2015

SPRING ECONOMIC STATEMENT

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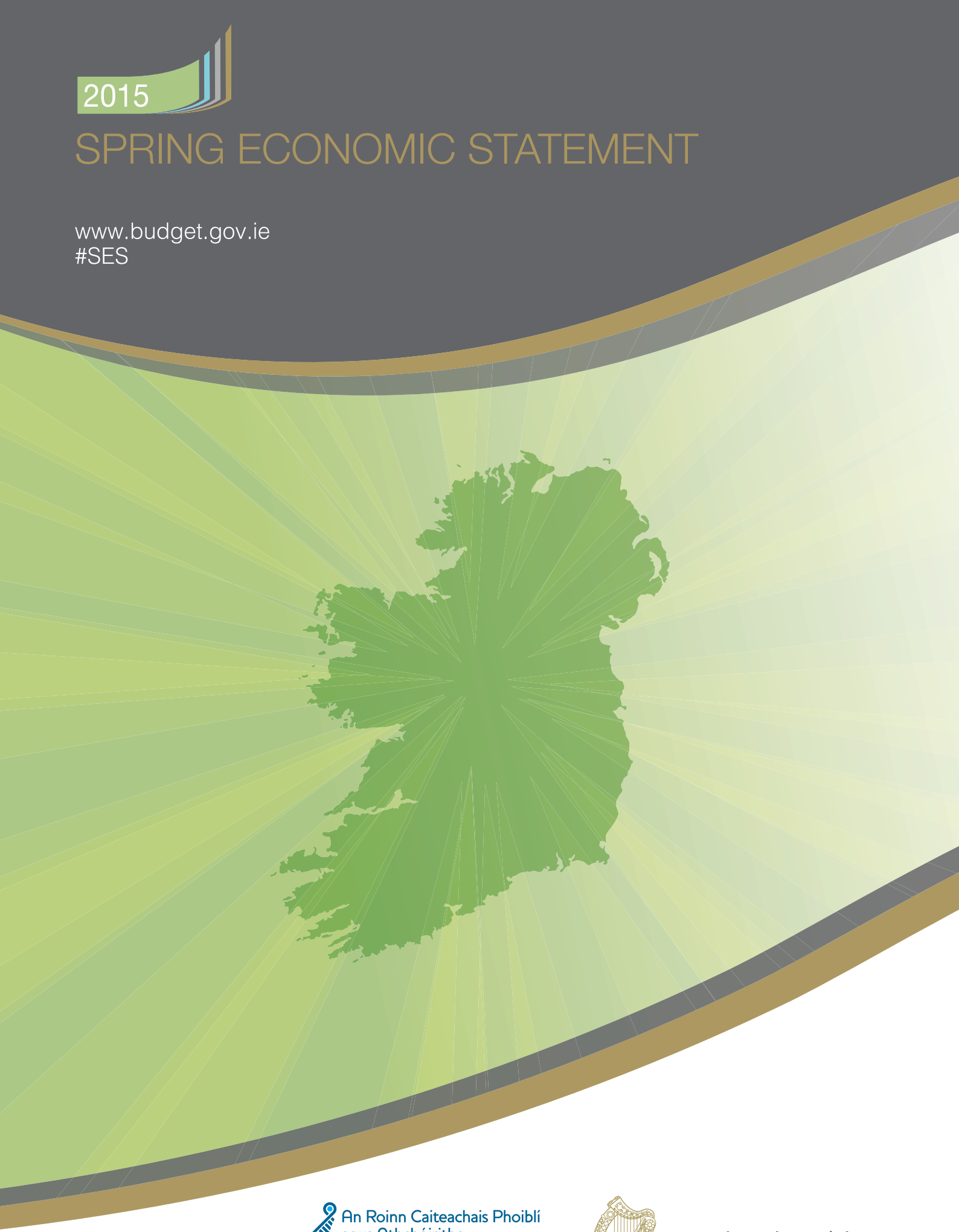


An Roinn Caiteachais Phoiblí
agus Athchóirithe
Department of Public
Expenditure and Reform

An Roinn Airgeadais
Department of Finance

Spring Economic Statement

April 2015

Foreword

When the Government came into office in 2011, the Irish economy was in the midst of an unprecedented crisis. Over many years, the Irish economy had been allowed to become too dependent on one engine of growth. This was to the detriment of the rest of the economy, where a high cost base affected our ability to attract inward investment and our exporting performance suffered accordingly.

This over-reliance on the construction sector and the subsequent collapse of the property bubble led to a sharp downturn in activity with disastrous consequences for the economy, the banking sector and the public finances.

Since the Government's first economic policy interventions – the May 2011 Jobs Initiative and Budget 2012 – much has been done to re-build our economy. Much of the competitiveness lost during the boom years has now been recovered. Prices and labour costs have risen at rates well below our trading partners. The most important example of the success of this strategy is in the labour market. Unemployment, while still too high, has fallen by 5 percentage points and is set to fall below 10 per cent in the coming months. We have seen the fruits of this success in our exports which are at record levels. Jobs in the exporting foreign direct investment sector are also at an all-time high. Employment has grown by 95,000 (or 5 per cent) from its low-point, and by 90,000 since the Government launched its Action Plan for Jobs in 2012 with the aim of adding 100,000 jobs to the economy by 2016, with 2 million people at work. We expect all of the employment lost during the downturn will be recovered by 2018.

When this Government came to office, the public finances were in a worse position than had been seen in a generation. The government deficit was close to one-tenth of economic output and the State was reliant on a programme of external assistance for financing needs. Public debt had spiralled, not only because of actions taken to re-capitalise the banking sector, but because of the huge borrowing needed to cover day-to-day expenditure.

The Government's first three Budgets were guided by the need to reduce our deficit and to put debt on a sustainable path. Nonetheless, the Government made sure to prioritise policies to support jobs and growth throughout this period. We have always sought to frame fiscal policy in a way that is prudent and right for the country in the changing economic circumstances.

By last October, it was clear that buoyant economic growth as well as savings on debt interest meant that the fiscal position going into 2015 was better than expected, and, therefore, that contractionary policies were no longer required. Instead, the Government was able to implement a modestly expansionary Budget, which was prudent and appropriate for the circumstances. In doing so we were also able to target a deficit safely within the agreed ceiling and to provide a buffer should economic growth surprise on the downside. The fiscal position has been very positive in the opening months of 2015, with revenues growing in double-digit terms year-on-year.

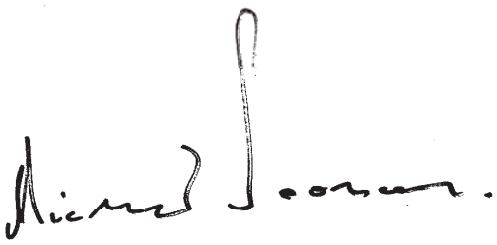
Our strategy over the medium term is to build on the considerable improvements to date. The task of repairing the economy is not yet complete, but we are on the right path. From a

budgetary policy perspective, short-termism is a thing of the past and we will not go back to the days of boom and bust when windfalls were spent straight away and any downturn had to be met with immediate cuts.

Tax and spending policy will be made on the basis of a prudent medium-term view of the economy and public finances. This has been the guiding principle over the last four years and it is the guiding principle for our plans over the remainder of this decade. Budget 2016, which will be announced in October, is the next stage in the process. On the basis of present estimates, Budget 2016 will include a package within the range of €1.2 billion to €1.5 billion, to invest in services, support employment and boost growth potential while still maintaining fiscal prudence.

The policy measures we will continue to implement will be supportive of sustainable growth and job creation over the medium term. We have committed to reducing the tax rate on low- and middle-income earners while maintaining the income tax system's highly progressive nature. This is to ensure that work pays and that no one is deterred from taking up employment by the amount of tax they would have to pay. Investment - which was cut most of all during the economic downturn - will need to grow modestly again in order to support the needs of a growing economy and society.

The policies implemented by this Government have been appropriate and are designed to build sustainable growth for a generation. This is the guiding principle for our plans out to 2020 and more immediately for Budget 2016 which will be announced in the autumn. It is a model and approach that has been seen to work and will continue to work to deliver a more prosperous future.



MICHAEL NOONAN T.D.
MINISTER FOR FINANCE

BRENDAN HOWLIN T.D.
MINISTER FOR PUBLIC EXPENDITURE & REFORM

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Chapter 1
Economic Strategy 2015 to 2020

After a very difficult number of years, the Irish economy is now firmly in recovery mode. GDP is growing strongly, exports are at historic highs, employment is expanding and the public finances are in a much healthier position. Economic recovery did not happen by chance: it is the result of difficult decisions, decisive policy implementation and the sacrifices made by the Irish people.

The short- and medium term outlook is bright, and reasonable estimates suggest we can achieve solid growth of around 3 per cent per annum over the medium term. But we cannot take this for granted – recovery remains fragile and risks remain. Perhaps the greatest threat to recovery is the potential for rowing back on the reforms that have been undertaken in recent years.

Achieving sustainable improvements in employment, incomes, living standards and public services is contingent upon sensible policy implementation and – crucially - living within our means. Policy choices matter and the policies being implemented by the Government are designed to deliver steady, stable growth over the medium term; we will not countenance a return to the boom-bust approach of the past.

Our strategy for future prosperity is multi-faceted.

Through *Pathways to Work* and the *Action Plan for Jobs*, the Government is working to create employment and to reduce unemployment. We are investing in education and skills to ensure that the unemployed have the skills required by employers. We are re-balancing the tax system to make it more growth-friendly and ensure that it does not act as a disincentive to taking up employment.

We are working to ensure adequate credit supply for SMEs through, for instance, state-sponsored vehicles such as the Ireland Strategic Investment Fund (ISIF) and the Strategic Banking Corporation of Ireland (SBCI). We will continue to explore ways of improving credit supply, including through non-bank sources. We are actively engaged in work at a European level on the Capital Markets Union (CMU) and the European Fund for Strategic Investments (ESFI).

We will continue to implement prudent budgetary policies consistent with the need to reduce public debt, improve public services and boost the growth capacity of the economy. Sustainable public finances are a pre-requisite for improvements in living standards and we have made substantial progress in recent years. The fiscal rules – embedded in the Stability and Growth Pact – are designed to support economic growth not hinder growth. We have accumulated significant banking assets and the banks are now profitable once again; it is our intention to dispose of these assets in a manner that maximizes the return to the Irish taxpayer.

Economic recovery has gained momentum in recent years. Some of this recovery is cyclical, and reflects the strong rebound from the very sharp downturn in the crisis. Over the next few years steady economic growth in line with the economy's medium term potential growth rate of about 3 per cent per annum is anticipated. However, growth of this magnitude should not be taken for granted. It depends on the right fiscal and economic policies being implemented.

The improvement in the public finances in recent years has been considerable, reflecting the necessary fiscal consolidation which has meant huge sacrifices by the people of Ireland. This period of austerity is now over. But it does not mean that we should return to the boom-and-bust policies of the past. The European fiscal rules are designed to ensure that sensible levels of debt and deficit are achieved, and that increased public expenditure can be financed. Over the last number of months there have been substantial improvements in how these rules are applied for all Member States. Over the next number of years this will allow modest growth in public expenditure. At the same time they will ensure that the deficit falls and public debt continues its downward path. We expect public debt to fall below 100 per cent by 2017.

The downturn saw a fall of around 15 per cent in employment as well as a fall in the labour force as a result of declining participation and outward migration. The economy is now creating jobs once again, although the labour force response, particularly as regards participation remains sluggish, and the migration balance is still negative. The economic growth forecast by the Department of Finance is driven by an increase in participation and net outward migration is expected to cease next year with a return to inward migration from 2017 onwards. However, this is dependent on the right policies being implemented to ensure that workers are encouraged to find employment and that employers can find the right mix of skills.

- The Government's **Labour Market Activation agenda** – including JobPath - is key to ensuring that the long-term unemployed experience a sustained labour employment outcome.
- The Government's **Further Education and Training Programme** is undergoing restructuring to ensure that the skills needs of a growing economy are met.
- We have indicated our intention to further **lower the burden of taxation on labour**, which should encourage emigrants to return home and encourage more workers to come back into the labour force.
- To deal with a growing population, the current housing supply shortages in certain areas must also be addressed by **an increase in house building** and implementation of the Government's Construction 2020 strategy is key.

Sustained implementation of these policies is key to seeing continued growth in employment and output essential for the betterment of the lives of Ireland's citizens.

Chapter 2
Economic Developments and Outlook

2.1 Economic Background

The Irish economy experienced very strong growth during the 1990s, driven in the main by inflows of Foreign Direct Investment (FDI) which in turn generated robust export growth. Income per capita converged toward the norm for industrialised economies, driven by improvements in productivity as well as by considerable increases in labour supply, the latter reflecting both inward migration and higher participation rates.

