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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

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1. INTRODUCTION

Ireland has submitted its Draft Budgetary Plan (DBP) for 2017 on 17 October in compliance with Regulation (EU) No 473/2013 of the Two-Pack[1]. Ireland is subject to the preventive arm of the Stability and Growth Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO), a structural deficit of 0.5% of GDP.

As the debt ratio was 78.6% of GDP in 2015 (the year in which Ireland corrected its excessive deficit), exceeding the 60% of GDP Treaty reference value, during the three years following the correction of the excessive deficit Ireland is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark. In this period (2016-2018) it should ensure sufficient progress towards compliance.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission 2016 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 forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2016-2017 (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 (CSRs) adopted by the Council on 12 July 2016. Section 6 provides a summary.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the DBP assumes that economic growth will remain robust but moderate compared to the scenario underlying the April 2016 Stability Programme. Real GDP is assumed to grow by 0.7 pp. less in 2016 and 0.4 pp. less in 2017 than in the latest Stability Programme. This correction mainly reflects subdued economic growth in key export markets and a more cautious assessment of domestic demand, reflecting heightened global and regional economic uncertainty. Nevertheless, private consumption and investment

[1] On 19 October, the Irish authorities submitted a revised DBP to correct minor inaccuracies in the first submission.

(gross fixed capital formation) are assumed to grow at solid rates — close to or above 3% and 6% respectively. The scenario assumes that no additional changes to corporate strategies would affect the composition or volume of GDP over the forecast horizon. This means that the level-shift in the volume of GDP in 2015 is assumed not to revert or repeat.

The Commission 2016 autumn forecast is based on similar assumptions. It projects real GDP to grow slightly more in 2017 than in the DBP scenario, mainly on account of a more positive outlook for net exports and investment — based, respectively, on more optimistic external demand assumptions, the expected stronger recovery of construction and additional stimulus from the Investment Plan for Europe. The Commission forecast is however more prudent as regards private consumption in 2017. While the DBP scenario assumes that the household savings rate will decline to support consumption, the Commission forecast expects the savings rate to remain broadly constant or to marginally increase due to the heightened uncertainty of the economic outlook.

As regards HICP inflation, the DBP scenario and the Commission forecast are broadly in line. They both project a negative inflation rate in 2016, given the outturn for the first nine months of the year, but expect a positive inflation rate above 1% in 2017 in view of the expected recovery in energy prices and the positive outlook for the labour market and wages. While the Commission forecast presents a slightly more cautious labour market outlook, both the forecast and the DBP scenario expect sizeable employment growth to continue pushing the unemployment rate down, despite natural population growth and inward migration.

Overall, therefore, the macroeconomic scenario underlying the DBP is plausible and in line with the Commission 2016 autumn forecast.

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

The macroeconomic forecast in Ireland's DBP for 2017 was prepared by the Department of Finance. A detailed description of the economic forecast methodology is contained in section V of the Medium-Term Budgetary Framework (MTBF – July 2014)[2].

The task of assessing and endorsing the macroeconomic forecast underpinning the draft budget and the Stability Programmes was assigned to the Irish Fiscal Advisory Council (IFAC) in the Fiscal Responsibility Acts of 2012 and 2013.

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. The IFAC endorsed the macroeconomic forecasts underpinning the 2017 DBP; the letter of endorsement was published on 12 October. In its endorsement, the IFAC underlined that "data published by the CSO in the 2015 National Accounts create particular challenges for the estimation of supply-side variables such as potential output and the output gap", adding that "a mechanical application of the Commonly Agreed Methodology (CAM) could have seriously distorted the measures used to assess compliance with the fiscal rules, thereby potentially also distorting budgetary policy over the medium term". At the same time, IFAC has reviewed the technical adjustments to the CAM applied by the Department of Finance following engagement with the European Commission and concluded that "[the Council] is

2 http://www.finance.gov.ie/sites/default/files/140718%20Medium%20Term%20Budgetary%20Framework%20-%20revised.pdf

satisfied that they reflect an appropriate response to the challenges caused by the revised National Accounts data".

The IFAC is an independent statutory body established by the Fiscal Responsibility Act with a mandate to independently provide an assessment of, and to comment publicly on, whether the government is meeting its own stated budgetary targets and objectives (in particular through assessments of annual budgets and the stability programmes). Its five board members are appointed based on competence and experience for a four-year term that can be renewed once. The IFAC is granted "all such powers as are necessary for, or incidental to, the performance of its functions", which would include access to data and freedom of communication, which has been exercised in practice since its establishment.

