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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(2019) 9109 final}

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1. INTRODUCTION

Ireland submitted its Draft Budgetary Plan for 2020 on 15 October 2019 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.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2019 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2019 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2019-2020 (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 2019,[1] including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the Draft Budgetary Plan is based on the assumption of the UK leaving the EU without a deal (at the end of October 2019). After an increase of 8.2% in 2018, real GDP is expected to grow by 5.5% in 2019, an upward revision of 1.6 percentage points from the expected growth in the 2019 Stability Programme. The upward revision reflects stronger-than-expected exports growth in the first half of the year, on the back of a surge in exports of computer services. By contrast, growth in underlying domestic demand has been weaker than previously assumed in the first half of the year, owing to weaker-than-expected domestic investment. The GDP growth forecast would be 0.4 percentage points higher (5.9% in the Department of Finance counterfactual deal scenario) were it not for the assumption of the UK leaving the EU in the fourth quarter of 2019.

The macroeconomic projections for 2019 in the Draft Budgetary Plan are broadly in line with the Commission 2019 autumn forecast. The main differences relate to expectations regarding investment in intangible assets and services imports (which offset each other and are thus

[1] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Ireland and delivering a Council opinion on the 2019 Stability Programme of Ireland, OJ C 301, 5.9.2019, p. 35.

GDP neutral in the short-term). For 2020, the significant difference between the Department of Finance and Commission GDP growth and inflation projections reflect different assumptions on the relationship between the UK and the EU. The Department of Finance counterfactual deal scenario of a 3.1% GDP growth rate in 2020 is broadly in line with the Commission forecast.

The output gap as recalculated by the Commission based on the information in the Draft Budgetary Plan, following the commonly agreed methodology, points toward a positive, albeit declining, gap in 2019 and 2020. The methodology has been adjusted to mitigate distortions of the potential output estimate due to the high GDP growth rates and the discrepancy between wage inflation and productivity, which are largely driven by the activities of multinational companies with limited impact on the domestic economy.[2] The output gap of the Draft Budgetary Plan taken at face value is in line with the Commission's recalculated gap for 2019 and higher in 2020, but both are positive.[3] The Department of Finance has developed its own alternative estimation methods, based on statistical filters, which point to a lower output gap of 1.0% in 2019. In 2020, the alternative estimates suggest a negative output gap of -0.3%, reflecting the projected deceleration of GDP growth from 5.5% in 2019 to 0.7% in 2020.

The uncertainty and risks surrounding the current projections are particularly high given the ongoing discussion on the terms of the UK's withdrawal from the EU and hence unknown final agreements on customs, tariffs and other barriers between Ireland and the UK as well as possibly effects that go beyond trade. All these effects can have a marked impact on fiscal outcomes, including contingency fiscal spending to stabilise the Irish economy.

Overall, the macroeconomic scenario underlying the Draft Budgetary Plan is plausible for 2019 and cautious for 2020. However, this is due to the assumption that the UK leaves the EU without a deal.

[2] A dummy has been included for 2015, 2017 and 2018 for total factor productivity and a Hodrick-Prescott filter of the unemployment rate has been 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 Draft Budgetary Plan. The Department of Finance's alternative estimates are set out also in *Estimating Ireland's output gap: an analysis using selected statistical filters*, December 2018, available at: https://assets.gov.ie/5397/040119115814-205b264d88e64a729720ec988bfe027e.pdf

Table 1. Comparison of macroeconomic developments and forecasts

	2018	2019			2020		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	8.2	3.9	5.5	5.6	3.3	0.7	3.5
Private consumption (% change)	3.4	2.7	2.7	2.7	2.5	1.4	2.5
Gross fixed capital formation (% change)	-21.1	6.9	50.4	44.3	5.5	-24.0	4.5
Exports of goods and services (% change)	10.4	5.2	10.2	11.4	4.5	0.9	4.1
Imports of goods and services (% change)	-2.9	5.9	22.6	22.3	5.0	-6.5	4.2
Contributions to real GDP growth:							
- Final domestic demand	-5.0	3.0	13.2	11.9	2.5	-7.2	2.6
- Change in inventories	-1.6	0.0	-0.1	-0.4	0.0	0.0	0.0
- Net exports	15.4	1.0	-7.6	-5.9	0.8	7.9	0.9
Output gap[1]	1.3	2.4	2.8	2.0	1.7	0.9	1.2
Employment (% change)	3.2	2.2	2.4	2.4	2.1	0.8	1.7
Unemployment rate (%)	5.8	5.4	5.2	5.2	5.2	5.7	5.0
Labour productivity (% change)	4.8	1.7	3.0	3.2	1.2	-0.1	1.8
HICP inflation (%)	0.7	0.9	0.9	0.8	1.1	1.3	1.1
GDP deflator (% change)	0.8	1.5	0.4	0.8	1.7	1.6	1.5
Comp. of employees (per head, % change)	2.1	3.0	3.5	3.5	3.2	3.0	3.7
Net lending/borrowing vis-à-vis the rest of	-5.8	8.4	0.1	-14.6	8.0	7.0	-13.4

