2016

SUMMER ECONOMIC STATEMENT

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

An Roinn Airgeadais
Department of Finance

Summer Economic Statement

June 2016

Foreword

Economic recovery is now firmly established. Nowhere is this more evident than in the labour market where the unemployment rate has dipped below 8 per cent and the level of employment is within touching distance of the two million mark.

Decisive policy action means that the public finances are now in a much better position – indeed the correction of the excessive deficit represents a key milestone in our progress on the fiscal front over recent years. The debt-GDP ratio is on a sharp downward trajectory, and the Irish sovereign is now rated as investment grade by all of the main credit rating agencies.

Against this relatively positive economic and fiscal backdrop, a new set of challenges is emerging. Perhaps most notably, the faster-than-expected economic recovery has boosted the demand for housing – both public and private. To date, and reflecting a multitude of factors, the supply response has been insufficient to keep pace with demand, with adverse economic and social implications. A key priority for the Government will be to address market failures so as to ensure the delivery of 25,000 new houses per annum by the end of this decade, in order to better align demand and supply in the market. To this end, the Government will publish and implement an *Action Plan for Housing* – to be overseen by the Taoiseach and modelled on the successful *Action Plan for Jobs* – which will set out key action points, targets and deadlines.

A related issue is that of mortgage arrears. While in overall terms mortgage arrears are falling, there remains a significant cohort of difficult-to-resolve cases, particularly in the longer-term category. It is in all of our interests that both creditors and debtors work together in order to conclude durable solutions; in this regard, a key priority for Government will be to continue to strengthen the mortgage arrears framework.

The demand for healthcare has also increased more rapidly than the capacity of the system to provide additional services. Similar capacity constraints have emerged in the provision of other public services. To address these issues, the Government has set a high level of ambition with regard to the provision of high-quality public services, both in the immediate future and over the medium-term. Relative to 2016, at least €6.75 billion of additional funds will be allocated to provide public services by 2021. It will be crucial, of course, to continue to better align public sector outputs with inputs; value-for-money considerations and the continued focus on reform of our public services will be paramount.

Our public investment rate fell during the crisis years and the Government is conscious of the need to boost the supply of critical infrastructure. The public capital plan[1] provides for €42 billion of capital investment over the 2016-2021 period and the Government remains committed to this. In addition, the Government will propose for Oireachtas approval an additional €5.1 billion in capital spending over this period. This ambitious programme of capital spending is aimed at addressing infrastructural bottlenecks, particularly regional infrastructural shortages. Creating deeper infrastructural linkages between the stronger

[1] Building on Recovery: Infrastructure and Capital Investment 2016-2021.

growth hubs and other parts of the country will help to spread growth more evenly and hence address some of the regional imbalances that have emerged in recent years. Achieving a more equal regional distribution of economic activity is at the core of the *Programme for a Partnership Government*.

Further job creation will continue to be at the forefront of Government policy in the coming years. Building upon the *Action Plan for Jobs*, the Government is targeting the creation of an additional 200,000 jobs over the period to the end of this decade, with two-thirds of these (135,000 jobs) being targeted outside the capital, in order to achieve a better regional balance of economic activity. Such employment levels would be consistent with the achievement of full employment and reversing the outward migration trend evident in recent years.

Income tax reform will be a key element in supporting employment growth. There is a strong economic rationale for a broad income tax base with lower marginal rates that incentivise and reward work. Reform of the income tax system – including the phasing out of the Universal Social Charge – will be targeted towards middle income earners, underpinned by the objective of making work pay. In a similar vein, the Government will provide for an increase in earnings at the lower end of the pay spectrum by increasing the minimum wage over the next five years.

Supply-side reforms – investing in our infrastructure and increasing labour market participation – will enhance the capacity of the economy to expand which, in turn, will provide us with the necessary resources to fund crucial public services, promote greater levels of inclusivity and reduce inequality.

An additional challenge relates to expectations. While the Irish public can reasonably expect more and better quality public services, lessons from the last decade highlight the importance of ensuring that such improvements are sustainably financed. In this regard, the public service pay bill, which amounts to some 29 per cent of current expenditure, will be managed through the agreed provisions of the Lansdowne Road Agreement that provide for a sustainable and prudent approach to the necessary elimination of the Financial Emergency Measures in the Public Interest (FEMPI) legislation. Moreover, this Government will not jeopardise the recovery by increasing public expenditure at a pace in excess of the capacity of the economy to absorb. Similarly, pro-cyclical fiscal policy will be avoided by, for instance, the establishment of a rainy day fund once a balanced budget is achieved.

In summary, the Government is setting out an ambitious and credible set of economic priorities designed to build upon the solid progress made to date, to enable all citizens participate in the recovery, to ensure a more regionally balanced composition of activity, to enhance the provision of high quality public services and to make the economy more resilient to external events over which we have limited, if any, control. Principal among the risks we face at present is the upcoming referendum on EU membership. Prudent fiscal management has laid the foundations for Ireland's recovery and we will build on this.

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Minister for Finance

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Chapter 1
Economic Strategy

Ireland's recovery from the sharpest economic contraction in its history is now firmly established. Reflecting a combination of decisive policy implementation as well as relatively favourable external tailwinds, GDP looks set to increase by around 5 per cent this year. Indeed, both GDP and GDP per capita have already moved above their pre-crisis levels and, crucially, economic activity is more balanced between domestic and external sources of growth. This is most clearly evident than in the labour market where the unemployment rate has dipped below 8 per cent, from a peak of 15 per cent in early-2012. Steady growth for the past 14 quarters means that the level of employment is within touching distance of the two million mark. Growth of GDP in 2015 was the strongest since 2000, and was better balanced between domestic demand and exports.

This recovery has not happened by accident. It has been supported by the firm application of prudent and consistent fiscal and economic policies. This means that the public finances are now in a much better position – indeed the correction of the excessive deficit represents a key milestone in our progress on the fiscal front over recent years – from an underlying deficit of 11.5 per cent in 2009 to a projected 0.9 per cent by the end of this year. The debt-GDP ratio is on a sharp downward trajectory - from a peak of over 120 per cent in 2012 to 93.8 per cent at the end of 2015. The Irish sovereign is now rated as investment grade by all of the main credit rating agencies.

The key challenge now is to build upon the solid foundations that have been put in place in recent years. The Government stresses that economic growth is not an end in itself; rather it is the means through which continued social progress can be achieved. The over-arching objective of policy in the coming years, therefore, is to create a virtuous circle in which continued robust economic growth provides the resources necessary to advance social progress, promote inclusivity and provide high-quality public services to all citizens.

1.1 Strategy for Sustainable Growth

The Government has therefore adopted a strategy to achieve sustainable growth supported by prudent fiscal policies. This involves a number of key mutually-reinforcing elements:

Sound public finances and a stable and broad tax base

Sustainable public finances are essential for continued economic and social progress. A broad tax base that ensures financing of public expenditure is crucial, as is the need to ensure maximum efficiency in terms of public expenditure. Continuing to reduce public indebtedness is also a priority, to minimise debt service costs and build up sufficient buffers to be able to absorb the economic 'shocks' that are inevitable for a small, open economy such as Ireland. The Government will *inter alia*:

- Achieve a balanced budget in headline and structural terms by 2018;[2]
- Establish a rainy day fund;
- Increase public expenditure in a sustainable manner, with a particular focus on rebuilding capital investment;
- Given that personal tax rates in Ireland are too high, the incidence of tax will be reduced over the next five years, with particular emphasis on phasing out the USC;

A supportive environment for enterprise and employment

The Government will continue to work to ensure an economic environment that promotes and rewards both entrepreneurship and work. To this end, the Government will build upon existing initiatives that improve access to finance on reasonable terms for small- and medium-sized businesses. By maintaining a broad tax base, marginal tax rates on labour can be reduced, helping to ensure that an important goal of the Government's economic policy – namely that work pays – is achieved. More specifically, the Government is committed to measures including:

- Reducing marginal tax rates on labour, including by phasing out the USC;
- Continuing to implement the *Enterprise 2025 Strategy*;
- Increasing the Earned Income Tax Credit for the self-employed to match the PAYE credit by 2018;
- Introducing a PRSI scheme for the self-employed;
- Reducing the rate of Capital Gains Tax for new start-ups to 10 per cent from 2017;
- Maintaining Ireland's Corporation Tax rate at 12½ per cent and monitoring how the Knowledge Development Box is promoting the development of knowledge-based capital in Ireland.

