An Oifig Buiséid Pharlaiminteach
Parliamentary Budget Office

Tithe an Oireachtais
Houses of the Oireachtas

The European Commission's Opinion on *Ireland's Draft Budgetary Plan 2019*

PBO Note 27 of 2018

Introduction

As part of the Autumn Package published on 21 November 2018, the European Commission ('the Commission') provided its Opinion on *Ireland's Draft Budgetary Plan 2019*[1]; this was accompanied by a *Staff Working Document*. This marks the commencement of the European Semester process for Budget 2020.[2]

The Draft Budgetary Plan (DBP) is Ireland's Annual Budget, modified to fit an EU template. The format of the Draft Budgetary Plan varies significantly to the Budget 2019 documentation presented to Dáil Éireann, having only limited text and is primarily presented in tabular format.

Key issues

- The Commission has concluded that *Ireland's Draft Budgetary Plan* (DBP) 2019 is compliant with the requirements of the Stability and Growth Pact (SGP). Ireland will also comply with the transitional debt rule in 2018 and with the debt reduction benchmark in 2019;
- The Commission Opinion forecasts that Ireland will achieve the Medium-term Objective (MTO) in 2018 and 2019;
- Notwithstanding those assessments of compliance, there remain issues affecting Ireland's fiscal position which remain to be addressed;
- The Commission refers to Ireland's Country Specific Recommendations (CSRs) 2018 and expresses concern that the scope of tax expenditures has not been limited nor has enough action been taken to expand the tax base;
- The Commission expresses concern that windfall revenue collected in 2018 has been used to fund current expenditure increases in healthcare;
- The Commission has confirmed the existence of particularly serious non-compliance with the Stability and Growth Pact (SGP) in the case of Italy;
- Greece has been integrated into the European Semester process for the first time.

[1] The Commission's Opinion was issued as part of the European Semester Autumn 2018 Package and included other documents analysing Ireland's position notably the *Annual Growth Survey 2019* and the *Alert Mechanism Report 2019*.

Ireland's position in the euro-area

Ireland's position among 19 euro-area states in respect of compliance with the Stability and Growth Pact (SGP) is set out in Table 1 (below). This year's 'Compliant' status is a positive advancement on last year's, when Ireland was found to be 'Broadly Compliant'. However, there are caveats to this status.

Table 1 – Stability and Growth Pact (SGP): euro-area compliance

Compliant	Broadly Compliant	Risk of non-compliance	SGP Corrective arm
Germany, **Ireland**, Greece,* Cyprus, Lithuania, Luxembourg, Malta, Netherlands, Austria, and Finland	Estonia, Latvia, and Slovakia	Belgium, France, Italy,** Portugal, and Slovenia	Spain (at risk of non-compliance)

Source: European Commission – Based on information set out in Press release of 21 November 2018.

*Greece has, for the first time, been integrated into the European Semester process.

**The Commission has confirmed "the existence of a particularly serious case of non-compliance with the Recommendation addressed to Italy by the Council on 13 July 2018" and "adopted an Opinion on 23 October 2018 identifying a particularly serious non-compliance in the initial DBP presented by Italy on 16 October 2018."[3]

Budget 2019 economic forecasts

The European Commission states that macroeconomic projections in *Ireland's Draft Budgetary Plan 2019* are broadly in line with the Commission's own forecast. The Commission's forecasts are slightly more optimistic on GDP growth rates over the forecast period than the Irish Government's. The Irish Fiscal Advisory Council (IFAC) has independently endorsed the Budget's macroeconomic forecast as is required by EU rules.

[2] The PBO has previously produced a Briefing Paper discussing in detail the relationship between the 2018 European Semester process and *Ireland's Draft Budgetary Plan 2019*.

[3] 'European Semester Autumn Package: Bolstering inclusive and sustainable growth', 21 November 2018, European Commission.