Note:

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

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

Box 1: The macroeconomic forecast underpinning the budget in Ireland

The macroeconomic forecast in Ireland's Draft Budgetary Plan for 2020 was prepared by the Department of Finance. The procedures underlying the endorsement process have been set out in a Memorandum of Understanding, which was agreed between the Department of Finance and the Irish Fiscal Advisory Council that has the task of assessing and endorsing the macroeconomic forecast.

On 30 September 2019, the Irish Fiscal Advisory Council sent a letter to the Department of Finance on the macroeconomic forecasts of the Department.[4] The Draft Budgetary Plan states clearly the endorsement. The Fiscal Council has endorsed the set of macroeconomic projections underpinning the 2020 Draft Budgetary Plan for 2019 and 2020, as "within the range of appropriate forecasts". In the endorsement letter, the Fiscal Council stressed that the endorsement decision comes at a time of exceptional uncertainty for the Irish economy. It underlines that, although the Department of Finance has taken on board a scenario in which the UK leaves the EU without a deal in its forecast, the potential impact from such a scenario could be more severe, especially in the short run.

[4] https://www.fiscalcouncil.ie/wp-content/uploads/2019/10/Endorsement-Letter-September-2019.pdf

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The Draft Budgetary Plan projects a general government surplus of 0.2% of GDP in 2019, in line with the 2019 Stability Programme and the Commission 2019 autumn forecast.

For 2020, the Draft Budgetary Plan projects a general government deficit of 0.6% of GDP, compared with an expected surplus of 0.4% in the 2019 Stability Programme. The difference is mainly due to the Draft Budgetary Plan assuming that the UK leaves the EU without a deal, as mentioned in Section 2. This scenario implies lower economic growth in 2020 and, consequently, lower government revenue. In addition, the Draft Budgetary Plan incorporates contingency provisions, of 0.35% of GDP in 2020, to cover for temporary and targeted measures that will be defined and implemented only if the underlying assumption materialises. Excluding this contingency expenditure from the calculations, a deficit of 0.2% would be expected. This is still on the low side compared with the surplus expected in the 2019 Stability Programme mainly due to weaker revenue projections in the Draft Budgetary Plan. The Commission forecast is based on the assumption of an unchanged trade relationship between the UK and the EU and therefore projects stronger economic growth and associated higher government revenue and does not incorporate the contingency provisions. It projects a government surplus of 0.3% of GDP in 2020.

As mentioned above, the macroeconomic scenarios underlying the Draft Budgetary Plan and the Commission forecast are based on significantly different assumptions. Consequently, for 2020, it is less relevant to compare the figures (ratios) presented in Table 2, in particular as the denominator (nominal GDP) differs substantially in the two projections. On the revenue side, the Commission forecast implies higher revenue in nominal terms, associated with stronger economic growth. However, as a percentage of GDP, the different revenue items are broadly similar to the figures in the Draft Budgetary Plan, in line with the general tendency of revenue to move in tandem with economic developments. Total expenditure, both in nominal terms and as a share of GDP, is higher in the Draft Budgetary Plan scenario as it includes the contingency spending whereas the Commission forecast does not. This is primarily driven by the "Other" component of expenditure, where the Draft Budgetary Plan incorporates this contingency provision because the destined expenditures, including expenditure for employment supports, have not yet been defined.

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

Based on the information provided in the Draft Budgetary Plan, the structural balance[5] is estimated at -1.3% of GDP in 2019 and at -1.0% in 2020. Conversely, the 2019 Stability Programme forecasted the (recalculated) structural balance at -1.0% of GDP in 2019 and -0.5% in 2020. For 2019, the estimates of the output gap have been revised upwards, which led to a lower structural balance in the Draft Budgetary Plan than in the 2019 Stability Programme estimates. For 2020, the significant gap between the structural balance estimates is mainly due to the different macroeconomic scenarios underpinning the two projections.