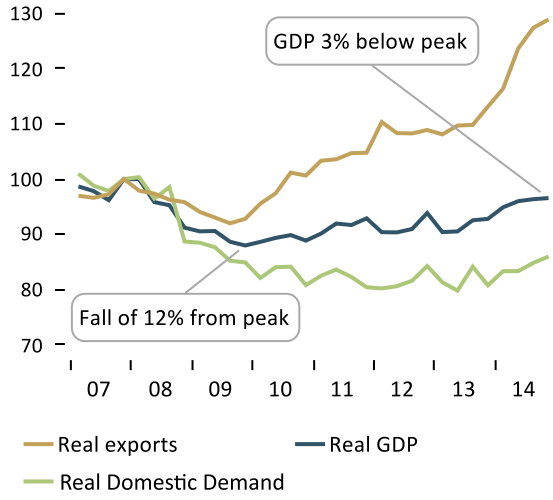
By the mid-2000s, however, economic activity had become unbalanced. In particular, construction activity grew to unsustainable levels on the back of relaxed credit standards and a speculative bubble in property prices emerged. This had knock-on effects on the tradable sector of the economy as rising prices and labour costs led to a loss in competitiveness.

The subsequent bursting of the property bubble had a severe impact on employment, living standards, the banking sector and the public finances. GDP fell by 12 per cent from peak-to-trough and employment fell by 15 per cent from its peak (see figure 1). This boom-and-bust approach has imposed substantial costs on the Irish people and the Government is determined that this will never be allowed to happen again. Steady and broadly-balanced growth rates, in line with the economy's growth potential, is the best way to achieve lasting improvements in living standards.

A modest recovery in economic activity has been underway since 2011, and this has gained momentum over the past year and a half. Initially led by the exporting sectors – as would be expected to be the case for a small open economy like Ireland – the recovery has become broader based over the past year; in fact, domestic demand made a positive contribution to economic growth last year for the first time since the crisis began. Recovery is also clearly evident in the labour market, where the level of employment has increased by 95,000 (just over 5 per cent) since the low point of 2012, with the rate of unemployment falling by 5 percentage points since then.

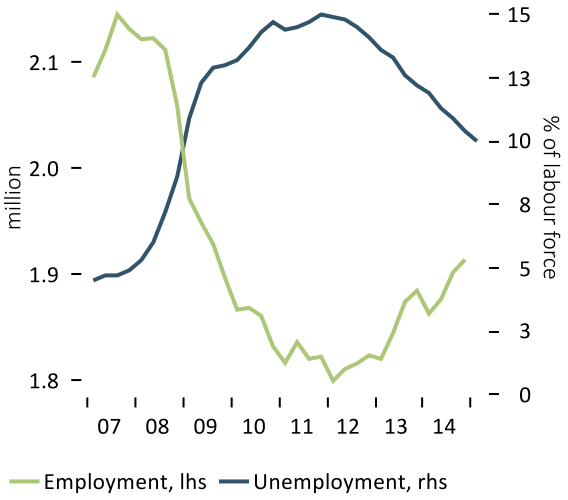
Figure 1: Economic trends

Real GDP level 2007-2014



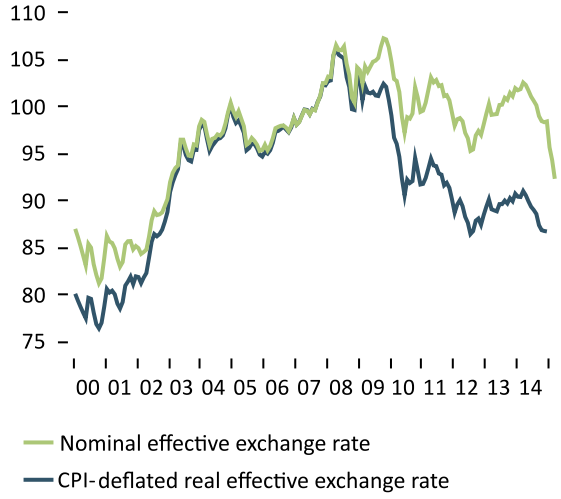
Source: CSO: Note: Q4 2007 = 100

Labour market 2007-2015



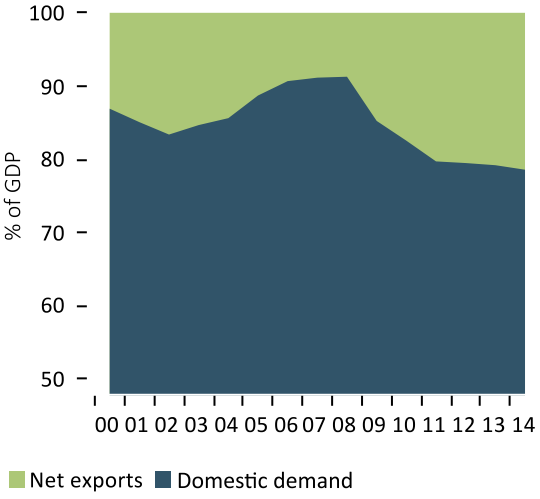
Source: CSO

Improvement in competitiveness



Source: ECB. Note: 2007 = 100

Net exports as a share of GDP



Source: CSO

The economic recovery to date is, in large part, due to the considerable improvement in competitiveness that has taken place in recent years. Prices and labour costs have grown less in Ireland than in our trading partners. Combined with the recent depreciation of the euro, this has seen Irish competitiveness – as measured by the real effective exchange rate - recover most of the deterioration recorded during the boom years (see chart in figure 1).

This recovery in competitiveness has facilitated a reallocation of resources towards the tradable sectors of the economy. Exports are now at an all-time high. Total employment in IDA-supported client companies grew to 174,000 in 2014 from a low of 145,000 in 2009.

The improvements in competitiveness and productivity have been key to ensuring the turnaround in the economy and the successful return to growth and employment in recent years. It is essential that these improvements are not lost so that a solid base for sustainable growth in employment and living standards over the medium term can be maintained.

2.2 Short-Term Economic Outlook

Almost all of the available evidence points to another year of solid growth in 2015. On the external front, economic activity remains robust in the UK and the US. Importantly, incoming data relating to the euro area for the first quarter have proved stronger than initially expected: the decline in energy prices since the mid-part of last year has provided a positive stimulus, while the depreciation of the euro exchange rate – mainly related to quantitative easing in the euro area – is another tailwind. All told, therefore, the pickup in external demand together with competitiveness improvements should support strong export growth in Ireland once again this year.

Domestic demand should contribute positively to overall economic activity once again this year, with relatively strong spending by both households and firms. In overall terms, therefore, GDP growth of 4 per cent is projected for this year. If confirmed, this would take the level of GDP above its pre-crisis level, which would be a remarkable turnaround given the scale of the downturn.

The strong growth should have a positive dividend in the labour market, where the employment level is projected to increase by 43,000 (2.2 per cent). An average unemployment rate of 9.6 per cent is projected for the year as a whole; indeed, if present trends continue, it is highly likely that the unemployment rate will move below 9 per cent by end-year.

Table 1: Key indicators

% change unless otherwise stated	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Real GDP	4.8	4.0	3.8	3.2	3.2	3.0	3.0
Real GNP	5.2	3.9	3.5	2.7	2.6	2.5	2.5
Employment	1.7	2.2	2.2	1.9	1.9	1.8	1.7
Employment ('000)	1,915	1,960	2,000	2,040	2,080	2,115	2,155
Unemployment (rate)	11.3	9.6	8.8	8.4	7.8	7.3	6.9
General government balance (% of GDP)	-4.1	-2.3	-1.7	-0.9	-0.1	0.7	1.7
General government debt (% of GDP)	109.7	105.0	100.3	97.8	93.6	89.4	84.7

Source: 2014 - CSO; 2015 to 2020 - Department of Finance
Note: Macroeconomic forecasts include the €1.2 billion of fiscal measures in 2016 (for more detail see Chapter 4 of this document). This was not included in the forecast endorsed by the Irish Fiscal Advisory Council (IFAC). For more detail on the reconciliation see Annex 3 of the SPU
See footnote 13

2.3 Economic Outlook for Next Year and Over the Medium Term

The outlook for next year and over the medium term is reasonably positive, but is contingent upon sensible economic policies being adopted. Internationally, the baseline scenario is one in which recovery in the euro area gains traction next year, while solid growth is anticipated in other key trading partners. Combined with the assumption of a continued recovery in domestic demand, GDP is projected to expand by 3.8 per cent next year.

Thereafter, the growth rate of the economy is assumed to move in line with its potential growth rate. While the latter is difficult to measure, especially in such an open economy as Ireland's, reasonable estimates put this at around 3-3¼ per cent per annum over the medium term. Employment growth averaging 2 per cent per annum is assumed over the period; this is consistent with the level of employment reaching 2.1 million by end-2018 as set out in the *Action Plan for Jobs 2015*, and the target of 100,000 extra jobs being reached one year earlier than originally planned.

Box 1: Key developments

A number of key improvements in the economy, labour market and public finances have been achieved since the Government came to office in early 2011.

Economy

- *GDP growth last year was 4.8 per cent, the highest in the European Union.*
- *The European Commission is forecasting that the Irish economy will once again be the fastest growing economy in the European Union this year.*
- *Domestic demand increased last year for the first time since 2007.*
- *The level of exports is at its highest level ever and inflows of foreign direct investment have been very strong, especially in higher-technology sectors.*

Labour Market

- *Employment has increased by 95,000 from its low point, a 5 per cent increase.*
- *Unemployment has fallen from over 15 per cent at its peak to 10 per cent in March, and is on-track to fall below 9 per cent by the end of this year.*
- *The number of people on the Live Register for a year or more (long-term unemployed) is currently 160,400 compared with a peak of 201,500.*

Deficit

- *The general government deficit[1] has fallen from a peak of 11.5 per cent of GDP in 2009 to an estimated 2.3 per cent this year.*
- *The 'excessive deficit' will be corrected this year.*
- *Ireland was the first euro area country to exit an EU-IMF Programme, and this was achieved without a precautionary arrangement.*
- *The interest rate on ten-year Irish government bonds is currently below 1 per cent.*

Debt

- *Gross government debt has peaked, and is now on a firm downward path – it is expected to be below 100 per cent of GDP in 2017.*
- *Net debt – excluding liquid and semi-liquid assets – was about 90 per cent of GDP at end 2014.*
- *The debt burden has been reduced through determined Government actions (swapping of promissory notes, maturity extensions, interest rate reductions on European loans, early repayment of IMF loans).*
- *Government debt, both net and gross, will decline over time as we dispose of our banking assets, currently valued at over €15 billion – the schedule for disposing of these assets will ensure maximum return to the Irish taxpayer.*

[1] For comparison purposes, the underlying deficit is used which excludes the impact of the capital injections to the financial sector.

Chapter 3
Policies for Growth

3.1 Building on the Recent Performance

The recovery of the Irish economy has not happened by accident. It has been supported by a balanced, credible, consistent and effective policy mix over the last number of years. These policies have delivered in terms of restoring economic growth, generating employment, reducing unemployment and repairing the public finances. The task now is to build upon the success to date in order to ensure sustainable improvements in living standards for all into the future. A number of policies will help this, including:

- A growth-friendly tax system
- Access to finance for SMEs
- Labour market policies
- Recouping the cost of the bank bail-out
- Reducing the drag from public debt
- Targeted sector-specific interventions

3.2 A Growth-Friendly Tax System

The decline in tax revenues in the 2008-2010 period made clear that the Irish tax system was overly reliant on taxes which were based on transactions or were sensitive to asset price fluctuations. For example, stamp duty and Capital Gains Tax (CGT) fell from a peak of 15 per cent of total tax revenues pre-crisis to only 5 per cent in 2012.

Re-balancing the tax system

In response to this, policy has been focussed on putting the tax base on a more stable footing and reducing the dependence on transactions-based revenue streams. The approach has been to broaden the revenue base, thereby raising revenue while limiting the need for increases in marginal tax rates which can be detrimental to growth. After the current Government was elected in March 2011, the previous Government's commitments to further increase income taxes through reductions in income tax bands and credits were replaced by alternative growth friendly measures to reduce the deficit. Measures implemented include the introduction of a carbon tax, an annual tax on residential property - Local Property Tax (LPT) - and a substantial elimination and curtailment of tax expenditures, all of which were recommended by the Commission on Taxation in its report of 2009.

The LPT has been a success with compliance rates at 95 per cent. Having regard to the potential impact of property price developments since its introduction, a review group chaired by Dr Don Thornhill will report to the Minister for Finance by the summer of this year with recommendations aimed at ensuring relative stability in coming years in the LPT yield.

Taxation of labour

Despite the reforms of recent years, the overall burden may have shifted excessively towards taxation of labour. All workers have incurred substantial increases in their marginal and effective tax rates since 2008. While this was necessary in light of the significant consolidation requirements, the impact on growth of an excessive burden of taxation on labour is not insignificant. Research from the OECD has shown that, while all taxes are distortionary and act as a drag on growth, some taxes - especially taxes on labour - can significantly impact on growth prospects relative to less distortionary taxes such as those on property. Building on this, research by the Department of Finance has shown that a rebalancing of the tax mix away from labour taxes towards taxes that are less harmful to economic growth, such as consumption and property taxes, can result in permanent increases in GDP and employment. On the other hand, increases in labour and corporate taxation can have detrimental impacts on growth and employment (see box 3 and box 8 for further details)

While the income tax system remains highly progressive by international standards, disincentive effects are obvious with a marginal tax rate of 51 per cent for middle-income workers, and top marginal rates of 52 per cent for PAYE workers and 55 per cent for certain self-employed persons, when Universal Social Charge (USC) and PRSI are taken into account. At the other end of the income distribution, care is needed to ensure that work must always pay and that the burden of the USC on low-paid workers is fair and proportionate.

