2018

Expenditure Report

BAILE ÁTHA CLIATH
ARNA FHOILSIÚ AG OIFIG AN tSOLÁTHAIR
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Executive Summary

This document is the Expenditure Report for Budget 2018, as presented to Dáil Éireann. It sets out the Government's voted expenditure allocations and measures for 2018. It also provides the expenditure ceilings for 2019 and 2020. Strengthened economic growth combined with continued careful management of the public finances mean that it is possible to increase public expenditure modestly once again. Public spending is now firmly on the path of steady and sustainable expenditure planning, and sensible spending is at the core of the objectives for the next three years.

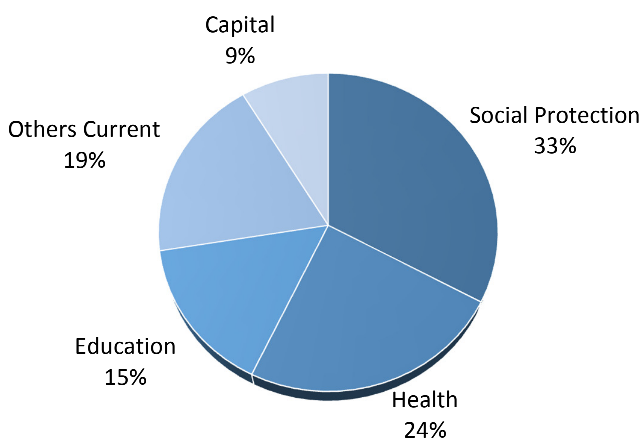
Total gross voted expenditure for 2018 will reach €60.9 billion as shown in the table below. This is consistent with Ireland's fiscal targets and its path towards structural balance.

Estimate of Gross Voted Expenditure 2018	
	€ million
Current Expenditure	55,593
Capital Expenditure	5,330
Total	**60,923**

*Rounding affects total

The chart below shows the distribution of total Government voted expenditure across the main spending headings. It reflects the importance of strategic programmes in the social protection and education areas as part of Government's focus on protecting the most vulnerable in society and prioritising core social services.

Prioritisation of Public Spending 2018



The 2018 allocations to Departments for current and capital expenditure are outlined in the table below. More information about these allocations are provided in Parts II and III of this Report.

Ministerial Vote Group Gross Current Expenditure Ceilings

	2017	2018	Change
	€ million	*€ million*	*%*
Agriculture, Food and the Marine Group	1,230	1,284	4.4%
Business, Enterprise & Innovation Group	302	311	3.0%
Children and Youth Affairs Group	1,285	1,356	5.5%
Communications, Climate Action & Environment Group	357	372	4.2%
Culture, Heritage & the Gaeltacht Group	237	249	4.9%
Defence Group	847	869	2.6%
Education & Skills Group	8,844	9,339	5.6%
Employment Affairs & Social Protection Group	19,799	20,002	1.0%
Finance Group	439	458	4.2%
Foreign Affairs Group	704	725	3.0%
Health Group	14,152	14,798	4.6%
Housing, Planning & Local Government Group	1,122	1,327	18.3%
Justice Group	2,388	2,488	4.2%
Public Expenditure and Reform Group	943	989	4.9%
Rural & Community Development	132	140	6.3%
Taoiseach	182	187	2.4%
Transport, Tourism and Sport	680	699	2.8%
Provision for 2017 Christmas Bonus	230	-	-
Year-end underspends-unallocated	(100)		-
Gross Current Expenditure – Excluding One-Off Cost	**53,776**	**55,593**	**3.4%**
Water Charge Refunds	**179**	-	-
Gross Current Expenditure	**53,955**	**55,593**	**3.0%**

*Rounding affects total

Ministerial Vote Group Gross Capital Expenditure Ceilings

	2017	2018	Change
	€ million	*€ million*	*%*
Agriculture, Food and the Marine Group	238	248	4.2%
Business, Enterprise & Innovation Group	555	560	0.9%
Children and Youth Affairs Group	26	28	9.3%
Communications, Climate Action & Environment Group	171	209	22.2%
Culture, Heritage & the Gaeltacht Group	51	54	5.8%
Defence Group	74	77	4.1%
Education & Skills Group	693	745	7.5%
Employment Affairs & Social Protection Group	10	10	0.0%
Finance Group	25	26	1.7%
Foreign Affairs Group	11	13	18.2%
Health Group	454	493	8.6%
Housing, Planning & Local Government Group	694	1,130	62.8%
Justice Group	180	146	(19.0%)
Public Expenditure and Reform Group	151	175	16.2%
Rural & Community Development	77	88	14.3%
Taoiseach	0	0	
Transport, Tourism and Sport	1,130	1,327	17.5%
Total Gross Capital Expenditure	**4,540**	**5,330**	**17.4%**

*Rounding affects total

Selected Key Areas of Expenditure 2018

In 2018, voted Government expenditure will be €60.9 billion. This will be the fourth successive year in which expenditure has been increased. This increase of expenditure will have an impact broadly across all sectors and regions. Outlined below are summaries of the key spending areas. Details of the services to be delivered by all Departments are set out in Part II of this Report.

Social Protection

In order to protect the most vulnerable in society, the Government will provide an allocation of €20 billion for the Department of Employment and Social Protection. This will allow for a measured increase in social welfare payments. The significant provision of supports through the social protection system represents an important strand of the Government's commitment to tackle poverty and social inequality in Ireland.

Health

The €15.3 billion to be allocated to the Health sector for 2018 represents the highest ever level of resources and will allow Government to support the continued development of Healthcare in Ireland. The service provided through this expenditure will benefit all sections of society and include acute services, primary care, mental health, disability, services for older people and services in the area of health and well-being.

Housing and Homelessness

Reflecting the key challenges facing the State in this area, nearly €2.5 billion will be allocated to the Department of Housing, Planning and Local Government in 2018. An overall provision for the Housing programme of €1.9 billion[1], up from €1.3 billion in 2017, will support the delivery of some 25,500 new social housing supports in 2018 with a further €116 million dedicated to supporting people experiencing homelessness.

Children

€1.38 billion is being invested specifically to support children and young people in Ireland. Central to the continued development of our younger generations will be the delivery of services through organisations such as the Child and Family Agency (Tusla). Increased funding for Early Years Care and Education demonstrates the Government's commitment to support the provision of services for the care, development and wellbeing of children and young people.

Business and Innovation

Given the many challenges and opportunities facing both domestic and international businesses, the Government is committed to investing to secure the future of enterprise in Ireland. The Department of Business, Enterprise and Innovation will continue to support Ireland's economic development by directly supporting over 435,000 jobs through the enterprise agencies. The aim is to grow this to 470,000 jobs during 2018.

[1] €1.8bn Exchequer funded supplemented by €92m local authority funding

Education and Skills

The Government will spend over €10 billion in the Education sector in 2018. Responding to Ireland's changing population, demographic profile and developments in our labour market today and into the future, this significant allocation will support the delivery of key services across all levels of the Education system.