Table 1. Comparison of macroeconomic developments and forecasts

	2015	2016			2017		
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**
Real GDP (% change)	26,3	4,9	4,2	4,1	3,9	3,5	3,6
Private consumption (% change)	5,0	3,9	3,3	3,4	2,7	2,9	2,1
Gross fixed capital formation (% change)	32,9	13,5	15,8	16,0	7,0	6,0	6,8
Exports of goods and services (% change)	34,4	8,0	3,6	2,8	5,5	4,5	4,2
Imports of goods and services (% change)	21,7	9,0	5,9	4,9	5,8	5,1	4,4
Contributions to real GDP growth:							
- Final domestic demand	8,9	4,9	5,1	5,1	3,0	2,8	2,6
- Change in inventories	-0,9	-0,7	0,1	0,0	0,0	0,0	0,0
- Net exports	18,3	0,7	-1,0	-1,1	0,9	0,7	1,0
Output gap[1]	1,4	1,7	2,1	1,7	0,9	1,5	1,0
Employment (% change)	2,5	2,6	2,6	2,3	2,3	2,1	1,9
Unemployment rate (%)	9,4	8,4	8,3	8,3	7,8	7,7	7,8
Labour productivity (% change)	23,2	2,3	1,6	1,8	1,6	1,4	1,6
HICP inflation (%)	0,0	0,4	-0,1	-0,2	1,7	1,3	1,2
GDP deflator (% change)	4,9	2,6	-1,3	-0,5	1,2	1,0	1,2
Comp. of employees (per head, % change)	2,8	2,6	2,9	2,7	2,5	2,7	2,5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	9,7	4,5	9,4	8,2	3,9	8,2	8,0

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP for 2017 is the first after the abrogation of the excessive deficit in spring 2016. On the basis of the available information, it confirms the commitment of the Irish government to make the correction durable.

The DBP projects a general government deficit of 0.9% of GDP in 2016, slightly less than the 1.1% of GDP predicted in the 2016 Stability Programme and in line with the Commission 2016 autumn forecast. The slight improvement compared to the 2016 Stability Programme reflects two opposing developments: (i) the mechanical effect of the exceptional uplift of 2015 GDP on the deficit-to-GDP ratio; and (ii) the additional expenditure adopted in June, mainly to address emerging overruns in the health sector. As in 2015, larger-than-expected corporate tax receipts will partly offset spending increases in 2016. The uncertain and volatile nature of this source of government revenue would recommend a more prudent management of fiscal policy in line with previous EU policy guidance under the EDP and the CSRs to use windfalls to accelerate deficit and debt reduction.

For 2017, the DBP targets a general government deficit of 0.4% of GDP, in line with the target included in the 2016 Stability Programme, prepared under no-change-policy assumptions. The new deficit target includes a comprehensive package of new measures worth around EUR 1.3 billion, consisting of tax cuts and spending increases. A detailed description of the new measures is provided in Section 3.3 below.

On the revenue side, the DBP projects total revenues at EUR 75.3 billion in 2017, EUR 1.7 billion up from the 2016 Stability Programme, mainly due to the carry-over of 2016 revenue outperformance on the back of resilient economic growth. The DBP estimates income tax revenues to grow by 3.9% y-o-y despite planned tax cuts, the effect of which is partly offset by a range of tax compliance measures and the continued non-indexation of the income tax bands. Similarly, taxes on production and imports are projected to increase by 5.6% y-o-y, as a result of sustained growth of household income and personal consumption. Non-tax revenues, calculated as the difference between total revenue and the tax burden, are expected to increase by nearly 9% y-o-y to EUR 6.8 billion in 2017. This arises from the assumptions of higher Central Bank surplus income and other receipts, which more than offset reductions to other non-tax revenues.

Turning to the expenditure side, the DBP projects primary expenditure to reach EUR 70.5 billion in 2017, nearly EUR 2.1 billion above the targets presented in the 2016 Stability Programme. On a year-on-year basis, primary expenditure is projected to increase by 3.1%. This is still fairly below the 4.5% expected increase in nominal GDP, driving the expenditure-to-GDP ratio down to 27.8% in 2017, 0.5 pp. below the level in 2016. Interest expenditure is projected to be more than EUR 200 million (nearly 0.1% of GDP) lower than in the 2016 Stability Programme, reflecting more favourable market conditions.

The Commission 2016 autumn forecast projects a general government deficit of 0.5% of GDP in 2017, 0.1 pp. higher than in the DBP, on account of a less-tax-rich composition of GDP and a somewhat more dynamic forecast for government expenditure, caused by recurring overspending compared to government plans in the past several years. Public finances are expected to improve further in 2018 on the back of resilient, yet more moderate, economic growth.

Risks associated with the DBP and the Commission budgetary projections mainly relate to uncertainties surrounding the macroeconomic outlook and the volatility of some sources of government revenues. On the upside, end-November cash returns could further exceed expectations.