These measures will be funded *inter alia* by:

- Increasing revenue by not indexing tax credits and bands;
- Removing the PAYE tax credit for high earners to further enhance the progressivity of the income tax system;
- Funding part of the increase in expenditure by increasing taxation on measures that promote healthier lifestyles.

More investment in economic, regional and social infrastructure

Higher levels of investment are crucial in supporting balanced regional growth, eliminating capacity constraints and enhancing the growth potential of the economy. From an economic perspective, investment relates to both physical capital – roads, water infrastructure, broadband, etc. – and also human capital, the latter being an increasingly important driver of competitiveness in a globalised economy. To enhance prospects in this area the Government will amongst other measures:

[2] Defined as a structural deficit of 0.5 per cent of GDP.

- Increase investment in skills and training;
- Protect the €42 billion capital investment – of which €27 billion is Exchequer funded – set out by the previous Government for the period 2016-2021;
- Propose to the Oireachtas that there should be additional Exchequer capital investment of a cumulative €5.1 billion by 2021;
- Allocation of this additional capital investment will take place following a mid-term review of the capital plan that will be carried out in 2017:
    - priorities to be addressed include transport, broadband, education, health and flood defences;
- Prioritise measures that help to front-load investment in housing supply, both private and public, in order to ensure a better balance between demand and supply in this market.

Indeed, Government has already announced the establishment of the Local Infrastructure Fund to invest €200 million over the next three years to fund the provision of the necessary local public infrastructure to enable housing development on land for which there is planning permission to take place.

Access to finance

Access to finance is essential for local businesses and new start-ups. Government is targeting the delivery of €1 billion per year from new sources of finance through a range of measures including:

- New forms of equity;
- Mid-sized investment rounds;
- Development finance for manufacturing and international services;
- Export and trade finance; and
- Peer-to-peer lending.

A just and fair society and a more inclusive prosperity

The fruits of economic recovery will be used to ensure a reduction in inequality and poverty, as well as to ensure greater levels of inclusivity in our society. To this end, the Government will *inter alia*:

- Improve the take-home pay of families on low incomes, including by introducing a new Working Family Payment that promotes work over welfare by supplementing, on a graduated basis, the income of a household, while at the same time incentivising more hours and full-time work;
- Support an increase in the minimum wage to €10.50 per hour over the next five years and put in place mechanisms that mitigate the impact on employers in order to protect lower paid jobs taking into account the recommendations of the Low Pay Commission;
- Reinforce labour market activation policies, including by publishing a 'Pathways to Work for Jobless Households' to address the fact that Ireland has one of the highest rates of jobless households in Europe.

The Government's economic strategy – encompassing the policies outlined above as well as others – is aimed at consolidating the progress achieved in recent years, putting in place the building blocks necessary for further progress and creating the necessary buffers to support the economy in the event of deterioration in the global economic situation. The latter is particularly relevant at the current juncture given heightened levels of uncertainty at present.

The strong rebound of the Irish economy did not happen by accident; it is the direct consequence of determined policy implementation by the previous Government. These policies – designed to ensure sustainability of the public finances, to improve competitiveness and to ensure the availability of credit for viable business and households – have laid the foundations for our recovery. Some of the 'fruits' of these policies are presented in box 1 below.

Box 1: Impact of determined policy implementation

Economy

- GDP growth last year was 7.8 per cent, the strongest pace of growth since 2000 and the highest rate 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 for the third consecutive year.
- The recovery has become more broadly based with both domestic demand and exports contributing.
- Exports grew by almost 14 per cent last year, the strongest rate of growth since 2000.

Labour Market

- Employment has increased by almost 160,000 from its low point, a 9 per cent increase.
- Unemployment has fallen to 7.8 per cent in May down from a peak of over 15 per cent.
- The number of people unemployed for one year or more (long-term unemployed) is currently 100,600, half the level it was at its peak.

Deficit

- The general government underlying deficit has fallen from a peak of 11.5 per cent of GDP in 2009 to a projected 0.9 per cent this year.
- The excessive deficit was corrected last year.
- The interest rate on 10-year Irish government bonds is currently below 1 per cent.

Debt

- Gross government debt was 93.8 per cent of GDP last year, down from a peak of over 120 per cent in 2012.
- Net debt - excluding liquid and semi-liquid assets - was 80 per cent of GDP at end-2015.
- Irish sovereign debt is now rated investment grade by all the main credit rating agencies.

Chapter 2
Economic Developments and Outlook

2.1 Economic Background

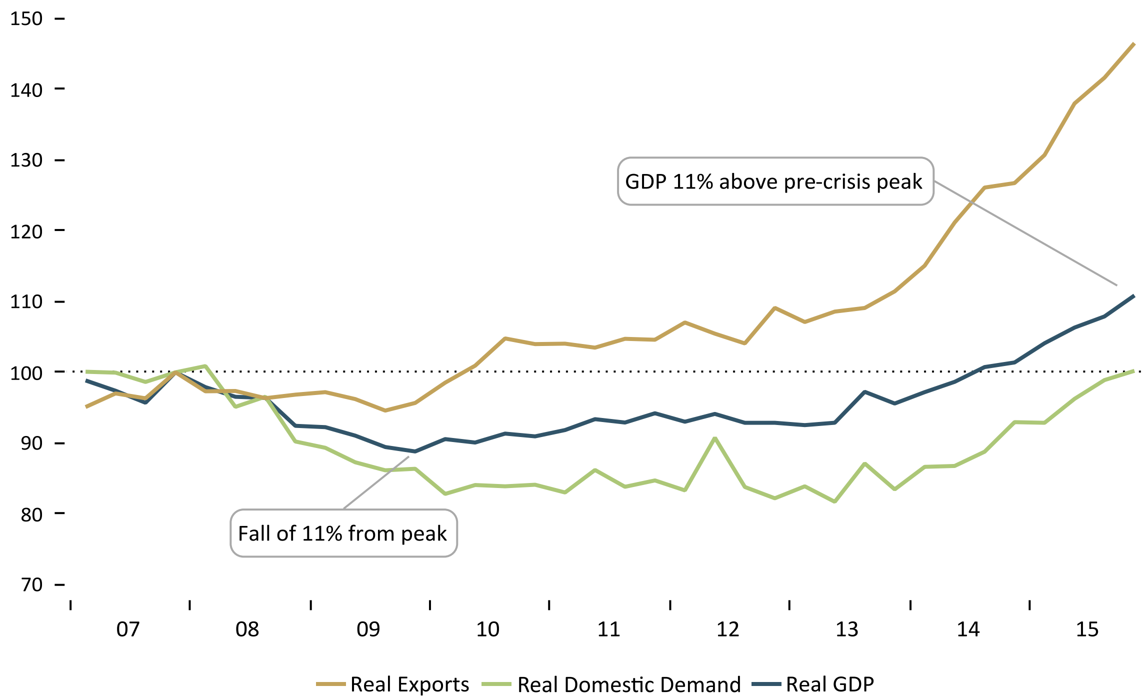
The recovery has gained momentum in recent years, with a particularly strong performance recorded last year when GDP rose by 7.8 per cent, by far the strongest growth rate in the European Union. GDP per capita – a key measure of living standards – moved above its pre-crisis peak last year, a remarkably rapid turnaround given the scale of the downturn in Ireland. Importantly, the composition of activity is now more balanced, and not dependent on any one particular sector of the economy, enhancing the sustainability of the recovery.