Justice

The area of Justice and Equality incorporates a diverse array of Government activity and includes support for human rights, immigration and asylum, the oversight of policing and the delivery of services across the court system, in prisons and through An Garda Síochána. To support all these areas, the Government is committing over €2.6 billion of expenditure in 2018. This will deliver extra Gardaí on the street, secure over 3,670 prisoners on a daily basis, deliver services for refugees and, through the Policing Authority, review Garda performance.

Multi-annual Increases in Capital Expenditure

A mid-term review of the Capital Plan was carried out in 2017. On the basis of this review, over €4 billion in additional capital expenditure has been allocated over the period 2018 - 2021 as part of Estimates 2018. This is in addition to the €2.2 billion which has already been provided in support of the Action Plan for Housing and Homelessness over the period. In overall terms, the planned total increase in public capital between 2018 and 2021 is 40% above what was originally set out under the Capital Plan in 2015.

Taking account of these increases capital expenditure will increase by approximately 85% between 2016 and 2021. **Gross voted capital expenditure will reach 3.5% of GNI* by 2021** and will account for over 11% of total voted expenditure. This will see public investment in Ireland moving from relatively low levels to **among the highest in the EU.**

In line with the assessment of the Mid-Term Review of the Capital Plan the following priorities have been identified for public capital investment:-

- **Transport** – an additional €1,258 million will be invested in the sector. This investment will deliver major public transport such as the new Bus Rapid Transit Network for Dublin and the extension of the Dart to Balbriggan. There will also be significant additional investment in local and regional roads and projects to address congestion such as the M50 Variable Speed Limits project.
- **Housing** – on the basis of the review of the Action Plan for Housing and Homelessness an additional €500 million has been allocated for the direct building of over 3,000 additional social houses by 2021 increasing the overall Rebuilding Ireland ambition to be achieved through build, refurbishment, acquisition and leasing over the period 2016-2021 from 47,000 to 50,000 new homes;

- **Education** – An additional €322 million has been allocated for the schools sector which will deliver 350 planned large scale projects. An additional €257 million has been allocated for Higher Education, which will allow for the commencement of new programme of infrastructure renewal for the higher education sector, focused on large-scale refurbishment and/or infrastructure replacement projects which are essential to expand capacity, address health and safety issues, and/or improve quality in areas of key skills needs.
- **Health** – the additional €471 million will assure the delivery of the National Children's Hospital project and will allow the Government to address needs in other priority areas including: Primary Care, Mental Health, Acute Services, Social Care.
- **Business, Enterprise and Innovation** – an additional €310 million will ensure the delivery of the Government's Regionalisation Agenda, provide transformational supports for indigenous enterprise to respond to Brexit challenges and ramp up R&D investment in support of Government's science strategy "Innovation 2020".
- **Communications** – an additional €200 million in order to expand the energy efficiency programmes, continue to rollout the Renewable Heat Incentive Scheme, increase uptake of electric vehicles and ensure the roll out of the National Broadband Plan (following finalisation of the procurement process) to ensure all that citizens can access high speed services regardless of where they live or work.

Introduction

This Budget and the decisions detailed in this Report are set in the context of sustained economic improvements over the past number of years. The increased allocations in the Report will deliver continued enhancements to public services, which are intended to make a steady improvement in people's lives. The underlying economic situation, with Ireland growing at a strong pace and unemployment falling to pre-crisis levels, has allowed this Government to focus on the key objectives of continuing to deliver sustainable improvements in public services, alongside major improvements in public investment, and to broadly 'balance the books' in 2018, while also achieving Ireland's key structural budgetary target.

Public expenditure policy has a key role to play in safeguarding economic growth through efficient and effective investment in economic and social priorities. The decisions taken in this Budget will allow for steady improvements to public services that Irish society will benefit from in the short-term, while significant increases in public investment will underpin recent gains by building a better platform for fully realising Ireland's long-term growth potential.

It is important to recognise that the global trading environment, in which the Irish economy must remain competitive, is currently subject to unprecedented risks and uncertainties. The UK's exit from the EU, possible changes to tax regimes in both the EU and US, and the emergence of protectionism all constitute serious risks to Ireland due to our high degree of openness and integration in the global economy. To mitigate these potential risks, the Government will broadly 'balance the books' and reach our Medium-Term Objective under the Stability and Growth Pact in 2018. This represents the most appropriate fiscal stance at this point in the economic cycle. This achievement, and the commitment to reduce our public debt further, will lay down a solid economic foundation to help deliver steady and sustained improvements in living standards in a rapidly changing world.

This Expenditure Report sets out the Government's decisions in relation to spending by Government Departments for 2018 and its voted funding over the period 2018 to 2020. The structure of the Report is as follows:

Part I provides an overview of the main macro-economic, fiscal and expenditure policy considerations which have been taken into account in setting the expenditure strategy for the period 2018 to 2020.

Part II outlines the multi-annual expenditure ceilings agreed for each Government Department, including summary data on the overall ceilings for current and capital spending. It also sets out information in relation to each Department describing the nature of its funding allocations for current spending, the public services to be delivered in 2018, and a summary of the new measures being funded from the Budget announcements.

Part III contains the full details of the expenditure allocations for 2018 with a presentation of the Estimates for Public Services for each Vote.

Part I - Public Expenditure Strategy

Chapter 1

Economic and Fiscal Context

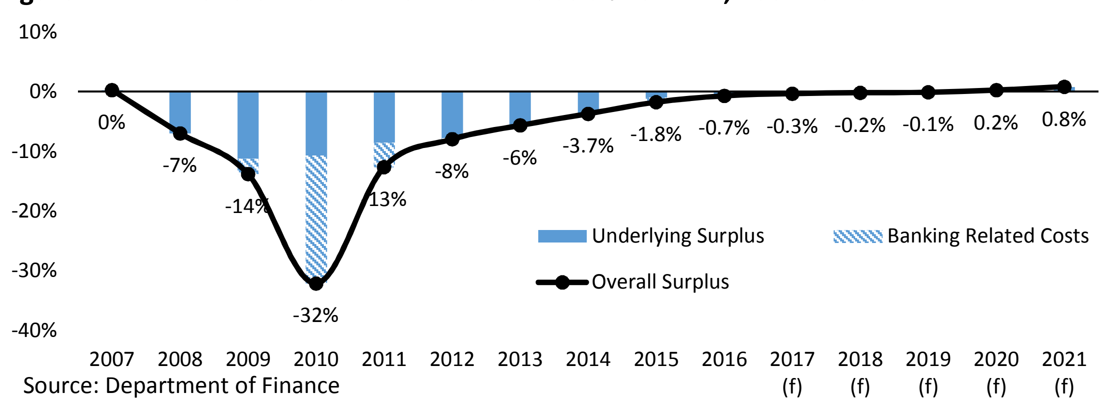
The sustained positive performance of the Irish economy has contributed to the restoration of stability in the public finances and provides a solid base for the three-year expenditure ceilings detailed in this Report. As this period of stability continues, it is important to underpin the recent gains by investing in Ireland's long-term future. In particular, public expenditure has a key role to play in safeguarding economic growth through efficient and effective public capital investment in economic and social priorities.

