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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Ireland

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Ireland

{C(2018) 8019 final}

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1. INTRODUCTION

Ireland submitted its Draft Budgetary Plan (DBP) for 2019 on 15 October 2018 in compliance with Regulation (EU) No 473/2013. Ireland is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium term budgetary objective (MTO).

As the debt ratio was 76.8% of GDP in 2015 (the year in which Ireland corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit Ireland is also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark in 2018 and ensure compliance with the debt reduction benchmark as of 2019.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission 2018 autumn forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2018 autumn forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2018-2019 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations in the context of the European Semester adopted by the Council in July 2018,[1] including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

[1] Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of Ireland and delivering a Council opinion on the 2018 Stability Programme of Ireland (OJ C 320, 10.9.2018, p. 27–32).

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the DBP assumes that economic growth will remain robust. After an increase of 7.2% in 2017, real GDP is expected to grow by 7.5% in 2018, an upward revision of almost 2 percentage points from the expected growth in the 2018 Stability Programme. The revision reflects both stronger-than-assumed expansion in underlying domestic demand in the first half of the year and a more positive impact of multinational companies' activities on the headline figures. Notwithstanding the impact of multinationals, various indicators point to a healthy and broad-based domestic economic activity, in particular when looking at the robust performance of the labour market.

The macroeconomic projections in the DBP are broadly in line with the Commission 2018 autumn forecast, even if the latter estimates slightly more positive GDP growth rates over the forecast horizon. The differences are mostly linked to expectations regarding business services imports, particularly imports of intangibles, and their subsequent impact on GDP growth rates. Nevertheless, discounting for the impact of multinationals, growth of the underlying domestic activity is expected to remain strong in both the DBP and the Commission forecast, supported by solid construction investment and private consumption.

As regards HICP inflation, the DBP scenario and the Commission forecast are in line for 2018 but they differ for 2019. They both project an inflation rate of 0.7% in 2018, given the outturn for the year so far, and an acceleration in 2019, as service prices rise in line with strong domestic demand. However, the DBP's inflation forecast is more dynamic than that of the Commission, as it factors in a waning of the deflationary trend in goods prices, while the Commission expects non-energy industrial goods to keep dampening inflation, owing to quality adjustment issues. Employment growth is expected to improve further in both forecasts, even though the Commission expects slightly lower unemployment rates in 2019.

Table 1: Comparison of macroeconomic developments and forecasts

	2017	2018			2019		
	CO	SP	DBP	CO	SP	DBP	CO
Real GDP (% change)	7,2	5,6	7,5	7,8	4,0	4,2	4,5
Private consumption (% change)	1,6	2,6	3,5	3,1	2,4	3,0	2,9
Gross fixed capital formation (% change)	-31,0	8,5	-8,9	-7,3	7,4	7,1	5,7
Exports of goods and services (% change)	7,8	6,9	7,0	6,1	5,4	5,6	4,5
Imports of goods and services (% change)	-9,4	6,6	0,9	-0,3	5,9	6,2	4,1
Contributions to real GDP growth:							
- Final domestic demand	-10,1	3,0	-0,5	-0,2	2,8	2,7	2,6
- Change in inventories	-1,1	0,0	0,5	0,5	0,0	0,0	0,0
- Net exports	19,1	2,5	7,5	7,5	1,2	1,4	1,9
Output gap[1]	0,0	0,8	0,6	0,2	0,5	1,1	0,8
Employment (% change)	2,9	2,7	3,0	3,1	2,3	2,8	2,6
Unemployment rate (%)	6,7	5,8	5,8	5,6	5,3	5,2	5,1
Labour productivity (% change)	4,2	2,8	4,4	4,6	1,7	1,4	1,9
HICP inflation (%)	0,3	0,8	0,7	0,7	1,0	1,5	1,2
GDP deflator (% change)	0,4	0,0	1,8	1,7	1,3	1,9	1,9
Comp. of employees (per head, % change)	0,9	2,6	2,4	2,7	2,8	3,0	3,0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1,1	12,2	12,0	3,5	11,4	11,7	3,8

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the DBP/programme scenario using the commonly agreed methodology.