To ensure that income tax did not act as an excessive impediment to recovery, Budgets 2012, 2013 and 2014 did not increase marginal taxes on income, notwithstanding the fiscal challenges faced. Budget 2015 provided the first tangible easing of the tax burden on incomes, allowing for an improvement in weekly take-home pay of around €10 for those on middle incomes.

In Budget 2015, the Government signalled the start of a multi-year programme of income tax reform to address these issues. The standard rate band was increased so as to move average wage workers out of the scope of very high marginal rates, while at the same time the marginal rate was reduced for middle-income workers and households, with USC also eased for low-paid workers. This programme of reform will continue and in the process will raise disposable income, encourage labour market participation, and create jobs. The Department of Finance estimates, based on the ESRI HERMES macroeconomic model, suggest that a three-year programme of income tax reform similar in scale each year to the €640 million package in 2015, would increase employment by approximately by 1 per cent (the equivalent of 20,000 jobs) relative to baseline forecasts after five years. The impact is broadly symmetric, highlighting the detrimental impact on employment of high levels of labour taxation.

Tax expenditures

In the pre-crisis period the use of tax expenditures led to a hollowing-out of the tax base, leading to an inequitable system while contributing to an overheating of the economy. With this in mind, the Department of Finance has introduced official guidelines for the evaluation of tax expenditures,[2] and all Government Departments recently took part in a training session on their application provided by Department of Finance officials. The guidelines, which apply to both ex-ante and ex-post tax expenditure evaluations, are based on the principle that the tax system should only be used in limited circumstances where there are demonstrable market failures and where it can also be shown that a tax-based incentive is more efficient than a direct expenditure intervention.

However, there can be a role for carefully targeted tax reliefs. Recent examples show that focused and time-bound incentives can generate activity in certain sectors. These include the reduced rate of VAT in the hospitality sector, the home renovation and CGT incentives which helped the recovery in the property and construction sector, and the Special Assignee Relief Programme (SARP) scheme which enhanced the competitiveness of Ireland for overseas investment. Following from recent reviews of the audio-visual, agriculture and marine sectors, we will continue to examine sectoral tax supports in a manner consistent with the tax expenditure guidelines to ensure that supports are underpinned by a convincing economic rationale, are fit for purpose and are cost effective.

Box 2: Tax policy supporting recovery

Since their respective low points employment has grown by 95,000. Tax policy has supported this recovery.

Income Tax

- *No income tax increases in Budget 2012, 2013 or 2014.*
- *330,000 individuals were removed from the USC entirely in Budget 2012.*
- *Income tax reductions in Budget 2015 benefiting 742,000.*
- *A further 87,000 were removed from the USC entirely in Budget 2015.*
- *Every taxpayer who paid income tax and/or USC in 2014 will have benefited from the tax changes introduced this year.*

Value Added Tax

- *A 9 per cent VAT rate was introduced for the hospitality sector in the 2011 Jobs Initiative.*
- *Employment in the accommodation and food service sector increased by 6,200 jobs within a year, a 6 per cent improvement during a period in which the overall economy was still shedding jobs.*
- *Employment in the sector had fallen consistently from 136,000 in the first quarter of 2007 to*

[2] See 'Report on Tax Expenditures Incorporating Department of Finance Guidelines for Tax Expenditure Evaluation', Department of Finance, October 2014, available for download here: http://www.budget.gov.ie/Budgets/2015/Documents/Tax_Expenditures_Oct14.pdf

115,000 when the measure was introduced. Since then employment in the sector has increased by 20 per cent to 138,000 – an increase of 23,000 jobs

Small Business

- *A 10- point tax reform plan to help small business has been published.*
- *The Start Your Own Business initiative was introduced in Budget 2014 to incentivise long-term unemployed individuals to start their own businesses.*
- *The VAT cash receipts basis accounting threshold was increased from €1 million in 2012 to €2 million to help cash flow and reduce administration costs for SMEs.*
- *€41.5 million was invested in 2013 under the Employment and Investment Incentive Scheme. The scheme was enhanced in Budget 2015 and taken out of the High Earners Restriction.*
- *The Seed Capital Scheme is being re-launched and re-branded as "StartUp Refunds for Entrepreneurs". This generous tax refund scheme, aimed at entrepreneurs, will be heavily marketed by the Local Enterprise Offices.*
- *The list of countries that qualify for the Foreign Earnings Deduction, which helps companies develop new export markets, has been expanded significantly in line with the Government's Trade, Tourism and Investment Strategy to include certain countries in Asia and South America. The number of total eligible countries now reaches 28.*
- *The introduction of a new CGT incentive was announced in Budget 2014 to encourage entrepreneurs to invest and re-invest in assets used in new productive activities.*

Sectoral Initiatives

- *The Home Renovation Incentive was introduced in Budget 2014 and has resulted in 20,000 qualifying works with an aggregate value in excess of €385 million carried out by over 4,700 contractors by April 2015. The scheme has been extended to include rental properties, whose owners are subject to income tax.*
- *A time-bound CGT incentive was introduced in Budget 2012 under which gains from the disposal of property purchased within a defined period and held for seven years would be exempt from CGT in respect of that seven-year period. This measure helped to encourage increased transactions in the property market over a period and has since been discontinued as it served its purpose and was no longer needed.*
- *Arising from the comprehensive Agri-Taxation Review conducted by Department of Finance and Department of Agriculture, Food and the Marine, a number of tax measures were announced in Budget 2015 to support farming and specifically to encourage long-term leasing of land and productivity improvement.*
- *The Living City Initiative has now overcome all EU State Aid hurdles and will be launched on 5 May in all six Irish cities with the aim of regenerating core city centre areas as attractive places to live and work.*
- *The Film Relief was restructured in 2012 to give film relief a new focus and provide more targeted relief in the form of a payable tax credit of 32 per cent of eligible expenditure spent on a film, up to a maximum of €50 million which is paid directly by the Revenue Commissioners to a producer company.*

Foreign Direct Investment

- *Business Research and Development (R&D) expenditure, which is supported by the R&D tax credit, has risen to over €1,900 million per annum in recent years, the bulk of which is undertaken by foreign enterprises. Recent reforms to the R&D tax credit such as the abolition of the base year restriction will continue to support business R&D expenditure and innovation*

into the future.

- *Ireland's accelerated capital allowance scheme for intangible assets has been enhanced to make Ireland an attractive location for companies to locate and develop intellectual property.*
- *The Knowledge Development Box, a new incentive to stimulate innovation in Ireland, will be introduced in the next Finance Bill.*
- *Additional competent authority staff for Revenue are being recruited to protect Ireland's tax base.*
- *The Special Assignee Relief Programme (SARP) to help attract high quality mobile talent to Ireland has been enhanced following a comprehensive review.*

Corporate taxation

Alongside other complementary policies, a low corporation tax rate – aimed at attracting foreign direct investment - has been an important and longstanding element of enterprise policy and of wider economic policy in Ireland. The tax rate is settled policy and Ireland remains completely committed to the 12.5 per cent corporation tax rate. This will not change. However, the international rules governing corporate taxation and the way countries are competing are changing.

The publication of the roadmap for Ireland's tax competitiveness alongside last year's Budget set out how Ireland will compete in a changing world and contains a suite of measures aimed at repositioning Ireland towards having a best-in-class, internationally competitive and sustainable tax regime. We will continue to examine our international tax strategy to ensure it remains best-in-class taking into account changes in the international policy arena, including the OECD Base Erosion and Profit Shifting (BEPS) initiative at which Ireland is a key participant.

Box 3: The importance of corporation tax to the economy

Ireland's corporation tax policy is frequently cited as a key feature that supports growth in the Irish economy. Since the 1950s, Ireland's corporation tax policy has sought to address the limitations that come with a peripheral geographical location. As part of a wider suite of policies, it has been designed to attract foreign direct investment (FDI) and to encourage domestic enterprise to support employment and growth. It also serves an important function by generating tax revenue which funds public services.

The impact of corporate tax on FDI flows is well established. Research by the OECD in the mid-2000s suggests that a 1 per cent rise in corporation tax results in a fall in FDI flows of 3.7 per cent. In terms of the overall impact of corporation tax on growth, empirical cross country research indicates a negative relationship of between 0.6 per cent and 1.8 per cent on economic growth for each 1 per cent change in the statutory corporate tax rate.

Last year, the Department of Finance commissioned the Economic and Social Research Institute (ESRI) to examine the effects of corporation tax rates on the location decisions of multinational companies. The research, which is based on an analysis of over 3,000 greenfield multinational investments across 26 European countries from 2004 to 2012, found a strong negative effect of corporation tax on the locational decision of multinational firms, controlling for a range of other important factors. The ESRI found that corporation tax had the largest negative impact on the probability of locating in a particular jurisdiction of all factors included in the analysis. The ESRI results provided hard evidence on the importance of Ireland's corporation tax regime for FDI. For example, it showed that if Ireland's corporation tax rate had been 15 per cent during the 2000s instead of 12½ per cent, the probability of a firm locating a new FDI project in Ireland would have fallen by 22 per cent, and if it had been at the EU average of 22½ per cent, the probability would have fallen by 54 per cent.

3.3 Access to Finance

The Government recognises that small- and medium-sized enterprises (SMEs) are essential for growth in employment and economic activity in Ireland. SMEs comprise 99.6 per cent of all employer firms and account for almost 70 per cent of private-sector employment. SMEs are key for the creation of new jobs: 67 per cent of all new job-creation in Ireland comes from businesses in the first five years of existence. In order to support growth, Government policy is focusing on ensuring that all viable SMEs have access to an appropriate supply of finance from a diverse range of bank and non-bank sources. A number of policy initiatives have been taken by the Government in order to improve access to credit for small and medium businesses.

Ireland Strategic Investment Fund

The National Pensions Reserve Fund (NPRF) has become the Ireland Strategic Investment Fund (ISIF), facilitating a re-orientation of resources on a commercial basis to areas of investment in the Irish economy in order to support productive economic activity and employment. It is a

€7.4 billion fund with €1.5 billion committed to date and the ISIF has plans to increase this to €2-€2½ billion by the end of this year.

Strategic Bank Corporation of Ireland

The Strategic Banking Corporation of Ireland (SBCI) launched its first product programme on 19 February 2015 and lending commenced on 9 March 2015 through both Bank of Ireland (BOI) and Allied Irish Banks PLC (AIB). A total of €800 million has been secured by the SBCI which will be made available for lending to SMEs. The SBCI provides SMEs - through its lending partners - discounted investment and working capital loans that can have a term of up to 10 years. The new longer-term loans will encourage SMEs to invest in their business and make their growth more sustainable as the repayments on the investments are less onerous on their cash flow. The Government's aim for the SBCI is to enhance the range and profile of SME finance providers in Ireland. The SBCI will achieve this by working with existing and new providers to develop specific funding products and by supporting new entrants to the SME lending market. Roughly €400 million of the SBCI's resources will be allocated to a number of new and non-traditional SME finance providers. It is also an objective of the SBCI to encourage competition within the SME funding market through the provision of funding to a broad range of potential lending partners.

Supporting SMEs Online Tool

The Supporting SMEs Online Tool, a cross-government initiative, was launched in May 2014 and has had almost 50,000 hits to date. On answering eight simple questions, the small business will receive a list of available Government supports. The Supporting SMEs Online Tool is available at www.localenterprise.ie/smeonlinetool.

Credit Review Office

The Credit Review Office (CRO) was set up in 2010 and helps SMEs or farm borrowers who have had an application for credit of up to €3 million declined or reduced by either BOI or AIB, and who feel that they have a viable business proposition. It also examines cases where borrowers feel that the terms and conditions of their existing loan, or a new loan offer, are unfairly onerous or have been unreasonably changed to their detriment. To date, the CRO has overturned 55 per cent of the refusals that have been appealed to the Office. Ulster Bank has announced that it will participate with the CRO from June of this year.