The official macroeconomic outlook, published today, estimates growth of 4.3% this year and 3.5% in 2018, with annual average growth rates of approximately 2.9% between 2019 and 2021. These forecasts take into account the likely adverse impacts following the decision by the UK to exit the EU. In particular, there are continued risks on account of exchange rate developments and the uncertainty of the Brexit negotiations. On a more positive note, the rate of global growth is expected to increase, along with the prospect of more stable growth in the medium-term.

The very difficult decisions made following the onset of the economic and financial crisis from 2008 onwards have helped to correct the large imbalances in the public finances over the past number of years. However, particularly for a small open economy like Ireland, the achievement of a balanced government budget and a healthier debt position will assist in weathering unforeseen adverse events that will arise in the future.

Figure 1 shows the rapid deterioration and subsequent gradual improvement in the deficit position since 2007. The scale of the gap in the public finances, which developed from 2008 onwards, necessitated very significant levels of borrowing to deliver key public services. However, sustained progress has been made in reducing the deficit, and will continue to be made under the Government's fiscal strategy.

Figure 1 General Government Balance as a % of GDP, 2007 to 2021

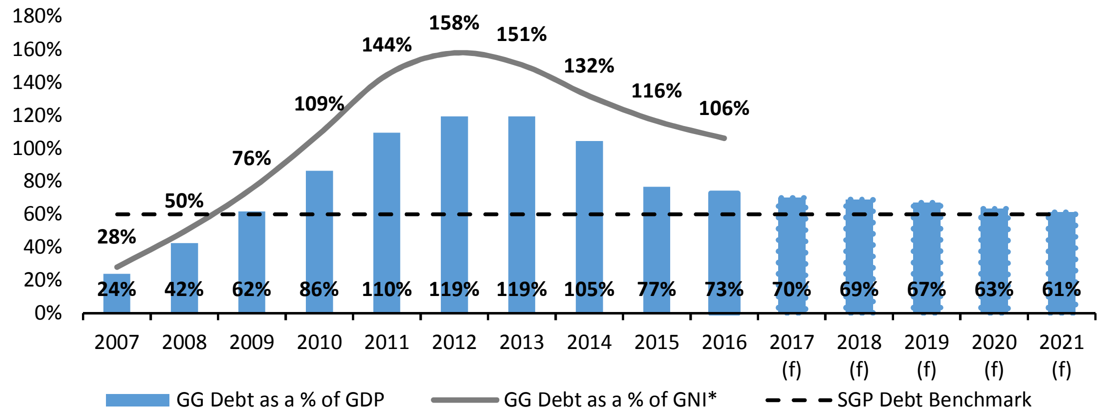


Source: Department of Finance

Public debt, having peaked in 2012, at around 120% of GDP has now fallen to almost 70% and is expected to fall below this level by next year. However, the marked reduction in the debt ratio that occurred in 2015 was primarily as a result of the unprecedented GDP growth that year. Using the modified GNI (GNI*)[2] measure as the base, recommended by the Economic Statistics Review Group, the public debt ratio is elevated to 106% in 2016. This remains a very high level of indebtedness by international standards and limits the scope for absorbing external shocks. Ensuring that our public debt ratio is further reduced will assist in making the underlying public finances even more solid and sustainable, and particularly for a small open economy, protect against the risks of external/domestic shocks and the risk of increases from current very low levels in the interest rate paid on public debt.

As Figure 2 illustrates, the current trend details that Ireland's debt remains on a firm downward trajectory and is projected to approach the Stability and Growth Pact (SGP) 'debt benchmark' of 60% of GDP just beyond 2021. Once major capital projects have been completed, the Government will target a further reduction in the debt ratio to 45% of GDP.

Figure 2 General Government Debt as a share of GDP, 2007 to 2021



Source: Department of Finance

[2] This adjusted level indicator adjusts Gross National Income (GNI) for the retained earnings of re-domiciled firms and depreciation on foreign-owned domestic capital assets in the GNI figures, to provide a more accurate measure of national income.

Chapter 2

Public Expenditure Policy

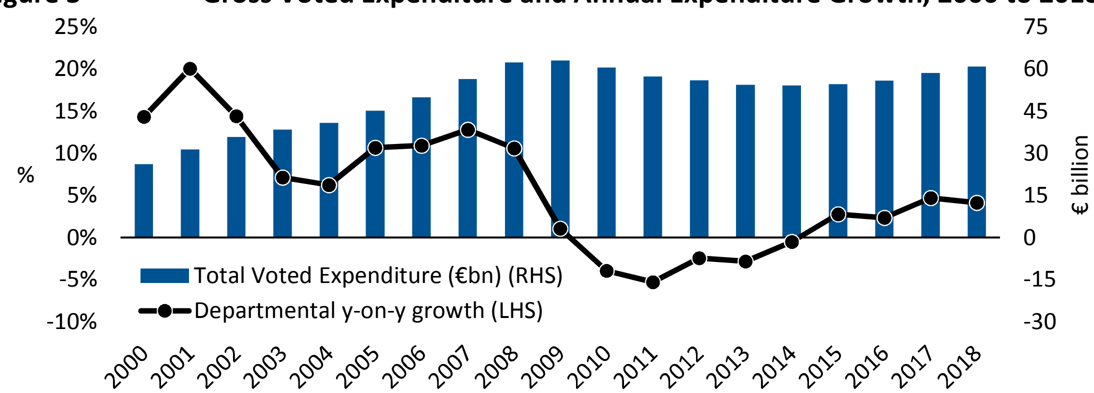
This chapter presents an overview of historical trends in public expenditure and assesses how these levels compare with other countries. It also discusses the expenditure strategy for Budget 2018 and the overall fiscal framework in which it operates.

2.1 Expenditure Trends

Public expenditure levels have undergone significant transitions since the turn of the century, as detailed in Figure 3. Expenditure levels stood at the low nominal level of €26 billion in 2000 but rapidly increased in the early years of this century, with expenditure growth rates of 20% and 14.4% recorded in 2001 and 2002 respectively. After two years of more modest growth, expenditure growth accelerated once more in the years prior to the economic collapse, with growth rates of over 10% for four years in a row. While the spending increases in the earlier years were underpinned by sustainable economic growth, the later increases reflected unsustainable growth in tax revenues fuelled by the economic bubble.

Subsequent to the economic collapse, there was a period of negative or nil expenditure growth as the State sought to bring spending back under control. While the expenditure reductions had significant social costs, Scott and Bedogni (2017)[3] found that the consolidation played a role in the stabilisation of the State's finances and was effective in terms of the fiscal criteria applied and also in terms of the timing and composition of the adjustment.

Figure 3 **Gross Voted Expenditure and Annual Expenditure Growth, 2000 to 2018**



Source: Department of Public Expenditure and Reform

From 2015 onwards, in recognition of the improving economic conditions, the need for enhanced public services and public investment and in seeking to secure a sustainable long-term path for growth, public expenditure has increased in significant and stable amounts. The evolution of the overall levels of expenditure and how these increases are spread across key areas is shown in Table 1.

