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COMMISSION OPINION

of 28.11.2014

on the Draft Budgetary Plan of IRELAND

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING IRELAND

3. On the basis of the Draft Budgetary Plan for 2015 submitted on 15 October 2014 by Ireland, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. After the completion of the Economic Adjustment Programme, Ireland remains subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure for Ireland on 7 December 2010. The country is recommended to correct the excessive deficit by 2015.

5. The Irish economy reached a turning point in the latter part of 2013 and has displayed significant momentum since early 2014. Real GDP growth is forecast at 4.7% in 2014, up from 0.2% in 2013, with contributions from domestic demand and net exports of 3.6 and 1.3 pps., respectively. Growth in gross fixed capital formation is forecast to be particularly strong at 14.6%. The Draft Budgetary Plan assumes that the recovery in domestic demand will accelerate further in 2015 to underpin real GDP growth of 3.9%. The Commission 2014 autumn forecast is somewhat more conservative in both 2014 and 2015, albeit sharing the expectation of the strong growth of 2014 continuing into 2015.

6. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the Irish Fiscal Advisory Council (IFAC). The IFAC is a statutory body mandated to monitor public finances; its independence is formally guaranteed by law. In its endorsement, the IFAC nevertheless flagged the recent changes in the size of Ireland's net exports related to contracted manufacturing (goods and services produced outside Ireland on behalf of an Irish company and sold abroad), which contributed to the exceptionally strong GDP performance in the first half of 2014. According to the IFAC, these changes could make it more difficult to identify the underlying pattern of growth in the economy. For instance, the incidence of export activities from contracted manufacturing could be deferred in time with respect to imports increasing the volatility of national accounts estimates.

7. The Draft Budgetary Plan targets a general government deficit of 3.7% of GDP in 2014 (down from 5.7% of GDP in 2013), 1.4% of GDP below the EDP target and 1.1% of GDP below the target of 4.8% of GDP presented in the 2014 Stability Programme released in April. The improved position for 2014 is expected to carry over into 2015 and beyond. The Draft Budgetary Plan targets a general government deficit of 2.7% of GDP in 2015, 0.3% of GDP lower than in the 2014 Stability Programme. The 2014 headline target presented in the Draft Budgetary Plan implies a primary surplus of 0.3% of GDP - the first primary surplus since 2007. Compared to the 2014 Stability Programme, the improved budgetary outlook for 2014 reflects a combination of factors, notably the stronger-than-expected economic recovery, some windfall revenues beyond the growth surprise due to higher tax elasticities, and the transition to the ESA 2010 accounting methodology. Revenues across the main tax headings have been consistently ahead of profile over the first nine months of 2014. In addition, the presence of some temporary effects (0.25% of GDP), such as increased dividends and higher Central Bank surplus income also contributed to the improving deficit outlook, which the Draft Budgetary Plan assumes to be repeated in 2015.

8. The projections of the Draft Budgetary Plan are broadly in line with the Commission 2014 autumn forecast. The latter assumes slightly higher revenues in 2014 mainly related to social security contributions which, however, are expected to be off-set by some slippages in the health care sector. In 2015, the Commission forecasts a deficit of 2.9% of GDP mainly on account of lower direct tax revenues associated with a more conservative forecast of wage growth.

9. The Draft Budgetary Plan projects gross public debt to fall to around 110.5% of GDP in 2014, down from 123.3% of GDP in 2013, and to 108.5% of GDP in 2015. The sharp decline in 2014 mainly reflects the reclassification of the Irish Banking Resolution Corporation (IBRC) as part of the general government sector with the transition from the ESA95 to the ESA 2010 accounting methodology. From an accounting perspective, the debt reduction is attained through a sizable stock-flow adjustment (€10.5 billion, mainly the effect of the liquidation of IBRC), nominal GDP growth (half of which due to the transition to the new accounting rules) and savings on interest expenditure. From 2015 onward, the projected reduction of the debt-to-GDP ratio is expected to be the result of sustained economic growth and a growing primary surplus. The Commission forecast projects the same downward pattern, with the gross public debt at around 110% of GDP in 2014 and 109% of GDP in 2015 due to the different assumption for the GDP growth, public deficit and deflator.