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

This has led to a worsening of the headline government balance, which has only been partially offset by a downward revision to the output gap. Similarly, the structural balance in the Commission forecast is also above the projection in the Draft Budgetary Plan, in both 2019 and 2020, and broadly in line with the improvement expected in the 2019 Stability Programme.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2018		2019			2020			Change: 2018-2020
	COM	DBP	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**25.4**	**25.4**	**25.6**	***25.2***	**25.3**	**25.2**	***25.2***	**25.2**	**-0.2**
of which:									
- Taxes on production and imports	7.9	7.9	8.0	*7.8*	7.8	7.8	*7.8*	7.8	-0.1
- Current taxes on income, wealth,	10.7	10.7	10.7	*10.6*	10.7	10.7	*10.7*	10.7	0.0
- Capital taxes	0.2	0.2	0.1	*0.1*	0.1	0.1	*0.1*	0.1	-0.1
- Social contributions	4.2	4.2	4.4	*4.4*	4.2	4.4	*4.4*	4.2	0.2
- Other (residual)	2.6	2.6	2.4	*2.3*	2.5	2.2	*2.2*	2.3	-0.4
Expenditure	**25.4**	**25.4**	**25.4**	**25.0**	**25.0**	**24.8**	**25.8**	**24.9**	**0.4**
of which:									
- Primary expenditure	23.7	23.7	24.0	23.6	23.7	23.6	24.7	23.8	1.0
of which:									
Compensation of employees	6.9	6.9	6.9	6.7	6.9	6.7	6.8	6.8	-0.1
Intermediate consumption	3.4	3.4	3.9	3.9	3.7	3.7	4.0	3.8	0.6
Social payments	9.3	9.3	8.9	8.7	8.8	8.6	8.8	8.7	-0.5
Subsidies	0.6	0.6	0.5	0.5	0.5	0.5	0.4	0.5	-0.2
Gross fixed capital formation	2.0	2.0	2.3	2.3	2.3	2.3	2.5	2.4	0.5
Other (residual)	1.7	1.7	1.5	1.5	1.6	1.8	2.2	1.6	0.5
- Interest expenditure	1.6	1.6	1.4	1.4	1.4	1.2	1.1	1.1	-0.5
General government balance (GGB)	**0.1**	**0.1**	**0.2**	**0.2**	**0.2**	**0.4**	**-0.6**	**0.3**	**-0.7**
Primary balance	**1.7**	**1.7**	**1.6**	**1.6**	**1.6**	**1.6**	**0.6**	**1.4**	**-1.1**
One-off and other temporary measures	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1
GGB excl. one-offs	**0.1**	**0.1**	**0.2**	**0.2**	**0.2**	**0.4**	**-0.6**	**0.3**	**-0.7**
Output gap[1]	1.3	2.0	2.4	2.8	2.0	1.7	0.9	1.2	-1.1
Cyclically-adjusted balance[1]	-0.6	-1.0	-1.0	-1.3	-0.8	-0.5	-1.0	-0.3	0.0
Structural balance (SB)[2]	**-0.6**	**-0.9**	**-1.0**	**-1.3**	**-0.8**	**-0.5**	**-1.0**	**-0.3**	**-0.1**
Structural primary balance[2]	1.0	0.7	0.4	0.1	0.5	0.7	0.1	0.8	-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 corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Ireland currently standing at 0.07[6]. Consequently, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in Ireland is expected to fall from 1.6% of GDP in 2018 to 1.4% in 2019 and is projected to decrease further next year, to 1.1% of GDP, well below

[6] 10-year bond yields as of 28 October 2019. Source: Bloomberg.

the 4.2% recorded 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.

3.2. Debt developments

Ireland's general government debt-to-GDP ratio is projected to continue declining. The Draft Budgetary Plan estimates gross debt to fall to 59.3% of GDP in 2019. The improvement in the debt-to-GDP ratio (by 1.8 percentage points) in 2019 compared to the projections in the 2019 Stability Programme is primarily due to the denominator effect, as GDP growth is expected to be stronger than previously estimated (see Section 2). For 2020, the Draft Budgetary Plan projects the debt-to-GDP ratio to fall to 56.5%, 0.7 percentage points higher than the projections in the 2019 Stability Programme. This is mainly driven by the less benign economic growth scenario assumed in the Draft Budgetary Plan and a lower primary balance.