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[3] Scott, Robert and Jacopo Bedogni; *The Irish Experience: Fiscal Consolidation 2008-2014*; IGEES, 2017

Table 1: Total Voted Government Expenditure, 2012 to 2018

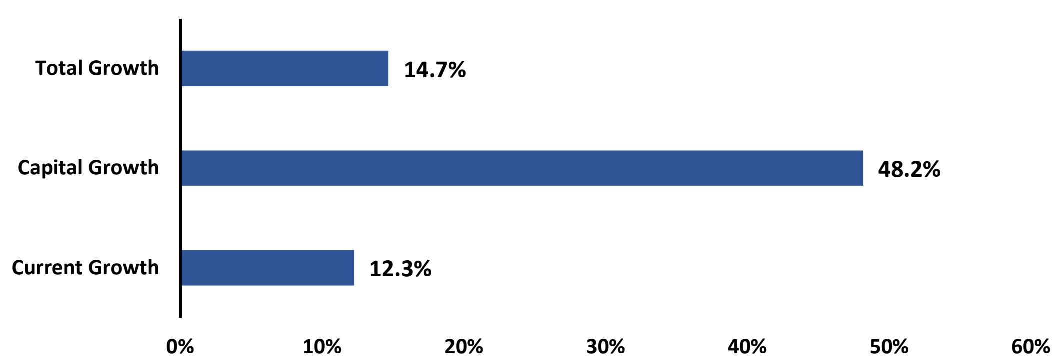
€ billion		2012	2013	2014	2015	2016	2017	2018
1	Pay	15	14.7	14.4	15.1	15.6	16.5	17.4
2	Pensions	3.1	2.8	3	2.9	3	3	3.1
3	Social Welfare - Live Register	3.8	3.7	3.3	3.1	2.8	2.5	2.1
4	Social Welfare - Other	16.9	16.6	16.4	16.8	17	17.4	17.8
5	Other Programmes	12.4	12.3	12.4	13.1	13.6	14.6	15.2
of which:								
5 a.	*Health non-pay*	*6*	*6.2*	*6*	*6.3*	*6.5*	*6.7*	*7*
5 b.	*Education non-pay*	*2*	*2*	*2*	*2*	*2*	*2*	*2*
5 c.	*Other*	*4.4*	*4.1*	*4.4*	*4.8*	*5.1*	*5.9*	*6.2*
6	Gross Current Expenditure (1-5)	51.2	50	49.5	50.9	51.8	54	55.6
7	Gross Capital Expenditure	3.8	3.4	3.6	3.7	4.1	4.5	5.3
8	**Gross Total Expenditure (6+7)**	**55**	**53.4**	**53.1**	**54.6**	**55.9**	**58.5**	**60.9**

Note: Rounding affects totals; the total spending figure for 2016 is an appropriation account figure whereas those for 2017 and 2018 are forecast outturn and estimate respectively; and figures pre-2015 have been adjusted to allow for a like-for-like comparison with later years to reflect the effect of the disestablishment of the HSE Vote on 1 January 2015.

The growth illustrated in Figure 4 shows the cumulative increase in Gross Voted Expenditure since the recent lowest point in 2014. It is clear that there has been sustained increases in public spending over that period but in a prudent and responsible manner, contrasting sharply with the expenditure growth rates pre-crisis. The expenditure allocations for 2018, as set out in Part II and Part III of this Report, maintain the prudent and responsible prioritisation of public investment through increases in capital expenditure.

In the area of public capital investment, drawing on the assessment contained in the Review of the Capital Plan, this Budget will allocate increased capital investment in priority areas such as social housing, roads, public transport and education. The need for additional investment in public capital infrastructure was highlighted as a key cross-sectoral priority in this year's National Economic Dialogue and confirmed in the recent Review of the Capital Plan. This assessment has informed Budget 2018 through the decision to support growth-enhancing and socially important investment and will also be demonstrated in the proposed 10-year National Investment Plan, which it is planned will be published before the end of the year.

Figure 4 Trough to Peak: Growth by Expenditure Type, 2014 to 2018

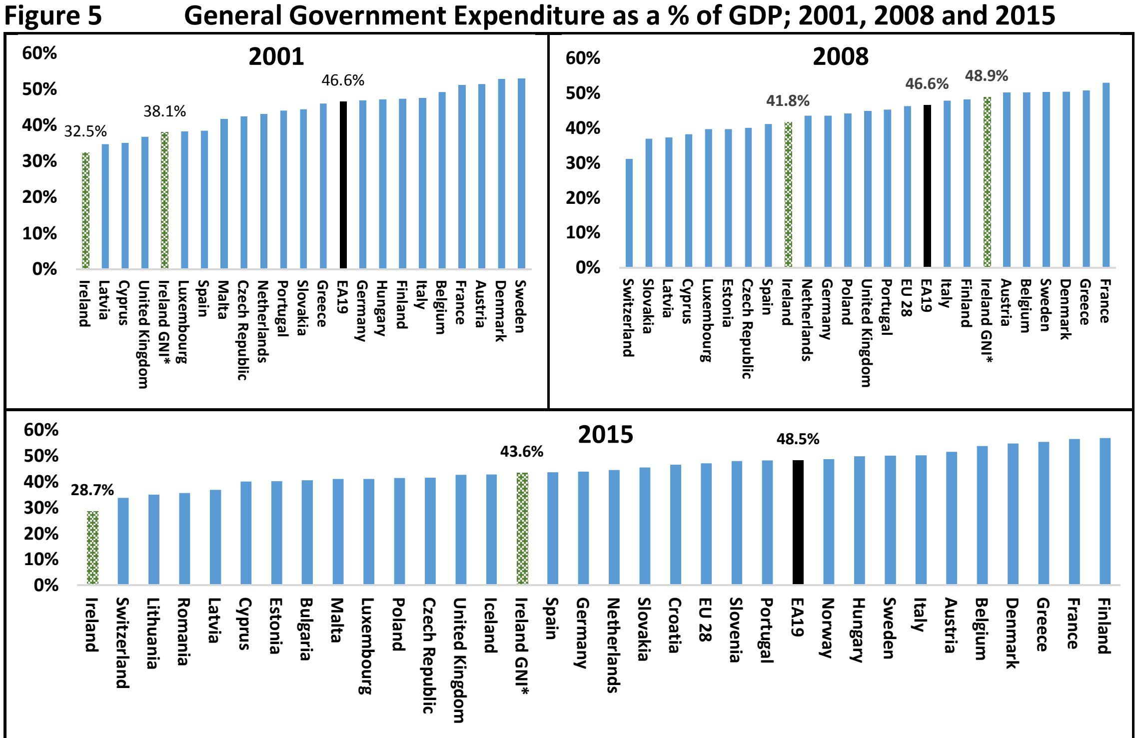


2.2 Expenditure Comparisons

Given developments in departmental expenditure during the boom and subsequent recession discussed above, the levels of overall Government spending compared to EU peers has varied over time. At the start of the 2000s Ireland was spending comparatively low amounts as a percentage of GDP. This reflected a combination of both modest growth in expenditure in the years prior and the large increases in nominal GDP in the years when the 'Celtic Tiger' took hold between the mid-1990s and early-2000s. From 2002 onwards, Ireland's comparative expenditure ranking steadily increased until 2008, where expenditure was almost 42% of GDP. This was as a result of successive years of expenditure growth, well in excess of nominal GDP growth which improved Ireland's international ranking substantially. In more recent years, Ireland has fallen back down the comparative rankings in spending the lowest as a percentage of GDP in 2015. This was as due to reductions in expenditure surpassing GDP declines in the years following the crisis and rapid GDP growth in recent years.