As part of the macroeconomic imbalance procedure of the European Semester a number of imbalances were identified in relation to Ireland and an In Depth Review (IDR) will therefore be carried out and published in February.[4]

Compliance with the Medium-term Objective

Formal compliance with the Medium-term Objective (MTO) for 2018 will be established in April 2019. The Commission currently forecasts[5] that Ireland will meet the 2018 MTO "by a margin". If Ireland achieves the MTO in 2018, compliance with the Expenditure Benchmark will not be evaluated. The Expenditure Benchmark currently points to "some deviation in 2018 … but a significant deviation in 2017 and 2018 taken together".[6] Thus, if the 2018 MTO is not achieved, when assessed in April 2019, Ireland is at risk of significant deviation from the budgetary rule of the SGP. The significant deviation regarding the Expenditure Benchmark, which was judged to be a risk in the 2018 European Semester's Autumn Package (released in November 2017), is related to the large increase in public expenditure during 2017 and 2018.[7] The current Commission forecast for 2019 shows that Ireland will achieve a structural budget balance of -0.5% of GDP, i.e. it will be at the MTO.

Debt compliance

The Commission forecast states that Ireland will comply "with the transitional debt rule in 2018 and with the debt reduction benchmark in 2019."[8,9] Ireland's debt-to-GNI* ratio in 2017 is 111%, and projected to be 101% in 2019.[10] For this, and other reasons, the fact that Ireland is now compliant with the SGP does not in and of itself constitute an assurance that our fiscal outlook is necessarily stable.

Taxation and Windfall Revenue

With regard to *taxation*, the Commission's Staff Working Document (SWD) refers to Ireland's 2018 Country-Specific Recommendations (CSRs), the Commission states that:

- "The DBP reports no new measures concerning the use of windfall gains to accelerate the reduction of the general government debt ratio"
- "Some measures do not contribute to limiting the scope of tax expenditures and expanding the tax base."[11]

The Commission have proposed in their 2018 CSRs for Ireland, that the scope of tax expenditures in Ireland be limited, to prevent the narrowing of the tax base. While Budget 2019 (and the DBP 2019) includes the restoration of the 13.5% VAT rate on tourism activities, certain other measures appear to conflict with this goal. For example, the decrease in the VAT rate on electronically supplied publications, and increases to self-employed and home carer tax credits.

The Commission notes that Ireland's DBP 2019 does not indicate the use of windfall gains to accelerate debt reduction. However, the Minister for Finance has indicated that windfall receipts would be set aside for use in the Rainy Day Fund (RDF). As previously outlined in the PBO's Budget 2019 – Issues for Members of the Houses of the Oireachtas (p.4), the allocations for the RDF for 2019-2021 in Budget 2019 are unchanged from the Stability Programme Update 2018 (at €500 million per annum). The SWD notes that windfall revenue collected in 2018 has been used to fund current expenditure increases in healthcare and expresses concern as to the long-term fiscal sustainability of this approach which it contrasts with focussing on the *Sláintecare Implementation Strategy*.[12]

[4] Ireland is one of thirteen Member States identified.

[5] As in November 2017, the Commission has re-calculated the structural balance forecast, provided in the DBP 2019, using the data contained in the DBP and its own commonly agreed methodology (CAM).

[6] Commission Staff Working Document: Analysis of the Draft Budgetary Plan of Ireland, 2018, p.11.

[7] The PBO has published a short paper on the Voted Expenditure Allocations, which includes analysis of the 2018 increase in expenditure.

[8] Commission Staff Working Document: Analysis of the Draft Budgetary Plan of Ireland, 2018, p. 15.

[9] PBO Note 26 of 2018 discusses the General Government Debt, and the suitability of debt-to-GDP, the measure used by the EU's fiscal rules, to the Irish economy. In summary, the convergence of Ireland's debt-to-GDP ratio to the target set out in the EU's fiscal rules (60%) is a function of GDP growth. Debt-to-GNI* likely provides a better indication of the burden of Ireland's General Government Debt, relative to the size of the overall economy than the debt-to-GDP ratio.

[10] Budget 2019: Economic and Fiscal Outlook, Department of Finance, p. 29.

[11] *Commission Staff Working Document*, p. 13

[12] *Ibid*

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