The improvement in our economic performance was, unsurprisingly, led by the exporting sectors in the initial phase (figure 1a). Over the past year or two, the recovery has broadened, with domestic demand now also making a significant contribution. Investment spending – including spending associated with the on-shoring of intangible assets – continues to lead the domestic recovery. This is not accidental; Ireland's positive endorsement of the OECD Base Erosion and Profit Shifting (BEPS) process further enhances our attractiveness as a location for mobile foreign direct investment. Moreover, recent domestic policy initiatives in this area – enhancements to the R&D tax credit, the introduction of the Knowledge Development Box, phasing out of legal loopholes, the introduction of country-by-country reporting – are all contributing in a positive way to making Ireland an even more attractive location for FDI. Finally, strengthening labour market conditions, rising disposable income and improvements in consumer confidence are supporting solid growth in personal consumer spending.

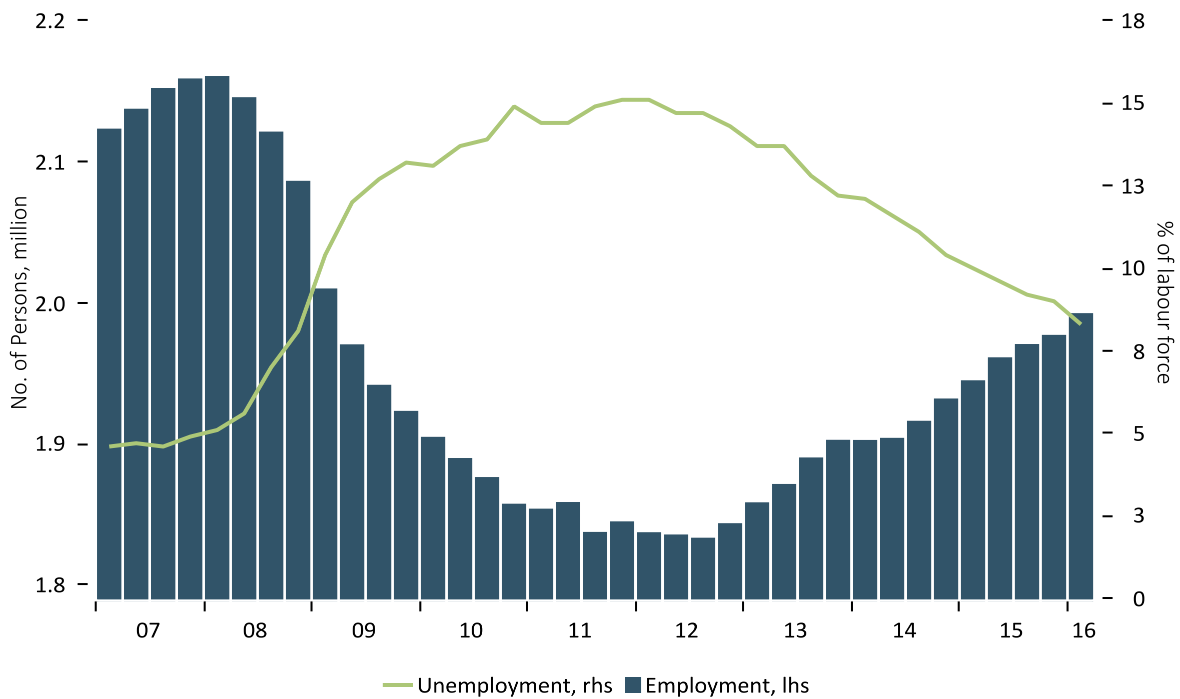
On the external side, the export performance has been very strong in recent years and, in aggregate terms, Ireland continues to gain market share. Central to this progress has been the restoration of Irish competitiveness, which is a pre-requisite for sustainable economic growth in a small, open economy. Favourable exchange rate developments, relatively good external demand, accommodative monetary policy – both standard and non-standard – and sector-specific factors have also contributed to this strong performance.

Conditions in the labour market continue to improve (figure 1b), with the level of employment up by almost 160,000 (9 per cent) since the low-point in 2012. Employment growth remains broad-based with employment levels in most sectors well above their troughs. The unemployment rate, which at one stage exceeded 15 per cent of the labour force, has now fallen below 8 per cent, and is currently at its lowest level since 2008. Net outward migration has fallen, and it is reasonable to assume that this will reverse in the near-term.

Figure 1: Economic trends



Source: CSO.



Source: QNHS published by CSO; note that the monthly unemployment rate has fallen to 7.8 per cent in May.

2.2 Economic Outlook: 2016

Forecasts produced by the Department of Finance and endorsed by the Irish Fiscal Advisory Council were published in the Stability Programme Update at end-April. The economic information flow in the interim period broadly confirms the Department's assessment, and the baseline macro-economic forecasts presented in this document are unchanged relative to the Stability Programme Update.

GDP is projected to increase by around 5 per cent this year. A relatively favourable external environment (especially for the UK, US and euro area – the regions with which Ireland conducts the bulk of its trade) is expected to support robust export growth once again. Having said that, the Stability Programme Update highlighted the fragility of the external environment, stressing that risks were tilted to the downside.[3] Prominent among these risks is the prospect of the UK voting to leave the European Union (See Box 2).

The recovery in domestic demand should have a positive dividend in the labour market, where the level of employment is forecast to increase by 50,000 (2.6 per cent) in 2016. As a result, there will be over 2 million people at work this year for the first time since the onset of the crisis.

Inflationary pressures are set to remain muted, with core inflation (i.e. excluding the volatile components of energy and unprocessed food prices) set to average just 1.0 per cent this year. A balance of payments surplus amounting to 4.5 per cent of GDP is envisaged, as the nation as a whole continues to reduce its net external liabilities. While sometimes overlooked, the balance of payments is a crucial indicator in a monetary union, in that it signals emerging imbalances and also highlights the exposure of an economy to so-called 'sudden stops', i.e. sharp declines, or even reversals, of capital inflows.

2.3 Economic Outlook: 2017 and the medium term

The outlook for next year and over the medium term is relatively benign, although this is contingent upon continued implementation of appropriate domestic policies, including fiscal policies. Reflecting the assumption of a relatively favourable external environment and a further rebound in domestic demand, GDP growth of 3.9 per cent for next year was projected in the Stability Programme.

From 2018 onwards, the growth rate of the economy is assumed to move towards its potential growth rate, which is estimated at around 3½ per cent per annum over the medium term. Employment growth averaging just under 2 per cent per annum is forecast over the 2018-2021 period. This is consistent with the level of employment reaching 2.1 million by 2018 as set out

[3] A risk assessment matrix – which lists the main identifiable economic risks as well as an assessment of their relative likelihood and impact – is set out in table 16 of the Stability Programme Update, April 2016.

in the *Action Plan for Jobs 2016.* The unemployment rate is projected to remain on a firm downward trajectory reaching 6 per cent by the end of the forecast horizon.

Achieving our potential is, of course, contingent upon the implementation of appropriate policies. The maintenance of competitiveness, in particular, will be crucial. By investing in skills and infrastructure, reforming the income tax system and promoting an environment supportive of entrepreneurial activity, the Government will play its part in ensuring competitiveness.

The Government will also support competitiveness by adopting prudent, stability-orientated budgetary policies (as set out in the next chapter).

