EUROPEAN
COMMISSION

Brussels, 5.6.2019
COM(2019) 507 final

Recommendation for a

COUNCIL RECOMMENDATION

on the 2019 National Reform Programme of Ireland and delivering a Council opinion on the 2019 Stability Programme of Ireland

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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 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, 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 21 March 2019. On 9 April 2019, the Council adopted the

1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.

recommendation on the economic policy of the euro area ('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 recommendation (1) and (3) below. In particular, focusing economic policy related to investment in the specified areas and introducing tax measures will help address the second euro area recommendation as regards supporting investment, public finances improvements and fight against aggressive tax planning.

(3) The 2019 country report for Ireland[3] was published on 27 February 2019. It assessed Ireland's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the 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 27 February 2019[4]. The Commission's analysis led it to conclude that Ireland is experiencing macroeconomic imbalances. In particular, large stocks of public and private debt and net external liabilities make Ireland vulnerable to adverse shocks but the flow variables have continued to improve. The stock of private debt remains high but economic growth is continuing to help reduce it. The activities of multinationals continue to influence corporate debt. Household debt appears broadly in line with fundamentals although it is high compared with disposable income. Government debt is projected to remain on a downward trajectory, while the deficit is moving closer to a balanced position. House prices have been growing at a rapid pace for a number of years but have slowed down recently. House prices are largely driven by supply constraints and there is no clear evidence of overvaluation. The stock of non-performing loans, although still high, has decreased further even if long-term arrears are falling at a slower pace.

(4) On 17 April 2019, Ireland submitted its 2019 National Reform Programme and, on 29 April 2019, its 2019 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(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[5], 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].

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3 SWD(2019) 1006 final.

4 COM(2019) 150 final.

5 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).

6 COM(2014) 494 final.

(6) Ireland is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2019 Stability Programme, the government expects the headline balance to improve to 0.2% of GDP in 2019 and to continue to gradually improve thereafter to 1.3% of GDP in 2023. Based on the recalculated structural balance[7], the medium-term budgetary objective, set at a structural deficit of 0.5% of GDP, is planned to be reached by 2020. According to the Stability Programme, the general government debt-to-GDP ratio is expected to fall to 61.1% in 2019 and to continue declining to 51.6% in 2023. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2020 onwards have not been sufficiently specified.

(7) On 13 July 2018, the Council recommended Ireland to achieve the medium-term budgetary objective in 2019. This is consistent with a maximum nominal growth rate of net primary government expenditure[8] of 7.0% in 2019, corresponding to an allowed deterioration in the structural balance of 0.3% of GDP. Based on the Commission 2019 spring forecast, Ireland is expected to comply with the recommended fiscal adjustment in 2019.

(8) In 2020, Ireland should achieve its medium-term budgetary objective. Based on the Commission 2019 spring forecast, this is consistent with a maximum nominal growth rate of net primary government expenditure of 3.7%[9], corresponding to an annual structural adjustment of 0.7% of GDP. Ireland is forecast to reach the medium-term budgetary objective. General government debt is forecast to remain on a firm downward path beyond the requirements of the debt rule. Overall, the Council is of the opinion that Ireland is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020. 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 important.

(9) Public finances have further improved on the back of robust output growth, but the risks of revenue volatility remain, and there is scope for making revenue more resilient to economic fluctuations and adverse shocks. Limiting the scope and number of tax expenditures and broadening the tax base would improve revenue stability in the face of economic volatility. While Ireland has increased the lower value added tax rate on tourism activities, some recent tax measures have focused on cuts and reliefs. Moreover, Ireland has further potential to improve the way its tax system can support environmental objectives. Such efforts could include reducing fossil fuel subsidies and

[7] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

[8] 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 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. 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.

[9] As in 2019, 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.

providing a stronger price signal to investors by committing to a schedule of increases in the carbon tax over the next decade.

(10) The fight against aggressive tax planning is essential to make tax systems more efficient and fair as acknowledged in the 2019 euro area recommendation. Spillover effects of taxpayers' aggressive tax planning strategies between Member States call for a coordinated action of national policies to complement EU legislation. Ireland has taken measures against aggressive tax planning, but 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 EU 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.

(11) Long-term fiscal sustainability risks related to the cost of ageing remain. Spending on healthcare is projected to rise from 4.1% of GDP in 2016 to 5.1% in 2070, with a peak of 5.2% in 2063. Though there are aspects of the healthcare system in Ireland that work well or have improved, the system is inefficient, struggles to meet demand and does not deliver coordinated, integrated care. In order to mitigate against the escalating pressures of demand, the Irish government approved the Sláintecare Implementation Strategy and set up the Sláintecare Programme Implementation Office to comprehensively reform and modernise Ireland's health and social care services over the next 10 years. The planned reform represents a credible vision for making the health system universally accessible and sustainable, meeting the demands of an ageing population and shifting care into the community, with a stronger focus on prevention. This is likely to have a positive impact in reducing the reliance on acute care, thereby making healthcare more cost-effective. However, implementation is endangered by the health system's difficulties in addressing the duplicate health insurance market and effectively managing its own budget, performance and workforce in the short term. Short-term costs will also need to be contained to fulfil the Sláintecare vision in the long run.