The Commission forecast expects a decline in the debt-to-GDP ratio for 2019 in line with the Draft Budgetary Plan. For 2020, it projects a lower ratio than in the Draft Budgetary Plan, due to expected stronger GDP growth and a higher primary balance, as a result of different macroeconomic scenarios. However, the GDP is inflated by the activities of multinational companies operating in Ireland. Alternative metrics, such as the debt-to-modified GNI (GNI*)[7] ratio, at 104% in 2018, or the interest-to-revenue ratio, at 6.4%, highlight that debt remains high in Ireland.

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 fixed rates, risks to debt projections mainly relate to changes to the economic outlook.

[7] Modified Gross National Income (GNI*) reflects more accurately the income standards 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 (notably intellectual property and assets associated with aircraft for leasing) and the undistributed profits of firms that have re-domiciled to Ireland.

Table 3. Debt developments

(% of GDP)	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**63.6**	**61.1**	**59.3**	**59.0**	**55.8**	**56.5**	**53.9**
Change in the ratio	-4.2	-2.5	-4.3	-4.6	-5.3	-2.8	-5.1
Contributions[2]:							
1. Primary balance	**-1.7**	**-1.6**	**-1.6**	**-1.6**	**-1.6**	**-0.6**	**-1.4**
2. "Snow-ball" effect	**-4.0**	**-1.9**	**-2.1**	**-2.5**	**-1.7**	**-0.2**	**-1.7**
Of which:							
Interest expenditure	1.6	1.4	1.4	1.4	1.2	1.1	1.1
Real growth effect	-5.1	-2.3	-3.3	-3.4	-1.9	-0.4	-2.0
Inflation effect	-0.5	-0.9	-0.3	-0.5	-1.0	-0.9	-0.8
3. Stock-flow adjustment	**1.5**	**1.0**	**-0.5**	**-0.5**	**-1.9**	**-2.0**	**-1.9**
Of which:							
Cash/accruals difference		0.2	0.3		0.2	0.3	
Net accumulation of financial		-0.2	-0.4		-0.8	-0.8	
of which privatisation proceeds		0.0	0.0		0.0	0.0	
Valuation effect & residual		0.0	0.0		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 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the Draft Budgetary Plan

The Draft Budgetary Plan for 2020 comprises tax reductions of around 0.05% of GDP, including increases in certain personal tax credits[8], changes to capital acquisition tax and several measures directed to support enterprises, in particular SMEs. It includes new spending initiatives of around 0.3% of GDP and contingency expenditure of EUR 1.2 billion (0.35% of GDP) that would be triggered in the event the UK leaves the EU without a deal. In total, the planned expenditure increase is more than 0.6% of GDP. This will be partly financed by several new revenue raising measures, including a carbon tax increase[9], amendments to the electricity and vehicle registration taxes, an increase in stamp duty on non-residential property and several compliance measures. The net revenue gain is reported to reduce the overall impact of the budgeted measures by around 0.1% of GDP[10]. All revenue measures were included in the Commission forecast except the continued non-indexation of income tax bands, with an estimated budgetary impact of around 0.2% of GDP, which is considered to be of a permanent nature. Furthermore, because the Commission forecast assumes an unchanged

[8] These refer to an increase in the Home Carer Tax Credit from EUR 1 500 to EUR 1 600 and to the increase of the Earned Income Credit for self-employed from EUR 1 350 to EUR 1 500.

[9] An increase in the carbon tax rate by EUR 6 to EUR 26 per tonne.

[10] This amount excludes the continued non-indexation of income tax bands, which, if included, increases the net impact of the budgeted revenue measures to 0.3% of GDP.

trade relationship between the UK and the EU, it did not include the EUR 1.2 billion contingency provision. Hence, the Commission forecast includes an overall net impact of the new measures of around -0.2% of GDP in 2020.

The bulk of the current expenditure increases is directed towards health,[11] social protection,[12] housing and homelessness,[13] education[14] and childcare[15]. The government's capital allocation for 2020 is broadly in line with the overall allocation set out in the National Development Plan.[16]

[11] Expenditure measures in the health area mainly relate to a commitment to improve the access to health and social services through the provision of community and hospital services. It includes also lower prescription charges and free access to a general practitioner for children under 8 years and free dental care for children under 6 years.