Table 1: Macro-fiscal forecasts (as set out in Stability Programme Update, April 2016)[4]

% change (unless stated)	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Economic Activity							
Real GDP	7.8	4.9	3.9	3.9	3.3	3.1	2.9
Real GNP	5.7	4.1	3.7	3.7	2.8	2.6	2.4
Prices							
HICP	0.0	0.4	1.7	1.9	1.9	1.9	1.9
Core HICP inflation	1.2	1.0	1.4	2.0	2.0	2.0	2.0
GDP deflator	5.3	2.6	1.2	1.3	1.3	1.3	1.3
Balance of Payments							
Current account (per cent GDP)	4.4	4.5	3.9	3.8	3.2	2.7	2.4
Labour Market							
Total Employment ('000)[1]	1,965	2,015	2,060	2,105	2,140	2,175	2,205
Employment	2.6	2.6	2.3	2.3	1.7	1.6	1.4
Unemployment (per cent)	9.5	8.4	7.8	7.0	6.6	6.3	6.0
Public Finances (per cent of GDP)							
General government balance	-2.3	-1.1	-0.4	0.4	1.2	2.0	2.8
Structural balance	-2.4	-2.0	-0.8	0.1	1.0	2.0	2.8
Debt ratio (year-end)	93.8	88.2	85.5	81.3	77.7	73.3	68.9
Net debt position (year-end)[2]	79.8	75.7					

Notes:
- Macro-fiscal forecasts before allocation of fiscal space.
1. nearest 5,000
2. Net debt position is for 2015 and 2016 only
Source: 2015 – CSO; 2016 to 2021 – Department of Finance

[4]Updated macroeconomic forecasts will be published with Budget 2017 in October.

Box 2: UK referendum on European Union Membership

The numbers set out in this document are contingent forecasts – they are based on assumptions for key inputs such as growth in our main trading partners, the evolution of commodity prices, etc. However, as outlined in the Stability Programme Update, there are numerous sources of uncertainty at present which pose risks to the central forecast. Principal among them is the prospect of the UK voting to leave the European Union.

An assessment of the potential economic impact of such an outcome is set out below.

Recently published work by both the UK Treasury and the UK's National Institute of Economic and Social Research (NIESR) using model based analysis suggest that a vote to leave the EU could reduce UK GDP by between 2.3 and 6.0 per cent, relative to baseline, under a range of scenarios [5] [6].

In relation to the impact for Ireland, estimates made using the ESRI HERMES model suggest that a 1 per cent reduction in UK GDP would reduce Irish GDP by approximately 0.2 per cent, relative to baseline, over two years. This implies a possible fall in Irish GDP relative to baseline in the range of 0.5 to 1.2 per cent based on Treasury and NIESR estimates.

A shock to UK GDP would also be expected to impact on our other trading partners. Estimates from the ESRI HERMES model suggest that if euro area GDP were to also fall by 1 per cent, a level estimated in the Treasury's 'severe scenario', Irish GDP would fall by a further 0.4 per cent relative to baseline.

Separately, both UK reports predict a depreciation of sterling in the event of a vote to leave. The impact of a 5 per cent sterling depreciation was previously presented in the Stability Programme Update in April, and indicated a loss in Irish GDP of 1 per cent after 2 years. This result also incorporates the impact on Ireland of wider spillover effects on the global economic environment from a sterling depreciation.

In addition to the macroeconomic assessments set out above, it must also be recognised that a UK decision to leave the EU will increase short term uncertainty, and volatility in the financial markets, potentially leading to negative outcomes internationally and in Ireland, beyond those set out above.

[5] UK Treasury analysis: the immediate economic impact of leaving the EU, May 2016. The Short-Term Economic Impact of Leaving the EU, National Institute Economic Review No. 236, May 2016.

[6] The UK Treasury analysis estimates the fall in UK GDP from baseline to be in the range 3.6 to 6.0 per cent over the short-term. NIESR estimates the fall in UK GDP from baseline to be in the range 2.3 to 2.4 percent over a 2 year time horizon.

Chapter 3
Budgetary Strategy

3.1 Background

In May, the European Commission proposed that the Excessive Deficit Procedure for Ireland – which was opened in April 2009 – be closed on the basis that the deficit in 2015 (at 2.3 per cent of GDP in headline terms, or 1.3 per cent of GDP once a banking-related transaction is excluded) had been brought below 3 per cent of GDP in a durable manner. The correction of the excessive deficit in a timely fashion is a remarkable achievement given the starting point for the public finances at the beginning of this decade. This also means that Ireland is now subject to a different set of fiscal requirements, namely those of the preventive arm of the Stability and Growth Pact. The preventive arm gives primacy to the structural balance – the budgetary position excluding one-off factors and taking account of the economic cycle (see below).

