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Subject: Recommendation for a COUNCIL RECOMMENDATION on the 2018 National Reform Programme of Ireland and delivering a Council opinion on the 2018 Stability Programme of Ireland

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Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission Proposal COM(2018) 407 final.

## COUNCIL RECOMMENDATION

of

**on the 2018 National Reform Programme of Ireland**

**and delivering a Council opinion on the 2018 Stability Programme of Ireland**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies<sup>1</sup>, and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances<sup>2</sup>, and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> OJ L 306, 23.11.2011, p. 25.

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Ireland as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the Recommendation on the economic policy of the euro area<sup>3</sup> ('Recommendation for the euro area').
- (2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Ireland should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in the recommendations below, in particular recommendations (1) and (2).

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<sup>3</sup> OJ C 179, 25.5.2018, p. 1.

- (3) The 2018 country report for Ireland was published on 7 March 2018. It assessed Ireland's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017<sup>4</sup>, the follow-up given to the country-specific recommendations adopted in previous years and Ireland's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission's analysis led it to conclude that Ireland is experiencing macroeconomic imbalances. In particular, large stocks of private and public debt and net external liabilities constitute vulnerabilities. However, the improvements have been substantial. Strong productivity growth in past years led to improved competitiveness and to a positive current account balance entailing a rapid reduction in the high stock of net foreign liabilities. Strong economic growth continues to support private deleveraging. However, the stock of private debt remains high, although the strong influence of the activities of multinational companies needs to be taken into account when evaluating corporate debt, while household debt appears broadly in line with fundamentals. Government debt is projected to remain on a downward trajectory, and the deficit is moving closer to balance. House prices are growing at a rapid pace, albeit from likely undervalued levels, which is also strengthening households' balance sheets. Banks are well recapitalised and their profitability is improving gradually. The stock of non-performing loans, although remaining high, continues to decrease. Policy action addressing these vulnerabilities has been taken, but some measures will take time to generate the expected effects.
- (4) Ireland submitted its 2018 National Reform Programme on 18 April 2018, and its 2018 Stability Programme on 30 April 2018. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

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<sup>4</sup> OJ C 261, 9.8.2017, p. 1.

- (5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council<sup>5</sup>, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.
- (6) Ireland is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2018 Stability Programme, the Government expects the headline deficit to decline slightly to 0,2 % of GDP in 2018 and to continue to gradually improve thereafter, turning into a surplus of 0,4 % of GDP in 2021. The medium-term budgetary objective — a structural deficit of 0,5 % of GDP — is expected to be met from 2019 onwards. According to the Stability Programme, the general government debt-to-GDP ratio is expected to fall to 66 % in 2018 and to continue declining to 58,7 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2019 onwards have not been sufficiently specified.

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<sup>5</sup> Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

- (7) On 11 July 2017, the Council recommended Ireland to ensure that the nominal growth rate of net primary government expenditure does not exceed 2,4 % in 2018, corresponding to an annual structural adjustment of 0,6 % of GDP. At the same time, the Council stated that consideration should be given to achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Ireland's public finances. Based on the Commission 2018 spring forecast, there is a risk of some deviation from the recommended fiscal adjustment in 2018 and over 2017 and 2018 taken together.
- (8) In 2019, Ireland should achieve its medium-term budgetary objective. This is consistent with a nominal growth rate of net primary government expenditure<sup>6</sup> which does not exceed 5,3 %<sup>7</sup>, corresponding to an annual structural adjustment of 0,1 % of GDP. Based on the Commission 2018 spring forecast, the structural balance is forecast to reach a deficit of 0,4 % of GDP in 2019, above the medium-term budgetary objective. Ireland is forecast to comply with the transitional debt rule in 2018 and the debt rule in 2019. Overall, the Council is of the opinion that Ireland needs to stand ready to take further measures to ensure compliance in 2018 and is projected to comply with the provisions of the Stability and Growth Pact in 2019. In view of the difference between measurements of GDP and domestic output in Ireland and the associated impact on the debt-to-GDP ratio, Ireland's current cyclical conditions and the heightened external risks, the use of any windfall gains to further reduce the general government debt ratio would be prudent.