SME Credit Demand Survey

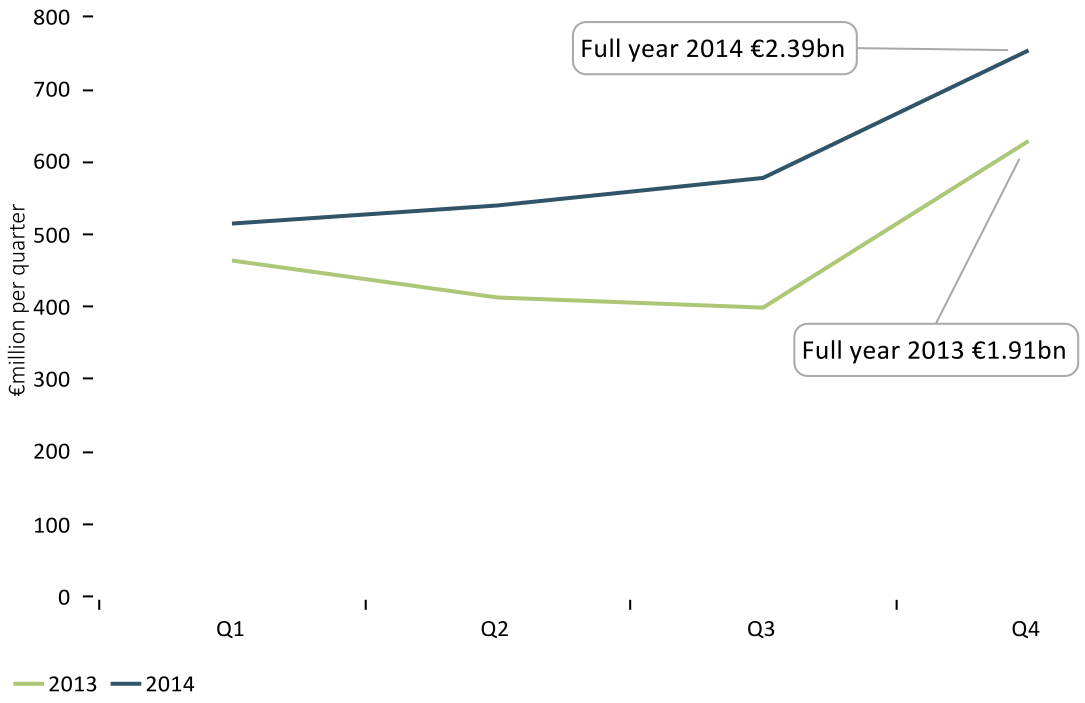
It is clear that the business conditions facing the SME sector in Ireland are improving. The results of the Department of Finance SME credit demand survey for the period April-September 2014, a comprehensive survey in which 1,500 SMEs were surveyed, show that 84 per cent of companies surveyed responded that turnover has increased or remained stable, 30 per cent responded that they have increased staff numbers, with the proportion of profit-making businesses at 56 per cent over the period. The loan approval rate by the banks has continued to improve with 86 per cent of applications approved when 'pending applications' are excluded.

Financing for Growth

In seeking to build on the progress to date and to further support the financing of growth within the SME Sector the Government's focus in 2015, outlined in the Action Plan for Jobs, will be to implement a series of actions under the following thematic areas:

- Support and influence the effective implementation of major policy initiatives to ensure that the maximum benefits are afforded to SMEs.
- Continue to raise awareness and understanding amongst SMEs and entrepreneurs of the full suite of state business supports that are available.
- Ensure that the Local Enterprise Office (LEO) network is a key conduit in providing information, support and advice to small businesses on access to finance issues and strengthening the links between enterprise capacity building, accessing finance and business guidance.
- Develop measures to ensure prompt payments and promote improvements in the payment culture and practices in Ireland.

Box 4: Credit advanced to Irish-resident SMEs (gross new lending)



Source: Central Bank of Ireland; Note: excludes Financial Intermediation and Property Related Sectors

Small and medium sized enterprises (SMEs) provide 68 per cent of all employment in the Irish economy. Ensuring the flow of credit to viable SMEs is a key policy objective. Gross new lending to non-financial, non-property related SMEs amounted to almost €2.4 billion over 2014; this was just over 25 per cent (€482 million) higher than 2013 as a whole (see chart above).

- *Since the Ireland Strategic Investment Fund was established on a statutory basis in December 2014, €314 million has been committed to eight projects/funds. This brings the total commitment value of completed transactions to date to €1,485 million.*
- *In relation to the Strategic Banking Corporation of Ireland, an initial sum of €400 million has been allocated between BOI and AIB for lending to SMEs.*
- *179 guarantees amounting to over €26 million have been sanctioned under the Credit Guarantee Scheme.*
- *522 loans to microenterprises of approximately €8 million have been approved from the Microenterprise Loan Fund. These measures have supported over 1,100 jobs.*
- *A "Jobs Ambassadors" project has been initiated to establish a team of well-trained communicators from within the Civil Service who will help contribute to the Government's top priority of job creation and tackling unemployment, by helping raise awareness of a range of Government programmes at key events across the country, including "Supporting SMEs".*

3.4 The Road to Full Employment

In many ways the labour market bore the brunt of the Irish crisis. Employment volumes fell by nearly one sixth, and the unemployment rate more than tripled in the space of three years. At a macroeconomic level, all of the Government's economic policies have, ultimately, been about job creation and reducing unemployment. Within 100 days of taking office, the Government announced the Jobs Initiative, which had at its heart the reduction in the VAT rate for the hospitality sector to 9 per cent Repairing the banking system, restoring order to the public finances and improving competitiveness have ensured economic recovery, and with this has come job creation. However, in tandem with these macro policies, the Government has, and continues to implement, targeted actions at a micro level to improve the functioning of the labour market. These are set out in the remainder of this section.

These policies have been designed to achieve the Government's job creation targets as set out in the Action Plan for Jobs, beginning in 2012. Its target is to add 100,000 jobs to the economy by 2016. There has been considerable success so far. Employment has grown by 95,000 (or 5 per cent) from its low point, and by 90,000 since the Government launched the Action Plan for Jobs. As a result, the target will be achieved this year, one year earlier than planned – the forecast is for 2.1 million people to be at work by end-2018, which would a full replacement of the jobs lost during the downturn with new jobs. Unemployment is set to fall below the 10 per cent barrier in the coming months and - on the basis of these forecasts - will dip below 8 per cent in 2018. Importantly, the migration balance is forecast to close next year and to turn positive in the following years. As a result, many of the Irish emigrants who left in recent years in response to the economic collapse will return home.

Nonetheless, the achievement of these outcomes is contingent on the policies which have been set out being fully implemented. Any additional structural reform measures in coming years have the potential to boost the supply capacity of the economy and further reduce the rate of unemployment. It is difficult to estimate at what unemployment rate the labour market clears in Ireland given the openness of the economy. Historical experience suggests that it would clear in the region of 7 per cent. Of course this could be reduced by full implementation of the Government's active labour market policies (see below).

Labour market activation

Pathways to work

The *Pathways to Work* Strategy sets out the Government's approach to tackling unemployment, and in particular long-term unemployment. Launched in 2012, the strategy has been designed to complement the *Action Plan for Jobs* as part of a two-pronged approach to tackling the significant increase in unemployment. The *Action Plan for Jobs* focuses on stimulating employment growth with *Pathways to Work* setting out actions aimed at ensuring that as many new jobs as possible - and other vacancies that arise in the economy, are filled by the unemployed.

The *Pathways to Work* Strategy has two core objectives:

- Preventing the drift into long-term unemployment; and
- Reducing the number of long-term unemployed

The latest iteration of the strategy - *Pathways to Work 2015* - contains 17 actions, measures and milestones. The total activation budget for 2015, including work experience, education and training programmes, is €1.6 billion. Almost 260,000 places will be provided in activation programmes across the Departments of Social Protection and Education and Skills, of which at least 85,000 are reserved for the long-term unemployed.

A Labour Market Council comprising of industry leaders and policy specialists has been appointed by Government to underpin the implementation of *Pathways to Work* and the Government's wider strategy to tackle unemployment.

Better engagement with the unemployed

The Department of Social Protection's new ***Intreo Offices*** have combined unemployment payment and case management functions into a cohesive employment activation service. By the end of March 2015, 54 Intreo offices had been opened across the country and the number of case officers assigned to provide group and one-to-one engagements with the unemployed has been doubled.

JobPath

Separately, the Department of Social Protection will oversee the roll-out in 2015 of an externally provided activation service focused on the long-term unemployed, in line with international best practice. This service will be operated by external contractors on an innovative payments-by-results basis with the bulk of the fees attached to the achievement of sustained employment outcomes for the long-term unemployed. The scheme is scheduled to be fully operational in autumn 2015. It is anticipated that this service will provide an additional 1,000 case officers to assist the long-term unemployed to find long term employment.

Better targeting of activation programmes

Over the course of 2014, the Department of Social Protection provided almost 32,000 starter places on activation programmes, designed primarily to provide work experience to the unemployed. Of these, 28,777 were reserved for, and availed of, by long-term unemployed individuals. New schemes have also been introduced, including:

> ***JobBridge,*** the National Internship Scheme that provides work experience placements for interns for a 6 or 9 month period. Over 39,000 internships have been provided since the scheme launched in July 2011.
>
> ***JobsPlus,*** which replaced the existing Employer Job Pay Related Social Insurance exemption and the Revenue Job Assist schemes and was launched in July 2013. This scheme provides a financial incentive to employers to provide employment opportunities to the long-term unemployed. To date, over 5,000 jobseekers have been supported on the scheme.

Further education and training

In 2014, the Department of Education and Skills (DES) provided 216,000 starter places in further education and training linked to labour market activation. Of these, 57,586 were reserved for, and availed of, by the long-term unemployed. The Further Education and Training sector is undergoing complete restructuring to ensure it is better placed to meet the skills needs of the economy and the retraining requirements of the unemployed.

- ***SOLAS*** is the new Further Education and Training Authority responsible for the integration, coordination and funding of further education and training. SOLAS published its first five year further education and training strategy in May 2014.
- ***Education and Training Boards*** are the direct providers of further education and training and have also been considerably restructured - 16 Education and Training Boards have been formed from the amalgamation of 33 Vocational Education Committees and 17 former FÁS training centres.
- ***Springboard*** provides part time flexible reskilling opportunities at higher education levels for unemployed and previously self-employed people in areas of emerging skills needs.
- ***The Momentum Programme*** has been designed as an outcomes-based model of training provision up to NFQ Level 7 (sub degree level).

The Youth Guarantee

To deal with the particular challenge of youth unemployment, the Government launched a comprehensive action plan in 2014 for implementing the EU Youth Guarantee in Ireland. In keeping with the Government's broader focus on tackling long-term unemployment, the plan targets interventions, in the first instance, at those young people most at risk of long-term unemployment. The plan sets out actions for more intensive engagement by the INTREO activation service with young people, more education, training and work experience opportunities for young people and new options around youth entrepreneurship and international work experience/training.

Other measures to incentivise employment

In addition to enhanced and more intensive engagement with the unemployed and additional education/training provision, a number of further measures have been introduced to incentivise people to take up employment opportunities. These include:

- A Back to Work Family Dividend which was announced in Budget 2015. This new scheme provides financial support to those who exit welfare to employment or self-employment. Eligible families can retain Qualified Child Increases for 2 years after they leave welfare for employment.

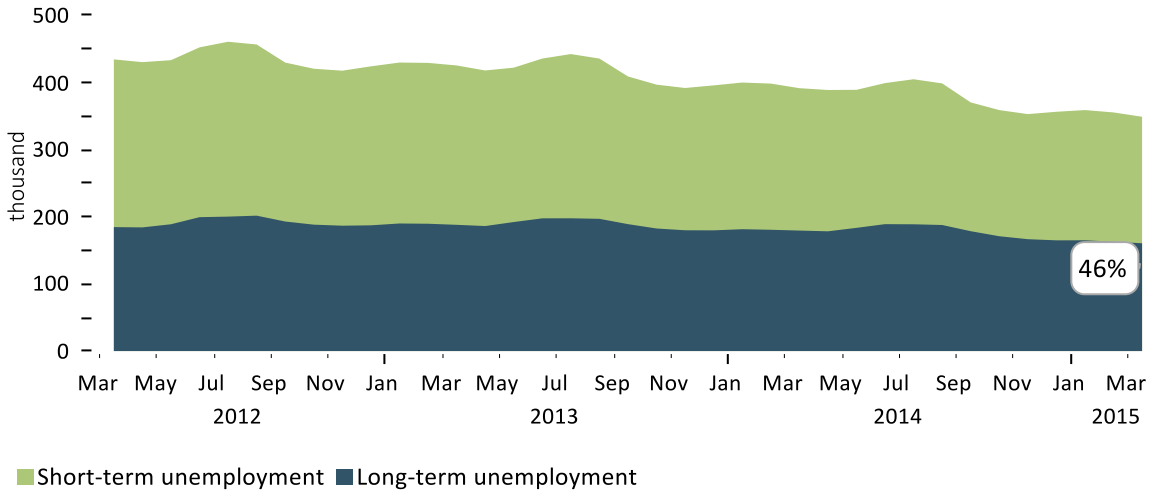
- Roll out of the Housing Assistance Payment, which is being introduced to provide a more integrated system of housing supports and aims to allow all social housing supports to be accessed through one body – the local authority, and allow recipients to

take up full-time employment and still keep their housing support, thereby removing a significant disincentive to work under existing arrangements.

Box 5: Getting people back to work and the long-term unemployed

The number of Live Register claimants has fallen significantly since early 2012, and this fall has been shared between both the short-term and long-term unemployed. For the past two years, during which the Live Register has fallen most significantly, the percentage of the Live Register that are long-term unemployed has remained consistent at 45-46%. This shows that the long-term unemployed are benefiting from the improvements in the labour market and labour market policy interventions. Further steps will be taken to intensify engagement with the long-term unemployed in recognition of the particular challenges faced by this cohort, including the roll-out of the JobPath initiative in 2015. Further targeting of employment support resources towards the long-term unemployed under the Pathways to Work strategy will also be critical.