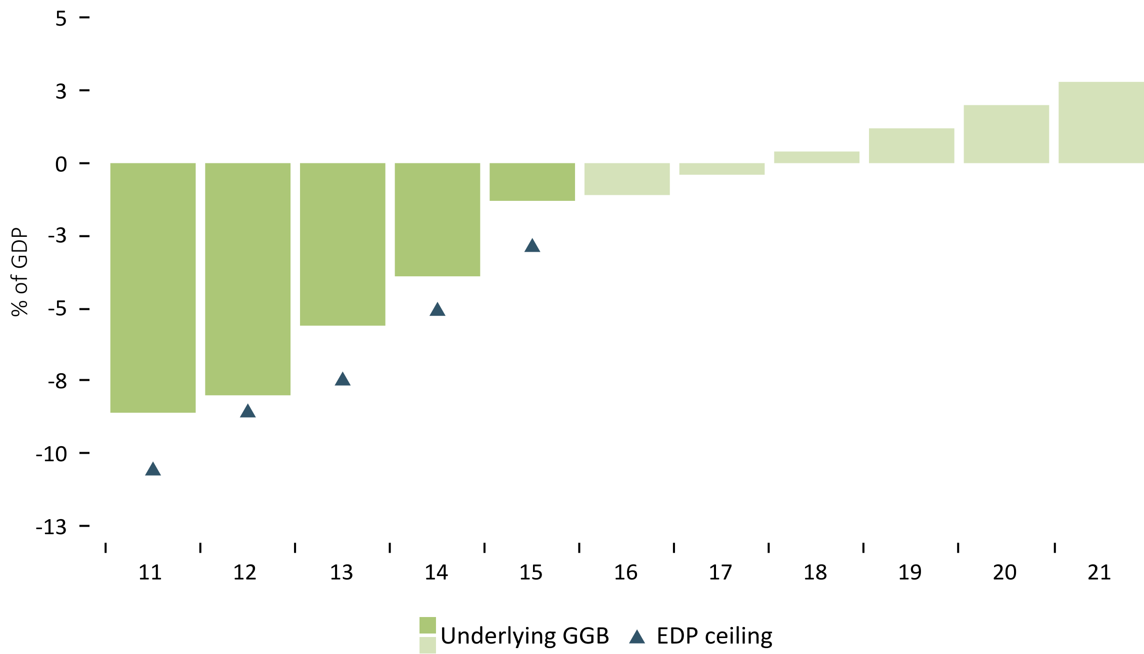
Fiscal developments to-date in 2016

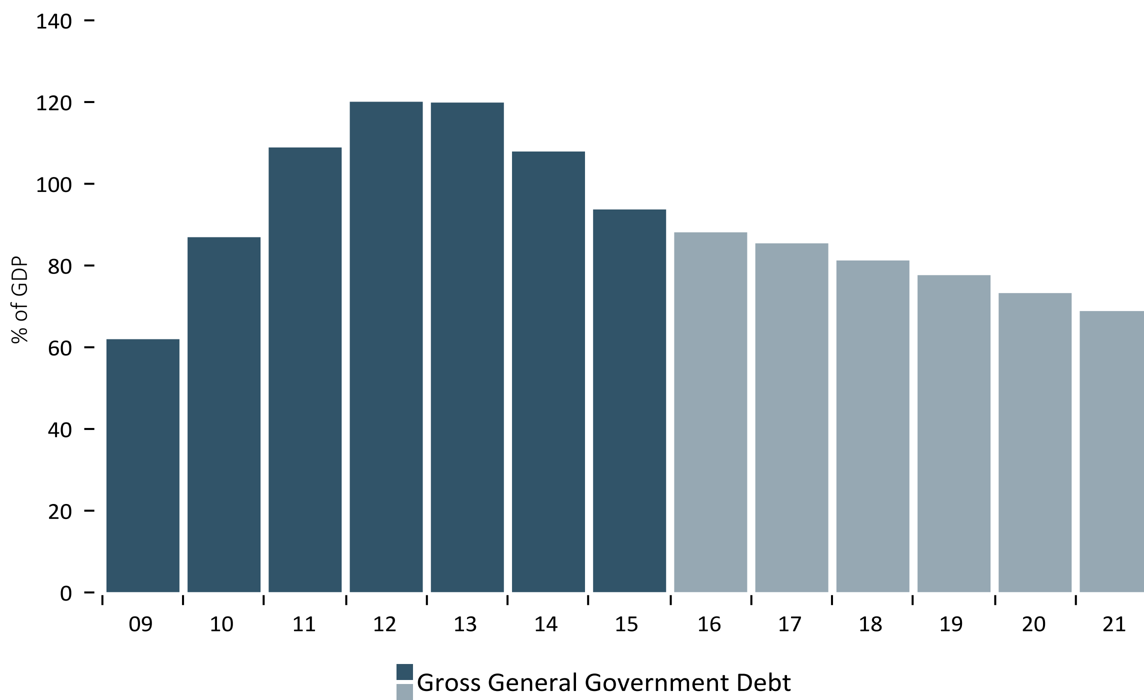
The April Update of the Stability Programme signalled the potential emergence of voted spending pressures. To address these the Government has included an additional €540 million (c. 0.25 per cent of GDP) in voted expenditure in the 2016 Revised Estimates Volume, allocating €500 million for health and an additional €40 million for justice-related demands respectively.

From a headline budget perspective, the additional expenditure allocations for this year will be fully offset by higher-than-expected taxation receipts and a strong PRSI performance in the year-to-date, which are now forecast to be around €900 million and €100 million respectively higher than originally projected. Specifically, a number of significant one-off payments support an increase in the 2016 tax revenue forecast, notably for income and corporation tax receipts. Smaller additional contributions are projected from both capital gains and capital acquisitions taxes. In relation to excise duties, receipts are currently ahead of expectations although part of this reflects health-related policy initiatives ('plain packaging') which have resulted in a front-loading of payments. All-in-all, it appears that the headline deficit for 2016 will now be 0.9 per cent of GDP.

The 2016 fiscal baseline position, updated for these spending increases and the assumption of the €1,000 million (0.4 per cent of GDP) of additional tax and PRSI revenue, is extended on a no-policy change basis in table A1, in annex 1. Separately, table 3 provides the *ex post* budgetary and key macroeconomic projections based on the fiscal policy assumptions contained in the *Programme for a Partnership Government* (hereafter PfPG), as set out below.

Figure 2: Fiscal trends (as set out in Stability Programme Update, April 2016)





3.2 Fiscal Strategy

The Government's medium term fiscal strategy is to 'balance the books' by 2018, once account is taken of the economic cycle on the public finances. The Government has adopted a medium term budgetary objective (MTO) of a structural deficit of 0.5 per cent of GDP, as provided for in the three-year update by the European Commission.

The preventive arm of the Pact requires annual progress towards a MTO at a sufficient pace – in 'normal' economic times, this means an annual improvement in the structural balance of 0.6 per cent of GDP until the MTO is achieved. To operationalise this, the Government will maintain public expenditure growth (net of discretionary revenue measures) below the trend growth rate of the economy in order to ensure compliance with the fiscal rules. Once a balanced budget is achieved, public expenditure (net of discretionary revenue measures) can then grow in-line with the trend economic growth rate.

With the MTO (and the adjustment path towards it) set in structural terms, budgetary policy is, by construction, set in an appropriately counter-cyclical manner, i.e. geared towards smoothing peaks and troughs in the economic cycle. Having said that, real time estimates of the structural balance are inherently uncertain for Ireland,[7] necessitating careful analysis. In these circumstances, were the economy to grow at a faster pace than currently assumed, it may be necessary to reassess the fiscal stance in order to ensure budgetary policy does not contribute to any overheating. The Government will, on an ongoing basis, assess whether the budgetary stance is appropriate from a macroeconomic stability perspective.

The fiscal space set out later in this document shows the available resources that would ensure compliance with the net spending rule of the preventive arm of the Pact. In the period following achievement of the MTO, the projections provide for a €1 billion per annum contribution from 2019 onwards to a rainy day fund or contingency reserve. Taking account of this, the structural budgetary path outlined below exceeds the minimum required -0.5 per cent of GDP threshold.

[7] The Department of Finance has set out the shortcomings of the harmonised methodology applied at a European level in various iterations of the Stability Programme Update as far back as 2003. Similarly, the Irish Fiscal Advisory Council has repeatedly expressed reservations about the use of the harmonised methodology for Ireland (see, for instance, *Fiscal Assessment Reports of June 2016, June 2015, November 2014*).

Box 3: Macro-fiscal impact of using the fiscal space

This Summer Economic Statement sets out the Government's economic and fiscal strategy over the short- and medium-term and is structured as follows. The analysis contained in the document is based on the macroeconomic assumptions that were set out in the Stability Programme Update, submitted to the European Commission at end-April. These numbers were endorsed by the Irish Fiscal Advisory Council at the time. High frequency macroeconomic data published in the interim broadly confirm this assessment of the outlook.

The fiscal projections have been updated to reflect expectations of higher expenditure growth this year as well as the assumption of full-year taxation and PRSI receipts beyond the level assumed in the Stability Programme. *Ceteris paribus* the higher-than-assumed level of expenditure this year could add c. 0.1 pp to the level of economic activity.

The revised baseline fiscal projections, together with more up-to-date inputs from the European Commission are used to estimate the available fiscal space over the forecast horizon. In terms of the distribution of this fiscal space, two-thirds is assumed to be allocated towards expenditure increases with the remainder allocated towards reductions in taxation. Once the MTO is achieved in 2018, a certain amount of the available fiscal space is set aside, in line with the Government's policy of establishing a rainy day fund. This is prudent budgeting and reflects the lessons learned from the deterioration in the public finances from 2008 onwards. It also reflects the indisputable fact that swings in the Irish economic cycle – both positive and negative – tend to be larger than elsewhere and that, as a result, it is appropriate to set aside a certain amount each year which can then be deployed to support activity and employment should the economic situation deteriorate.

Finally, a revised macroeconomic scenario is then set out which illustrates the impact of adopting such fiscal policies. Importantly, the allocation of fiscal space does not jeopardise the achievement of the MTO by 2018, a key element of Government fiscal policy.

A full macroeconomic projection will be produced in advance of the Budget.

3.3 Contingency Planning: a rainy day fund

Ireland is a small and very open economy and the experience of the crisis years clearly demonstrates that swings in the economic cycle can be much more pronounced than elsewhere, with consequent implications for the public finances. In recognition of this, and as set out in the PfPG, it is appropriate to establish a contingency reserve to be known as a 'rainy day' fund.

In terms of operationalising this, once the MTO is achieved in 2018 it is proposed to retain within the Exchequer of the order of €1 billion of the available fiscal space for 2019 as a contingency reserve which, if not deployed in the event of an unanticipated adverse shock to the economy, will be remitted to the rainy day fund towards the end of that year. While the amounts currently set out are provisional, in subsequent years, provided the MTO is maintained, a similar amount will be remitted to the rainy day fund which provides a prudent counter-cyclical buffer.

