



Note on Ireland's budgetary process and the European Semester 2018

PBO Note 1 of 2018

Introduction

This first PBO Note of 2018 provides Members with an overview of the relevance of the European Semester 2018 to Ireland's budgetary process. It also summarises the most important aspects of the European Commission's Opinion in respect of Ireland's Draft Budgetary Plan (DBP) 2018 and the Alert Mechanism Report (AMR) 2018 – two of the documents within the European Commission's *Autumn Package*.

An overview of the relevance of the European Semester 2018 to the budgetary process

The European Semester is the annual budgetary cycle of EU economic and fiscal policy co-ordination. Ireland participated in the Semester process for the first time in 2014.

The European Semester has an important bearing on the Irish budgetary process as it informs policy priorities for the coming year, and requires Ireland to present its Draft Budgetary Plan (DBP) to the European Commission for comment on or before 15 October each year. The European Semester process begins in November of the preceding year with the publication of the Autumn Package.

In addition to the Commission's Opinion, the Autumn Package includes the Annual Growth Survey (AGS), which Member States are invited to follow, wherein the European Commission compiles its broad budgetary, economic and social policy priorities for the EU.

The Alert Mechanism Report (AMR) accompanies the publication of the AGS and evaluates Member State economic policies against internal and external indicators under various themes in order to identify excessive imbalances or risks. If risks are detected, the Commission may decide to carry out an in-depth review which is then included with the Country Report published the following February. The conclusions of the Country Report are used as the basis for negotiating draft Country-Specific Recommendations (CSRs) that will be published by the Commission in May. Ireland's Stability Programme Update and National Reform Programme (published in April) also help to inform the Commission's approach to drafting the CSRs. Member States are invited to incorporate the CSRs (once adopted by the Council of the EU) into their policy priorities for their coming Budgets.

Other documents form part of the Autumn Package and may differ from year to year.

The accompanying PBO Briefing Paper 1 of 2018 addresses the European Commission's Autumn Package, which was published on 22 November 2017, in greater detail. The PBO has also published an infographic (1 of 2018) in advance of this Briefing paper. The infographic provides a calendar view of the key budgetary documents (including European Semester documents) that will be published in 2018.

For a detailed explanation of the European Semester process, please see the Oireachtas Library & Research Service Note, *EU Economic and Fiscal Policy Coordination – European Semester and the Two-Pack/Six-Pack measures* of 24 September 2015.

The Commission's Opinion in respect of Ireland's Draft Budgetary Plan 2018

The *Draft Budgetary Plan (DBP)* is Ireland's Annual Budget, modified to fit an EU template. The Irish Fiscal Advisory Council's (IFAC) *endorsement* of the Budget's macroeconomic forecast is required as part of this process. The European Commission published its *Opinion* (and accompanying *Staff Working Document*) in respect of Ireland's DBP 2018 as part of the Autumn Package (in November 2017). Ireland's position among 18 Euro area states in respect of compliance with the Stability and Growth Pact (SGP) is set out in Table 1.

Table 1 – Stability and Growth Pact (SGP) – Euro area compliance (18 Member States)

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

Source: European Commission – Based on information set out in *Press release* of 22 November 2017

Overall, the Commission Opinion concludes that Ireland's DBP 2018 is broadly compliant with the requirements of the SGP and states that Ireland is making sufficient progress towards compliance with the debt rule in both 2017 and 2018.

The Commission forecasts that Ireland will achieve the Medium Term Objective (MTO) in 2018. However, with regard to compliance with the adjustment *towards* the MTO, the Commission notes the following:

- Ireland is forecast to meet the MTO based on the *Structural Balance pillar*;
- When the years 2017 and 2018 are taken together, the *Expenditure Benchmark pillar* suggests that Ireland is at risk of a significant deviation from the requirements.

The Commission regards the Expenditure Benchmark (EB) as a more *appropriate* measure for fiscal policy in Ireland. As outlined in the Commission's Staff Working Document, the EB does *not* capture the additional revenue linked to the continued non-indexation of income tax bands. Taking this non-indexation into consideration, the Commission's estimate of the average deviation based on the EB pillar is *below but close* to the applicable significant deviation threshold of 0.25% of GDP. Their *overall* assessment is that there is a risk of a significant deviation in respect of 2017, and a risk of some deviation in 2018 from the required adjustment path towards the MTO according to the two-year average rule.

