COUNCIL RECOMMENDATION

of 11 July 2017

on the 2017 National Reform Programme of Ireland and delivering a Council opinion on the 2017 Stability Programme of Ireland

(2017/C 261/07)

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 ([1]), 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 ([2]), 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,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 16 November 2016, the Commission adopted the Annual Growth Survey, marking the start of the 2017 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission 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 9-10 March 2017. On 21 March 2017, the Council adopted the Recommendation on the economic policy of the euro area ('Recommendation for the euro area') ([3]).

(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 recommendations (1) to (3) below.

(3) The 2017 country report for Ireland was published on 22 February 2017. It assessed Ireland's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, 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 22 February 2017.

(4) The Commission's analysis led it to conclude that Ireland is experiencing macroeconomic imbalances. In particular, these imbalances are characterised by a large stock of external, public and private debt (of both households and non-financial corporations), which makes Ireland vulnerable to adverse shocks. Banks are still facing a high level of non-performing loans but are well capitalised and their profitability, although still low, is improving gradually. Housing

([1]) OJ L 209, 2.8.1997, p. 1.
([2]) OJ L 306, 23.11.2011, p. 25.
([3]) OJ C 92, 24.3.2017, p. 1.

prices are increasing and supply constraints persist. Non-financial corporations' debt stock decreased over 2015, but was still higher than it was at the end of 2014. Household debt stock decreased in 2015 and public debt is on a firm downward trajectory. Ireland's negative net international investment position had been falling at a fast pace before 2015, but it then reversed, partly due to a level shift in 2015. However, the external sustainability of the domestic sector does not seem to be at risk. The stock of non-performing loans has been declining over the last year but the pace of reduction was slowing down somewhat by the end of 2016. Property prices continued to increase in 2015, but as of now there is no significant evidence of overvaluation. Policy measures have been taken in recent years to address all imbalances highlighted, including in the banking sector (improved regulatory framework, measures to address the high level of non-performing loans). The Government has taken several relevant measures to address the undersupply in the housing market, but it will take time for them to generate effects.

(5) Ireland submitted its 2017 National Reform Programme on 13 April 2017 and its 2017 Stability Programme on 2 May 2017. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(6) 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 ([1]), 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 effectiveness of the ESI Funds to sound economic governance.

(7) Ireland is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2017 Stability Programme, the Government expects the headline deficit to decline slightly to 0,4 % of GDP in 2017 and to continue to gradually decrease thereafter, turning into a surplus of 1,0 % of GDP in 2021. The medium-term budgetary objective — a structural deficit of 0,5 % of GDP — is expected to be met from 2018 onwards. According to the Stability Programme, the general government debt-to-GDP ratio is expected to fall to 72,9 % in 2017 and to continue declining to 65,2 % in 2020. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2018 onwards have not been sufficiently specified.

(8) On 12 July 2016, the Council recommended Ireland to achieve an annual fiscal adjustment of 0,6 % of GDP towards the medium-term budgetary objective in 2017. Based on the Commission 2017 spring forecast, there is a risk of a significant deviation from the recommended fiscal adjustment over 2016 and 2017 taken together.

(9) In 2018, in light of its fiscal situation and, in particular, of its debt level, Ireland is expected to further adjust towards its medium-term budgetary objective of a structural deficit of 0,5 % of GDP. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure ([2]) which does not exceed 2,4 % in 2018. It would correspond to an annual structural adjustment of 0,6 % of GDP. 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. 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. Under unchanged policies, there is a

([1]) 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).

([2]) Net 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 4-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.

risk of some deviation from the requirement over 2017 and 2018 taken together. At the same time, Ireland is forecast to comply with the transitional debt rule in 2017 and 2018. Overall, the Council is of the opinion that further measures will be needed, in particular in 2017, to comply with the provisions of the Stability and Growth Pact. In view of 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. However, as foreseen in Regulation (EC) No 1466/97, the assessment of the budgetary plans and outcomes should take account of the Member State's budgetary balance in light of the cyclical conditions. As recalled in the Commission Communication accompanying these country-specific recommendations, the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Ireland's public finances. In that context, the Council notes that the Commission intends to carry out an overall assessment in line with Regulation (EC) No 1466/97, in particular in light of the cyclical situation of Ireland.