Proposals for the operation of the rainy day fund and the circumstances under which the amount would be deployed as a fiscal support for the economy will be developed. Accordingly, the Department of Finance will produce a paper, for consultation with the Oireachtas in late 2016 - early 2017 outlining the proposed operational modalities, including inter alia the trigger for deploying the fund. The Government will also consider the merits of using any one-off receipts (such as windfall corporate tax receipts – or indeed other windfall tax revenues) or part of the Ireland Strategic Investment Fund (ISIF) to capitalise the rainy day fund. This approach helps reduce net indebtedness while at the same time ensuring that liquid assets are available to be deployed in a timely and counter-cyclical manner to help smooth the business cycle.

3.4 Fiscal space for Budget 2017 and over the medium term

The difference between baseline public expenditure growth (net of discretionary revenue measures) and that which would ensure compliance with the budgetary benchmark is defined as the available fiscal space. For next year, it is estimated of the order €1 billion is available to provide for additional expenditure increases and taxation reductions. This amount is what remains after providing for key demographic pressures, the Lansdowne Road Agreement, capital plans and certain other pre-committed policies. This figure has been revised on foot of additional inputs from the European Commission's recent Spring forecast (not available at the time of the Stability Programme Update) which set certain parameters of this calculation for 2017.

This amount is in-line with ensuring convergence towards the MTO at an appropriate pace. Notwithstanding measured estimates of the output gap, there would appear to be some modest spare capacity in the economy – the unemployment rate is still high at 7.8 per cent - so this is appropriate from a macro stability perspective.

Estimates of the indicative fiscal space over the period 2017-2021 compliant with the budgetary benchmark are summarised in table 2 and are set out in detail in the appendix (table A2). Of course, it is crucial to bear in mind that estimates of fiscal space do not mean targets – spending increases and/or taxation-reductions should be evaluated on their own merits, taking into account the desired economic and social objectives. This is especially the case post-2018 when fiscal space opens up significantly on foot of achievement of a balanced budget in 2018.

Table 2: Indicative allocation of available net fiscal space 2017 – 2021

€ billions	**2017**	**2018**	**2019**	**2020**	**2021**	Cumulative
Net Fiscal Space[1]	1.0	1.2	3.0	3.1	3.0	**11.3**
Allocated to:						
Expenditure	0.67	0.79	1.38	1.46	1.44	**5.74**
Current	*0.61*	*0.61*	*0.95*	*1.02*	*0.98*	***4.16***
Capital[2]	*0.06*	*0.19*	*0.43*	*0.45*	*0.46*	***1.58***
Taxation	0.33	0.39	0.59	0.62	0.61	**2.54**
Rainy Day Fund[3]	0.00	0.00	1.00	1.00	1.00	**3.00**
Memo item						
Total additional capital[4]	0.25	0.75	1.18	1.38	1.59	**5.14**

Source: Department of Finance

1. Net fiscal space for 2017-2021 derived in compliance with budgetary benchmark. For full derivation see table A2 in annex 1.
2. The budgetary benchmark applies a 4 year smoothing adjustment to capital formation. In both 2017 and 2018, all the fiscal space for capital is assumed to relate to capital formation. For 2019 to 2021, €180 million, €195 million and €210 million respectively of the annual fiscal space will be used for capital grants; this element is not subject to the smoothing adjustment.
3. Rainy day fund contingency reserve is activated post achievement of the MTO in 2018.
4. Total additional capital expenditure is by reference to the Gross Voted Capital expenditure set out in the revised baseline forecast

- Rounding effects totals

Table 2 sets out an indicative allocation of this net fiscal space reflecting commitments in the PfPG to increase the level of current expenditure by at least €6.75 billion by 2021. In light of pre-committed spending of €2.6 billion (relating to demographic-related costs and those stemming from the Lansdowne Road Agreement), this is consistent with delivery of a current spending package of approximately €4.2 billion over the 2017-2021 period. Furthermore, an additional €5.1 billion in cumulative capital over 2017-2021 will be delivered, exceeding the €4 billion committed in the PfPG, which also indicates a Capital Plan mid-term review in 2017. Providing for a contingency reserve of the order of €1 billion per annum from 2019 and allocating the remaining space in a 2:1 ratio between public spending increases and taxation reductions, as outlined in the PfPG gives rise to the profiles shown above in table 2.

The indicative levels of fiscal space set out are calculated on the basis of provision for a rainy day fund / contingency reserve of approximately €1 billion per annum post-2018 and assume the utilisation of an additional uplift in capital spending arising from the smoothing effect (public capital formation is smoothed over four years). It is stressed that any estimate of fiscal space is subject to change, as the variables used as inputs in the calculations are point-in-time estimates. It is likely these will change between now and the Budget as the 2016 position develops from both an economic and fiscal perspective.

A policy decision to allocate available fiscal space will, of course, have an impact on aggregate demand as well as on the trajectory of both the headline and structural balances. Estimates of the economic and budgetary impact of such policies (assuming the above allocation) over the forecast horizon are presented in table 3 below. Critically, with the allocation of some €2.2 billion in net fiscal space over the period 2017 to 2018, the attainment of the MTO of -0.5 per cent of GDP in 2018 is not jeopardised.

Table 3: Ex post forecasts 2016-2021

€ million	2015	2016	2017	2018	2019	2020	2021
CURRENT BUDGET							
Expenditure							
Gross Voted Current Expenditure	50,845	51,870	53,180	54,405	55,760	57,205	58,645
Non-Voted (Central Fund) Expenditure	9,775	9,865	9,345	9,450	9,305	9,270	9,045
Gross Current Expenditure	**60,620**	**61,735**	**62,525**	**63,855**	**65,065**	**66,480**	**67,690**
less Expenditure Receipts and Balances	11,500	11,410	11,510	11,510	11,510	11,510	11,510
Net Current Expenditure	**49,120**	**50,325**	**51,015**	**52,345**	**53,555**	**54,970**	**56,175**
Receipts							
Tax Revenue	45,600	48,135	49,660	54,630	56,120	58,570	61,150
Non-Tax Revenue	3,515	3,375	2,175	2,075	2,100	2,090	1,985
Net Current Revenue	**49,115**	**51,510**	**51,835**	**56,710**	**58,220**	**60,665**	**63,135**
CURRENT BUDGET BALANCE	**-5**	**1,185**	**820**	**4,365**	**4,665**	**5,695**	**6,960**
CAPITAL BUDGET							
Expenditure							
Gross Voted Capital	3,825	3,965	4,380	5,140	5,915	6,515	7,125
Non-Voted Expenditure	1,645	1,065	1,140	1,140	1,135	1,130	860
Gross Capital Expenditure	**5,470**	**5,035**	**5,520**	**6,280**	**7,050**	**7,645**	**7,985**
less Capital Receipts	310	275	305	305	305	305	305
Net Capital Expenditure	**5,160**	**4,760**	**5,215**	**5,975**	**6,745**	**7,340**	**7,685**
Capital Resources	**5,105**	**2,430**	**910**	**960**	**960**	**945**	**955**
CAPITAL BUDGET BALANCE	**-55**	**-2,330**	**-4,305**	**-5,015**	**-5,785**	**-6,395**	**-6,730**
Contingency Reserve	**0**	**0**	**0**	**0**	**1,000**	**1,000**	**1,000**
EXCHEQUER BALANCE	**-60**	**-1,145**	**-3,485**	**-650**	**-2,120**	**-1,700**	**-770**
GENERAL GOVERNMENT BALANCE	**-4,935**	**-2,030**	**-1,075**	**-55**	**685**	**1,670**	**2,530**
Real GDP growth[1]	**7.8**	**5.0**	**4.2**	**4.4**	**3.8**	**3.6**	**3.3**
GDP nominal € billions[1]	**214.6**	**231.4**	**243.9**	**258.0**	**271.6**	**285.4**	**299.1**
GG balance % of GDP	***-2.3***	***-0.9***	***-0.4***	***0.0***	***0.3***	***0.6***	***0.8***
Structural balance % GDP	**-2.5**	**-2.0**	**-1.0**	**-0.5**	**0.0**	**0.6**	**1.2**
GG debt % GDP	**93.8**	**88.0**	**85.2**	**81.0**	**78.3**	**75.2**	**72.6**