Source:
Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

Similarly to the Commission forecast, risks to the macroeconomic projections underlying the DBP are tilted to the downside. The most important source of uncertainty in both forecasts relates to the ongoing negotiations over the terms of the UK's withdrawal from the EU, while changes to the international trade environment also represent a challenge.

The output gaps as recalculated by the Commission based on the information in the DBP, following the commonly agreed methodology, suggest a positive gap in 2018 and 2019. The methodology has been adjusted to mitigate distortions of the potential output estimate due to the high GDP growth rates and discrepancy between wage inflation and productivity, which are largely driven by the activities of multinationals with limited impact on the domestic economy.[2] The output gap of the DBP taken at face value is higher than the recalculated gap in 2018 and 2019, but both are positive in that period.[3]

Overall, the macroeconomic projections underlying the DBP are plausible.

Box 1: The macro economic forecast underpinning the budget in Ireland

The macroeconomic forecast in Ireland's DBP for 2019 was prepared by the Department of Finance. The task of assessing and endorsing the macroeconomic forecast underpinning the draft budget was assigned to the Irish Fiscal Advisory Council (IFAC), an independent statutory body also mandated to independently provide an assessment of, and to publicly comment on, whether the government is meeting its own stated budgetary targets and objectives.

The procedures underlying the endorsement process have been set out in a Memorandum of Understanding (MoU), which was agreed between the Department of Finance and IFAC. On 2 October 2018, the IFAC sent a letter to the Department of Finance on the macroeconomic forecasts of the Department. It endorsed the set of macroeconomic projections underpinning the 2019 DBP for the years 2018 and 2019, as within the range of appropriate forecasts.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP projects a general government deficit of 0.1% of GDP in 2018, slightly less than the 0.2% of GDP predicted in the 2018 Stability Programme, but in line with the Commission 2018 autumn forecast. The improvement compared to the 2018 Stability Programme is mostly due to the revised deficit outturn in 2017 and output projection for 2018. This is despite higher expenditure, mainly on the current side, primarily due to over-spending within the health sector.

For 2019, the DBP aims at eliminating the general government deficit, implying a slight improvement compared to the deficit of 0.1% of GDP expected both in the 2018 Stability Programme, prepared under no-policy-change assumptions, and the Commission 2018 autumn forecast. The Commission deficit forecast mainly reflects more conservative revenue estimates.

The DBP projects total revenues of EUR 85.2 billion in 2019, up by 5.4% compared to the previous year and EUR 2.6 billion above the 2018 Stability Programme, on the back of resilient economic growth and the announced revenue raising measures. The DBP projects income tax revenues to grow by 3.8% y-o-y despite the planned, yet fairly moderate, tax cuts, the effect of which is partly offset by tax compliance measures. Taxes on production and

[2] A dummy has been included for total factor productivity and Hodrick-Prescott filter of the unemployment rate has used instead of the non-accelerating wage rate of unemployment.

[3] Differences between the face value and the recalculation are mostly due to the above-mentioned adjustments of the methodology, not fully included in the DBP. The Department of Finance's preferred, alternative estimates also suggest lower output gaps than those of the DBP taken at face value (a modest negative output gap in 2018, turning slightly positive in 2019). Their fuller assessment is set out in *Budget 2019 – Economic and Fiscal Outlook*, October 2018, available at: http://www.budget.gov.ie/Budgets/2019/Documents/Budget_2019_Economic_and_Fiscal_Outlook_E.pdf

imports are projected to increase by 5.2% y-o-y, as a result of growth of personal consumption and the increase in the reduced rate of value added tax on tourism activities.

Turning to the expenditure side, the DBP projects primary expenditure to reach EUR 80.3 billion in 2019, nearly EUR 2.6 billion above the targets presented in the 2018 Stability Programme, reflecting the new spending initiatives. On a year-on-year basis, primary expenditure is projected to increase by 5.9%.

Risks associated with both the DBP and the Commission budgetary projections are on the downside and mainly relate to uncertainties surrounding the macroeconomic outlook, the volatility of some sources of government revenues, such as corporate income tax, and over-spending within the health sector.

