Irish Fiscal
Advisory Council

An Roinn Airgeadais
Department of Finance

Memorandum of Understanding between the Irish Fiscal Advisory Council and the Department of Finance relating to the "Endorsement Function" of the Council under the Fiscal Responsibility Acts 2012 and 2013

January 2019

1. Introduction

Under the Fiscal Responsibility Act 2012 (the FRA), the Irish Fiscal Advisory Council (the Council) has been assigned the monitoring and assessment functions required of an independent national institution under the Treaty on Stability, Co-ordination and Governance in the Economic and Monetary Union. The FRA establishes the Council and assigns to it responsibility for examining and reporting on the appropriateness of the fiscal stance.

Specifically, under the FRA, the functions of the Council are to:

- Assess the official forecasts produced by the Department of Finance;
- Assess whether the fiscal stance of the Government is conducive to prudent economic and budgetary management, including with reference to the provisions of the Stability and Growth Pact;
- Monitor and assess compliance with the budgetary rule as set out in the FRA, including assessment of whether exceptional circumstances exist or have ceased to exist;
- Be independent in the performance of its functions.

In addition to this assessment function, following the agreement at European level on the Regulation on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (EU Regulation No 473/2013), Ireland is required under Article 4.4 to have its national medium-term fiscal plans and draft budgets based on independent macroeconomic forecasts, which means macroeconomic forecasts produced or endorsed by an independent body. In Ireland's case, this endorsement function is set out in the Fiscal Responsibility Acts 2012 and 2013 (henceforth referred to as the Act) that entered into force on 23 July 2013. Under the Act, the Council as an independent body (as defined in Article 2.1.a of Regulation No 473/2013) has been assigned the endorsement function, and shall *"endorse, as it considers appropriate, the macroeconomic forecasts prepared by the Department of Finance on which the Budget and stability programme will be based"*.

The purpose of this Memorandum of Understanding between the Council and the Department of Finance is to outline the modalities of the arrangements necessary for the Council to carry out this endorsement function. It deals with:

- the coverage of the macroeconomic projections that are subject to endorsement;
- the informational requirements and the broad approach that will be used by the Council in undertaking the exercise;
- timing issues;
- the form in which an endorsement may be provided; and
- provisions for a periodic review of the arrangements described in this Memorandum.

2. Coverage of the Macroeconomic Projections

2.1 Demand side

The overall set of macroeconomic projections subject to formal endorsement by the Council are those underpinning the Budget for the following year and the forecasts to be published in the Stability Programme (SPU).[1] In line with requirements under the two-pack, the Government has decided that Budget Day will be on or before October 15th each year from 2013 on. The Stability Programme must be submitted to the European Commission by the end of April each year.

The set of key variables taken into account in the endorsement will cover those published in the Budget and the SPU and will include: (i) real and nominal aggregate GDP and GNP changes; (ii) changes in major expenditure components (nominal and real), namely, personal consumption of goods and services, gross domestic fixed capital formation (including components), net expenditure by central and local government on current goods and services, exports of goods and services, and imports of goods and services; (iii) the current account of the balance of payments; (iv) factor income and average wage compensation, employment, average hours worked, unemployment, personal disposable income and its decomposition into labour income, taxes, transfers and capital income;[2] (v) HICP inflation, the GDP deflator and the modified current account The Department will provide quarterly profiles for the variables set out in (i) and (ii), as well as for employment, unemployment, HICP inflation and the GDP deflator.[3]

2.2 Supply side

[1] Regulation No 473/2013 refers to "the main assumptions of the independent macroeconomic forecasts and important economic developments which are relevant to the achievement of budgetary targets" and "an annex containing the methodology, economic models and assumptions, and any other relevant parameters underpinning the budgetary forecasts and the estimated impact of aggregated budgetary measures on economic growth."

[2] The Council acknowledges that trends in some of the personal disposable income components can be volatile and prone to revision and will take this into account in interpreting the forecasts.

[3] For investment, the Department will provide quarterly profiles for aggregate headline investment and underlying investment, i.e. investment excluding intangibles and airplanes.

Consistent with the methodology commonly agreed between EU Member States and the European Commission, the Department will provide supply-side working estimates of: (vi) real potential output, (vii) total factor productivity (TFP), trend TFP, (viii) the capital stock, (ix) the working age population, the trend labour force participation rate, structural unemployment, and the trend level of hours worked.

