Does anyone disagree with the approach of the Fiscal Council?

At least one person does…

# Fergus Finlay, Irish Examiner 18/06/2019

“Isn't the Fiscal Advisory Council a disgrace? A bunch of overpaid academics and economists, sitting in their ivory towers, twice a year telling the rest of us what to do, spreading gloom and doom.

If the budget is balanced (after years of trying), they sneer. If our debt burden looks to have fallen significantly, they tell us that’s because we’re using the wrong measures. If there’s any little bit of spare capacity in the economy, they want us to cut it out right now.

We’re the people who keep making mistakes, according to the council, not least in the belief that we like to vote for popular things. We give them a little more than €500,000 to tell us that twice a year.

It may not be exactly a case of biting the hand that feeds you, but it’s hard sometimes to escape the feeling that these “I know best” merchants are just a bit too self-righteous.”

# Budget of the Council

## Fiscal Responsibility Act: Schedule

Funding

9. (4) The sum referred to in subparagraph (2) is —

(a) for the year in which section 7(1) comes into operation, **€800,000**, and

(b) for each subsequent year, the sum which (whether by virtue of clause (a) or this clause) applies for the preceding year as adjusted by the annual percentage change in the **Harmonised Index of Consumer Prices** published by the Central Statistics Office in respect of the preceding year.

# Accounts and Audit

(2) Accounts kept under this paragraph and signed by the chairperson of the Fiscal Council **(who shall be the officer accountable** for such accounts for the purposes of the Comptroller and Auditor General Acts 1866 to 1998) shall be submitted as soon as is practicable (but not later than 3 months after the end of the accounting period to which they relate) to the Comptroller and Auditor General for audit.

(3) A copy of any accounts of the Fiscal Council **audited by the Comptroller and Auditor General** shall be given to the Minister as soon as reasonably practicable and the Minister shall lay a copy of them before each House of the Oireachtas.

(4) The Comptroller and Auditor General shall, together with the report on the Appropriation Accounts for each year, **make a report to Dáil Éireann** with respect to the correctness of the sums brought to account by the Fiscal Council under this paragraph in the year.

# Oireachtas Appearances

Typically **three appearances** before the Committee on Budget Oversight a year

- Following the publication of each FAR
- In the run-up to the Budget

Appearances are useful for restating the Council’s position through the opening statement (which is circulated) but the questioning by Committee Members **rarely remains within the mandate** of the Council.

# Freedom of Information

12. Paragraph 1 of the First Schedule to the Freedom of Information Act 1997 is amended, in subparagraph (2), by inserting “the Irish Fiscal Advisory Council”.

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# Updating Ireland’s Fiscal Framework

The possibility of **SGP 4.0** has been mooted in recent years, in part due to the complexity added in recent years. (see Vade Mecum for the SGP).

One factor, among many, holding this reform back is the emphasis on **single-year estimates** of the output gap and structural balance in the current framework.

A **multi-year approach** including linking policy spending changes to plausible medium-term potential growth rates would likely be more reliable than the current approach.

# Costings

Ireland currently does not benefit from the input of independent costings into the policy sphere.

These could be:

- Policy costings
- Election costings

**Policy costings** could be provided by Ireland’s other IFI, the *Parliamentary Budget Office*.

Not clear that **election costings** are feasible, or worthwhile, in an Irish context but the provision of policy costings is a first, and necessary, step.

# Conclusion

Historically, Ireland did not have a well-developed fiscal framework which contributed to occasional fiscal crises.

In recent years, a complex fiscal architecture has been scaffolded to the EU's Stability and Growth Pact.

Simplification is necessary and this may also offer the opportunity for greater domestic ownership of fiscal responsibility through:

- Domestic fiscal rules based on common principles (such as multi-year spending limits).
- Should NOT be nominal targets for the budget balance.
- Primary assessment by local IFIs.
- Country-specific peculiarities (e.g. GNI*) not applied to all Member States.