[12] Spending on social protection includes an increase in the rate of Fuel Allowance by EUR 2 per week, increases in Jobseeker's Allowance rates for certain age groups, an increase in the Lone Parents and Working Family Payment income thresholds and enhancement of the school meals programme.

[13] Spending related to housing and homelessness includes an increase to the Housing Assistance Payment Scheme and Social Housing Current Expenditure Programme, and additional funding to support the demand for homeless services and the delivery of supported temporary accommodation.

[14] Expenditure in education relates to demographic pressures in the sector and supporting the continued prioritisation of Special Education, including the recruitment of additional Special Needs Assistants and Special Education teachers at primary and post primary level.

[15] Expenditure measures in childcare relate, *inter alia*, to the ongoing implementation of the National Childcare Scheme and additional funding for the *Tusla* child and family agency.

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

Table 4. Main discretionary measures reported in the Draft Budgetary Plan

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Taxes on production and imports	0.2	0.1
Current taxes on income, wealth, etc.	0.1	0.2
Capital taxes		
Social contributions	0.0	0.0
Property Income		
Other		
Total	**0.3**	**0.4**

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source:

Draft Budgetary Plan for 2020

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Compensation of employees	0.0	0.0
Intermediate consumption	0.0	0.1
Social payments	0.0	0.1
Interest Expenditure		
Subsidies		
Gross fixed capital formation	0.0	0.0
Capital transfers	0.0	0.4
Other		
Total	**0.0**	**0.6**

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source:

Draft Budgetary Plan for 2020

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 medium-term budgetary objective. Box 2 reports the latest country-specific recommendations in the area of public finances.

Box 2. Council recommendations addressed to Ireland

On 9 July 2019, the Council addressed recommendations to Ireland in the context of the European Semester. In particular, in the area of public finances the Council recommended Ireland (i) to achieve the medium-term budgetary objective in 2020 and (II) to use windfall gains to accelerate the reduction of the general government debt ratio.

In view of the Commission 2019 autumn forecast projecting that Ireland will be 0.3% of GDP away from its medium-term budgetary objective in 2019, the nominal growth rate of net primary government expenditure should not exceed 5.4%, corresponding to an improvement in the structural balance by 0.3% of GDP.

4.1. Compliance with the adjustment towards the medium-term budgetary objective

In 2019, based on the Draft Budgetary Plan, Ireland is projected to have a structural balance of -1.3% of GDP, lower than its medium-term budgetary objective of -0.5%. The nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, is expected to be below the applicable expenditure benchmark rate, leading to a positive gap of 0.8% of GDP in 2019. Similarly, over 2018 and 2019 taken together, the average deviation based on the expenditure benchmark also points to compliance. The (recalculated) structural balance is expected to deteriorate more than 0.3% of GDP allowed in 2019. Also, when looking at 2018 and 2019 taken together, the (recalculated) structural balance points to a risk of significant deviation (gap of -0.5% of GDP), based on the adjustment requirement for 2019 set in 2018, which remains fixed for the in-year assessment. This calls for an overall assessment. Given the very open nature of the Irish economy and the volatility of potential output estimates, the expenditure benchmark provides a more appropriate yardstick for fiscal policy. Hence, the overall assessment based on the Draft Budgetary Plan points to compliance in 2019.

Similar conclusions can be drawn based on the Commission forecast, with the expenditure benchmark pointing to compliance in 2019. However, for 2018 and 2019 taken together, the expenditure benchmark points to a risk of some deviation. Yet, it does not capture the additional revenue linked to the continued non-indexation of income tax bands. Taking this into account, the expenditure benchmark is expected to be below the applicable expenditure rate. The picture based on the structural balance pillar is similar to the Draft Budgetary Plan assessment. As above, the expenditure benchmark pillar is expected to reflect more appropriately Ireland’s underlying fiscal effort. Thus, the overall assessment based on the Commission forecast also points to compliance in 2019.

In 2020, the Draft Budgetary Plan projects a (recalculated) structural balance of -1.0% of GDP, below the medium-term budgetary objective of -0.5% of GDP. The expenditure benchmark is expected to be breached, with a deviation of 0.1% of GDP. Over 2019 and 2020 taken together, the expenditure benchmark would point to compliance. The (recalculated) change in the structural balance (0.2% of GDP) is expected to fall short of the 0.3% of GDP requirement in 2020 to ensure sufficient progress towards the medium-term budgetary objective. Similarly, over 2019 and 2020 taken together, the structural pillar also points to a

risk of some deviation (of 0.1% of GDP). Therefore, the overall assessment would point to a risk of some deviation in 2020 and compliance over 2019 and 2020 taken together.