On the basis of the information provided in the DBP, the structural deficit[4] is estimated at 0.4% of GDP in 2018 and 0.6% in 2019. Conversely, the 2018 Stability Programme projected the (recalculated) structural deficit at 0.6% of GDP in 2018 and 0.4% of GDP in 2019. The deterioration of the structural balance in the Commission 2018 autumn forecast is broadly comparable to that in the DBP. Against the background of falling interest expenditure, the projected change in the (recalculated) structural balance in 2018 and 2019 (of 0.0% and -0.2, respectively) is accompanied by a more pronounced deterioration in the structural primary balance (-0.3% of GDP in each year).

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Ireland currently standing at 0.99%.[5] As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the DBP, interest expenditure is expected to fall from 2.0% of GDP in 2017 to 1.6% in 2018 and 1.5% of GDP in 2019, well below the 4.2% recorded back in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from Ireland's plans is broadly confirmed by the Commission forecast.

[4] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology

[5] 10-year bond yields, 24 October 2018. Source: Bloomberg

Table 2. Composition of the budgetary adjustment

(% of GDP)	2017	2018			2019			Change: 2017-2019
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**	**DBP**
Revenue	**26,0**	**25,4**	***25,1***	**25,0**	**25,1**	***25,0***	**24,6**	**-1,0**
of which:								
- Taxes on production and imports	8,4	8,0	*7,8*	7,8	8,0	*7,8*	7,8	-0,6
- Current taxes on income, wealth, etc.	10,5	10,6	*10,6*	10,5	10,5	*10,4*	10,3	-0,1
- Capital taxes	0,2	0,1	*0,1*	0,1	0,1	*0,1*	0,1	-0,1
- Social contributions	4,3	4,2	*4,1*	4,1	4,2	*4,3*	4,2	0,0
- Other (residual)	2,7	2,5	*2,5*	2,4	2,3	*2,4*	2,2	-0,3
Expenditure	**26,3**	**25,6**	**25,2**	**25,1**	**25,2**	**25,0**	**24,7**	**-1,3**
of which:								
- Primary expenditure	24,3	23,9	23,6	23,5	23,6	23,5	23,3	-0,8
of which:								
Compensation of employees	7,0	6,8	6,8	6,8	6,7	6,7	6,6	-0,3
Intermediate consumption	3,4	3,4	3,4	3,4	3,3	3,8	3,7	0,4
Social payments	9,9	9,3	9,0	9,0	8,9	8,7	8,6	-1,2
Subsidies	0,6	0,6	0,6	0,6	0,6	0,5	0,6	-0,1
Gross fixed capital formation	1,8	2,2	2,1	2,1	2,3	2,3	2,4	0,5
Other (residual)	1,6	1,6	1,7	1,5	1,8	1,5	1,5	-0,1
- Interest expenditure	2,0	1,7	1,6	1,6	1,6	1,5	1,4	-0,5
General government balance (GGB)	**-0,2**	**-0,2**	**-0,1**	**-0,1**	**-0,1**	**0,0**	**-0,1**	**0,2**
Primary balance	**1,7**	**1,5**	**1,5**	**1,5**	**1,5**	**1,4**	**1,3**	**-0,3**
One-off and other temporary measures	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
GGB excl. one-offs	**-0,2**	**-0,2**	**-0,1**	**-0,1**	**-0,1**	**0,0**	**-0,1**	**0,2**
Output gap[1]	0,0	0,8	0,6	0,2	0,5	1,1	0,8	0,8
Cyclically-adjusted balance[1]	-0,2	-0,6	-0,4	-0,2	-0,4	-0,6	-0,5	-0,2
Structural balance (SB)[2]	**-0,2**	**-0,6**	**-0,4**	**-0,2**	**-0,4**	**-0,6**	**-0,5**	**-0,2**
Structural primary balance[2]	1,7	1,1	1,2	1,4	1,2	0,9	0,9	-0,6

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

3.2. Debt developments

Ireland's general government debt-to-GDP ratio is projected to continue declining, having peaked at just below 120.0% in 2012. The DBP estimates gross debt to fall to 64.0% of GDP in 2018 and to reach 61.4% in 2019, contingent on continued robust GDP growth and the realisation of primary budget surpluses. The improvement (by 2.0% and 2.1% of GDP, respectively) compared to the projections in the 2018 Stability Programme is primarily due to the denominator effect of higher nominal growth. However, due to the significant impact of multinational companies on Ireland's GDP and GNP, these macro-aggregates tend to overstate the actual size of the domestic economy. A range of other metrics, including a debt-to-modified-GNI[6] ratio, shows that Ireland's stock of public debt remains high by historical and international standards.[7]