Euro area sovereign bond yields remain at historically low levels. In Ireland, as of end-September, EUR 6.5 billion have been raised at a weighted average yield of 0.85% and with a weighted average maturity of close to 10 years. As a result of the lower market rates, benefitting new issuances, and the early repayment of IMF loans, total interest payments by the general government have continued to decrease.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2015	2016			2017			Change: 2015-2017
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**27,6**	**30,9**	***27,4***	**27,2**	**30,3**	***27,4***	**27,1**	**-0,2**
of which:								
- Taxes on production and imports	8,8	10,3	*8,9*	8,8	10,3	*9,0*	8,9	0,2
- Current taxes on income, wealth, etc.	10,9	12,2	*11,1*	11,0	12,1	*11,1*	11,0	0,2
- Capital taxes	0,2	0,1	*0,2*	0,2	0,1	*0,1*	0,2	-0,1
- Social contributions	4,5	5,1	*4,5*	4,5	5,0	*4,5*	4,5	0,0
- Other (residual)	3,3	3,2	*2,7*	2,7	2,8	*2,7*	2,6	-0,6
Expenditure	**29,4**	**32,0**	**28,3**	**28,1**	**30,7**	**27,8**	**27,6**	**-1,6**
of which:								
- Primary expenditure	26,8	29,3	25,9	25,7	28,1	25,6	25,4	-1,2
of which:								
Compensation of employees	7,4	8,7	7,5	7,4	8,5	7,5	7,4	0,1
Intermediate consumption	3,6	4,2	3,8	3,6	4,0	3,5	3,6	-0,1
Social payments	11,0	12,0	10,7	10,6	11,4	10,5	10,4	-0,5
Subsidies	0,7	0,7	0,6	0,6	0,7	0,6	0,6	-0,1
Gross fixed capital formation	1,7	1,7	1,7	1,7	1,6	1,8	1,8	0,1
Other (residual)	2,4	2,0	1,6	1,7	1,9	1,7	1,6	-0,7
- Interest expenditure	2,6	2,7	2,4	2,3	2,6	2,2	2,2	-0,4
General government balance (GGB)	**-1,9**	**-1,1**	**-0,9**	**-0,9**	**-0,4**	**-0,4**	**-0,5**	**1,5**
Primary balance	**0,7**	**1,6**	**1,4**	**1,5**	**2,1**	**1,8**	**1,7**	**1,1**
One-off and other temporary measures	-0,8	0,0	0,0	-0,1	0,0	0,0	0,0	0,8
GGB excl. one-offs	**-1,0**	**-1,1**	**-0,9**	**-0,8**	**-0,5**	**-0,4**	**-0,5**	**0,6**
Output gap[1]	1,4	1,7	2,1	1,7	0,9	1,5	1,0	0,0
Cyclically-adjusted balance[1]	-2,6	-2,0	-2,0	-1,8	-0,9	-1,2	-1,0	1,5
Structural balance (SB)[2]	**-1,8**	**-2,0**	**-2,0**	**-1,7**	**-0,9**	**-1,2**	**-1,0**	**0,6**
Structural primary balance[2]	0,9	0,7	0,4	0,6	1,6	1,0	1,2	0,2

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

Based on the information included in the DBP, interest expenditure in Ireland is expected to fall to EUR 6.2 billion (2.4% of GDP) in 2016 from EUR 6.7 billion (2.6% of GDP) in 2015 and is projected to decrease further next year, to EUR 6.1 billion (2.2% of GDP), well below the EUR 7.2 billion (4.1% of GDP) recorded back in 2012, at the peak of the euro area sovereign debt crisis. The fall in debt-servicing costs vis-à-vis 2016 reflects a lower cost of funding on Irish bonds and other programme related loans. These projections are in line with the Commission 2016 autumn forecast.

On the basis of the information provided in the DBP, the recalculated structural deficit[3] is estimated at 1.2% of GDP in 2017, down from 2.0% of GDP in 2016 and slightly above the estimate level derived from the 2016 Stability Programme (0.9% of GDP). The Commission 2016 autumn forecast estimates the structural deficit at 1.7% of GDP in 2016 and 1.0% in 2017[4]. The structural effort in 2017 is somewhat supported by the estimated position of Ireland in the economic cycle, with the positive output gap[5] expected to be fully absorbed over the forecast horizon.