Using the new recommended national income metric, modified GNI (GNI*)[4], Ireland's comparative ranking improves in all years, but the single largest increase of 15 percentage points (pp) occurs in 2015. This larger increase in 2015 illustrates the distortion to GDP caused by the re-domiciling of foreign owned assets to within Ireland, which the GNI* specifically adjusts for. Using GNI* shifts Ireland from being at the bottom of the international league table in 2015 to within a middle grouping of countries but somewhat below the Euro-area and EU average.

Figure 5 General Government Expenditure as a % of GDP; 2001, 2008 and 2015



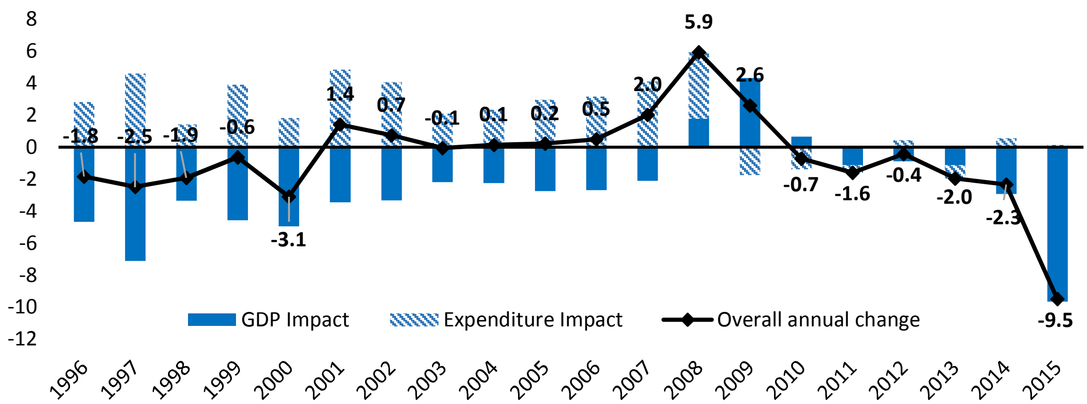
Source: CSO; OECD; DPER calculations

[4] See footnote 1

2.2.1 Complexity of International Comparisons

As discussed in the section above, Ireland's expenditure position has varied significantly since the beginning of this century and can partly explain changes in comparative rankings over these years. However, the larger impact on the change in Government spending, as a percentage of GDP, has been as a result of the large variations in GDP itself (the base effect). Looking back over the past two decades, figure 6 decomposes the impact of expenditure and GDP annual growth on the annual change in the expenditure/GDP ratio. The relatively large negative impacts of GDP growth have caused large reductions in the spending ratio in certain years, particularly 2014 and 2015.

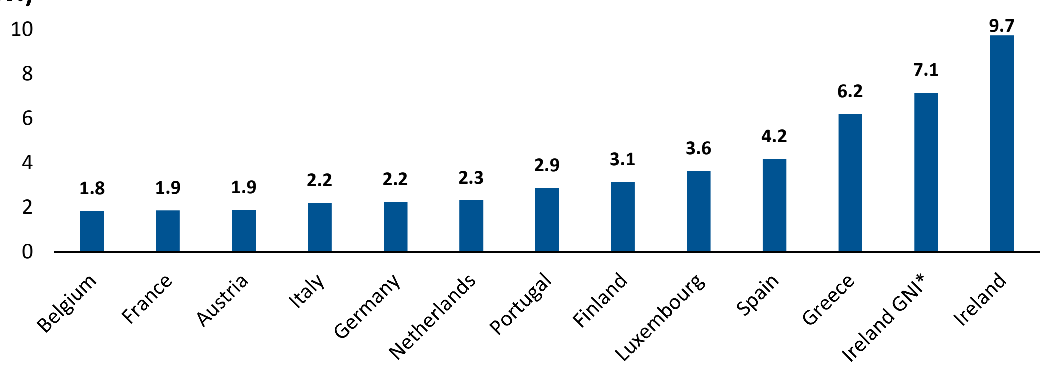
Figure 6 Decomposition of annual change of General Government Expenditure as a % of GDP



Source: AMECO database; DPER calculations

The impact of GDP changes are significantly higher in Ireland than most other countries in the EU, with figure 7 showing the volatility of nominal GDP growth rates for a number of euro-area countries. This is also the case for the new GNI* metric calculated by the CSO, where the volatility is higher than all the other countries GDP figures in the sample. This makes it quite difficult to target levels of expenditure as a percentage of GDP and causes Ireland's comparative position to change very significantly over time.

Figure 7 Volatility of nominal GDP growth since 2001 for euro-area countries (st. dev.)



Source: AMECO database; DPER calculations

2.3 Expenditure Policy – Achieving a Balanced Budget

Today, Ireland finds itself competing in a rapidly-changing global economic environment which generates significant opportunities for a flexible, dynamic economy like Ireland alongside unprecedented risks and uncertainties. The UK's imminent exit from the EU will have a long-lasting impact on the Irish economy given our strong ties with the UK. Possible changes to tax regimes in both the EU and US, and the emergence of protectionism constitute further risks to Ireland due to our high degree of openness and integration in the global economy. While Ireland currently has a younger demographic profile relative to other countries, our population profile has, and will continue to get, older over the coming years, exerting significant pressure on public expenditure and on the public finances.

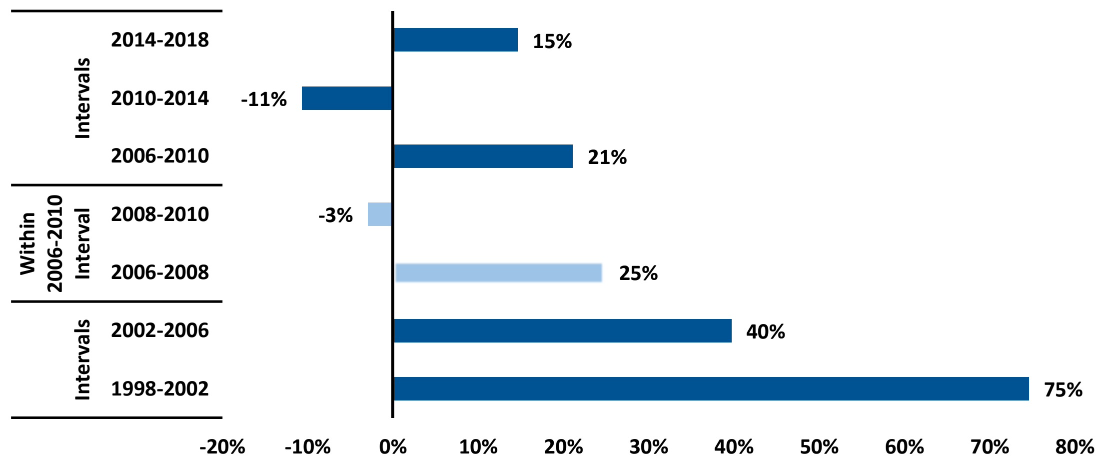
To address these risks but also to take advantage of emerging opportunities, the Government is committed to making the right preparations and to continue delivering steady and responsible improvements in public services. Ireland has achieved a successful and remarkable turnaround since the economic and financial crisis. The Irish economy is now growing at a strong pace with unemployment falling to its pre-crisis level. While it is important that increased resources are provided to meet our current and future needs, expenditure policy must also be responsible and sensible.