The Department will provide details to the Council of any changes to model parameters, data or other inputs used to calculate the supply-side estimates in line with the Commonly Agreed Methodology. The Department will clarify whether these changes have been agreed at European level. These Department of Finance variables are provided to inform the pace at which any output gap is assumed to close, as well as the assumed trend growth rate of the Irish economy.

The Department will also provide the alternative estimates of the supply side that it intends to publish with the Budget or SPU. The Department will provide details of any changes applied to the published set of models (Murphy et al., 2018) or any new models that may be incorporated into its approach. This information will be published in the Budget or SPU.[4] Significant changes to the model code used to construct these will also be provided, as required by the Council. The actual output measures used to calculate the output gap will be provided as will other input variables The Department will provide details on how any input variables are constructed.

[4] Murphy, G., Macheva, M., and Daly L. 2018 Estimating Ireland's Outout Gap

3. Informational Requirements and Approach to be Followed

a. The Department will set out its forecast methodology by way of a periodically-updated staff working paper, and engage in regular technical dialogue to ensure that Council staff and members have a full understanding of the process.

b. **For each endorsement exercise, the Department will provide, as a basis for the Council's endorsement the full set of macroeconomic variables referred to in Section 2, as well as the other relevant and necessary variables used to generate these published macroeconomic projections.** The Department will provide the Council with the information required (including the key quantitative elements) to assess the methodology and internal consistency of the forecasts. It will also outline by way of oral presentation to the Council the elements of judgement involved in its forecasts.

c. The Department will indicate the assumptions used for all exogenous variables, including interest rates, exchange rates, commodity prices and trading partner demand, the most up to date baseline fiscal assumptions for both the current year and subsequent forecast years.

d. The Department will provide in a timely manner relevant information used in the preparation of its forecasts that may reasonably be requested by the Council. Most of this information will be provided by Departmental staff. However, if important components of the Department's forecasts (for example, those for private investment or multinational sector exports) are based on views provided by other official agencies or non-official agencies, the Council may engage in direct contact with these agencies.

e. The Department will indicate to the Council what information shared with the Council as part of the endorsement function is required to be treated as confidential under the Act.

f. The Council will consider the appropriateness of the forecasts (as most likely projections), taking into account the suitability of the underlying forecast

methodology and the plausibility of the judgements embedded in the projections. The Council recognises the inherent uncertainty surrounding forecasts and that appropriate forecasts may lie within a range.

g. The Council will seek to develop and maintain the technical capacity and analytical expertise to evaluate in detail macroeconomic projections for Ireland. The Council will communicate regularly as to its approach to the endorsement function, including the analysis underpinning its assessments. While point estimates of macroeconomic variables are required as forecast outputs, both parties note that output volatility and the magnitude of revisions to Irish economic aggregates can be large.

4. Timing

a. It is expected that the process described in Section 3 will be ongoing, involving both written exchange of information and informal interaction. Interaction will mainly occur between members of the Council Secretariat and the relevant Department of Finance staff. The Council Secretariat and the Department will each designate one person to be the central point of contact for these exchanges (in the Department's case a member of the forecasting team), with all requests for information to be copied to the Central Budget Office, Department of Finance. Council members may also, on occasion, participate in the discussions, as appropriate.

b. In order to ensure that the Council is in a position to carry out its formal function in an effective and timely fashion, the following timetable, will apply:

(i) By no later than 10 September the Department will communicate in writing to the Council the day in October on which the Budget is to be held. The Department shall communicate to the Council no later than 11 March the date that the Stability Programme Update (SPU) is to be made public.

(ii) Once the date of Budget or SPU has been communicated to the Council, staff of the Department and the Council involved in the forecasting process will not discuss respective work-in-progress forecasts bilaterally until they have been communicated formally to Council Secretariat (see (iii)) This does not preclude discussions on technical clarifications.

(iii) As early as possible, in any event, by no later than fifteen working days prior to Budget day or the SPU's publication, Departmental staff will provide to the Council Secretariat their preliminary set of forecasts in electronic form. It is understood that these are provisional in nature, will necessarily not take into account data released between then and Budget day or SPU publication, and serve as a basis for informal discussion. Such discussion will include a presentation by Departmental staff at a meeting with the Secretariat in which individual Council members may participate.