Source: Department of Finance
See notes on following page

Notes to Table 3:

- Figures illustrate the impact of the use of fiscal space illustrated in table 2 relative to the revised baseline SPU fiscal position set out in Annex 1, Table A1. This assumes that post achievement of the MTO in 2018, approximately €1 billion is contributed to the contingency fund. Beyond the assumptions underpinning SPU 2016 estimates, the 2016 structural budgetary position takes account of (i) 0.2% of GDP in tax revenues deemed to be temporary in nature (2/3 of which relate to corporation tax, 1/3 to income tax) and (ii) expenditure of 0.1% of GDP relating to the EU Budget Own Resources Directive (ORD) Decision.
- The PfPG sets out a policy that the income tax system will not be indexed. The tax forecast horizon reflects this commitment and assumes that this policy decision will be confirmed by Government in advance of each budget.
1. These GDP forecasts take account of the impact of using the fiscal space including the additional capital uplift associated with the four-year smoothing associated with capital formation.
- Figures may not sum due to rounding.

The profile for the structural budget balance shown in table 3 is based on a fully re-estimated supply-side analysis of the economy reflecting the allocation of fiscal space outlined in table 2. The trajectory of structural adjustment towards the MTO re-calculates both the output gap element of the structural budget balance, as well as the headline fiscal path. Crucially the above allocation of fiscal space does not jeopardise the achievement of the MTO by 2018, a key element of Government fiscal policy. On foot of some €3 billion in available fiscal space being allocated to a contingency reserve, the headline and hence structural budget paths towards the end of the horizon imply a budgetary position which essentially represents an over-achievement of the MTO.

3.5 Reforms to the Budgetary Framework

The Government is committed to building upon recent reforms of the budgetary architecture. The objectives are to ensure a more inclusive process with greater Parliamentary engagement, to promote a shared understanding of both the parameters within which policy is framed and the key policy priorities and, finally, to facilitate continuous engagement and accountability over the full-year regarding budgetary outputs. Ultimately the goal is to promote better budgetary outcomes, namely a broad taxation base, maximum efficiency with regard to public expenditure including a better alignment of outputs with inputs, a balanced budget and lower levels of public indebtedness. The annual cycle is set out in table 4 below; at all stages greater participation by the Dáil is envisaged.

The forthcoming National Economic Dialogue (NED) will provide an opportunity to examine and review some of the main sectoral themes of the PfPG with the objective of encouraging discussion and promoting debate on particular priorities.

This will be followed by the publication of the Mid-Year Expenditure Report (MYER) in July, which will set out the detailed expenditure context for Budget 2017. It will identify baseline Ministerial Expenditure Ceilings for all Departments. These ceilings, in addition to the analysis in this report, will provide the starting point for the examination by the relevant Sectoral Oireachtas Committees of budgetary priorities for 2017.

Table 4: Budget 2017 process

Event	Timing	Content
Stability Programme Update	*April 2016*	*Sets out macroeconomic assumptions and broad indications of the medium term budgetary strategy.*
Summer Economic Statement	*June 2016*	*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	*June 2016*	*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.*
Tax Strategy Group Papers	*July 2016*	*The papers set out the various tax and social welfare options for the Budget and for the medium and longer term.*
Mid-year Expenditure Report	*July 2016*	*This will identify baseline expenditure ceilings and provide the starting point for examination of budgetary priorities by the Oireachtas.*
Budget 2017	*October 2016*	*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 2016*	*Engagement with the Oireachtas and implementation of Budget and other tax-related measures.*

Several institutional changes are also being implemented. In order to facilitate more Parliamentary engagement in the budgetary process – as is the case in some other European Member States – an Oireachtas Committee on Budget and Finance is to be established. This will allow greater scrutiny of expenditure and taxation options. It will also have a mandate to review the overall fiscal position. The new Committee will be supported by an Independent Budget Office within the Oireachtas Commission with the capacity to provide economic and fiscal advice to all Members of the House.

Chapter 4
Public Expenditure Strategy

The move to the Preventive Arm of the Stability and Growth Pact (SGP), and the changed budgetary landscape that this entails, requires that fiscal and economic sustainability be balanced with the continued provision of much needed public services. The analysis in this report shows that significant, targeted investment in key public services and infrastructure - as committed to in the Programme for a Partnership Government - can be made while respecting these prudent limits. Indeed, continued economic growth and competitiveness depends on prudent investment in both physical and social capital.

This chapter briefly discusses expenditure priorities in this context and reflects the social, re-distributive and growth-enhancing functions of public spending. In fact, there is evidence that suggests these features are not necessarily discrete, with higher levels of inequality shown to reduce longer-term economic prospects in certain circumstances. Public expenditure planning must consider these goals within the available resources. This must be enabled through a continuing emphasis on value-for-money and effectiveness, enabled by public service reforms and the focus on outputs provided by performance budgeting initiative.

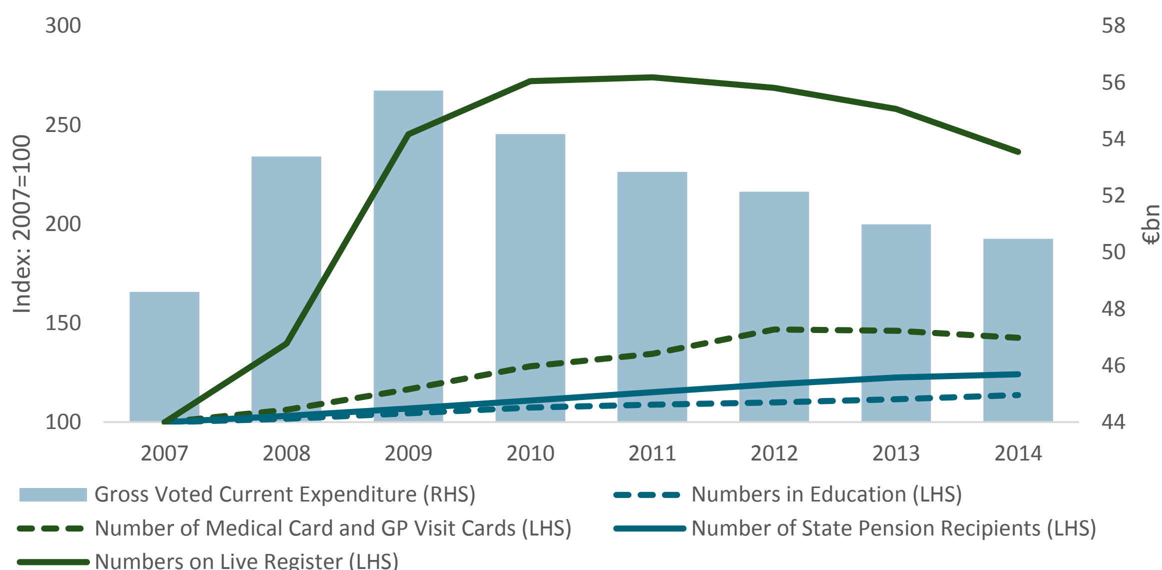
4.1 Context for Public Expenditure

Fiscal policy has moved dramatically in the last number of years reflecting the need to bring the public finances back to a safe and sustainable level. Between 2008 and 2014 Departmental expenditure decreased by €8 billion as successive Governments sought to bring the public finances under control, exit the EU-IMF Programme and re-establish market access.

Difficult decisions in areas including social welfare, health, capital and public sector pay and pensions were taken at a time of increasing demand for services in many areas, as shown in figure 3.

In implementing expenditure reductions, the priority has been to adopt a targeted approach in order to protect key public services and social supports, including support for the unemployed, to the greatest extent possible at a time of increasing demand.