In recent years, government spending has been managed in a sustainable and prudent manner with public expenditure growing at a lower rate than growth in the economy overall. With this in mind, it is important not to repeat mistakes that were made in the past. These led to unsustainable and pro-cyclical expenditure policies prior to the economic crash, as detailed in figure 8 below. Steady, incremental progress in public expenditure, alongside continuing sharp focus on the efficiency and effectiveness of spending in keeping with the principles guiding the Spending Review process and through the intensification of reform and innovation across the public service, will help move Ireland forward in meeting public expectations for the level and the quality of public service provision in an advanced developed economy. The commitment of increased funding for enhanced public services is manifested in the level of increases in public expenditure in the 2014-2018 period below.

Next year, the Government plans to broadly 'balance the books' and reach its Medium-Term Budgetary Objective under the Stability and Growth Pact. This is the appropriate fiscal stance at this point in the economic cycle. This achievement and the commitment to reduce our public debt further will lay down solid economic foundations to deliver steady improvements to people's lives in a changing world.

The Government recognises in this budget the leading role public capital investment plays in contributing to increased long-term growth, competitiveness, regional development, fairness and equality. These goals will be achieved through the implementation of major but sustainable increases in public capital expenditure in key areas on the basis of the assessment contained in the Review of the Capital Plan. It is essential that both current and capital spending is delivered in the most efficient way that is consistent with Government's economic and social priorities. The recent Spending Review and the Review of the Capital Plan are key tools to inform policy and guide resources to maximise their effectiveness. This is a fundamental pre-requirement in order to provide first-class public services in a sustainable and efficient manner.

Figure 8 Gross Voted Expenditure Growth: Four-Year Intervals 1998-2018



Source: Department of Public Expenditure and Reform

2.4 Ireland's Fiscal Framework

The objectives of the EU fiscal rules (i.e. counter-cyclicality, stability and sustainability), and their implementation, have an essential role to play in achieving fiscal policy objectives that are sustainable on a long-term basis. In that context, understanding and responding to methodological issues that can impact on their effectiveness is very important. Both the SB and the EB depend on estimates of potential output and the output gap (the difference between actual and potential (OG))[5]. However, these variables are unobservable by nature and must be estimated using statistical and economic models. The methodology employed by the Commission to estimating potential output, and agreed by all Member States, is called the Commonly Agreed Methodology (CAM)[6]. However in the case of Ireland, as highlighted *inter alia* by the Department of Finance and the Irish Fiscal Advisory Council, the CAM methodology has been an unreliable estimator of the structural (i.e. or cyclically adjusted) position of the economy and on that basis is subject to significant revision over time.

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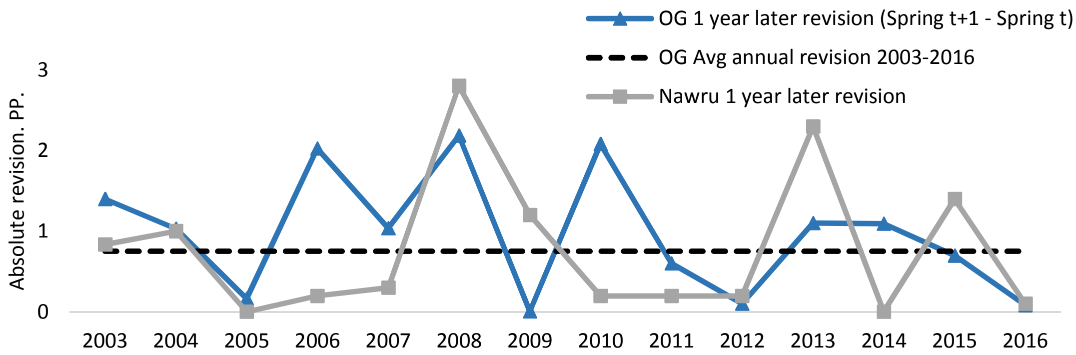
[5] The output gap (OG) is an estimated indicator that is used to assess the cyclical position of an economy. When the OG is negative there is slack in the economy. Conversely, if this is positive, the economy is likely to experience overheating.

[6] For more information see Havik, K., K. Mc Morrow, F. Orlandi, C. Planas, R. Raciborski, W. Röger, A. Rossi, A. Thum-Thysen, and V. Vandermeulen (2014). "The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps," Economic Papers 535, European Commission.

Figure 9: Output Gap and NAWRU Annual Revisions, 2003 - 2016



Source: Bedogni and Meaney (2017); forthcoming

An IGEES staff paper by Bedogni and Meaney[7] showed that estimates of potential output and in turn of the Output Gap (OG) tend to be revised very often and by large magnitudes (as large as the size of the OG). Particular difficulties arise in relation to real-time estimates. Figure 9 highlights the uncertainty of the Commission's estimates of the Irish OG using the CAM by showing annual absolute revisions of any given year from 2003 to 2016. For instance, the first point from the left (blue line) indicates that the 2004 spring forecast revised by 1.4pp the real-time estimate of the 2003 OG. Similarly, the second point indicates that the 2004 OG was revised by 1 pp compared to its real-time estimate with the 2005 spring forecast, and so forth. The average annual absolute revision to the OG is 0.8 pp. The IGEES paper found revisions to OG are mostly driven by revisions to the Non-Accelerating Wage Rate of Unemployment (NAWRU) which is used to derive potential output. The high volatility observed at turning points remark on the extent to which the methodology struggles to detect their occurrence. This is a problem common to all the approaches that produce estimates on the basis of historical data. Nonetheless, revisions to OG make it difficult to correctly assess, in real-time, the cyclical position of the economy and, in turn, the degree to which there is a risk of overheating in the economy. The Department of Finance has therefore, in response to a request from the IFAC, committed to producing other estimates of the cyclical position of the economy.[8]

Frequent changes to the variables underpinning the calculation of the EB create important challenges for the effective functioning of the Government Expenditure Ceilings. Prior to 2015, the EB was set for 3 years. However, with the goal to ensure better accuracy, fiscal parameters such as the reference rate and the converging margin are now updated annually. Conversely, the Expenditure ceilings represent medium-term strategic planning and are set for a 3-year period. Therefore, annual changes to the amount that can be spent will impact on the Government Expenditure Ceilings and can imply revisions to the ceilings.