(10) Although the economic recovery is robust and output is expected to grow at a solid pace in the years ahead, the outlook has become more uncertain, creating risks for the still fragile public finances. Therefore, more efforts should be taken to make revenue more resilient to economic fluctuations and adverse shocks. To this end, the proposal to introduce a Rainy-Day Fund should be advanced and reliance on highly concentrated and volatile revenue sources should be reduced. A balanced composition of different tax sources and broader tax bases improve revenue stability in the face of economic volatility. However, efforts to broaden the tax base have been limited in recent years and recent tax measures have focused on cuts and reliefs. The announced systematic evaluation of the costs and benefits of reduced VAT rates, which apply to an extensive range of sales, is pending. Recurrent property taxation is considered to be one of the most growth-friendly revenue sources. However, Irish revenues from immovable property only amounted to 1,0 % of GDP in 2014, compared to the Union average of 1,6 %. A gradual indexation of property values would help to smooth the local property tax profile by preventing a sudden increase in tax liabilities when properties are revalued in 2019. The differences in the taxation of diesel and gasoline for road users are environmentally unjustified.

(11) In the past, comprehensive expenditure reviews have focused primarily on reducing government spending to meet overall fiscal targets. There has been little evaluation of the effectiveness and efficiency of expenditure programmes, which has ultimately weakened the reliability of multi-annual spending plans. An appropriately designed spending review, in line with the common Eurogroup principles, would improve expenditure control and could free up resources for much needed public investment to boost growth. The spending review should, in particular, address the cost-effectiveness of the health sector. Ireland has introduced some important efficiency measures, such as a cost-saving agreement with the pharmaceutical industry, a financial management system, eHealth and activity-based funding. However, more could be done, for example by strengthening the role of primary care as a gatekeeper for Ireland's overburdened hospitals. Steps towards a universal single-tier health service are fragmented and lack an overarching vision.

(12) Promoting sustainable and inclusive growth that benefits all groups in society remains a challenge. Unemployment was below the Union average at 6,4 % in April 2017. However, the low work intensity of many households creates concerns that some people are left behind as the recovery continues. From 2013 to 2015, the percentage of the population living in low- or very low-work-intensity households fell by 15 %; the overall unemployment rate over the same period dropped by 28 %. Overall, the welfare system has worked well to contain poverty and inequality and Ireland has taken measures to incentivise employment by tapering the withdrawal of benefits and supplementary payments. However, barriers to inclusive growth still exist. The disparities between the employment rates of low-, medium- and highly-skilled workers are among the highest in the Union. Skills mismatches and skills shortages have emerged in certain areas, while upskilling and reskilling opportunities are insufficient. The labour market and social challenges point to the importance of an integrated approach to training and labour market activation for those furthest from the labour market. Moreover, concerns remain over the quality of childcare provisions, including the availability of full-time services. As a percentage of wages, net childcare costs in Ireland are among the highest in the Union. The availability and cost of quality full-time childcare present barriers to female labour market participation and hinder efforts to reduce child poverty, which has fallen slightly but remains higher than the Union average.

(13) Infrastructure needs should be addressed in order to promote durable and balanced growth. The economic crisis led to a shift in the composition of general government expenditure away from investment and towards current spending. Years of sharply reduced government investment have had a negative impact on the adequacy and quality of infrastructure. The shift in government expenditure has also affected public-sector support for research and development with possible implications for the competitiveness of SMEs. Ireland ranks 25th in the Union in public research and development investment as a percentage of GDP. The most severe infrastructure shortcomings are in transport, water services and housing. Demand for new housing currently exceeds supply by a wide margin in the country's main urban areas. As a result, residential property prices and rents continue to increase rapidly, in turn resulting in a recent high increase in housing exclusion and homelessness. There is currently no evidence of overvaluation, but constraints limiting the supply of housing could generate macro-financial risks if they are not resolved. A coherent and timely spatial plan would help to deliver new homes in the right areas.