Table 3. Debt developments

(% of GDP)	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**68,4**	**66,0**	**64,0**	**63,9**	**63,5**	**61,4**	**61,1**
Change in the ratio	-5,0	-2,4	-4,4	-4,6	-2,5	-2,6	-2,7
Contributions[2]:							
1. Primary balance	**-1,7**	**-1,5**	**-1,5**	**-1,5**	**-1,5**	**-1,4**	**-1,3**
2. "Snow-ball" effect	**-3,2**	**-1,9**	**-4,2**	**-4,3**	**-1,7**	**-2,3**	**-2,4**
Of which:							
Interest expenditure	2,0	1,7	1,6	1,6	1,6	1,5	1,4
Growth effect	-4,9	-3,6	-4,7	-4,9	-2,5	-2,5	-2,7
Inflation effect	-0,3	0,0	-1,1	-1,1	-0,8	-1,2	-1,1
3. Stock-flow adjustment	**0,0**	**1,0**	**1,3**	**1,3**	**0,8**	**1,1**	**1,1**
Of which:							
Cash/accruals difference		0,4	0,20		0,3	0,20	
Net accumulation of		-0,5	-0,70		-0,4	-0,30	
of which privatisation proceeds		0,0			0,0		
Valuation effect & residual		0,0			0,0		

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

According to the Commission 2018 autumn forecast, the general government debt-to-GDP ratio is projected to continue declining to 63.9% and 61.1% in 2018 and 2019 respectively, on the back of continued robust economic growth.

Overall, government financing has benefitted from the low interest rate environment and supportive bond market conditions. Any change to this favourable situation could have an adverse impact on debt projections. However, as most of the outstanding stock of debt is at

[6] The Modified Gross National Income (also known as GNI*), provided by the Irish statistical authorities, more accurately reflects the income of Irish residents than GDP. It differs from actual GNI in that it excludes *inter alia* the depreciation of foreign-owned, but Irish-resident, capital assets (most notably intellectual property and assets associated with aircraft leasing) and the undistributed profits of firms that have re-domiciled to Ireland.

[7] A fuller assessment of debt dynamics is set out in the Department of Finance's Annual Report on Public Debt in Ireland, September 2018 available at https://www.finance.gov.ie/updates/annual-report-on-public-debt-in-ireland/

fixed rates, risks to debt projections mainly relate to changes to the economic outlook. Prudently, the DBP's debt projections do not include potential revenue from envisaged sales of equity shares in a number of financial institutions.

3.3. Measures underpinning the Draft Budgetary Plan

The DBP for 2019 includes some tax reductions, including of personal income taxes by around 0.1% of GDP, mainly through an income tax band change[8], cuts in the Universal Social Charge (USC)[9], and increases in certain tax credits[10]. It includes new spending initiatives of more than 0.4% of GDP. They will be partly financed by several revenue-raising measures, including increases in the rate of value-added-tax on tourism activities, employer contributions to the National Training Fund, tobacco excise duties and betting duty, which are reported to reduce the overall net impact of the budgeted measures to around -0.1% of GDP. All were included in the Commission forecast. Not included is a continued non-indexation of income tax bands, with an estimated budgetary impact of around 0.2% of GDP in a full year, which is considered to be of a permanent nature. Hence, the Commission forecast includes an overall net impact of around -0.3% of GDP.

The bulk of the current expenditure increases are directed towards areas of health (around 0.2% of GDP),[11] social protection (around 0.1% of GDP),[12] housing (0.05% of GDP)[13] and childcare (0.05% of GDP).[14] The government's capital allocation for 2019 is broadly in line with the overall allocation set out in the National Development Plan.[15]

[8] The income threshold to the higher personal income tax rate will be raised by EUR 750 to EUR 35 300.

[9] The income threshold to the third USC rate will be raised by EUR 502 to EUR 19 372. The applicable rate will be cut by 0.25 percentage points to 4.5%.

[10] These refers to an increase in the Home Carer Tax Credit from EUR 1 200 to EUR 1 500 and to the increase of the Earned Income Credit for self-employed from EUR 1 150 to EUR 1 350.