(12) Despite past government efforts to contain spending on public pensions, the overall deficit of the pension system is expected to grow significantly in the long term as a result of pension expenditure rising from 5% of GDP in 2016 to 6.6% in 2070, with a peak of 7.5% in 2053. A full and timely implementation of the presented roadmap for pension reform is key to making the Irish pension system more fiscally sustainable.

(13) Increased investment in skills, education and training as well as in social inclusion are essential for improving Ireland's productivity and long-term inclusive growth. The tightening labour market and the emerging skills shortages and mismatches in certain sectors call for efforts to reach out to inactive groups of potential workers and to invest in under-tapped human capital. There is scope for promoting upskilling and better aligning education curricula and vocational training to labour market needs. The low percentage of the workforce with basic digital skills calls for further investment in workplace based training and upskilling of the adult workforce. Investing in access to quality and affordable childcare and rolling out the National Childcare Scheme will help increase women's rather low employment rate. The participation rate of people with disabilities in the labour market is among the lowest in Europe. The number of people living in households with low work intensity remains one of the highest in the EU, highlighting the scope for more integrated and targeted activation strategies to support this particular group.

(14) Years of low investment after the economic bust are taking their toll on the availability of affordable and social housing and of appropriate infrastructure in the areas of clean transport and energy, water and ultrafast broadband, which in turn pose barriers to business investment. Moreover, greenhouse gas emissions from road transport have increased strongly in the last 5 years. Improved infrastructure, combined with spatial planning, could be a critical enabler for improving the housing supply, increasing private investment, boosting productivity growth, and ensuring balanced regional economic development. Future-proof connectivity and sufficient digital skills remain crucial for domestic companies to effectively utilise digital technology and for a thriving domestic information and communications technology sector. Significant challenges remain in relation to access to ultrafast broadband, in particular in rural areas. More infrastructure investment in clean energy, clean and public transport and water services as well as intensified efforts in the field of decarbonisation, energy efficiency, renewable energy and the circular economy would help Ireland in its transition towards a low-carbon and environmentally resilient economy.

(15) While the launch of the National Development Plan could eventually lead to the provision of additional basic infrastructure, the weak capacity of the construction sector could become an obstacle to its timely delivery. Furthermore, diversifying maritime transport and energy connections with continental Europe could increase the resilience of the economy to external shocks. Ireland has so far failed to decouple its economic growth from the emissions of greenhouse gases and air pollutants. Greenhouse gas emissions have steadily risen, in particular in transport, agriculture, energy and the built environment. Lack of progress in this area will make it more difficult for Ireland to meet its EU obligations, while also increasing the cost of future action.

(16) Persistent supply shortages, coupled with increasing demand, continue to fuel rises in property prices. Although prices did not seem overvalued in 2017, affordability is becoming a concern. Housing supply shortages are also affecting social housing due to insufficient investment and builds over the last decade. While annual demand is estimated at about 72 000 units, just 10 000 are planned for delivery in 2019. A further 17 000 persons are to be assisted through Ireland's Housing Assistance Payment or Rental Accommodation Scheme, but this risks exacerbating rent increases in the private rental market where supply is already constrained. A large number of social homes are under-occupied, notably in the Dublin area, in part due to outdated succession practices. The inadequate mix in the types of social houses provided together with the very limited amount of affordable and cost-rental accommodation are factors further aggravating the situation. This has resulted in a steady rise in the number of people and families living in emergency accommodation with homelessness figures reaching new highs in February 2019.

(17) Fostering the innovation-driven productivity of domestic firms is crucial to support more robust and resilient productivity growth in the country. Business research and development expenditure continues to increase but it remains below the EU average and highly concentrated in the foreign-owned firms. There is scope to gear innovation policies to better support Irish small and medium enterprises. Indirect support (i.e. tax credits) remains the main instrument of public support for research and development in Ireland (accounting for 80% of total public support). Stronger linkages between multinationals and domestic firms could help to improve the diffusion of innovation throughout the economy. In addition, closer cooperation between firms and public research centres would also increase the innovation potential.