10. On account of the stronger-than-expected economic recovery in 2014 and buoyant tax revenues, the Draft Budgetary Plan targets a correction of the excessive deficit by 2015 without further consolidation measures beyond those already decided in the past, whereas the 2014 Stability Programme still envisaged additional measures of around €2.0 billion. On the contrary, while targeting a more ambitious headline deficit, the Draft Budgetary Plan includes new expansionary measures of around €1 billion (0.5% of GDP) consisting of both tax cuts and expenditure increases. As a result, the deficit reduction in 2015 essentially relies on the projected economic recovery and broadly stable expenditure levels compared to 2013.

11. In 2014, both the Draft Budgetary Plan and the Commission 2014 autumn forecast project a general government deficit that stays well within the EDP deficit ceiling of 5.1% of GDP. For 2015, the Draft Budgetary Plan targets a headline deficit that

would also stay within the EDP ceiling of 2.9% of GDP, albeit by a smaller margin than in 2014, while the Commission expects the deficit to be in line with the ceiling. According to the Commission forecast, the structural budget balance is estimated to improve by 1.0% of GDP in 2014 and by 0.4% of GDP in 2015. The adjusted average annual improvement of the structural budget balance is estimated at 1.1% of GDP over the period 2011-2014 and also 1.1% of GDP when taking into account 2015 projections, below the recommended average annual fiscal effort of 1.9% of GDP. An assessment of the individual, permanent consolidation measures taken under the programme and thereafter shows adherence to the amount of measures that were originally projected to be necessary to reach the annual fiscal targets over the period 2011-2014. In turn, the tax cuts and expenditure increases included in the 2015 budget conflict with the part of the EDP recommendation that asks Ireland to seize opportunities, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards 60% of GDP. Based on an overall assessment of the Draft Budgetary Plan, Ireland is expected to bring the general government deficit below the 3% of GDP reference value of the Treaty in 2015.

12. Concerning the fiscal recommendations issued in the context of the European Semester, in addition to the reaffirmed commitment to correct the excessive deficit by 2015, the Draft Budgetary Plan confirms that Ireland is on its way to enhance the credibility of the fiscal adjustment strategy as it includes budgetary planning for more than one year ahead. By contrast, no changes have been made regarding the need to ensure the binding nature of the government expenditure ceiling. The decision to put an end to the "double Irish" tax system can help broaden the tax base. Concerning other Country Specific Recommendations (CSRs), some progress has been achieved in implementing reforms in healthcare, active labour market policies, further education and training, addressing the financing needs of SMEs and in monitoring banks' performance against the mortgage arrears resolution targets. In turn, only limited progress has been achieved in implementing the recommended reforms to the legal services sector, in tackling low work intensity of households, addressing the poverty risk of children and facilitating female labour market participation. The Draft Budgetary plan contains measures that can reduce the tax wedge through a moderate reduction on personal income taxes (bands and rates) and easing the burden of the Universal Social Charge, targeting, in particular, the lowest income earners.

13. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Ireland, which is currently under the corrective arm, is compliant with the provisions of the Stability and Growth Pact. However, the Commission invites Ireland to use the better-than-expected economic recovery to accelerate the reduction of the debt-to-GDP ratio. While current forecasts are consistent with a timely correction of the excessive deficit, more ambitious deficit targets for 2015 and 2016 would help to firmly bring the very high government debt-to-GDP ratio on a downward path. Finally, the Commission invites Ireland to stand ready, if needed, to take the necessary measures to ensure the timely correction of the excessive deficit in 2015.

    The Commission is also of the opinion that Ireland has made some progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the 2014 European Semester and thus invites the authorities to make further progress.

Done at Brussels, 28.11.2014

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For the Commission
Pierre MOSCOVICI
Member of the Commission