[11] Expenditure measures in the health area mainly relate to a commitment to improve the access to health services, through investment across hospital services and the National Treatment Purchase Fund.

[12] Spending on social protection includes a EUR 5 per week increase in maximum rates, with proportionate increases for qualified adults and those on reduced rates. On the other hand, the continuing improvement in the number of unemployed has resulted in additional resources from the Live Register related savings. The DBP estimates savings of around EUR 287 million in 2019.

[13] This includes an increase to the Housing Assistance Payment Scheme and Social Housing Current Expenditure Programme.

[14] Expenditure measures in childcare relate to additional funding for the *Tusla* child and family agency and early years care and education.

[15] http://www.per.gov.ie/wp-content/uploads/NDP-strategy-2018-2027_WEB.pdf

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by general government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2018	**2019**	**2020**
Taxes on production and	0,0	0,2	0,0
Current taxes on income,	0,0	0,1	0,0
Capital taxes	n.a.	n.a.	n.a.
Social contributions	0,0	0,0	0,0
Property Income	n.a.	n.a.	n.a.
Other	n.a.	n.a.	n.a.
Total	0,0	0,3	0,1

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2019

B. Discretionary measures taken by general government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2018	**2019**	**2020**
Compensation of employees	0,0	0,2	0,0
Intermediate consumption	0,0	0,2	0,0
Social payments	0,0	0,0	0,0
Interest Expenditure	n.a.	n.a.	n.a.
Subsidies	0,0	0,0	0,0
Gross fixed capital formation	0,0	0,0	0,0
Capital transfers	n.a.	n.a.	n.a.
Other	0,0	0,0	0,0
Total	0,0	0,4	0,0

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2019

4. Compliance with the provisions of the Stability and Growth Pact

Ireland is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. Box 2 reports the latest country specific recommendations in the area of public finances. Ireland is also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark. After the transition period, as of 2019, Ireland needs to comply with the debt reduction benchmark.

Box 2. Council recommendations addressed to Ireland

On 13 July 2018, the Council addressed recommendations to Ireland in the context of the European Semester. In particular, in the area of public finances the Council recommended to Ireland (i) to achieve the medium-term budgetary objective in 2019 and (ii) to use windfall gains to accelerate the reduction of the general government debt ratio. However, in view of the Commission 2018 autumn forecast Ireland will be above its MTO in 2018 and, in line with the arrangements in place for updating the fiscal requirements contained in the country-specific recommendations[16], the nominal growth rate of net primary government expenditure should not exceed 7.0%, corresponding to an allowed deterioration in the structural balance by 0.3% of GDP.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2015, Ireland is in the transition period for the following three years to make sufficient progress (as defined by the minimum linear structural adjustment (MLSA)) towards compliance with the debt reduction benchmark at the end of the transition period.

Table 5. Compliance with the debt criterion

	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	68,4	66,0	64,0	63,9	63,5	61,4	61,1
Gap to the debt benchmark [1,2]					-4,5	n.a.	-7,0
Structural adjustment [3]	0,8	-0,5	0,0	0,0			
To be compared to:							
Required adjustment [4]	-2,8	-5,8	n.a.	-8,5			

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

[16] Those arrangements, known as the 'unfreezing' principle, are referred to in the Opinion of the Economic and Financial Committee of the Council on "Improving the predictability and transparency of the SGP: A stronger focus on the expenditure benchmark in the preventive arm", of 29 November 2016, and have been specified further in subsequent discussions with the Member States.

The DBP does not include sufficient information to assess compliance with the transitional arrangement for debt reduction. According to the Commission 2018 autumn forecast, the change in the structural balance is expected to exceed the required MLSA in 2018 (projected change of 0.0% of GDP vs. required change of -8.5% of GDP). Therefore, Ireland is expected to make sufficient progress towards compliance with the debt criterion in 2018.

As of 2019, Ireland needs to comply with the debt reduction benchmark. According to the Commission 2018 autumn forecast, the debt reduction benchmark is expected to be met in 2019, as Ireland's debt-to-GDP ratio is projected to be below the debt benchmark, with a gap of -7.0%.