Box 2: Fiscal implications of the large level increase of 2015 GDP

Ireland experienced an unprecedented level surge in GDP in 2015, primarily explained by changes to the strategy and operations of a few large multinational companies with a base in the country. The surge became visible when the Irish national statistical institute notified the full-year annual accounts estimates in July 2016. These estimates revised real GDP growth up by 18.5 pps., compared to the preliminary estimates released in March. This revision bears the following implications for fiscal policy and EU surveillance indicators:

1) Implications for indicators expressed as a percentage of nominal GDP

The revision carries a direct arithmetic impact on any indicator presented as a ratio to GDP, such as the debt and deficit ratios. In the absence of any other changes, such ratios fall as a simple mathematical result of any increase in GDP. Relative to the nominal deficit and debt figures notified in March 2016, the revision to GDP growth results in the general government deficit falling to 1.9 % of GDP in 2015 (0.4 pp. lower than notified previously) and the debt-to-GDP ratio falling to 78.7 % in 2015 (more than 15 pps. lower than anticipated).

As the revised debt-to-GDP ratio in 2015 is above the Treaty reference value of 60 %, Ireland will remain subject to the transitional arrangements for compliance with the debt criterion — for three years after the correction of its excessive deficit.

2) Implications for the cyclically-adjusted indicators

The extent to which cyclically adjusted indicators, mostly used in the preventive arm of the Stability and Growth Pact, are affected by the revision largely depends on the estimation of potential GDP under the estimation method agreed with Member States[6]. The Commission and the Irish authorities liaised early on to address the methodological challenges posed in this respect by the 2015 GDP surge. The proposed technical adjustments where endorsed by the relevant Council committees and applied in the context of the Commission 2016 autumn forecast and the present DBP assessment. The net result is a significant boost in the level of estimated potential GDP in 2015, leaving the output gap broadly unchanged from previous estimates.

[3] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the DBP, using the commonly agreed methodology.

[4] Discrepancies between structural balance estimates can also arise from the longer time-horizon of the Commission forecast routine compared to the one used in the recalculated DBP estimates.

[5] The output gap, which measures the cyclical position of an economy, is defined as the difference between actual and potential output. The latter is estimated by the Commission using a production function method, endorsed by the ECOFIN Council on 12 July 2002, which allows identifying the different components of potential output.

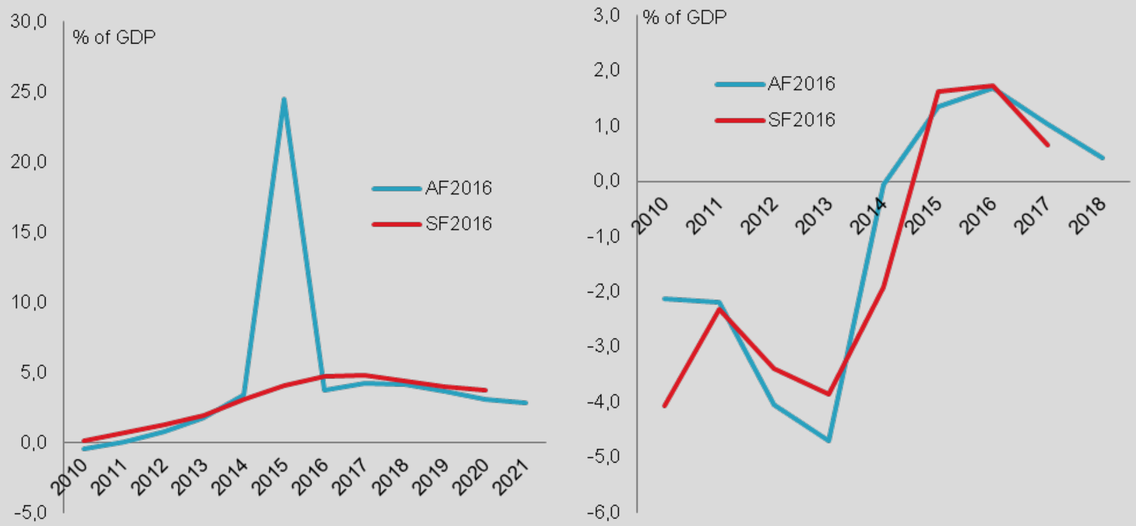
[6] Commonly Agreed Method (CAM). For a reference to the methodology used to estimate potential output see: http://ec.europa.eu/economy_finance/publications/economic_paper/2014/pdf/ecp535_en.pdf

Matrix of requirements. In principle, the ex-ante and ex-post assessment of compliance with the Stability and Growth Pact in 2016 and 2017 should only be marginally affected by the revision to 2015 GDP, since most parameters were frozen in spring 2015 and spring 2016. In particular, this is true for the requirements derived on the basis of the "matrix of requirements" following the commonly-agreed position on flexibility within the Stability and Growth Pact. Given that Ireland is expected to be relatively far from its MTO (a deficit of 0.5% of GDP in structural terms), and in view of its debt-to-GDP ratio above 60%, such a matrix would still require Ireland to achieve an annual fiscal adjustment of 0.6 % of GDP in 2016 and similarly in 2017.