Unemployed by duration: 2012 to date



Source: CSO, Live Register

3.5 Recovering the Cost of the Bank Bail-Out

Background

The investment by the Irish taxpayer in the banks has been unprecedented totalling over €64 billion to recapitalise the banks in 2011. This investment comprised €34.7 billion in Anglo Irish Bank/Irish Nationwide Building Society by the previous Government and €29.4 billion in the three viable banks of Allied Irish Bank (AIB), Bank of Ireland (BOI) and Permanent TSB (PTSB) over a number of years. Over the course of the past two years, major steps have been taken to reduce the overall cost of this recapitalisation. Through the sale of the debt investments in BOI and the sale of Irish Life, circa €5.0 billion has been returned to the State in addition to €5.9 billion from interest and fees across all the banks up to 31 December 2014 (see figure 2).

Progress and profitability

The Irish banking system is now in a much stronger position than in recent years with the banks continuing to make significant progress in restoring financial health, benefitting from the recent improvement in the macroeconomic environment. Both AIB and BOI returned to profit in 2014 on the back of improving interest margins and reduced levels of impairments. In addition, the loss reported by PTSB for 2014 was a significant reduction on the prior year position. With this improvement in profitability, the rate of the regulatory capital build in 2014 at AIB and BOI was strong. The funding position for Irish banks is in good shape with both AIB and BOI comfortably within the required loan-to-deposit ratio and with ready access to the wholesale debt markets at a cost that continues to reduce. Arrears management is a crucial area of continued focus and the banks are beginning to make real progress in this area with notable reductions in non-performing loans (NPLs) during 2014.

Liquidation of Irish Banking Resolution Corporation Limited (IBRC)

The success of the liquidation of IBRC to date has far exceeded expectations at the time of the promissory note transaction in 2013. In October 2014, the debt acquired by NAMA, as part of the promissory note transaction, was fully repaid. The success of the loan sales processes negated the need to transfer any assets to NAMA as part of this process and removes any residual risk of further calls on the Exchequer. At this stage, loans with a par value of €21.7 billion have been prepared, brought to the market and sold. Amongst other assets, loans with a par value of €3.6 billion remain which the special liquidators continue to manage. To 6 February 2015 (the second anniversary of the IBRC liquidation), €16.5 billion of cash inflows had been generated. This has allowed for the payment of €14.7 billion to IBRC's preferential creditors and costs to date. This has resulted in a cash balance of c. €1.85 billion which ultimately will be available for distribution to creditors.

Valuation

The improvement in the performance of the viable banks has impacted positively on their valuation. The preliminary independent valuation of the State's equity and preference share holding in AIB, recently completed for the NTMA, stands at €11.7 billion. In addition, the State also holds €1.6 billion of convertible capital notes (CoCos) in that bank. Work is ongoing in relation to the bank's capital structure. Our equity investment in BOI, based on current market prices, is approximately €1.6 billion. The State also hold €400 million of CoCos in PTSB. This brings the total current value of the State's investments to over €15 billion, excluding the State's equity shareholding in PTSB.

The total recouped from investments in the viable banks is now only €3.9 billion below the total investment of €29.4 billion, taking into account 2014 year-end valuations, disposals, fees and income received from our banking investments up to 31 December 2014 (see figure 2). The Government is confident that, over time, the aggregate funds that the State has invested in AIB, BOI and PTSB will be recovered. This will be done in a manner that ensures that the banks are operated in the best interests of the Irish economy and that the return to the taxpayer is maximised.

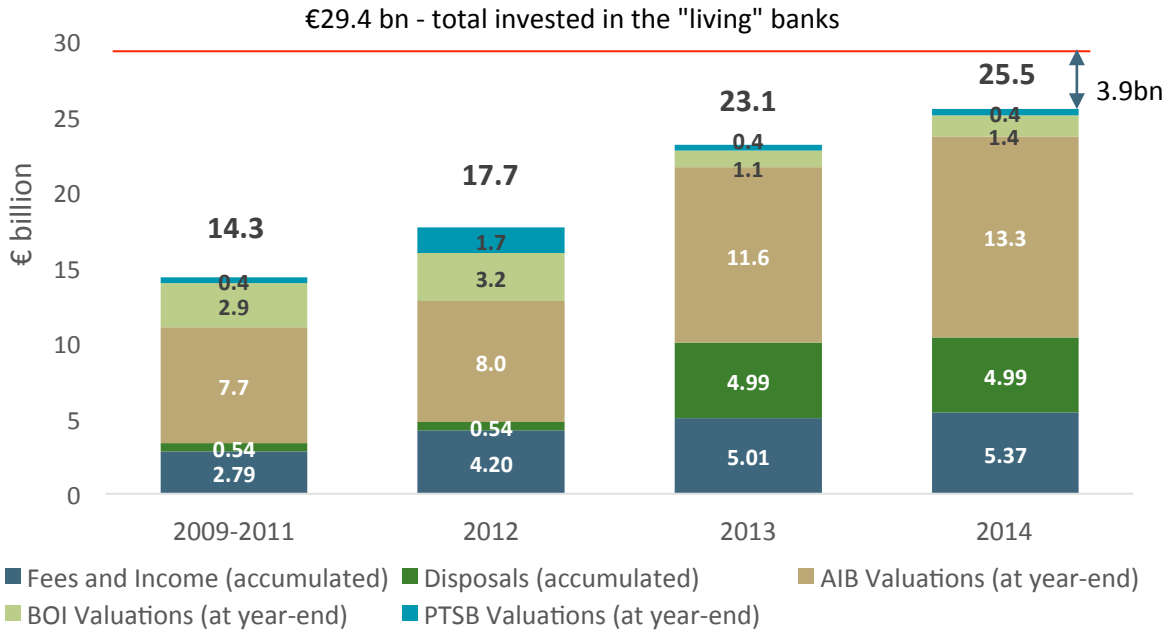
Permanent TSB Capital Raise

PTSB is in the process of completing a capital raise from a range of institutional investors having successfully received approval from the European Commission for its restructuring plan in early April 2015. Following meetings with over 100 potential investors over several months, the equity capital raise was priced at the top end of the price range (€3.90 - €4.50) and as a result, for technical reasons, PTSB requested the Minister for Finance to sell a quantum of shares as part of the transaction leaving the State holding 75 per cent of the enlarged share capital. At a share price of €4.50 this holding is worth €1.5 billion.

The completion of the capital raise is expected to result in the repurchase of €400 million par value of CoCos issued as part of the recapitalisation of PTSB in July 2011, which would bring the total capital receipts (including the sale of shares referred to above) from the €4 billion investment to over €1.8 billion (approximately 45 per cent). A key part of this capital raise will be the issuance of €125m of Additional Tier 1 (AT1) capital which has become an important part of the evolving regulatory capital framework for European banks generally. The Department of Finance is in the process of reviewing the tax treatment of AT1 issuance in Ireland and the Minister for Finance has indicated that he is positively disposed to addressing the dividend withholding tax obligations which currently apply to such instruments.

In addition, the completion of the capital raise and the proposed migration of PTSB to the main markets of the Irish and London Stock Exchanges will provide the State with the option for further sell-downs in a carefully controlled manner in order to assist in reducing the overall cost to the taxpayer over time. The capital raise will also provide a market valuation for the State's residual equity investment in PTSB.

Figure 2: Value and returns from the "living" banks



Source: Department of Finance
Note: (1) AIB: Valuation at year-end 2014 includes equity and preference shares valued by the ISIF and CoCos valued at par.
(2) BOI: 2014 year-end valuation was €1.4bn and valuation as at 20 April 2015 was €1.6bn.
(3) PTSB: In addition to its investment in the CoCo (valued at par), the State also has invested €2.3 billion in PTSB equity. The State holds this investment at the investment value in the Finance Accounts. No recent independent valuation has been commissioned, nor is such an independent valuation required for the Finance Accounts.
(4)PTSB: The 2012 valuation includes the State's holding of Irish Life valued at €1.3bn (which was sold in 2013)
(5)Fees and income include CIFS and ELG fee income, coupon payments on State held instruments and recapitalisation fees up to 31 December 2014.
(6) This chart does not incorporate the outcome of the PTSB capital raise which is expected to complete shortly.

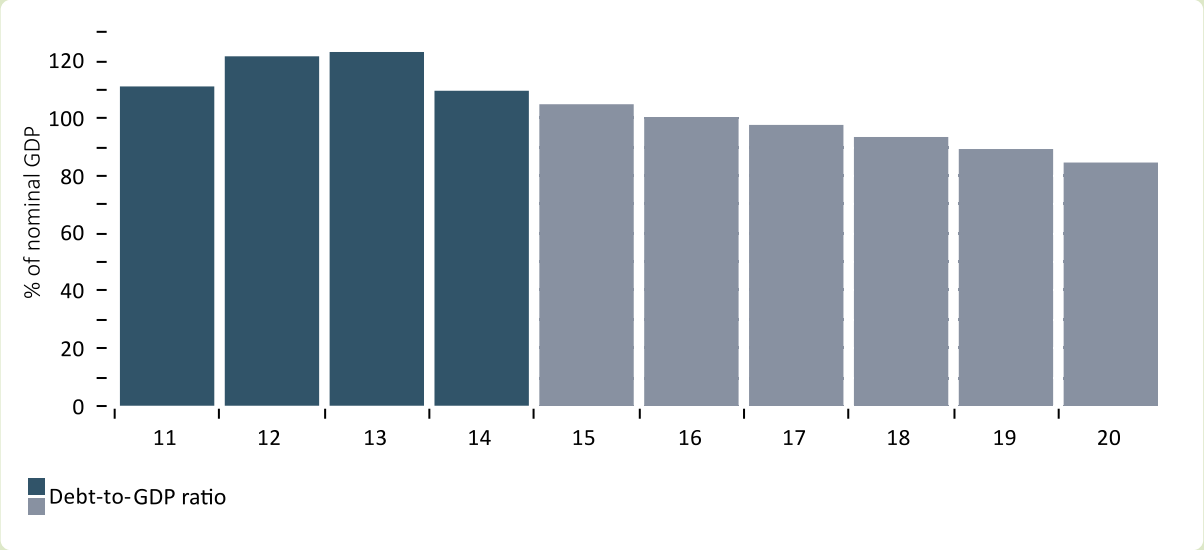
3.6 Reducing the Drag on Growth from High Levels of Public Debt

High levels of public debt divert resources away from growth-enhancing expenditure or imply higher levels of taxation. In this way, the debt service costs associated with high levels of public debt reduce growth and weigh on living standards. Policy efforts by the Government to reduce the debt burden have reaped considerable benefits and are ensuring that it does not become a drag on growth (see box 6).

Ireland's general government debt-to-GDP ratio peaked in 2013 at 123 per cent. It fell to just below 110 per cent at the end of last year and is projected to fall to below 100 per cent by 2017. This has been supported by sustained deficit reduction and a return to economic growth. As a result of policies implemented in recent years – as outlined in box 6 - the cost of this debt burden has been reduced considerably thereby improving debt sustainability.

Box 6: Public debt – recent and prospective developments

Debt-to-GDP Ratio



Source: CSO and Department of Finance

A number of policies in recent years have successfully seen the reduction of Ireland's interest costs and re-financing needs. These are set out below.

- *The Government has been successful in achieving a reduction in interest rates on the EU funding mechanisms and bilateral loans which form part of the EU/IMF Programme; as well as securing the extension of maturities to EFSF and EFSM loans.*
- *The promissory note deal and the successful liquidation of IBRC: The main legacy cost of this is the portfolio of eight floating rate Government bonds held by the Central Bank. The current total outstanding is just under €25 billion. The first of these bonds does not mature until 2038 with the final maturing in 2053. The cost of financing these bonds is low, which improves debt sustainability.*
- *The restructuring of the IBRC promissory note and maturity extensions to loans from the EFSF and EFSM reduce the State's funding requirement significantly; by approximately €40 billion over the 10 year period to 2022.*
- *The lending from the IMF which attracted the highest rate of interest, has been fully redeemed ahead of schedule, and replaced with cheaper market based funding. This means that just over €18 billion of the original €22.5 billion loan has been repaid early, delivering over €1.5 billion in interest savings.*
- *Net debt – excluding cash and other assets – was about 90 per cent of GDP at end-2014.*
- *The NTMA has taken advantage of the favourable interest rate environment and issued €9.5 billion in long term bonds in Q1; the most recent auction in March saw €1 billion of the benchmark 30-year bond sold at a yield of 1.307 per cent.*
- *From a high of over 14 per cent in July 2011, the yield on ten-year Irish government bonds has fallen to well below 1 per cent.*
- *The interest burden is expected to fall to an estimated 10 per cent of general government revenues in 2015, down from 13 per cent in 2013 and considerably lower than the highs of the 1980s. This interest to revenue ratio is expected to fall to about 8 per cent by 2020.*

3.7 Targeted Policies to Support Strategically Important Sectors

Despite the limited resources available to this Government, a range of targeted initiatives in various economic sectors were introduced to support the economic recovery and job creation whilst maximising value for money to the Exchequer. The targeted approach to rebuilding the economy sector-by-sector has proved to be very successful.