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<sup>6</sup> Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a four-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out. The expenditure benchmark for Ireland reflects an adjustment to correct for a distortion to the 10-year reference rate of potential growth caused by the exceptionally high surge in real GDP growth in 2015. Following the approach taken by the Irish authorities in their Budget 2017 calculations, the Commission has taken the average of potential growth rates in 2014 and 2016.

<sup>7</sup> As in 2018, the expenditure benchmark reflects an adjustment to correct for a distortion to the 10-year reference rate of potential growth caused by the exceptionally high surge in real GDP growth in 2015.

- (9) Public finances have further improved on the back of robust output growth, yet risks of revenue volatility remain, and there is scope for making revenue more resilient to economic fluctuations and adverse shocks. Limiting the scope and the number of tax expenditures, and broadening the tax base would improve revenue stability in the face of economic volatility. However, some recent tax measures have focused on cuts and reliefs, and seem to have further increased reliance on highly pro-cyclical sources of revenue. Moreover, Ireland has further potential to improve the way its tax system can support environmental objectives.
- (10) As indicated in the 2018 euro-area recommendation, the fight against taxpayer's aggressive planning strategies is essential to impede distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spill-over effects of taxpayers' aggressive planning strategies between Member States call for a coordinated action of national policies to complement Union legislation. The high level of royalty and dividend payments as a percentage of GDP suggests that Ireland's tax rules are used by companies that engage in aggressive tax planning. Limited application of withholding taxes on outbound (i.e. from Union residents to third-country residents) royalty and dividend payments made by companies based in Ireland may lead to those payments escaping tax altogether, if they are also not subject to tax in the recipient jurisdiction. Furthermore, companies may use certain provisions in bilateral tax treaties between Ireland and some other countries to overrule the new tax residence rule put in place in Ireland in 2015 and further analysis of this issue is warranted. The outcome of the consultation undertaken by Ireland following the Independent Review of the Corporation Tax Code will be relevant for the design of the announced tax reforms. The Commission takes note of recent positive steps announced or adopted (i.e. steps taken to tackle aggressive tax planning domestically; possible defensive measures against listed non cooperative jurisdictions). Based on recent exchanges, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

- (11) Long-term fiscal sustainability risks related to the cost of ageing remain. Ireland has introduced some significant efficiency measures such as a cost-saving agreement with the pharmaceutical industry, a financial management system and activity-based funding. Some measures have also been taken to improve the availability of primary healthcare. However, the Irish healthcare system is costly and faces many challenges, which are compounded by a rapidly ageing population. Moreover, primary and community care services are not yet capable of alleviating the mounting pressure on capacity and costs within hospital care. The planned move towards universal healthcare needs to be supported by multi-year budgeting and better expenditure control. In addition, it has to be informed by the findings from a comprehensive spending review of the effectiveness and efficiency of the health sector. In addition, strengthening the gatekeeper role of primary care for Ireland's overburdened hospitals should be considered. Despite a wide range of reforms to contain public pension expenditure, the overall pension system deficit is expected to grow significantly in the long term. A timely implementation of the presented roadmap for pension reform is key to strengthening the fiscal sustainability of the Irish pension system.
- (12) Years of low investment following the economic bust are taking their toll on the availability of appropriate infrastructure in the areas of transport, clean energy, water services, housing and telecommunications. Persistent supply shortages, coupled with increasing demand, continue to fuel property price increases. Although prices did not seem overvalued in 2016, affordability is a concern. If not addressed, constraints limiting the supply of housing could contribute to imbalances building up. Combined with spatial planning, improved infrastructure is a critical enabler for an appropriate housing supply response, the enhancement of private investment, productivity growth and a balanced regional economic development. Moreover, infrastructure investment in clean energy, clean and public transport and water as well as intensified efforts in the field of renewable energy and the circular economy will be essential for Ireland to succeed in its transition towards a low-carbon and environmentally resilient economy. The National Development Plan 2018-2027 and the National Planning Framework, which are part of the 'Ireland 2040 Strategy', will be strong steps in the right direction once acted upon and implemented in close coordination with stakeholders.