[7] Bedogni, J. and K. Meaney (2017a). "EU Fiscal Rules and International Expenditure Rules", Irish Government Economic and Evaluation Service (IGEES) staff papers, DPER. Bedogni, J. and K. Meaney (forthcoming). "EU Fiscal Rules: Real-time measurement issues of the output gap", IGEES Analytical Note Series, DPER.
[8] IFAC (2017); Fiscal Assessment Report June 2017; Dublin

The EU fiscal rules are detailed in the Vade Mecum of the Stability and Growth Pact. The Vade Mecum is prepared by the Directorate-General for Economic and Financial Affairs (ECFIN) of the European Commission and illustrates the procedures and methodologies that a Member State should follow to implement the SGP (European Commission, 2017)[9]. The Vade Mecum was initially published in 2013 and was then revised as the fiscal rules evolved. In particular, since its first version, three major changes were introduced:

1. On the flexibility use within the SGP, which refer to:
    a. the introduction of a matrix which modulates the annual fiscal adjustment towards the MTO on basis of the cyclical conditions that the economy is experiencing and the country's debt level;
    b. flexibility on account of the implementation of structural reforms, which allows for a temporary deviation from the MTO (or the adjustment path towards it), if these are major, have direct long-term positive effects on growth and the sustainability of public finances, and are fully implemented;
    c. flexibility granted for Government investment aiming at, ancillary to, and economically equivalent to the implementation of major structural reforms can justify a temporary deviation;
2. Greater focus on the EB when assessing compliance. The EB rule is thought to be a better operational target which is less affected by cyclical developments and largely under the direct control of the policy maker; and
3. The exclusion of one-offs from the EB when assessing compliance to give more consistency to the fiscal framework as one-off measures were already excluded from the calculation of the SB.

In summary, the EU fiscal framework as set out in the fiscal rules is complex but it has played a pivotal role in providing a strong anchor to the successful conduct of fiscal and expenditure policy in Ireland. As discussed above, work is ongoing at EU level to strengthen the effectiveness of the EU Fiscal framework. The objectives of the fiscal rules are critically important to maintaining the very hard-won gains secured in terms of the sustainability and stability of Ireland's public finances. Improved methodologies to assess the supply-side and capacity constraints of the Irish economy have a key role to play in ensuring the continued appropriateness of fiscal policy and the fiscal stance in the years ahead.

[9] European Commission (2017), Vade Mecum on the Stability and Growth Pact - 2017 Edition, European Economy, Institutional Paper 052.

Chapter 3

Drivers of Expenditure

This chapter will discuss some of the key drivers of public expenditure in the medium-term and how they will impact on the expenditure ceilings detailed in part II of this report. The drivers of focus in this chapter are:

- demographics;
- the Exchequer Pay Bill; and
- the Labour Market.

3.1 Demographics

While Ireland currently has a younger demographic profile relative to other countries, our population will get larger and older over the coming years and this will exert pressure on expenditure and on our public finances. The size and age structure of the population influences the demand for public services, particularly for the areas of education, childcare, healthcare, income supports and additional infrastructural investment. In the absence of achieving greater efficiency in Government expenditure being sought, the increasing annual costs of demographics will diminish the available fiscal space and adversely impact on the deficit position. The expenditure ceilings in 2018 already have provision for additional staff in the health and education sectors to deal with demographics (€0.12 billion).

The IGEES paper, *Budgetary Impact of Changing Demographics 2017 – 2027*[10], forecasts the likely additional costs over the next decade due to increased demands for public spending across the health, education and social protection areas. This paper projects the annual increased costs due to demographics at €440m, €428m and €435m in 2018, 2019 and 2020 respectively. This analysis provides the baseline for the underlying demographic costs captured within the expenditure ceilings set out in Part II of this Report. Given the scale of the additional funding required to service these 'no policy change' costs, expenditure efficiencies continue to be sought to ensure high quality and effective public services can continue to be provided for our population.

3.2 Exchequer Pay Bill

In 2018, the gross Exchequer pay bill is expected to be €17.4 billion. The pay bill is driven by two key elements, namely the numbers of public servants employed and the rates at which they are remunerated.

[10] Connors, Duffy and Newman; *Budgetary Impact of Changing Demographics 2017 – 2027*; IGEES, 2016

In terms of the latter, a new Public Service Stability Agreement (PSSA) was approved by the Government and ratified by the Public Services Committee of the ICTU in September 2017. The agreement will run from 2018 to 2020 and will cost €887 million over this period.

The agreement builds on the initial steps taken by Government to unwind the FEMPI measures. These measures were a critical component of the budgetary consolidation imposed during the financial emergency in line with the economic recovery. However, as additional resources have become available, sustainable increases in pay have been agreed. Importantly, the PSSA provides certainty on the level of additional resources that will be required for public service pay between 2018 and 2021 as well as contributing to a much more stable industrial relations climate for the public service.

On the numbers side, increased and better quality public services are largely delivered by increasing the number of public servants: extra nurses, doctors, special needs assistants, teachers and Gardaí in terms of frontline public service provision. Growth in public service numbers in these areas, since the recruitment moratorium was lifted, builds capacity in frontline public service provision.

Since the end of the moratorium, public service numbers have grown by more than 3 per cent per year on average, equating to an additional 8,000 FTEs per year and an additional €1.8 billion in pay bill expenditure between 2014 and 2017. This recent growth in public service staffing means that at the end of 2017 overall numbers will be approaching peak levels. While the increased service delivery that can be provided through additional staff is important, particularly following a period of significant consolidation from an expenditure sustainability perspective, as highlighted in the Summer Economic Statement, in the future it is likely that more modest growth in numbers (inclusive of demographics) will be required.

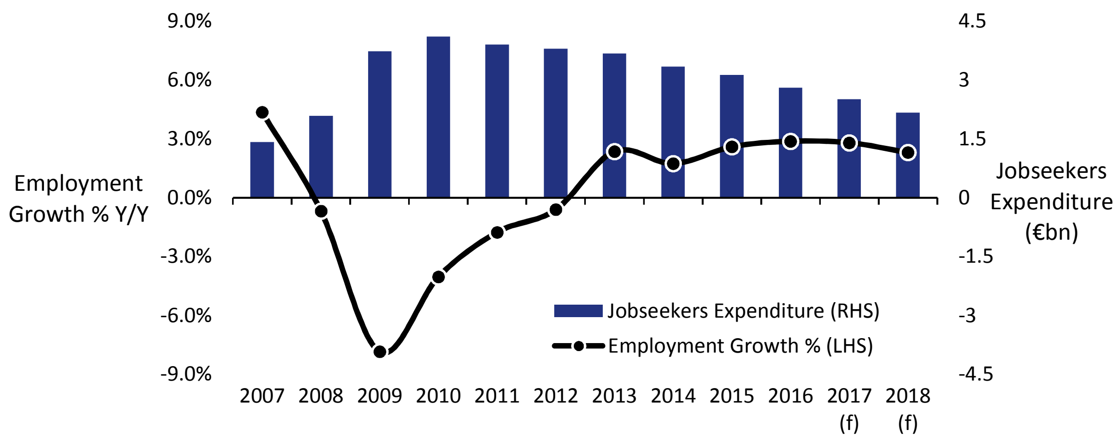
Over the medium-term, the continued prioritisation of front line public servants will require an increased focus on the level and composition of the overall public service workforce as well as enhanced workforce planning practices to ensure the overall sustainability of the Exchequer pay bill within overall fiscal parameters consistent with the fiscal rules.