For example, initiatives were introduced in the hospitality sector and the construction sector, whilst in other sectors such as film and TV productions schemes were reformed to maximise economic impact. Incentives were enhanced for enterprises active in R&D, whilst a range of focused measures were introduced to support job creation by multinational corporations and indigenous enterprises.

The introduction of a 9 per cent VAT rate in the hospitality sector has been shown in studies by the Department of Finance, industry bodies, and independent economists to have had a substantial employment impact. The hospitality sector is a labour intensive sector that competes for domestic and foreign customers and which suffered particularly during the economic downturn. In the construction sector the Living City Scheme was introduced to support the restoration of our cities; the Home Renovation Incentive was designed to stimulate the legitimate construction sector, and the CGT incentive helped to encourage increased transactions in the property market and has since been discontinued as it served its purpose. A review was carried out on agri-taxation measures due to the importance of the agriculture sector for Ireland, and a number of recommendations were implemented to ensure that resources were directed towards activities of maximum benefit to this sector.

Given the clear market failure that exists in respect of private sector R&D investments, the R&D tax credit has been reformed by gradually eliminating the impact of the 2003 base year for allowable expenditure thereby further incentivising R&D incentives and economic spill-overs. Following a detailed evaluation, the film relief has been reformed to attract more foreign productions into Ireland, while at the same time eliminating some of the inefficiencies of the old scheme.

A range of targeted measures to support the enterprise sector have also been introduced. These include: the Foreign Earnings Deduction which encourages companies to expand their exports to countries with large potential markets for Irish goods, the Special Assignee Relief Programme (SARP) which aims to make Ireland more attractive to highly skilled mobile workers, a CGT entrepreneurial relief which encourages entrepreneurs to invest and re-invest in assets used in new productive activities, and the Start Your Own Business Scheme which was introduced in Budget 2014 to assist long-term unemployed individuals who start their own business.

Box 7: Sectoral and regional growth initiatives

The Government is prioritising a number of initiatives across various sectors of the economy to boost the productive capacity of the economy. These are set out below.

Innovation

- *Ireland's success in attracting high-quality FDI and creating successful indigenous companies is attributable to many important factors. Among these is the economy's capacity to innovate which, after sustained and targeted investment over the past 15 years, has been greatly expanded.*
- *On the expenditure side, Ireland's network of financial and other supports to researchers will continue to play a key role in ensuring that high-quality, publicly-funded research is carried out in sectors relevant to the needs of Ireland's economy and society.*
- *Further investment in our supports to public and private research over the coming years, and the promotion of public-private collaboration, will be articulated in a new Science, Technology and Innovation (STI) strategy which the Department of Jobs, Enterprise & Innovation (DJEI) will publish in 2015.*

Regional Industrial Development

- *The benefits of the economic recovery must be felt across all sections of society. Employment and job creation across all regions is therefore a priority and is necessary to ensure that living standards rise across all of Ireland's regions. This emphasis is evident in a number of important policy initiatives adopted by Government.*
- *In terms of sectoral policy, the tourism sector is one where there is a significant spatial dispersion of economic activity and employment across the country. The sector has benefited strongly from the earlier introduction of the Jobs Initiative by the Government which included a targeted VAT reduction measure in respect of tourism-related services, including hotel and holiday accommodation. The 9 per cent VAT rate for tourism has benefitted SMEs across all areas of the economy. Overseas trips to Ireland have increased by 26 per cent since 2010.*
- *With regional prosperity in mind a €250 million fund has been established which will be used to accelerate job recovery, with the IDA rolling out a five-year €150 million capital investment property programme to help attract more multinational jobs into each region.*
- *Work is continuing to develop the Government's National Broadband Plan, with the aim of ensuring that that every citizen in Ireland will have access to high speed, high quality broadband services by 2020. The plan covers the 30 per cent of the premises in Ireland without commercial operators and will consist of approximately 700,000 homes, schools, farms and businesses. A nationwide high-speed broadband network will bring jobs and economic dividends to all parts of the country. It is designed to stimulate innovation in enterprise, farming, tourism and a range of public services including education and health.*
- *The DJEI is currently undertaking an extensive consultative process with stakeholders around the country and will deliver targeted, regional strategies across Ireland's eight regions over the coming months.*

Manufacturing

- *In recent years, sectors such as manufacturing have been reprioritised and will continue to be a major source of employment, exports and growth across the economy. The latest data shows that employment in the sector continues to expand.*
- *The publications* Making it in Ireland: Manufacturing 2020 *and* Future Skills Requirements for Manufacturing *sets out the Government's approach to ensuring that Ireland maintains and*

further enhances its competitiveness in manufacturing.

Agriculture

- *The Government has a very ambitious growth agenda for the agri-food sector. Under Food Harvest 2020, it set out a strategy to map the future direction of this important indigenous sector. Specific stretch targets are set in Food Harvest 2020. These include a 33 per cent increase in the value of primary agriculture by increasing its value from €4.5 billion to €6.1 billion, an export target of €12 billion, (representing a 42 per cent increase from a baseline figure of €8.2 billion) and a 40 per cent increase in value-added from a 2008 baseline. In addition to these value increases, the dairy industry targeted a 50 per cent increase in milk production by 2020, once the cap on milk production was lifted in April 2015.*
- *By end-2014, the value of all primary output increased significantly to just under €6 billion, virtually reaching its target of a 33 per cent increase. Export performance has also been strong at €10.5 billion, more than halfway towards achieving the 2020 target of €12 billion. Gross value added has increased to over €7.5 billion, which means it is more than two-thirds of the way to its target increase of €2.5 billion by 2020.*
- *The Rural Development Programme 2014-2020 contains some €4 billion of schemes and supports for rural areas. It is designed to enhance the competitiveness of the agri-food sector, achieving more sustainable management of natural resources and ensuring a more balanced development of rural areas.*
- *In the marine sector, the Seafood Development Programme 2014-2020 will facilitate greater investment in the sustainability of the fleet, in processing and in the development of the seafood sector generally.*

Action Plan for Jobs

The Government began the Action Plan for Jobs process in 2012. It is a whole-of-Government, multi-annual initiative which mobilises all Government Departments to work towards the objective of supporting job creation.

An Action Plan for Jobs is published every year, setting out clear actions and targets to help create positive conditions for job creation. Results are reviewed quarterly and progress reports are published (www.actionplanforjobs.ie). The OECD reviewed the Action Plan for Jobs process in early 2014 and concluded that it is a key instrument of institutional reform and for delivering on the Government's concerted approach to addressing the reform and employment challenge.

The Action Plan for Jobs has **Five Strategic Ambitions**:

1. To support 100,000 additional jobs by 2016.
2. To get Ireland back to a top-five ranking in international competitiveness.
3. To stimulate the domestic economy and generate employment in locally traded sectors.
4. To build an indigenous engine of growth that drives up the export market share of Irish companies.
5. To build world-class clusters in key sectors of opportunity.

Employment has increased by over 5 per cent since the launch of the first Action Plan for Jobs, representing an increase of almost 90,000 jobs. The unemployment rate has fallen from a peak

of 15.1 per cent at the start of 2012 to 10.0 per cent in March 2015. We are on track to reach the original target of 100,000 additional jobs by 2016 a year early and the Government has set a goal to bring employment to 2.1 million by 2018 – two years earlier than our original target – effectively restoring all jobs lost during the economic crisis.

Action Plan for Jobs 2015 (APJ 2015) builds on the reforms of previous years in the areas of competitiveness, innovation and entrepreneurship and in fostering new sources of growth. There are six new Disruptive Reforms to be advanced in 2015. These are discrete projects within the APJ framework. They are identified as having the potential to break out of conventional structures and to generate impact across a ranges of sectors. Thereby, either putting Ireland ahead, or building self-sustaining growth.

1. **National Talent Drive** – focussed on strengthening employability of learners and enhancing employer engagement at all levels.
2. **Delivering Regional Potential** – including the launch of competitive funding initiatives to promote innovative collaborations to support entrepreneurships and innovation in the regions.
3. **Europe's Energy Innovation Hub** – including the provision of a one-stop shop to position Ireland at the forefront of innovation and attracting mobile investment in energy related research, management services, technologies and solutions. Also driving energy efficiency in the public and private sectors to improve competitiveness.
4. **Strategic Banking Corporation of Ireland** – leveraging funding of €800 million to provide tailored loans and a range of new products for enterprises across the country via existing and new financial intermediaries over the next 24 months.
5. **Increasing Entrepreneurial Activity** – by driving implementation of the actions in the new National Entrepreneurship Policy Statement we will double the jobs impact of start-ups in Ireland over the next five years from 93,000 currently. We will also increase by 25 per cent, the number of start-ups, the survival rate, and the capacity of start-ups to grow to scale.
6. **Intellectual Property in Enterprise** – including doubling the number of patents, industrial designs registered and other intellectual property management activities of firms. The objective is to achieve best in class in the European Union by enhancing support for firms, drive commercialisation through Enterprise Ireland/Knowledge Transfer Ireland and introduce a Knowledge Development Box to ensure the tax environment is optimised for innovative enterprises located here.

The forthcoming *Enterprise Policy 2025* strategy will provide a medium term framework for sustainable full employment to 2025, and this Spring Economic Statement will underpin that ambitious agenda for building a new economy based on talent and skills, innovation, and leadership in markets.

Box 8: Effect of structural reforms on real GDP path

The growth in potential GDP, a measure of the productive capacity of the economy, has been in

decline in many advanced economies, even before the onset of the crisis. This has been driven in part by falling contributions from labour force growth, as a result of demographic constraints, as well as declines in productivity growth. Structural reforms can raise the productive capacity of economies through their effects on labour supply, particularly through improvements in participation rates, as well as productivity levels.

Broadly speaking, structural reforms include labour market reforms (for example, training the long-term unemployed) and product market reforms (for example, to facilitate competition or ease regulatory burdens).

While the Irish economy is already fairly flexible, there is always scope for further reform. Economic research by the Department of Finance and others (e.g. the Central Bank of Ireland and the European Commission) has consistently identified quantifiable upside potential for the economy from selected structural reforms. The Department of Finance's research[3] has shown that overall, if a range of reforms in the areas of tax policy, access to finance, competition policy, wage competitiveness, labour market activation and human capital are introduced, it would result in a permanent increase of 1.3 per cent in the level of real GDP and a reduction in unemployment of 2⅓ per cent by 2020 relative to baseline forecasts.

The research also identified the macroeconomic impacts of certain adverse developments, for example a weakening of product market competition, losses in competitiveness or higher costs of credit to the domestic sector of the economy. It is estimated that these scenarios would reduce GDP by 1 per cent and lead to nearly 20,000 fewer jobs relative to baseline by 2020.

[3] "Quantification of the economic impacts of selected structural reforms in Ireland"(Department of Finance, July 2014)

Chapter 4
Budgetary Strategy

4.1 Background

The pro-cyclical nature of fiscal policy during the years to 2008 had disastrous consequences for the Irish economy. The subsequent collapse of the property bubble exposed these policy errors: tax receipts fell by 30 per cent, with the most significant falls recorded in receipts of capital gains tax (a 90 per cent peak-to-trough decline) and stamp duties (a 75 per cent peak-to-trough decline). Unemployment expenditure rose by over 150 per cent during the period, as employment fell by 15 per cent due to the over-concentration of economic activity in sectors such as construction.

The deterioration in the public finances – much of which was structural in nature – coupled with significant capital injections into the banking sector, ultimately resulted in the loss of market access for the Irish sovereign. In order to provide 'breathing space' to put the public finances back on a sustainable path, Ireland sought assistance from the European Union Member States and the IMF, and a Programme of Financial Assistance was agreed in late-2010.

Sustainable public finances are a pre-requisite for economic growth and prosperity. The Government has made significant inroads into reducing the deficit and putting the debt ratio on a downward trajectory. The target of bringing the deficit below 3 per cent of GDP will be achieved this year.

4.2 Fiscal Strategy

Fiscal Framework 2009-2015

The fiscal objectives under the Programme dovetailed with those of the Excessive Deficit Procedure (also known as the 'corrective arm' of the Stability and Growth Pact (SGP)) which was opened for Ireland for the first time in 2009. The one notable change was that, upon entry into the Programme, the period for correcting the excessive deficit, i.e. for bringing the deficit below 3 per cent of GDP, was extended by one year to 2015. Interim targets for the headline deficit between 2010 and 2015 were also set to act as a flight-path towards the 3 per cent limit. Consolidation amounting to almost 17 per cent of GDP[4] was implemented over the period 2008 to 2014. This fiscal effort, along with economic recovery, meant that the general government balance outperformed these targets each year during the Programme (see chapter 3 of the SPU for more detail).

[4] As a proportion of GDP in 2014.