(13) Existing climate change mitigation efforts will not enable Ireland to achieve its Europe 2020 climate goals domestically. Only limited progress has been achieved in decarbonising key parts of the economy, mainly in agriculture, road transport and the residential sector. This will make it necessary for Ireland to use available flexibilities to comply with the Effort Sharing Decision, such as buying allocations from other Member States. National projections, published in 2017, highlight the scale of additional efforts needed: emissions under the Effort Sharing Decision (setting binding annual greenhouse gas emission targets for Member States for 2013-2020) are expected to increase up to 2025, before stabilising at a level slightly below 2005 emissions, on the basis of existing policies. Ireland recently adopted a National Mitigation Plan laying out a roadmap towards a low-carbon economy and a coherent framework to tackle persisting challenges in the energy sector. As it stands, however, the plan offers few specific new mitigation measures. The National Planning Framework also has a climate component, in recognition of the fact that adequate spatial planning will be a critical enabler of climate change mitigation given that the population is so widely dispersed and Ireland only has a small number of large urban areas, all of which face serious congestion and public transport issues. Finally, the National Development Plan 2018-2027 and its effective implementation will play a crucial role in decarbonising the economy. The plan will in fact determine the extent to which additional means are mobilised for the decarbonisation of the power sector, the deployment of renewable energy sources and the improvement of public transport and energy efficiency.

- (14) Ensuring inclusive growth remains a challenge in Ireland. Unemployment fell to 6,7 % in 2017 but certain groups are still largely detached from the labour market and socially excluded. The social protection and taxation systems are very effective in curtailing poverty and inequality, and Ireland has taken measures to incentivise employment by tapering the withdrawal of benefits and supplementary payments. Ireland's persistent high at-risk-of-poverty-or-social-exclusion rate is linked to the high proportion of people living in households with low work intensity (almost twice the Union average and highest in the Union — 18,2 % versus 10,5 % in 2016). This is particularly prevalent for single-parent households. Almost three quarters of people who are not working in Ireland are inactive. Both the overall and child at-risk-of-poverty-or-social-exclusion rates fell slightly in 2016 but remain higher than the Union average. As a result, Ireland needs to complete the implementation of its Action Plan for Jobless Households, including by improving the integrated support to people furthest from the labour market. The supply of social housing requires continued attention to meet ambitious targets and high demand.
- (15) Access to affordable, full-time and quality childcare remains a challenge. According to the Organisation for Economic Co-operation and Development, childcare costs in Ireland — relative to wages — were in 2015 the highest in the Union for lone parents and the second highest in the Union for couples. The high costs of childcare can act as a barrier to accessing paid employment, particularly in low-income households, including single-parent households. This has a negative effect on women's employment rate, which stood in 2016 at 65,4 %, close to the Union average. A law on the Single Affordable Childcare Scheme is nearing finalisation in Parliament. Implementation delays are already becoming apparent. The quality of childcare provision has also been promoted in particular through initiatives to ensure robust staff qualifications.