4.2. Compliance with the adjustment towards the MTO

In 2018, according to the information provided in the DBP, the MTO is projected to be met, thus currently pointing to compliance. At the same time, in 2017, Ireland received an adjustment requirement for 2018, which remains fixed for the in-year assessment. The expenditure benchmark would currently point to a deviation of 0.3% from that requirement of a nominal rate of growth of net primary government expenditure[17] not exceeding 2.4%. The two-year average deviation would be above the applicable significant deviation threshold of 0.25% of GDP. The (recalculated) change in the structural balance (0.0% of GDP) would be below the 0.6% of GDP required to ensure sufficient progress towards the MTO, based on the frozen requirement for 2018. Over 2017 and 2018 taken together, the structural balance pillar would point to a risk of some deviation (of 0.1% of GDP), based on the frozen requirement for 2018.

Similar conclusions can be drawn based on the Commission 2018 autumn forecast, according to which the MTO is projected to be met by a margin, thus currently pointing to compliance. The expenditure benchmark would point to some deviation in 2018 from the frozen requirement, but to a significant deviation in 2017 and 2018 taken together. This would be confirmed even taking into account the additional revenue linked to the continued non-indexation of income tax bands. The structural balance would point to a significant deviation in 2018 and some deviation in 2017 and 2018 taken together, based on the frozen requirement. If compliance with the MTO can no longer be established at the time of the ex-post assessment for 2018, an overall assessment of compliance will need to take into account a possible deviation from those requirements.

[17] Net government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out. Ireland's data on current and capital transfers from EU institutions remain unavailable.

Table 6: Compliance with the requirements of the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	-0,5	-0,5		-0,5	
Structural balance[2] (COM)	-0,2	-0,2		-0,5	
Structural balance based on freezing (COM)	-1,1	-0,2		-	
Position vis-a -vis the MTO[3]	Not at MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0,3	0,6		0,0	
Required adjustment corrected[5]	0,3	0,6		-0,3	
Change in structural balance[6]	0,7	0,0	0,0	-0,2	-0,3
One-year deviation from the required adjustment[7]	0,4	-0,5	-0,6	0,1	0,0
Two-year average deviation from the required adjustment[7]	0,1	-0,1	-0,1	-0,2	-0,3
Expenditure benchmark pillar					
Applicable reference rate[8]	2,2	2,4		7,0	
One-year deviation adjusted for one-offs[9]	-0,4	-0,3	-0,5	0,7	0,5
Two-year average deviation adjusted for one-offs[9]	-0,4	-0,4	-0,5	0,2	0,0

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2017) was carried out on the basis of Commission 2018 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations.

In 2019, Ireland is projected to have a structural balance of -0.6% of GDP, slightly lower than the MTO of -0.5%, based on the DBP. The nominal growth rate of government expenditure, net of discretionary revenue measures, is expected to be below the expenditure benchmark, leading to a positive gap of 0.7% of GDP. Similarly, over 2018 and 2019 taken together, the average deviation based on the expenditure benchmark pillar also points to compliance. The (recalculated) change in the structural balance is expected to be above the -0.3% of GDP required in 2019. Over 2018 and 2019 together, the (recalculated) structural balance points to some deviation (gap of -0.2% of GDP), based on the frozen requirement for 2018. This calls for an overall assessment. Given the very open nature of the Irish economy and the volatility of potential GDP estimates, the expenditure benchmark provides a more appropriate yardstick for fiscal policy. Hence, the overall assessment based on the DBP points to compliance.

Based on the Commission 2018 autumn forecast, Ireland is projected to remain at its MTO in 2019. Thus, the assessment based on the Commission 2018 autumn forecast also points to compliance.

5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

The decline in the general government deficit projected by the DBP for 2019 is driven by a slightly stronger decline of expenditure than in revenues as a percentage of GDP, with revenues expected to decline by 0.1% of GDP and expenditure by 0.2% of GDP (to 25.0% of GDP in 2019 in both cases). Similarly, the projected improvement of the structural balance in recent years has been largely driven by declining expenditure ratios, mainly due to lower interest spending but also linked to a reduction in primary expenditure. Based on the DBP projections, public investment is expected to increase by 0.2% of GDP (to 2.3%) in 2019, in line with the government's approach to increase productive investment.