Structural balance. The 2015 GDP revision, the new potential GDP estimate and the revised forecast of actual GDP growth result in a smoother profile of the output gap, as compared to the Commission 2016 spring forecast. Other things being equal, this implies a small additional structural effort for Ireland to fulfil the required fiscal effort both in 2016 (given an increase of the positive output gap) and 2017 (as the output gap closes more slowly).

Expenditure benchmark. This indicator is sheltered from the 2015 GDP surge, given that the medium-term reference rate of potential GDP growth (the *t-5* to *t+4* average of potential GDP growth rates) has been already determined for the purpose of assessing compliance in 2016 and 2017. However, beyond 2017, the effect of the 2015 GDP surge on the medium-term reference rate may inflate the indicator.

Potential GDP growth rate and output gap estimates (autumn vs. spring 2016 forecast)



Source: European Commission

3) Implications for the EU-Budget contributions

The own resource contribution, based on Value Added Tax (VAT) and Gross National Income (GNI), will also be affected by the revision of national account data. The precise amount will be based on the estimated GNI for 2015, which the Irish statistical authorities have submitted to Eurostat in September. Fiscal projections for 2017 include an increase of contributions by around 0.1% of GDP, in line with the government's preliminary estimates.

3.2. Debt developments

Ireland's general government debt-to-GDP ratio is projected to continue declining, after having peaked at 119.5% in 2012. The DBP estimates gross debt to fall to 76.0% of GDP in 2016 and to reach 74.3% in 2017, contingent on still robust GDP growth and the realisation of primary budget surpluses.

The improvement (by around 12 pps.) compared to the projections in the 2016 Stability Programme is primarily due to the arithmetic effect of the large revision to 2015 GDP in the July 2016 National Accounts. However, the stock of debt remains very high and is projected to increase by nearly EUR 13 billion over the period 2016-2019[7], leaving little room to increase borrowing in an adverse scenario of a significant drop in tax revenues.

Table 3. Debt developments

(% of GDP)	2015	2016			2017		
		SP	**DBP**	**COM**	**SP**	**DBP**	**COM**
Gross debt ratio[1]	**78,6**	**88,2**	**76,0**	**75,4**	**85,5**	**74,3**	**73,6**
Change in the ratio	-26,6	9,6	-2,6	-3,3	-2,7	-1,7	-1,8
Contributions [2] :							
1. Primary balance	**-0,7**	**-1,6**	**-1,4**	**-1,5**	**-2,1**	**-1,8**	**-1,7**
2. "Snow-ball" effect	**-22,1**	**-2,7**	**0,1**	**-0,4**	**-1,7**	**-1,0**	**-1,2**
Of which:							
Interest expenditure	2,6	2,7	2,3	2,3	2,6	2,2	2,2
Growth effect	-20,9	-3,6	-3,2	-3,1	-3,3	-2,5	-2,6
Inflation effect	-3,9	-1,9	1,0	0,3	-1,0	-0,7	-0,8
3. Stock-flow adjustment	**-2,7**	**14,1**	**-1,4**	**-1,4**	**1,2**	**1,2**	**1,2**
Of which:							
Cash/accruals difference		0,5	0,5		0,7	0,3	
Net accumulation of financial		-1,1	-1,0		-0,3	-0,4	
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

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

The debt projections in the 2017 DBP are broadly in line with the Commission 2016 autumn forecast. Divergences in 2016 mostly relate to different inflation estimates.

[7] In particular, changes in liquid assets reflect the increase in the funding requirement, owing primarily to large bond redemptions, in 2019/2020 especially.

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 the budgetary outlook rather relate to changes to the economic outlook. Over the longer term, there are also some risks arising from the potential under-achievement of legally binding climate change targets which would require Ireland to purchase additional emission allowances, the cost of which cannot be assessed at present. On the other hand, the potential sales of shares the government still retains in the three major domestic banks would reduce public debt.

3.3. Measures underpinning the draft budgetary plan

The DBP for 2017 includes new expansionary measures worth around EUR 1.3 billion (around 0.5% of GDP) at a ratio of three euros in spending increases for every euro in tax cuts.

Reductions in the Universal Social Charge (USC) account for the vast bulk of changes to government revenue[8]. Other revenue-decreasing tax measures include a tax rebate to first-time buyers of newly-built homes, increases to tax credits for self-employed and home carers, a higher threshold for capital acquisition tax on inheritances, a cut in capital gains tax on qualifying asset disposals for entrepreneurs. On the other hand, in addition to an increase in excise duties on cigarettes, a range of revenue-increasing tax compliance initiatives, mostly directed to offshore tax evasion and misused special tax regimes, reduces the overall budgetary impact of the new tax measures to -0.1% of GDP.