(14) The Irish economy presents a division between the mostly small and medium-sized Irish-owned firms and large multinational companies operating in Ireland. Linkages between multinational companies and Irish-owned firms remain limited. Their export performances and profiles are significantly different, while the productivity gap between them is growing wider. Irish-owned firms present a weaker exporting profile than multinationals established in Ireland. Their exports are heavily concentrated by sector and destination, making them more vulnerable to shocks. Investing in innovation would foster the productivity and exporting potential of Irish firms at a time when diversifying exports and export destinations could help stabilise the performance of Irish firms. Public research and development expenditure remains low. Fully implementing measures to increase public research and development, in particular measures to support the innovation capacity of SMEs, depends on the return to a trend of sustained investment. To stimulate innovation by SMEs, innovation policies could be rebalanced towards more direct forms of funding. Support from the Government for business research and development has increasingly relied on research and development tax credits. More targeted policy mixes with more direct funding may better address the needs of Irish young innovative firms and exploit opportunities from the strong investing power of multinational companies. This would serve to facilitate access to global value chains and accelerate knowledge spillovers.

(15) In an environment of heightened external uncertainty, further progress in reducing non-performing loans is important to ensure the stability of the financial sector. Although progress has been made, high non-performing loans ratios remain a drag on banks' profitability and an obstacle to the full economic recovery of households and firms. The deleveraging of households and domestic firms continues, but their indebtedness remains one of the highest in the Union at 276,8 % of GDP (September 2016). High corporate debt may hinder firms from borrowing for investment, which in turn also limits banks' ability to improve their own profitability.

(16) According to the Central Bank of Ireland, the average non-performing loans ratio of the domestic Irish banks was 14,2 % in September 2016. This is substantially above the Union average of 5,3 %. Non-performing loans of the domestic Irish banks fell by EUR 12,7 billion or 32,7 % year-on-year in September 2016. The pace of resolution of arrears has slowed down somewhat as the remaining long-term arrears are also the most difficult to restructure. The momentum should not be lost: arrears restructuring should be sustainable in the long term and different forms of debt reduction need to be considered. 14 % of the mortgage stock was in arrears at the end of September 2016, while accounts in arrears of over 2 years represented around 70 % of the total mortgage loan balances in arrears greater than 90 days. Commercial real estate loans held by domestic banks and business loans also remain areas of concern, with non-performing loans ratios of 32,6 % and 11,8 % respectively in September 2016. The use of personal insolvency, bankruptcy, examinership and out-of-court arrangements intended to restore households and business to viability remains low and should be better incentivised. After several delays, the central credit register is expected to enter the final phase of its implementation. Its finalisation should be a priority as it will serve as the basis for adequate credit risk assessment of borrowers and ensure prudent future lending.

(17) Implementation of the 2015 Legal Services Regulation Act ('the 2015 Act') started in late 2016. The full implementation of the 2015 Act will be crucial in Ireland's efforts to increase competition in the sector because it will allow barristers direct access to the profession, as well as the creation of corporate groups by multidisciplinary

practices and the operation in Ireland of alternative business models used in other Member States. Independent legal services are an input to all sectors of the economy and their cost has a bearing on Ireland's competitiveness. Therefore, it is paramount that the implementation of the 2015 Act introduces competition-enhancing and cost-reducing provisions following public consultation processes, or incorporates such provisions in regulations to be issued by the Legal Services Regulatory Authority so as to boost competition and reduce costs.

(18) In the context of the 2017 European Semester, the Commission has carried out a comprehensive analysis of Ireland's economic policy and published it in the 2017 country report. It has also assessed the 2017 Stability Programme, the 2017 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 their compliance 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.

(19) In the light of this assessment, the Council has examined the 2017 Stability Programme and its opinion [1] is reflected in particular in recommendation (1) below.

(20) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2017 National Reform Programme and the 2017 Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) and (3) below,

HEREBY RECOMMENDS that Ireland take action in 2017 and 2018 to:

1. Pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact. Use any windfall gains arising from the strong economic and financial conditions, including proceeds from asset sales, to accelerate the reduction of the general government debt ratio. Limit the scope and the number of tax expenditures and broaden the tax base.

2. Better target government expenditure, by prioritising public investment in transport, water services, and innovation in particular in support of SMEs. Enhance social infrastructure, including social housing and quality childcare; deliver an integrated package of activation policies to increase employment prospects of low-skilled people and to address low work intensity of households.

3. Encourage a continued and more durable reduction in non-performing loans through resolution strategies that involve write-offs for viable businesses and households, with a special emphasis on resolving long-term arrears.

Done at Brussels, 11 July 2017.

For the Council

The President

T. TÕNISTE

[1] Under Article 5(2) of Regulation (EC) No 1466/97.