3.3 The Labour Market

The policies and action plans introduced in recent years to improve job opportunities and job prospects have contributed to the transformation of the labour market. As the labour market continues to improve, the savings in Live Register related costs allow for funding to be reprioritised for other services and investment. The level of employment has grown on average by 2.8% for the last two years and there is an expected growth of 2.3% next year. Since the lowest point of employment in Q3 2012, the number of people in jobs has increased by 230,000. Each of the regions has benefitted in terms of job growth in this time.

The significant increase of the number of people working is also reflected in the reduction in unemployment since 2012. The level of unemployment has dropped from just over 15% in early-2012 to an expected average level of 6.3% this year. It is expected that the unemployment rate will reduce further next year, to 5.7%. This trend shows that our labour market is on the path towards the objective as set out in the *Programme for a Partnership Government*, to reach full employment by 2020. Figure 10 below shows the trends in Jobseekers expenditure and the growth in employment. The impact of job creation has meant that jobseekers expenditure is expected to drop by around 41% or €1.5 billion between 2013 and 2018.

Figure 10 Annual Growth in Employment and costs of Jobseekers 2007 to 2018



Source: Department of Finance and Department of Social Protection

Chapter 4

Reformed Expenditure Frameworks

4.1 Equality Budgeting

It is important to ensure that Government maintains its focus not just on the level of expenditure, but also on *how* public funds have been spent. To this end, the *Programme for Partnership Government* commits to developing a process of budget and policy proofing as a means of advancing equality, reducing poverty and strengthening economic and social rights. Equality Budgeting involves providing greater information on the likely impacts of proposed and ongoing budgetary measures, which, in turn, enhances the potential to better facilitate the integration of equality concerns into the budgetary process, avoid unintended adverse outcomes and enhance the Government's decision making framework.

A paper accompanying this report, *Equality Budgeting – Proposed Next Steps in Ireland*[11]*,* sets out the pilot approach to equality budgeting that will be adopted for this budgetary cycle. The approach is anchored in the performance budgeting framework that is currently in place. It will involve Departments setting concrete measurable targets for equality objectives in the Revised Estimates Volume and reporting on progress in the Public Service Performance Report. The learning from the pilot approach can be used to inform the expansion of the equality budgeting initiative.

4.2 Spending Review 2017 and 2018

The Spending Review 2017 took place during the first half of this year and is the first in a series of rolling, selective reviews which will cover the totality of Government spending over a three year period to 2019. The Spending Review process allows for the systematic examination of existing spending programmes to assess their effectiveness in meeting policy objectives and also to identify scope for re-allocating funding to meet expenditure priorities. In this way, focus is directed towards the totality of Government expenditure, rather than the incremental changes announced each year at Budget time.

The results of the first year of this new approach were published with the Mid-Year Expenditure Report 2017 and include key sectoral trend analysis and a number of individual topic papers[12]. The published papers extend across a significant number of spending programmes and wide range of diverse policy areas, yielding specific findings and recommendations in every instance.

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[11] Available at www.budget.gov.ie

[12] Available at http://www.per.gov.ie/en/spending-review/

The Spending Review operated as a complementary process to the Budget Estimates process. The Spending Review was undertaken over the first half of the year in order to enable the output of the review in each area to feed into the consideration of expenditure proposals for Estimates 2018. The results of the Spending Review analysis provided a robust evidence base on key expenditure issues that informed discussions on Estimates proposals in the context of Budget 2018.

Building on the output of the 2017 Spending Review, the intention is that the Spending Review in 2018 will further reinforce the more structured and systematic means of analysing spending focusing on an assessment of efficiency, effectiveness and sustainability. The 2018 Spending Review will continue to support the development of better policy options for Government by broadening and deepening the knowledge of a range of complex policy areas to facilitate future discussions regarding the evolution of Government expenditure.

4.3 Mid-Term Review of the Capital Plan

Investment in public infrastructure is essential to support balanced regional growth and increase the capacity of the economy over the long-run. Taking account of the significant resources of €4.3 billion in additional capital expenditure to be allocated the key elements of the review are to assess and report on:

- the quality and capacity of Ireland's public infrastructure in light of key drivers of future demand such as demographics; and
- priority public capital investment requirements, reflecting in particular where infrastructural congestion and bottlenecks may be jeopardising the sustainability of Ireland's growth performance.

The review also sought to assess how enhancing public capital infrastructure can strengthen the economy's resilience to risks related to Brexit, climate change, and the potential for overheating as the economy approaches full capacity.

The review of the Capital Plan provides an evidence base, reflecting sectoral gaps identified by robust analysis. This evidence base includes detailed submissions by Departments and Offices, an extensive public consultation, as well as an Infrastructure Capacity and Demand Analysis completed by members of the Irish Government Economic and Evaluation Service (IGEES). Based on the analysis of this evidence base the review identifies the following sectoral priorities:

- Transport and Higher Education are identified for prioritisation;
- Health requires further analysis in the context of reviewing the totality of health capacity and infrastructure; and
- Housing requires continued investment, reflecting progress to 2021.

These priorities were largely assessed at a national, aspatial level to identify the type of infrastructure gaps which exist. The National Planning Framework (NPF) influences where those gaps need to be filled to support future growth, and in particular regional growth centred on cities.

The review also highlighted the importance of a planned and measured increase in the rate of public capital investment, avoiding sharp or unexpected increases, so as not to outstrip the pace of the supply response feasible from the construction sector. It is also essential that public capital investment is:

- efficient, focused on infrastructural priorities which are properly appraised;
- yields a high economic and social rate of return; and
- makes best use of construction sector resources given the level of private investment demand.

Chapter 5

Conclusion

This Budget will allocate additional resources to key priority areas of public services and public infrastructure, while also ensuring that the public finances will be broadly balanced in 2018. In setting out the expenditure allocations in this Report, the broad consensus on key priorities at the National Economic Dialogue are represented in the large relative increases for housing, health and public infrastructure. These increases will deliver sustainable improvements in public services that will make a steady change in people's lives, while also setting a sustainable platform for Ireland's long-term future.

This has been achieved while also delivering on the objective of a broadly balanced budget and achieving our Medium-Term Objective under the Stability and Growth Pact in 2018. This achievement, and the commitment to reduce our public debt further, will allow Ireland to weather unforeseen adverse events that will arise in the future. The emergence of external risks, such as Brexit, possible changes to tax policy in the EU and US, the emergence of protectionism amongst trading partners, and continued domestic risks to the public finances making it all the more important to continue on a sustainable path for our public finances and for expenditure policy. This clearly represents the correct policy approach to take at our current point in the economic cycle.