On the expenditure side, current expenditure increases focus on public pay rises and recruitment of additional staff (around 0.1% of GDP)[9], and social protection initiatives (nearly 0.2% of GDP). The latter includes a EUR 5 per week increase in pension payments, a EUR 5 per week rise in working age income supports, a new single universal childcare scheme and an increase of housing assistance payment. Government capital expenditure, which was significantly reduced during the post-2007 consolidation process, is projected to increase by 9% compared to 2016. Investment will focus on social housing and education.

[8] The three lowest rates on USC have been cut by 0.5 percentage points, reducing the marginal rate of tax for the average single worker by 0.5 pp. to 49%.

[9] Mainly teachers, nurses and police forces.

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)		
	2016	**2017**	**2018**
Taxes on production and	0,0	0,0	0,0
Current taxes on income,	n.a.	-0,2	0,0
Capital taxes	n.a.	0,0	0,0
Social contributions	n.a.	n.a.	n.a.
Property Income	n.a.	n.a.	n.a.
Other	n.a.	0,1	0,0
Total	0,0	-0,1	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 revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2017

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2016	**2017**	**2018**
Compensation of employees	n.a.	0,1	0,1
Intermediate consumption	n.a.	0,0	n.a.
Social payments	n.a.	0,2	0,1
Interest Expenditure	n.a.	n.a.	n.a.
Subsidies	n.a.	n.a.	n.a.
Gross fixed capital formation	n.a.	0,1	0,0
Capital transfers	n.a.	n.a.	n.a.
Other	n.a.	n.a.	n.a.
Total	0,0	0,4	0,2

Note:

The DBP refers to the Expenditure Report for a detailed budgetary impact of expenditure measures. The budgetary impact in the table is the aggregated impact of measures as estimated from the Expenditure Report. A positive sign implies that expenditure increases as a consequence of this measure.

Source: 2017 Expenditure Report.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Ireland, following the correction of the excessive deficit in 2015, is subject to the preventive arm of the Stability and Growth Pact and should ensure sufficient progress towards its MTO.

Box 3 reports the latest country-specific recommendations in the area of public finances. Ireland is also subject to the transitional debt rule in the period 2016-2018.

Box 3: Council recommendations addressed to Ireland

On 28 June, 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 to: (i) achieve an annual fiscal adjustment of 0.6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017; (ii) use windfall gains from strong economic and financial conditions, as well as from asset sales, to accelerate debt reduction; (iii) reduce vulnerability to economic fluctuations and shocks, inter alia by broadening the tax base; (iv) enhance the quality of expenditure, particularly by increasing cost-effectiveness of healthcare and by prioritising government capital expenditure in R&D and in public infrastructure, in particular transport, water services and housing.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2015, Ireland is in the transition period as regards the debt criterion for the following three years. This implies that, during the three-year period over 2016-2018, Ireland is required to make sufficient progress towards compliance with the debt criterion – as defined by the minimum linear structural adjustment (MLSA) – and comply with the debt benchmark at the end of the transition period.

The DBP does not include sufficient information to assess compliance with the transitional arrangements for the debt reduction benchmark. According to the Commission 2016 autumn forecast, the structural effort is higher than the required MLSA both in 2016 (0.1% of GDP vs. required -0.3% of GDP) and in 2017 (0.7% of GDP vs. required -0.5% of GDP).

Table 5. Compliance with the debt criterion

	2016			2017		
	SP	DBP	COM	SP	DBP	COM
Gross debt ratio	88,2	76,0	75,4	85,5	74,3	73,6
Gap to the debt benchmark [1,2]						
Structural adjustment [3]	0,1	-0,2	0,1	1,1	0,8	0,7
To be compared to:						
Required adjustment [4]	-0,5	n.a.	-0,3	-0,8	n.a.	-0,5

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

4.2. Compliance with the adjustment towards the MTO

In 2016, according to the information provided in the DBP, the recalculated structural balance is estimated to deteriorate in 2016 by 0.2% of GDP, leading to a significant deviation from the required structural adjustment of 0.6% of GDP. Conversely, the growth rate of government expenditure, net of discretionary revenue measures, is expected to be below the expenditure benchmark in 2016, leading to a positive gap of 0.3% of GDP. This calls for an overall assessment.