(18) Although the low levels of public research and development continue to cause concern (1.05% of GDP compared to an EU average of 2%), the recently adopted Future Jobs Ireland 2019 programme provides a promising framework to stimulate innovation and technological change and improve the productivity of small and medium enterprises. However, its full implementation will depend on a significant increase in public expenditure on research and innovation and the translation of the recently adopted programme into concrete policy measures. As it stands, this ambitious list of measures still lacks important details and precise implementation dates. For instance, for actions to be taken in 2019, no measures have been identified to increase the availability of long-term equity investment to support indigenous companies in scaling their business; the policy mix to incentivise small and medium enterprises to invest in new technologies combines tax credit and non-tax incentives to encourage small and medium enterprises to invest in innovation, but the relative magnitude of these measures remains unknown. While the strategy recognises the importance of broadband infrastructure for productivity, no specific actions and deliverables are planned to address the gap between Ireland and other EU countries when it comes to rolling out future-proof broadband networks in line with EU 2025 Gigabit Society targets.

(19) Regional disparities in Ireland are significant and have been increasing over the last decade. Ireland has rather high regional economic disparities compared to other EU countries in terms of GDP per capita. Between 2000 and 2016, GDP per capita in the Southern and Eastern region increased by 74%, 63 percentage points more than in the Border, Midland and Western region and the increase accelerated after 2012. By 2016, GDP per capita in the Southern and Eastern region was 2.6 times higher than in the Border, Midland and Western region. The Dublin area, with 40% of Ireland's population, contributed by 62 percentage points to GDP growth between 2000-2016.

(20) Regulatory barriers to entrepreneurship (in particular certain regulations related to commercial property and legal services) negatively affect firm entry and exit and thereby the productivity of indigenous Irish firms. Barriers to entry into retail markets represent a challenge. Ireland scores among the top five countries with the greatest number of procedural requirements as regards the establishment of retail outlets. Retailers face procedural obstacles which delay and increase the costs of opening new shops and may have a negative impact on market structure and dynamics.

(21) The new Legal Services Regulation Act remains to be implemented, as the introduction of regulations continues to experience significant delays, even if preparatory consultations are ongoing. Allowing for direct professional access to barristers on contentious matters as well as for legal persons to become partners in all types of legal practices remain uncertain possibilities. Overly complex operation and management rules for multidisciplinary practices are, on the other hand, to be avoided. An ambitious implementation of open-ended reforms is a matter of top priority. 'Ambition 2.3' in the Future Jobs Ireland 2019 programme is supposed to tackle problems with the cost of legal services, but the only deliverable in 2019 is tentative and the timing is ambiguous. Delays in implementing this reform contributes to the high cost of legal services in Ireland, to the detriment of business, small and medium enterprises in particular, and individuals. Since legal services are an important input for other business services, restrictions in that sector contributes to the high cost of other services (e.g. insurance).

(22) Non-performing loan ratios have continued to fall and were down by 3.4 percentage points to 7.8% in the year up to the third quarter of 2018. Banks are well on track to

meet their reduction targets, supported by portfolio sales, restructuring efforts and rising property prices. Long-term mortgage arrears (over 2 years past due) remain relatively high, helping to keep the non-performing loan ratio above the euro area average. A number of initiatives and draft bills, such as the ‘no consent, no sale’ bill have been proposed to address the social and economic impact of non-performing loan resolution, including for vulnerable households. The credit register became fully functional for consumer loans in 2018 and will be crucial for assessing whether borrowers are capable of servicing their debts. Insolvency procedures and the use of in- and out-of-court options for arrears resolution remain limited. Further reducing long-term mortgage arrears while building on initiatives for vulnerable households without creating undue obstacles for non-performing loans resolution remains a challenge and requires continued monitoring.

(23) The programming of EU funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the country report[10]. This would allow Ireland to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.

(24) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Ireland’s economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme and the 2019 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.

(25) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion that Ireland is expected to comply with the Stability and Growth Pact.

(26) In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (3) below.

HEREBY RECOMMENDS that Ireland take action in 2019 and 2020 to:

1. Achieve the medium-term budgetary objective in 2020. Use windfall gains to accelerate the reduction of the general government debt ratio. Limit the scope and number of tax expenditures, and broaden the tax base. Continue to address features of the tax system that may facilitate aggressive tax planning, and focus in particular on outbound payments. Address the expected increase in age-related expenditure by making the healthcare system more cost-effective and by fully implementing pension reform plans.

2. Provide personalised active integration support and facilitate upskilling, in particular for vulnerable groups and people living in households with low work intensity. Increase access to affordable and quality childcare.

3. Focus investment-related economic policy on low carbon and energy transition, the reduction of greenhouse gas emissions, sustainable transport, water, digital

[10] SWD(2019) 1006 final.

infrastructure and affordable and social housing, taking into account regional disparities. Implement measures, including those in the Future Jobs strategy, to diversify the economy and improve the productivity of Irish firms – small and medium enterprises in particular - by using more direct funding instruments to stimulate research and innovation and by reducing regulatory barriers to entrepreneurship.

Done at Brussels,

For the Council
The President