- (16) The differences between the employment rates of low, medium and highly skilled workers were among the highest in the Union in 2016 and the employment rate of low-skilled labour is 10 percentage points lower than before the economic crisis. As a consequence and linked to the change in economic activity, skills mismatches and skills shortages are becoming more evident in several areas. This accentuates the need to accelerate upskilling and reskilling policies and measures. Ireland has in particular a low level of participation in lifelong learning among low-skilled people in employment, which makes them vulnerable to changes in labour demand. Ireland has overall one of the lowest levels of digital skills in the Union, which is in stark contrast to the high proportion of science, technology, engineering and mathematics graduates leaving the Irish higher education system. Ireland also has one of the lowest employment rates of people with disabilities in the Union.
- (17) Productivity growth in Ireland is mainly driven by multinational companies. The productivity performance gap between these firms and Irish indigenous firms —mostly small and medium-sized enterprises — is increasing. The high international mobility of some of the multinationals and current uncertainties may put the sustainability and resilience of the Irish economy at risk in the longer term. Recent research has revealed that Irish-owned firms draw limited spill-overs and benefits in terms of productivity growth, innovation and export performance from the activities of multinationals in Ireland. However, Irish firms that carry out R&D efforts do benefit from spill-overs from multinationals. Public-sector incentives to carry out R&D and increasing the availability of skilled workers to Irish small and medium-sized enterprises would foster the diffusion of new technologies in those firms. In addition and as repeatedly indicated by the Irish National Competitiveness Council, ensuring the competitiveness of Irish firms requires limiting the growth of certain inputs and of legal costs in particular. Barriers in the market for legal services continue to represent a challenge, hampering competition and raising costs for service recipients. These affect mostly small businesses as they increase litigation costs. No implementing regulations are as yet in place for the new Legal Services Regulation Act. Public consultations, which are a pre-requisite to implementing legislation, are experiencing significant delays.

- (18) Even if Ireland's financial sector is on the way to a sustained recovery, legacy issues still create constraints. Although Ireland continued to make progress in reducing non-performing loans, their ratio to total gross loans (11,2 % in September 2017) remains among the highest in the Union. Debt overhang, market concentration and heightened uncertainty in some exporting sectors weigh on the demand for credit by small and medium-sized enterprises which remains subdued. It is crucial to reduce the long-term arrears, of which those overdue for more than two years account for around 60 % of total mortgages in arrears in 2017. Reducing long-term arrears could also help address the problem of debt overhang, which reduces the incentives for corporations, and small and medium-sized enterprises in particular, to put credit into more productive uses. Although its 2017Q4 Report on Residential Mortgage Arrears and Repossessions noted that approximately 87 % of restructured mortgages are meeting the arrangements, the Central Bank of Ireland has highlighted that restructures involving a temporary payment reduction are particularly prone to re-defaults. The viability of repossessions and write-offs as last resort options could be improved and complemented by a strong consumer protection framework safeguarding the positive developments in secondary market loan sales and the durability of loan restructuring solutions.
- (19) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Ireland's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Ireland in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Ireland but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (20) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion<sup>8</sup> is reflected in particular in recommendation (1) below.

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<sup>8</sup> Under Article 5(2) of Regulation (EC) No 1466/97.

(21) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (3) below,

HEREBY RECOMMENDS that Ireland take action in 2018 and 2019 to:

1. Achieve the medium-term budgetary objective in 2019. Use windfall gains to accelerate the reduction of the general government debt ratio. Limit the scope and the number of tax expenditures, and broaden the tax base. Address the expected increase in age-related expenditure by increasing the cost-effectiveness of the healthcare system and by pursuing the envisaged pension reforms.
2. Ensure the timely and effective implementation of the National Development Plan, including in terms of clean energy, transport, housing, water services and affordable quality childcare. Prioritise the upskilling of the adult working-age population, with a focus on digital skills.
3. Foster the productivity growth of Irish firms, and of small and medium enterprises in particular, by stimulating research and innovation with targeted policies, more direct forms of funding and more strategic cooperation with foreign multinationals, public research centres and universities. Promote faster and durable reductions in long-term arrears by the use of secondary markets, building on initiatives for vulnerable households and, where necessary, using write-offs of non-recoverable exposures.

Done at Brussels,

*For the Council*

*The President*

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