The Commission 2019 autumn forecast projects that Ireland will meet its medium-term budgetary objective in 2020. Thus the assessment points to compliance.

The different conclusions regarding compliance with the progress towards the medium-term budgetary objective in 2020, based on the Draft Budgetary Plan and the Commission forecast, derive mainly from the different macroeconomic scenarios underlying the two projections. As mentioned before, the Draft Budgetary Plan assumes that the UK leaves the EU without a deal. In this adverse scenario, revenue would be weaker, due to more modest economic growth. Furthermore, the Draft Budgetary Plan incorporates contingency expenditure of 0.35% of GDP, not included in the Commission forecast, which is based on the assumption of an unchanged trade relationship between the UK and the EU. Thus, the Commission assessment is underpinned by a more benign economic scenario, with higher revenue and lower expenditure, leading to a more positive assessment than the one based on the Draft Budgetary Plan.

Table 7: Compliance with the requirements of the preventive arm

(% of GDP)	2018	2019		2020	
Initial position[1]					
Medium-term budgetary objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-0.6	-0.8		-0.3	
Structural balance based on freezing (COM)	-0.2	-0.8		-	
Position vis-a -vis the MTO[3]	Not at MTO	At or above the MTO		Not at MTO	
	2018	**2019**		**2020**	
(% of GDP)	**COM**	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.4	0.0		0.3	
Required adjustment corrected[5]	0.4	-0.3		0.3	
Change in structural balance[6]	-0.4	-0.3	-0.2	0.2	0.5
One-year deviation from the required adjustment [7]	-0.9	-0.1	0.0	-0.1	0.2
Two-year average deviation from the required	-0.2	-0.5	-0.4	-0.1	0.1
Expenditure benchmark pillar					
Applicable reference rate[8]	3.1	7.0		5.4	
One-year deviation adjusted for one-offs [9]	-0.5	0.8	0.4	-0.1	0.0
Two-year average deviation adjusted for one-offs [9]	-0.5	0.1	-0.1	0.4	0.2

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 is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance corresponds to 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 ed. 2018, 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 2018) was carried out on the basis of Commission 2019spring 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 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

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

The Draft Budgetary Plan for 2020 was prepared on the assumption of the UK leaving the EU without a deal, implying a slowdown in economic growth with negative implications on the fiscal position. Consequently, the general government deficit is expected to deteriorate to -0.6% of GDP, after nine years of improvement since the economic and financial crisis. This is primarily driven by weaker revenue associated with the economic slowdown and contingent expenditure, of around 0.35% of GDP, to be triggered only if the underlying assumption materialises. In 2020, the total expenditure-to-GDP ratio is projected to increase by 0.8 percentage points (to 25.8% of GDP) while revenue is expected to maintain its share of GDP at 25.2%. Overall, the Draft Budgetary Plan focuses on spending increases rather than tax cuts, which would otherwise put additional pressure on revenue. The public investment-

to-GDP ratio is projected to increase by 0.2 percentage points (to 2.5% of GDP) in 2020, in line with the government's approach to increase productive investment.

The Draft Budgetary Plan benefited from a spending review process, the third and final in the three-year process, which aims at, *inter alia*, ensuring prudent allocation of expenditure with a focus on efficiency and effectiveness. In 2019, 30 new reports were published, and key themes relate to the development of multi-year sectoral expenditure analysis and the alignment of the spending review and the public spending code. It remains to be seen how the budget preparations will actually benefit from the spending reviews. The Department of Public Expenditure and Reform will examine the degree to which the process has achieved its objectives and ways to improve it.

The Draft Budgetary Plan includes an increase in the carbon tax by EUR 6 per tonne to EUR 26 that is expected to raise EUR 130 million in a full year. The proceeds from this measure are expected to be ring-fenced for climate action measures.[17] Other measures in the Draft Budgetary Plan that go in the same direction include amendments to the electricity and vehicle registration taxes.

To some extent, the Draft Budgetary Plan has also benefited from equality budgeting, based on the pilot project introduced along with the 2019 Budget focused on gender equality elements. In 2020, the aim was to expand the scope to more dimensions of equality including poverty, socioeconomic inequality and disability.