The DBP (specifically in Table 7a) contains a summary of the main country-specific recommendations and (in Table 7b) actions to meet the targets set by the European Union's Strategy for Growth and Jobs. Table 7a offers a short description of the on-going efforts to implement structural reforms, listing initiatives and legislative proposals which have been adopted or are planned in the near future.

The DBP reports no new measures concerning the use of windfall gains to accelerate the reduction of the general government debt ratio. With regard to the structural part of the fiscal recommendations, the Commission welcomes the increase in the reduced rate of value added tax on tourism activities, limiting the scope of this tax expenditure. However, some measures do not contribute to limiting the scope of tax expenditures and expanding the tax base.[18]

The DBP reported the publication of the *Sláintecare* Implementation Strategy, which sets out the actions to be taken in the first three years of the healthcare reform programme. However, much of the better-than-expected revenue for 2018 is being used to fund within-year current expenditure increases in healthcare, which raises concerns both about the long-term fiscal sustainability and the pace of adoption of the Strategy. The DBP reports no new measures since the Stability Programme 2018 concerning the sustainability of the pension system.

A comprehensive description of progress made in implementing the country-specific recommendations will be made in the 2019 Country Report.

The DBP for 2019 benefitted from a spending review process which, in its second three-year cycle, has focussed on key strategic/priority areas of expenditure, in terms of the amount of expenditure and the significance of the emerging policy challenges. While expenditure ceilings now include demographic pressures and carry-over effects of previously announced

[18] This includes a decrease in the value added tax rate on electronically supplied publications; increases to tax credits for self-employed and home carers, the interest relief for landlords, the fiscal incentive for certain types of share-based remunerations, a capital acquisition tax threshold; and an extension of a young trained farmers stamp duty relief.

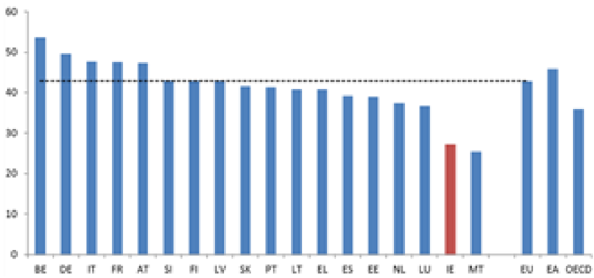
measures, at least in the most critical areas, they have kept drifting up on the back of better-than-expected (but possibly temporary) revenues. The DBP has to an extent also benefited from equality budgeting, where, reflecting the availability of relevant studies, the initial focus is specifically on gender as an equality dimension.

Box 2 – Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker’s net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Ireland for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Ireland at the average wage and at low wage (2017)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

The DBP includes some measures aimed at further relieving the tax burden on labour, mainly through a moderate reduction in personal income taxes. The income threshold to the third USC rate will be raised by EUR 502 to EUR 19 372. The applicable rate will be cut by 0.25 percentage points to 4.5%. By the same token, the income threshold to the higher personal income tax rate rises by EUR 750 to EUR 35 300. The DBP also increases a tax relief for the self-employed and home carers. The measures would contribute to further decreasing the tax burden, particularly on low to middle income earners. The Department of Finance estimates that the cost to the general government in a full year will be approximately EUR 356 million. Conversely, the DBP for 2019 has increased the employer contribution to the National Training Fund levy, which, *ceteris paribus*, will increase the tax wedge. The DBP includes materials and tables showing the impact of those measures on several categories of income earners.

6. OVERALL CONCLUSION

In 2018, the MTO is projected to be met by a margin. Thus, the current assessment of the DBP points to compliance. At the same time, in 2017, Ireland received an adjustment requirement for 2018, which remains fixed for the in-year assessment. Following an overall assessment of the DBP, the expenditure benchmark would currently point to a risk of some deviation from that requirement in 2018 and a significant deviation over 2017 and 2018 taken together. The same conclusion can be drawn based on the Commission 2018 autumn forecast. If compliance with the MTO can no longer be established at the time of the ex-post assessment for 2018, an overall assessment of compliance will need to take into account a possible deviation from those requirements.

In 2019, based on the Commission 2018 autumn forecast, Ireland is projected to remain at its MTO. Thus, the assessment points to compliance. It is confirmed by an overall assessment based on the DBP.

Compliance with the transitional debt rule in 2018 and with the debt reduction benchmark in 2019 is ensured.