In the case of Ireland, owing to the very open nature of its economy, the estimates of annual potential growth and output gap are subject to considerable variations due to frequent and sizeable data revisions of national accounts and factors impacting on the supply side of the economy. In particular, the large level-shift revision to 2015 GDP has increased the instability of such estimates. Therefore, in the case of Ireland, the expenditure benchmark provides a more stable and reliable anchor for prudent fiscal policy. However, a one-off transaction in 2015[10] has increased the aggregate expenditure in that year leading to a positive effect on compliance with the expenditure benchmark in 2016. Therefore, the overall assessment would point to some deviation in 2016.

The same conclusion can be drawn on the basis of the Commission 2016 autumn forecast, which projects the structural balance to improve only marginally (0.1% of GDP) in 2016, pointing to a risk of a significant deviation from the 0.6% of GDP recommended adjustment

[10] The one-off relates to the statistical treatment of a restructuring operation in a state-owned bank's capital base.

towards the MTO. On the other hand, the growth rate of government expenditure, net of discretionary revenue measures, is expected to be below the expenditure benchmark leading to a positive gap of 0.1% of GDP in 2016. The difference between the two indicators mostly stems from the one-off transaction indicated above and a revenue windfall linked to the continued non-indexation of income tax bands, which is considered to be partially of a permanent nature. Taking both factors into consideration the expenditure benchmark would point to a deviation vis-à-vis the requirement below but close to 0.5% of GDP. On this basis, the overall assessment points to a risk of some deviation from the required adjustment path towards the MTO in 2016.

In 2017, according to the information provided in the DBP, the recalculated improvement of the structural balance (0.8% of GDP) is above the 0.6% of GDP required to ensure sufficient progress towards the MTO while the expenditure benchmark is expected to be breached by 0.2% of GDP[11]. This calls for an overall assessment. The difference between the two indicators is partly due to the projected decline of interest expenditure, which improves the effort as assessed on the basis of the structural balance compared to the one based on the expenditure benchmark. In addition, the annual potential GDP growth rate used in the computation of the structural balance is higher than the medium-term rate used in the calculation of the expenditure benchmark. In the case of Ireland, as indicated above, the medium-term reference rate used for the computation of the expenditure benchmark is deemed to be a more stable and prudent estimate of the country's medium-term growth potential. Therefore, the overall assessment points to a risk of some deviation from the required adjustment path towards the MTO in 2017.

Based on the Commission 2016 autumn forecast conclusions are broadly the same. The structural balance is projected to improve by 0.7% of GDP in 2017, above the recommended structural adjustment towards the MTO. Conversely, the growth rate of government expenditure, net of discretionary revenue measures, is expected to exceed the expenditure benchmark in 2017, leading to a negative gap of 0.3% of GDP. For the reasons expressed above, given that the expenditure benchmark provides a more stable and reliable indicator for fiscal policy, the overall assessment points to a risk of some deviation from the required adjustments path towards the MTO in 2017.Over 2016 and 2017 taken together, some deviation is projected based on the structural balance pillar, mostly reflecting the shortfall expected in 2016. Over the same period, a marginal deviation is also projected based on the expenditure benchmark pillar.

Following an overall assessment of Ireland’s DBP, some deviation from the adjustment path towards the MTO is to be expected in 2016 and 2017.

[11] As indicated by the Irish authorities, the deviation from the benchmark is mostly due to the higher EU budget contribution expected in 2017 following the surge in 2015 GDP (see Box 2).

Table 6: Compliance with the requirements of the preventive arm

(% of GDP)	2016		2017	
Initial position[1]				
Medium-term objective (MTO)	0,0		-0,5	
Structural balance[2] (COM)	-1,7		-1,0	
Structural balance based on freezing (COM)	-1,7		-	
Position vis-a -vis the MTO[3]	Not at MTO		Not at MTO	
(% of GDP)	**2016**		**2017**	
	DBP	**COM**	**DBP**	**COM**
Structural balance pillar				
Required adjustment[4]	0,6		0,6	
Required adjustment corrected[5]	0,6		0,6	
Change in structural balance[6]	-0,2	0,1	0,8	0,7
One-year deviation from the required adjustment [7]	-0,8	-0,5	0,2	0,1
Two-year average deviation from the required adjustment [7]	EDP in 2015		-0,3	-0,2
Expenditure benchmark pillar				
Applicable reference rate[8]	0,1		1,2	
One-year deviation [9]	0,3	0,1	-0,2	-0,3
Two-year average deviation [9]	EDP in 2015		0,1	-0,1
Conclusion				
Conclusion over one year	Overall assessment	Overall assessment	Overall assessment	Overall assessment
Conclusion over two years	EDP in 2015		Overall assessment	Overall assessment

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 27.).

[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 2014) was carried out on the basis of Commission 2015 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 and revenue increases mandated by law 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 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations.

5. IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

The 2017 DBP (specifically in Table 7a) contains a summary of the main CSRs the Council addressed to Ireland in the context of the European Semester on 28 June 2016 and (in Table 7b) actions to meet the targets set by the European Union's Strategy for Growth and Jobs. Table 7a offers a very short description, sometime incomplete or outdated, 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.

Concerning the recommendations in the area of fiscal governance, and notwithstanding the required fiscal adjustment towards the medium-term budgetary objective (see section 4), the Commission welcomes the use of incomes from the sale of government's shares in state-owned-banks to reduce the debt. At the same time, the government's decision to use the large part of volatile, still uncertain, tax intakes to allocate additional permanent expenditure in 2016 does not appear in line with the CSR asking Ireland to use windfall gains form better-than-expected economic and financial conditions to accelerate the deficit and debt reduction.

The establishment of a *rainy-day-fund*, if appropriately designed, could provide a fiscal buffer during a future economic downturn and, together with the announced 45% target for the debt-to-GDP ratio to be achieved by the end of next decade, could reduce vulnerability to economic fluctuations. However, in the short-term, the DBP for 2017 has introduced a wide range of tax expenditure measures, including a tax rebate to first-time buyers of newly-built homes, increases to tax credits for self-employed and home carers, which are likely to narrow the income tax base, thereby increasing public finances' exposure to shocks. This adds to the suspension of water charge payments earlier this year, and the decision to further delay to November 2019 the revaluation of self-assessed property values used to calculate local property tax (LPT) liabilities.

The recent budgetary reform incorporates novel procedures that can help to improve communication on expenditure limits, increase stakeholder engagement and harness public support to improve the quality of expenditure. Those changes are welcome, though it is open how and when those innovations will ultimately affect government expenditure policy.

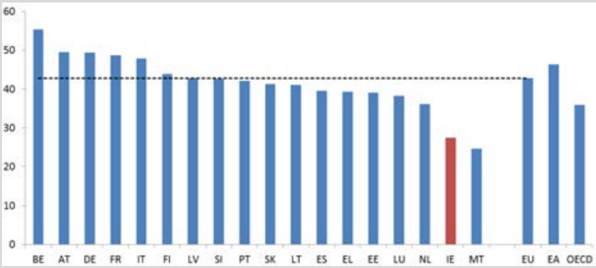
A comprehensive assessment of progress made in the implementation of the country-specific recommendations will be made in the 2017 Country Reports and in the context of the country-specific recommendations to be adopted by the Council in 2017.

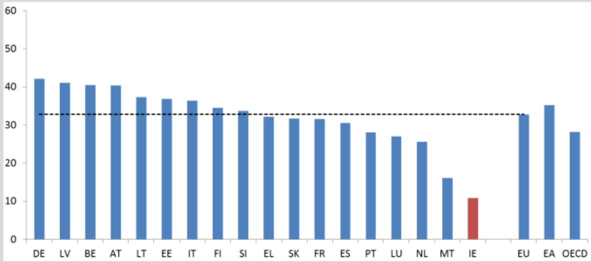
Box 4: Addressing the tax burden on labour in the euro area

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 a low wage (2015)





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 large bulk of the government revenue measures included in the Ireland's DBP aims at reducing personal income taxes mostly through changes to the Universal Social Charge (USC). The USC rates were cut in each of the three lowest bands, from 1% to 0.5%, from 3% to 2.5% and from 5.5% to 5%. According to the government plan, the gradual reduction of the USC rates has to be seen as a step towards the full elimination of the tax introduced in 2011 with the bursting of the housing bubble and the dramatic deterioration of public finances. The measures will lower the marginal tax rate for a single middle-income earner by 0.5 pp. to 49%. The Department of Finance estimate that the cost to the exchequer in 2017 will be approximately EUR 335 million.

The DBP includes materials and tables showing the impact of those measures on several categories of income earners. The measures would contribute to further decrease the tax wedge for all income categories, particularly low wage earners.

6. OVERALL CONCLUSION

Following an overall assessment of the DBP, there is a risk of some deviation from the required adjustment path towards the MTO both in 2016 and in 2017. The same conclusion can be drawn on the basis of the Commission 2016 autumn forecast. The overall assessment mostly relies on the expenditure benchmark in the case of Ireland as it provides a more stable yardstick of prudent fiscal policy. Of note, such an overall assessment points to a deviation below – but close to – 0.5% of GDP in 2016. In addition, the government's decision to use a large part of volatile, still uncertain, tax intakes to allocate additional expenditure in 2016 does not appear to be in line with Council recommendations in the context of the European Semester which encourage Ireland to use windfall gains form better-than-expected economic and financial conditions to accelerate the deficit and debt reduction. Based on the Commission 2016 autumn forecast, Ireland is making sufficient progress towards complying with the debt rule in both 2016 and 2017.