It should also be noted that the Commission *re-calculated* the structural balance forecast, provided in the Draft Budgetary Plan 2018, of *-0.5% of GDP*. The figure that appears in the Commission's Staff Working Document (Table 2) is a structural balance of *-0.6% of GDP*. This re-calculation was carried out on the basis of the information provided in the DBP, using a commonly agreed methodology. The Opinion states that the Government should stand ready to take further measures within the national budgetary process to ensure that the 2018 Budget will be compliant with the Stability and Growth Pact.

With regard to *taxation*, the Commission's Staff Working Document (SWD) refers to Ireland's 2017 *Country-Specific Recommendations* (CSRs), stating that the measures to limit the scope of tax expenditures (i.e. limit or remove tax 'breaks') and broaden the tax base were mixed, and that a more detailed discussion of the CSRs would be carried out as part of the Country Report (due for publication in February 2018). With regard to *expenditure*, the SWD notes that the DBP 2018 benefited from *a new spending review process* which has initially focussed on specific critical spending areas, representing around 30% of current government expenditure, such as prescription drug costs in the health sector, disability and employment programmes in the area of social protection, and public transport. The SWD acknowledges that expenditure ceilings now include demographic pressures and carry-over effects of previously announced measures. It states, however, that it remains too early to assess whether or not the new spending review process will improve the reliability of the State's multi-annual spending plan.

Alert Mechanism Report

The Alert Mechanism Report is an annual document that scores national economies against 14 macro-economic indicators. The goal is to identify any areas of the economy where there is a risk of an economic imbalance developing. Ireland's score was outside the acceptable thresholds for five of these indicators in the *Alert Mechanism Report (AMR) 2018*.

Table 2 – AMR 2018: Five macro-economic indicators where thresholds were exceeded

Indicator	Net International Investment Position	Consolidated Private Sector Debt	General Government Gross Debt	Real Effective Exchange Rate	House Price Index
Measure	% of GDP	% of GDP	% of GDP	3-year % change	1 year % change
Thresholds	-35%	133%	60.00%	±5%	6%
Ireland	-176.20%	278.10%	72.80%	-6.60%	6.60%

Source: SWD (2017) 661 final, Commission Staff Working Document Statistical *Annex*, AMR 2018, p.99

The Commission has therefore decided that an in-depth assessment of Ireland's economy is required in 2018. An assessment was also considered necessary in 2017.

Summary

- The European Semester is the annual budgetary cycle of EU economic and fiscal policy co-ordination which has an important bearing on the Irish budgetary process;
- The Commission has concluded that Ireland's Draft Budgetary Plan (DBP) 2018 is broadly compliant with the requirements of the Stability and Growth Pact;
- Ireland is stated to be making sufficient progress towards compliance with the debt rule in both 2017 and 2018;
- The Opinion forecasts that Ireland will achieve the Medium Term Objective (MTO) in 2018;
- However, there is a risk of a significant deviation in 2017 and a risk of some deviation in 2018 from the required adjustment path towards the MTO according to the two-year average rule;
- The Commission states that an in-depth review of Ireland's economy is required in early 2018. This will contribute to the draft Country-Specific Recommendations to be published in May.

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Publications

PBO Initial Objectives & Services 4 October 2017

Commentaries

Post-Budget 2018 Commentary for the Committee on Budgetary Oversight 24 October 2017

Quarterly Economic and Fiscal Commentary (Q3 2017) 5 October 2017

Summary of Pre-Budget 2018 Commentary 4 October 2017

Pre-Budget 2018 Commentary for the Committee on Budgetary Oversight 25 September 2017

Briefing Papers

Briefing Paper 3 of 2017 *Rainy Day Fund* 19 December 2017

Briefing Paper 2 of 2017 *Supplementary Estimates 2017* 4 December 2017

Briefing Paper 1 of 2017 *The role and functions of Ireland's Parliamentary Budget Office (PBO)* 24 November 2017

PBO Notes

Note 3 of 2017 *Note on rainy Day Fund Proposals* 19 December 2017

Note 2 of 2017 *Public Service Performance Report 2016* 17 November 2017

Note 1 of 2017 *Gender Budgeting* 17 November 2017

Infographics

Budgetary Cycle 2018 10 January 2018

Exchequer revenue – Significant months 6 December 2017