The Draft Budgetary Plan (in Table 17) contains a summary of the main country-specific recommendations and (in Table 18) actions to meet the targets set by the European Union's Strategy for Growth and Jobs. Table 17 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 Draft Budgetary Plan 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, namely broadening the tax base and limiting the scope of tax expenditures, no significant measures have been announced in the Draft Budgetary Plan. On the contrary, some measures are expanding the scope of tax expenditures.[18] The Commission welcomes the increase in the carbon tax rate, and Ireland's intention to put in place a trajectory for further annual increases, thus improving the way the tax system supports environmental objectives.

The Draft Budgetary Plan intends to introduce Anti-Hybrid Rules, as part of Ireland's commitment to implement the EU Anti-Tax Avoidance Directive[19], with the purpose of preventing associated corporate taxpayers under different jurisdictions from exploiting differences in their tax treatment (hybrid mismatches) to generate tax advantages. It reports no

[17] More details on these measures can be found in the report of Department of Public Expenditure and Reform (2019), "*The Carbon Tax Increase-What it will be spent on*", October 2019, available at: http://www.budget.gov.ie/Budgets/2020/Documents/Budget/The%20Carbon%20Tax%20Increase_What%20it%20will%20be%20spent%20on.pdf

[18] These include increases to tax credits for self-employed and home carers; an increase in the capital acquisition tax threshold; and an extension of the Help to Buy scheme.

[19] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016, p.1.

new measures since the Stability Programme 2019 concerning the cost-effectiveness of the healthcare system and the sustainability of the pension system.

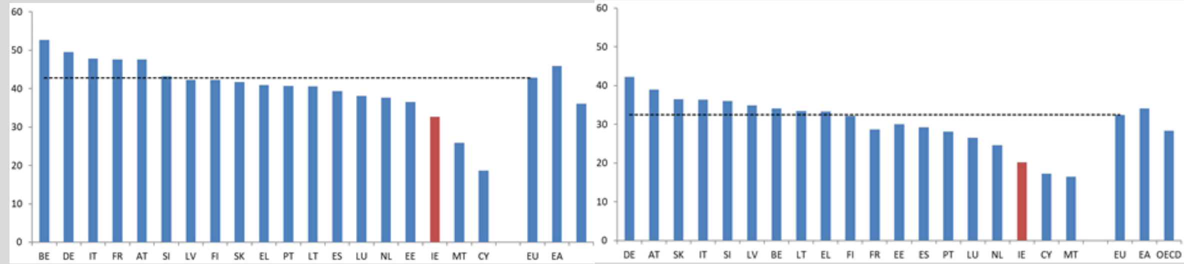
A comprehensive description of progress made in implementing the country-specific recommendations will be made in the 2020 Country Report.

Box 3 – 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 (2018)



Notes: 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.

Ireland's Draft Budgetary Plan includes measures aimed at further relieving the tax burden on labour, mainly through a moderate reduction in personal income taxes. They relate to an increase in the home carer tax credit from EUR 1 500 to EUR 1 600 and an increase in the earned income credit from EUR 1 350 to EUR 1 500. In addition, the reduced rate of the Universal Social Charge for medical card holders has been extended by one year. The measures would contribute to further decreasing the tax burden and reducing the less favourable tax treatment for the self-employed. The Department of Finance estimates that the cost of these measures to the general government in a full year will be approximately EUR 43 million. The Draft Budgetary Plan includes materials and tables showing the impact of these measures on several categories of income earners.

6. OVERALL CONCLUSION

Based on the Commission 2019 autumn forecast and the Draft Budgetary Plan for 2020, following an overall assessment, the expected structural adjustment points to sufficient progress towards the medium-term budgetary objective in 2019.

Both the Draft Budgetary Plan and the Commission forecast project that, in 2019, the general government debt will decline below the 60% of GDP reference value of the Treaty. However, the Irish GDP is inflated by the activities of multinational companies and the level of public debt remains high based on alternative metrics.

In 2020, the Draft Budgetary Plan points to a risk of some deviation from the required structural adjustment path. This is largely due to projections relying on the assumption of the UK leaving the EU without a deal, with a negative impact on economic growth and the fiscal position. However, the Commission forecast, which is based on the technical assumption of an unchanged trade relationship between the UK and the EU, projects that Ireland will achieve its medium-term objective in 2020.