Box 9: Main expenditure changes

Expenditure consolidation has played a vital role in ensuring that our fiscal targets have been met. Gross voted expenditure has been reduced from its peak of €63.1 billion in 2009 to €54.0 billion in 2014 – a reduction of 14.4 per cent. Some of the key measures implemented to deliver the required reduction in expenditure included: reducing public service rates of pay and the numbers of public service employees; scaling back the public capital programme in the context of key infrastructural deficits having been addressed; and driving administrative efficiencies across all Government Departments and Agencies.

The Government's approach to fiscal consolidation was not to simply apply blanket reductions to all areas of spending. In the context of the sharp contraction in output and employment, the Government recognised the need to support economic growth and protect society's most vulnerable to the greatest extent possible. This targeted prioritisation of spending has allowed the increased demands placed on public services over the past number of years to be accommodated.

Fiscal framework 2016 onwards

The requirements of the corrective arm of the SGP are relatively simple and well understood – headline deficits must be brought below 3 per cent of GDP in a timely manner – and as outlined above – Ireland is on track to correct the excessive deficit this year. From next year, the public finances will be subject to the requirements of the preventive arm of the SGP, which are somewhat more complex.[5]

The cornerstone of the preventive arm is the so-called medium-term (budgetary) objective (MTO). This is essentially a fiscal target – Member States of the European Union are required to ensure that their budgetary balances are at, or approaching sufficiently rapidly towards their MTOs. These MTOs are set in structural terms; this is the government balance that would prevail if the economy was operating at full capacity (excluding one-off factors).

Compliance with the requirements of the preventive arm is assessed on the basis of two pillars. Under the first pillar, if a Member State is not at its MTO, then an annual improvement in the structural position of 'greater than 0.5 per cent of GDP' is required. Measures of the structural deficit (and the related structural effort) are notoriously difficult to measure in Ireland. For instance, although some 17 per cent of GDP in consolidation effort has been implemented since 2008, the underlying structural budget balance has not recorded the same improvement. This means that the estimates of changes in the structural position must be treated with a high degree of caution in an Irish context, as the figures are often counter-intuitive. Because of uncertainties associated with calculating the structural position, the 2011 reforms of the SGP introduced the concept of the expenditure benchmark. Under this second pillar, public

[5] There is also the preventive arm requirement to reduce the debt ratio by one-twentieth of the difference between the actual ratio and the 60 per cent threshold, although a transition period applies for Ireland over the period to 2019.

expenditure[6], in the absence of discretionary revenue measures, should grow in line with the trend growth rate of the economy, the latter estimated as an average over a ten-year horizon. Furthermore, if a Member State is not at its MTO, expenditure should grow at a rate that is sufficiently below the trend growth rate (allowing for a so-called 'convergence margin') in order to ensure rapid convergence towards the MTO. The benchmark rate for expenditure growth is then calculated, taking into account projections for inflation in order to preserve the real value of expenditure.

Turning specifically to the Irish case, the MTO is for a balanced budget in structural terms. From 2016 onwards, the requirement under the preventive arm is to eliminate the structural deficit at a sufficiently rapid pace. On the basis of macro-economic and budgetary projections, an improvement in the structural deficit amounting to 0.3 per cent of GDP is expected in 2016, with an average annual structural effort of over 1.0 per cent per annum over 2015 to 2020 with the result that the MTO is achieved by 2019[7].

Negotiations on application of the fiscal rules

The rationale behind the expenditure benchmark is to ensure spending grows in line with the trend growth rate of the economy, the latter estimated over a 10-year period incorporating a backward-looking element (t-5) and a forward-looking element (t+4). While not codified, the reference rate has, heretofore, been updated on a three-year basis; the last iteration being in 2013 and covering the period 2008-2017. For Ireland this resulted in an average potential growth rate of just 0.7 per cent (as it covers the exceptionally difficult years when the potential growth rate was in negative territory) to apply over the period 2014-2016.

This is exceptionally low and does not take into account the fact that the future trend growth rate of the Irish economy is reasonably positive – probably somewhere in the region of 3 per cent. Applying an excessively low reference rate could lead to inappropriately restrictive fiscal policies and potentially jeopardise economic recovery in Ireland.

Reflecting this, technical discussions have been underway involving officials from the Department of Finance and the European Commission. It is crucial to stress that the discussions centred around the application of the rules – and the anomalies that were arising – rather than the rules themselves. The aim of technical discussions has been two-fold:

- to improve the methodology for calculating potential output.
- to promote the calculation of the reference rate on a more frequent (annual) basis.

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[6] The expenditure aggregate used in the calculation excludes debt interest payments, expenditure co-financed by the European Union and the cyclical component of unemployment spending. In addition, public capital formation is smoothed over a four-year average.

[7] Estimates of potential output using the harmonised methodology are used to assess compliance with the preventive arm of SGP. Consistent with SPU projections, these estimates suggest structural budgetary improvement of 0.3 percentage points in 2016.

The overall objective of the discussions has been to ensure that the application of the rules produces credible results.

Following interventions from Ireland to use a more plausible outlook for projected population levels when estimating potential output, the Economic Policy Committee on 1 April 2015 endorsed an alternative approach for the projection of working age population growth for Ireland, Latvia and Lithuania. For Ireland, this results in a 1.0 percentage point improvement in potential output growth over 2017 to 2020.

In relation to the expenditure benchmark, the focus of discussions has been to calculate the reference rate on an annual basis rather than use outdated estimates. This more logical approach means that fiscal policy consistent with the rules is based on latest available information regarding both the outturn and prospects for the Irish economy. A short technical paper was produced by the Department and sent to the Commission advocating a more logical application of fiscal rules, specifically the expenditure benchmark. In particular, the proposal sought an annual update of the 10-year potential growth reference rate. The motivation was to ensure that the rules take account of the most up-to-date outturn and outlook for potential GDP growth.

Following an assessment, the Commission has concluded that an annual update of the reference rate is preferable. This alternative approach of annual updating will commence immediately (i.e. in the assessments of the 2015 Stability Programmes), with a short transitional arrangement to facilitate Member States wishing to retain the status quo in 2016. The 'convergence margin' will also be updated on an annual basis.

Box 10: Illustrative application of the expenditure benchmark

The figures below set out an illustrative application of the expenditure benchmark for Ireland in 2015 and 2016, although the provisions of the benchmark will only formally apply from 2016 onwards. To isolate the benefit which these negotiations have successfully delivered, the spending space consistent with the benchmark is compared both ex-ante and ex-post. The negotiations have resulted in some 0.4 per cent of GDP in additional fiscal space in 2016.

The ex-post figures incorporate the higher potential output path resulting from the population arrangement, the annual update in both the reference rate and convergence margin components of the benchmark. As Ireland must deliver 'greater than 0.5 pp' correction per annum, the convergence margin should be scaled appropriately. For consistency with 2015 spending outturns, the SPU estimate of the 2016 GDP deflator is used to translate spending allowances into nominal levels.

The ex-post scenario incorporates the impact of higher potential output in reference rate estimates following 1 April Economic Policy Committee agreement and the annual update of the reference rate. The annual update of the convergence margin was put in place in Spring 2014 and forms part of the 'status quo' assumptions. The nominal fiscal space is estimated on the basis of projected permitted benchmark spending level outturns for 2015 consistent with SPU 2015.

As the table demonstrates, projected growth compliant with the benchmark in 2016, is below that which is permitted, confirming compliance with this metric. Detailed calculations behind these figures are set out in the SPU annex.

It should be noted however that the Commission's assessment of Ireland's compliance with these provisions will be based on its own estimates for the deflator path averaged between the respective Spring and Autumn forecast rounds in each year.

	2015	2016
Ex-ante status quo		
Reference rate	0.7	0.7
Convergence margin	1.7	1.8
Real permitted expenditure growth %	-1.1	-1.1
Nominal permitted expenditure growth %		0.4
A. Nominal general government fiscal space € million		240
Ex-post negotiations		
Reference rate	1.5	1.9
Convergence margin	1.8	1.8
Real permitted expenditure growth %	-0.3	0.05
Nominal permitted expenditure growth %		1.6
B. Nominal general government fiscal space € million		1,030
Buoyancy effect		300
Implied nominal general government fiscal space € million*		**1,330**[8]
Marginal benefit of negotiations on nominal spending space (% GDP) [B-A]		**0.4 %**

Note: Real permitted growth % = RR-CM. Nominal permitted % = [1+ RR-CM/100*% PVGD] where PVGD = GDP deflator. Nominal general government fiscal space is on a net basis, i.e. net of discretionary revenue measures (DRM). Final nominal general government fiscal space includes the estimated impact of positive buoyancy arising from implementation of a €1.2bn budgetary package.
*Calculations behind projected benchmark spending are set out in the SPU annex.

The Irish Fiscal Advisory Council, in a note[9]*released on 1 April, acknowledged that the use of outdated potential growth rate figures in the calculation of the reference rate could result in an inappropriate fiscal stance for Ireland and advocated an approach whereby there would be an update of the reference rate for 2016. The agreement reached by the Department goes further, in that there will now be an annual updating of the reference rates. Given the expected recovery in potential GDP growth over the medium-term, this will have an important bearing on the fiscal stance.*

Given the implications of the annual update in reference rate and the benefit resulting from the incorporation of more plausible population projections, Ireland will not avail of the transitional arrangement in place for 2016. Instead, Budget 2016 will frame spending decisions using a yearly

[8] A budgetary package of €1.2 billion in new measures is designed with reference to this quantum of general government fiscal space. A prudent provision is made to allow for other potential costs, for example, an increase in EU Budget contributions which is a mandatory non-voted expenditure.
http://www.fiscalcouncil.ie/wp-content/uploads/2012/01/ExpenditureBenchmarkNote_310315_Final_1.6.pdf

updated reference rate. Actual estimates of the benchmark parameters (the base year (2015) nominal benchmark level, reference rate, convergence margin and deflator paths) will be based on the appropriate, latest available outlook when Budget decisions are being framed in October 2015.

As a result, the above calculations should be seen as indicative and are used purely to illustrate the benefit in terms of prospective fiscal space which these successful negotiations have delivered.

Potential fiscal space for Budget 2016

Under the preventive arm of the SGP, Ireland will have to adhere to an adjustment path towards the MTO. This is assessed in two ways. Firstly, until the MTO is reached, a minimum annual improvement in the structural balance greater than 0.5 per cent of GDP is required. The second pillar assessment is compliance with the expenditure benchmark. This metric is designed to limit growth in expenditure with reference to the potential growth rate of the economy and is complementary to the minimum structural improvement.

Following discussions with the European Commission, the Commission has recently issued clarifications on the application of the Expenditure Benchmark that are positive from an Irish perspective. The revised application is set out a clarification[10] will now be applied by the Commission in assessing compliance with the expenditure benchmark.

Identifying the potential fiscal space in any year involves the interaction between the requirement to improve the structural balance by greater than 0.5 per cent of GDP and the need to comply with the expenditure benchmark. In most cases, this is not an issue but, as set out below, a particular issue arises with relation to 2016 whereby compliance with the expenditure benchmark is met on current estimates but delivery of structural adjustment is lower than required. Estimates of potential output based on the harmonised methodology suggest a structural budgetary adjustment of 0.3 percentage points

The Department of Finance estimates that using fiscal space in a full year of the order €1.2 billion - €1.5 billion in 2016 will deliver compliance with the expenditure benchmark[11]. This range, which depends on the composition of measures, takes account of carryover costs from earlier years, the application of the convergence margin and the impact of discretionary revenue measures.

[10] Calculations in box 10 use reference rates based on Commission estimates of potential output produced after the 1 April EPC endorsement of revised population projections for Ireland. The convergence margin is calibrated to deliver greater than 0.5pp structural adjustment. As a result, calculations differ from those contained in the Commission assessment.

[11] Further details demonstrating compliance with the expenditure benchmark in 2016 will be set out in an annex of the SPU. The range of €1.2 to €1.5 billion does not take into account re-allocation within expenditure funded by savings from efficiencies and policy measures. For example, Live Register savings over and above those related to the cycle due to lower unemployment as a result of existing activation measures will be available to fund new measures.

The fiscal forecasts contained in this document and those of the accompanying Stability Programme Update are based on a technical assumption of a budgetary package of €1.2 billion in 2016, which is split evenly between expenditure increases and tax cuts. Such a package is similar in quantum to what was introduced in Budget 2015. It strikes a balance between providing a tangible benefit to the taxpayer from the economic recovery, while allowing for continued investment in the public services and infrastructure which are needed to support economic growth and still maintaining fiscal prudence.

In addition, the projections capture a range of other developments compared to Budget 2015 assumptions. For 2015, account is taken of interest savings of €0.5 billion, an increased Central Bank surplus, €1.0 billion in additional tax revenues and €0.25 billion in higher spending that takes into account the Revised Estimates Volume (REV) and subsequent policy decisions. This feeds into the base for 2015 and the latter years.