(iv) Following such interaction, no later than ten working days prior to Budget day or SPU publication, the Department will provide at a meeting with the Council its "provisional final" macroeconomic forecasts. These forecasts will incorporate the impact of the most recent, officially-articulated consolidation/expansion measures foreseen in the Budget.

(v) The final amount of fiscal measures, and their composition between expenditure and tax measures (as well as the precise details of individual measures) may not be available, pending subsequent Government decisions and announcement on Budget day. Accordingly, the official macroeconomic forecasts published in the Budget may differ from the "provisional final" forecasts endorsed by the Council (see Section 5).

(vi) If modifications are made, the Department will provide to the Council on Budget day a reconciliation table between endorsed and final forecasts for all years affected by the discretionary fiscal policies.

(vii) The Department will detail the specific calculations (including multipliers and import elasticity assumptions) used in (v) determining the impact of the aggregate of Budget measures on the endorsed forecasts for GDP and its components, HICP and the labour market.

(viii) This information may be used by the Council in its subsequent publications and communications.

(ix) Any revisions to the "provisional final" forecast in the light of interactions with the Council or other factors would be provided to the Council at least two working days before the final deadline to send the endorsement letter referred to in Section 5.

5. Endorsement

5.1 Communication of Endorsement Decision

An endorsement would be provided via a formal letter from the Chair of the Council to the Secretary General of the Department of Finance, and simultaneously in electronic format. This letter would be sent after the meeting referred to in 4.1.b.(iv) and no later than five working days in advance of Budget day or SPU publication. This letter would be made public by the Council and the Department of Finance no later than on Budget day, once the Minister for Finance begins speaking, or on the day of SPU publication and will also be included in the Budget book or the SPU publication as appropriate.

The letter from the Chair of the Council would not typically contain any commentary on the macroeconomic forecasts. Council views regarding the forecasts or parts thereof (including any possible late modifications referred to in 4 1.b.(v)) would be contained in the Council's subsequent Fiscal Assessment Report.

In the event that the Council were to conclude on a preliminary basis that it had significant reservations as regards the preliminary or the "provisional final" forecasts referred to above, these would be communicated to the Department immediately on an informal basis. Further discussions could then take place between the Department and the Council and a revised "provisional final" forecast addressing the concerns raised could be provided to the Council as a basis for endorsement subject to the timing set out in 4.1.b.(ix). The substantive conclusions of such discussions would be reflected in written communications between the Council and the Department.

If, at the end of the process, the Council was not in a position to endorse the macroeconomic forecasts underlying the Budget or SPU, the Chair of the Council would write to the Secretary General prior to the publication of the Budget or SPU outlining the reasons why such was the case, no later than five working days prior to Budget day or SPU publication. Such a letter would also be made public by the Council and the Department no later than on Budget day or SPU publication, once the Minister for Finance begins speaking.

5.2 Post-endorsement discussions

Departmental staff and the Council secretariat will meet no later than six weeks after each endorsement to review the implementation of the process. Council members may attend as appropriate.

5.3 Commentary on endorsement

The Council may comment on the endorsement exercise in its subsequent Fiscal Assessment Report or other publications. Material of a factual nature relating to the endorsement exercise for publication will be supplied to the Department no later than five working days in advance of publication to allow for comment on issues solely of a factual nature. This does not prejudice the Council's sole responsibility for the content of the Report.

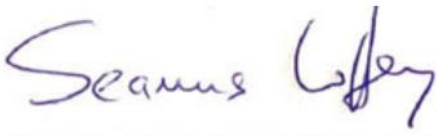
6. Publication and Review

This Memorandum of Understanding will be posted on the websites of both the Council and the Department.

In any event, the content of this Memorandum will be reviewed by both sides no later than one year from the date of signature, or earlier at the agreement of both parties. Any revisions that may prove necessary as a result of this review will be introduced subject to the agreement of both parties.

Derek Moran
Secretary General, Department of Finance

Date: 26/2/19



Seamus Coffey
Chair, Irish Fiscal Advisory Council

Date: 28/02/2019