The impact on the general government balance and debt of Irish Water has also been included on a provisional basis pending a decision from Eurostat. In general government debt terms, debt projected to be accumulated by Irish Water would be worth just under 1 per cent of GDP or approximately €2.3 billion by the end of 2020. Further information on the impact of Irish Water's inclusion in the forecast is set out in Chapter 3 of the 2015 Stability Programme Update. If the final Eurostat decision on the classification of Irish Water places it outside general government (as is expected to be the case), the Government will consider how to make the best use of the improvement in the fiscal forecasts that would result.

It should be noted that the variables used for the expenditure benchmark and the structural balance are point in time estimates. These will almost certainly change between now and the Budget and as the 2015 position develops from both an economic and fiscal perspective.

The post-2016 projections revert to a no-policy change position other than a provision for demographics pressures and indexation of the income tax system. While the projections are indicative, they show an annual average improvement in the structural balance of 1.1 per cent per annum over the 2015 to 2020 period, with the MTO being met in 2018-2019.

Table 2: Fiscal variables

% of GDP	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
General government balance	-4.1	-2.3	-1.7	-0.9	-0.1	0.7	1.7
Structural balance	-4.0	-2.6	-2.3	-1.3	-0.3	0.8	2.1
Structural improvement pp		1.7	0.3	1.0	1.0	1.1	1.3
Debt-to GDP improvement pp		4.7	4.7	2.5	4.2	4.2	4.7

Source: Department of Finance

Estimates of potential output consistent with the SPU forecast produced using the harmonised methodology suggest structural budgetary adjustment of 0.3 percentage points in 2016. If an

alternative estimate of structural unemployment were used, the structural adjustment would amount to ½ a per cent of GDP[12].

The requirement of the preventive arm is to improve the structural deficit at a rate '*greater than 0.5 per cent of GDP'* per annum until the MTO is met. It is the intention of this Government to ensure that we move towards the MTO at this minimum rate on average over the coming years, an approach supported by the IMF[13]. As is evident from table 2, the pace of structural budgetary improvement significantly exceed this minimum rate on a no policy change from 2017 onwards. On the basis of current estimates, this suggests the availability of considerable fiscal space in later years. For example, initial estimates from the Department of Finance suggest that there would be sufficient fiscal space to implement a budget along the lines planned for 2016 in each year[14], whilst complying with the rules and still achieve our MTO over the forecast horizon. Once the MTO is achieved no further improvements in the structural position will be required.

The minimum improvement in the structural balance and the expenditure benchmark are designed to be complementary. In Ireland's case for 2016, compliance with one assessment, the expenditure benchmark, results in not meeting the other assessment, the annual improvement in the structural balance. This somewhat counterintuitive outcome emphasises the material problems posed by some of the technical aspects the rules can generate. It should be noted however that the difficulty in accurately calculating the output gap and structural balance is one of the key reasons why the expenditure benchmark was introduced by the 'six-pack' to account for country specific issues. In general, Commission assessments of the fiscal stance have taken a pragmatic approach to some of these country specific aberrations and is not expected to be a substantive issue for Ireland.

As Ireland is only recently out of a programme of assistance, a steady and consistent improvement in the underlying position of the public finances is required to provide a degree of certainty to the markets that Ireland will continue to bring our high debt burden down to more sustainable levels. In order to assist this process, a further pillar of the SGP requires that the debt-to-GDP ratio should make sufficient progress towards compliance with the debt benchmark of 60 per cent of GDP. While Ireland is not fully subject to this requirement until 2019, the table shows that Irelands forecast improvement in debt to GDP ratio will meet this target.

[12] For instance, HP-filtering the unemployment rate

[13] IMF Article IV Selected Issues paper 'Technical challenges in implementing EU fiscal rules in Ireland', March 2015.

[14] Under this scenario, estimates suggest the unemployment rate would be a further 0.2 percentage points lower by 2018, or 0.4 percentage points by 2020.

Table 3: Budgetary projections 2014-2020

€ million	2014	2015	2016	2017	2018	2019	2020
CURRENT BUDGET							
Expenditure							
Gross Voted Current Expenditure	50,455	49,715	50,045	50,345	50,645	50,945	51,245
Non-Voted (Central Fund) Expenditure	10,730	9,770	9,895	9,595	9,795	9,810	9,690
Gross Current Expenditure	**61,185**	**59,485**	**59,940**	**59,940**	**60,440**	**60,755**	**60,935**
less Expenditure Receipts and Balances	11,435	11,205	11,135	11,450	11,760	12,150	12,560
Net Current Expenditure	**49,750**	**48,280**	**48,805**	**48,490**	**48,680**	**48,605**	**48,375**
Receipts							
Tax Revenue	41,280	43,300	45,290	45,865	49,925	50,835	52,875
Non-Tax Revenue	2,965	3,350	3,090	2,280	2,080	2,035	2,050
Net Current Revenue	**44,245**	**46,650**	**48,380**	**48,145**	**52,005**	**52,870**	**54,925**
CURRENT BUDGET BALANCE	**-5,505**	**-1,630**	**-425**	**-345**	**3,325**	**4,265**	**6,550**
CAPITAL BUDGET							
Expenditure							
Gross Voted Capital	3,550	3,670	3,690	3,785	3,785	3,785	3,785
Non-Voted Expenditure	1,635	1,215	900	890	900	885	885
Gross Capital Expenditure	**5,185**	**4,885**	**4,590**	**4,675**	**4,685**	**4,670**	**4,670**
less Capital Receipts	350	300	300	300	300	300	300
Net Capital Expenditure	**4,835**	**4,585**	**4,290**	**4,375**	**4,385**	**4,370**	**4,370**
Capital Resources	**2,155**	**2,750**	**2,930**	**980**	**990**	**990**	**980**
CAPITAL BUDGET BALANCE	**-2,680**	**-1,835**	**-1,360**	**-3,395**	**-3,395**	**-3,380**	**-3,390**
EXCHEQUER BALANCE	**-8,185**	**-3,465**	**-1,785**	**-3,740**	**-70**	**885**	**3,160**
GENERAL GOVERNMENT BALANCE	**-7,630**	**-4,610**	**-3,580**	**-2,055**	**-290**	**1,645**	**4,075**
% of GDP	-4.1	-2.3	-1.7	-0.9	-0.1	0. 7	1.7

Source: Department of Finance

Notes:

- This table is prepared on a cash basis. The comparison between 2015 and 2016 is impacted by an amount of €270m that represents the crystallisation of a pay and pensions accrual. Excluding this amount the year on year increase in voted current expenditure is €600m.
- The voted expenditure amounts do not include a provision to cover inflationary pressures. Each 1% on the Exchequer pay & pensions bill costs €175m and 1% on Social Protection payments amounts to €185m.
- It is assumed that capital expenditure increases in line with published figures into 2017. Post 2017, the allocation is left unchanged in nominal terms. This is a technical assumption and these allocations will be revised upwards when the Capital Review is published in due course.

Chapter 5
New Budgetary Framework

5.1 Background

The wide-ranging ranging reforms to the budgetary architecture, introduced by the Government, have been informed by the core principle that a more open and transparent process, allowing for clearer accountability and oversight, supports the efficient use of public funds to deliver effective services for citizens.

Among the first actions of the Government in 2011 was to implement a medium term expenditure framework to enhance the management of public expenditure. This new framework along with the two Comprehensive Reviews of Expenditure have provided the opportunity to move discussions about expenditure decisions away from consideration of short-term issues to a broader strategic debate about key challenges facing public expenditure and public services.

Initiatives such as the Public Spending Code and Value for Money Policy Reviews are well-established and aim to systemically analyse Departmental expenditure, and the establishment of the Irish Government Economic and Evaluation Service continues to enhance the analytical capacity of Government Departments. The introduction of Performance Budgeting, provides a link between the funds allocated and the key outputs and performance indicators of each Department.

These reforms to the domestic expenditure framework facilitate the work of Dáil Éireann and its Select Committees in engaging with Government Departments with regard to their multi-annual expenditure ceilings and priorities, and in holding Ministers and Heads of Departments to account regarding the use of public funds.

The Government has also set up the Irish Fiscal Advisory Council (IFAC). The role of the Council is to independently assess, and comment publicly on, whether the Government is meeting its own stated budgetary targets and objectives. It is required to assess and endorse, as it considers appropriate, the official macroeconomic forecasts underpinning each Budget and stability programme. The Council also assesses the fiscal forecasts and the fiscal stance, and monitors compliance with legislated fiscal rules.

5.2 The European Semester

Considerable changes to the annual cycle of budgetary and economic policy surveillance (known as the 'European Semester') have taken place at EU level in recent years. The rationale for these changes lies in the need to better coordinate policies in the Union, taking into account one of the key lessons of the crisis, namely that spill overs between Member States of the Union are larger than was originally foreseen.

The European Semester starts every year with the publication by the European Commission of the Annual Growth Survey (AGS) in November/December which outlines general economic priorities for the EU. Member States then present national programmes in the spring of each year, namely the Stability Programme (outlining medium-term fiscal policies) and the National Reform Programme (outlining structural reforms and updates on EU2020 targets). In May/June, the Commission then proposes Country-Specific Recommendations (CSRs) to each Member State, based on its assessment of national economic situations and programmes. Member States are expected to reflect the recommendations in their budgetary and policy plans for the subsequent year and to implement them in the coming twelve months. Member States are required to present a draft Budget not later than the 15th of October, with execution of the Budget by the end of the calendar year.

5.3 New Budgetary Framework in Ireland

Considerable improvements in the budgetary framework have been implemented in recent years. However, further reforms are necessary in order to ensure a more joined-up and integrated budgetary process; one that is more transparent, that promotes a shared understanding of the priorities and which, ultimately, leads to better budgetary outcomes. This Spring Economic Statement represents the first stage in the reformed budgetary process; it will be followed by a National Economic Dialogue, a more formalised public consultation process before the announcement of the Budget in October of each year. The budgetary framework could be complemented with the establishment of an Independent Budget Office to facilitate independent costings of policy proposals by the Oireachtas. More detail is provided below.

Spring Economic Statement

These changes to the budgetary timetable at EU level present an opportunity to further adapt the domestic budgetary process to enhance the whole-of-year approach towards the Budget. The publication of a Spring Economic Statement (SES) in April, setting out the broad parameters for macroeconomic growth and the fiscal outlook and constraints over the medium term, can facilitate an open discussion about fiscal options and priorities well in advance of the October Budget.

National Economic Dialogue

It is proposed that a National Economic Dialogue be held in July this year in order to facilitate a transparent and inclusive societal debate about the main structural challenges faced by the economy and society and the options for the allocation of public resources over the coming period. The Dialogue will be informed by the macroeconomic and fiscal parameters set out in the SES. In terms of the content, the Dialogue will concentrate on public policy issues within the parameters and the realities of the various rules and frameworks that apply to the exercise of fiscal policy e.g. SES and the overall EU semester including Country-Specific Recommendations (CSRs). With mid-year timing, the discussions during the Dialogue about where our resources should best be allocated, and how to accommodate the many demands

and pressures for increased resources, can then inform the work of the Government in deciding on Budget measures, and the work of the Oireachtas in considering the Budget later in the year.

Independent Budget Office

As a further potential reform to the Budgetary process, the Government will examine the possibility of establishing an Independent Budget Office. This would allow for independent costings of policy proposals from political parties and Groups in the Oireachtas, taking into account second-round effects (i.e. economic) as well as looking over a multi-year horizon. Given the need for consultation, this is a policy that would only be fully in place after the next election. In the intervening period, the current arrangements for the costings of Budget measures will continue and will be available on the basis of existing rules.

The Department of Finance and the Department of Public Expenditure and Reform have begun scoping the possible new arrangements and potential structures of the Office. Several matters would have to be considered including:

- Ensuring that equality of access would be available to all political groupings while ensuring that costings are produced in a timely manner.
- The practical arrangements for interaction with Government Departments, Revenue and/or other relevant agencies.
- International experience of similar institutions.
- The extent to which costings would take into account behavioural responses to policies and second-round economic effects (the 'multiplier').
- Whether the medium- and long-term impacts of policy measures including indexation and demographic pressures would be taken into consideration.
- Ensuring minimum criteria in terms of detail which would have to accompany any request for costings.

The Budget process

Table 4 outlines the process leading to the publication and implementation of Budget 2016.

Table 4: Budget 2016 process

Event	Timing	Content
Spring Economic Statement	*April 2015*	*Sets out the broad parameters to underpin the discussion of economic and fiscal policy over the medium term and to frame discussion over the summer months*
National Economic Dialogue	*July 2015*	*A means of widening consultation on the forthcoming Budget with key stakeholders at national level. This will be followed by a public call for written Budget submissions to be received by the start of September.*
Budget	*October 2015*	*Government announcement of its decision on the fiscal stance for the following year, as well as the detailed policy measures to underpin this.*
Finance Bill, Revised Estimates and other legislation	*October to December 2015*	*Engagement with the Oireachtas and implementation of Budget and other tax-related measures*

Tithe an Rialtais
Sráid Mhuirfean Uacht
Baile Átha Cliath 2
Éire

Government Buildings
Upper Merrion Street
Dublin 2
Ireland

T: +353 1 676 7571
@IRLDeptFinance
@IRLDeptPER