Figure 3: Increasing demand for public services in a time of reducing expenditure



Ireland in 2016 faces very different circumstances. The deficit is now under control and debt is falling as a share of economic output. The European Commission has recommended Ireland's exit from the Excessive Deficit Procedure and confidence in the country from international lenders and credit ratings agencies has been restored.

However, there are also new challenges. The new fiscal framework, enacted in Ireland by the Fiscal Responsibility Act 2012 and 2013, will support a sustainable expenditure policy anchored by adherence to the fiscal rules. The expenditure benchmark maintains expenditure growth in line with the long-term average potential growth of the economy, thereby ensuring that the level of spending is sustainable and can continue to be supported by the economy, in the absence of accommodating revenue raising policy measures. The complementary structural balance rule indirectly restricts expenditure as it requires that Ireland achieve a balanced structural budget, having adjusted for the economic cycle and for one-off transactions.

As the economic recovery takes hold, these macro-fiscal rules provide a very different context for public expenditure policy than during past periods of strong growth. The potential to increase public expenditure through buoyancy in tax revenue - buoyancy that may prove temporary and unsustainable - has been curtailed.

This new system is designed to replace periodic, sharp fiscal retrenchments with an ongoing emphasis on prudent and sustainable growth in public expenditure. A major challenge is to prioritise between policy initiatives to ensure resources are allocated to areas where they can have the greatest impact in terms of economic and social gain.

4.2 Public Expenditure Strategy

The continuing reform of the budgetary process will widen the conversation on expenditure priorities. Given the size of the available fiscal envelope available under the fiscal rules, there must be a focus on the main challenges facing Ireland, both now and into the future.

The PfPG sets out the ambition to build a strong economy and to deliver a fair society so that communities thrive throughout both urban and rural Ireland. These goals are mutually reinforcing, with sustainable growth required for continued public service delivery and well directed public service and investment initiatives supporting a strong economy.

These overall expenditure policy aims must be delivered by an effective and flexible system of public expenditure management. Key reforms to Ireland's budget architecture, introduced since the advent of the downturn, have laid the foundation for a longer-term view of fiscal policy in Ireland and aimed to support better decision making and value for money and ensure that public funds are used efficiently to deliver effective services for citizens.

Programme for a Partnership Government

The Government committed to spending at least €6.75 billion more on public services by 2021 compared to 2016. Given the allowances already incorporated into budgetary projections over the 2017-2021 period for expenditure priorities such as demographic pressures in Social Protection, Health and Education and the Lansdowne Road Agreement, this implies an additional €4.2 billion in current expenditure measures over the period.

For each of the policy challenges contained in the Government's Programme a clear unambiguous high-level output is also identified, including:

- meet the target of building 25,000 new homes needed every year by 2020;
- create 200,000 jobs by 2020, including 135,000 outside Dublin (with the support of an additional €500m to support Irish companies);
- reducing waiting times in the health sector; and
- maintain social cohesion.

The Government will ensure that a balance is struck between addressing urgent priorities - utilising the action plan framework set out in the Programme document - and engaging in long-term planning so that lasting solutions with broad based support are implemented.

In terms of infrastructural investment in the economy, there is also a commitment in the PfPG for a cumulative, additional €4 billion in capital expenditure. This includes investment to accelerate export-led jobs growth across Ireland's regions to be administered by Government agencies. This commitment to increased investment is reflected in the cumulative additional capital expenditure of €5.1 billion included in the fiscal forecasts presented in chapter 3 of this document.

Management of Public Expenditure

The introduction of multi-annual expenditure ceilings was a key element of the Medium-Term Expenditure Framework (MTEF) introduced in 2012. The introduction of multi-annual ceilings has provided greater clarity about the resources available to Departments over a three-year period. This facilitates a more strategic approach to resource allocation by emphasising the prioritisation of key policy areas and services while operating within overall expenditure restrictions. Other reforms introduced include regular Comprehensive Reviews of Expenditure (CREs), greater emphasis on tools to support evaluation such as the Public Spending Code and establishment of the Irish Government Economic and Evaluation Service (IGEES) and the performance budgeting initiative.

The legislative basis for these multi-annual ceilings, and the circumstances in which they can be subject to change, has been highlighted as a concern in the European Council's Country Specific Recommendations (CSRs). However, implementation of the Ministerial Expenditure Ceilings needs to be considered in the wider context of meeting key fiscal targets while managing severe demographic and other cost pressures. The MTEF has been an important mechanism in ensuring compliance with the prevailing fiscal requirements and, given the recent closure of the excessive deficit, in this it has been successful. The new budgetary environment from this year, and the return to more 'normal' medium-term budgetary management, may require review of certain aspects of the operation of the MTEF including the treatment of risk and uncertainty, as envisaged in its establishment. These issues will be discussed in more detail in the forthcoming Mid-Year Expenditure Report.

Public Service Reform

A very significant programme of reform has been implemented since the first Public Service Reform Plan was published in 2011, as set out in the recently published Annual Progress Report on the Public Service Reform Plan. The final year of the implementation of the current three year Public Service Reform Plan commenced in January 2016, and work is also continuing on implementing the Civil Service Renewal and other sectoral reform programmes. The Government is committed to the development of a future strategy to build on current progress.

The primary objective of the Public Service Reform Programme is to improve service delivery and outcomes for users of public services. The performance of the Public Service has major implications for the management of the State's finances and, as such, Public Service Reform was a central element of the response to the challenges of recent years. While the economy is recovering, budgets will remain constrained and significant demographic pressures mean that reform of the Public Service will continue to be a priority in 2016 and beyond. It is essential that

targeted recruitment and investment in public services is done in tandem with further Public Service Reform measures.

Box 4: Managing growth in public expenditure

In 2016, an amount of €55.8 billion has been allocated for total gross voted expenditure. This represents an average annual increase in gross voted expenditure since 2014 of 2½ per cent. The fiscal projections now show an increase of just over €1.7 billion or 3 per cent in the gross voted expenditure amount for 2017. In 2017 gross voted current expenditure of €53.2 billion will be broadly in line with the amount of €53.4 billion spent in 2008.

The implementation of the budgetary measures required to return the public finances to a sustainable level, was supported by the efforts of all public service bodies to seek savings and pursue efficiencies. As we look to continue with ongoing sustainable increases in expenditure, the requirement to seek savings and efficiencies must remain. With total gross voted expenditure of almost €56 billion this year, there must be as much focus on effectively and efficiently delivering the services supported by this funding as on the enhancements to be delivered by the incremental increase.

This ongoing review of the public expenditure can be supported by the key elements of the public expenditure framework including:

- regular Comprehensive Reviews of Expenditure;
- reviews of expenditure programmes being informed by relevant evaluations of the effectiveness and efficiency of programmes utilising the Public Spending Code and the Irish Government Economic and Evaluation Service;
- performance budgeting with a focus on the impact of public services;
- greater engagement with the Oireachtas in reviewing the expenditure challenges and priorities.

In looking at medium term expenditure projections, it is appropriate to utilise all elements of the public expenditure framework to ensure that the available resources are directed to effectively deliver key social and economic priorities. To support this approach, when looking at a budgetary no policy change position, allowance is made for specific key non-discretionary drivers of expenditure such as projected expenditure pressures in Health, Education and Social Protection arising from demographics and the additional pay costs arising from the Lansdowne Road agreement with public service unions. This targeted approach, rather than applying general inflationary increases to expenditure, supports a continuing emphasis on value-for-money and effectiveness, enabled by public service reforms and the focus on outputs provided by performance budgeting initiative. This will help ensure that the

expenditure framework in place promotes and encourages detailed and comprehensive scrutiny and assessment of all the resources allocated for public expenditure to achieve value for money on an ongoing basis.

Health Spending

The provision of quality healthcare is a key Government priority and this has been reflected in Budgetary policy over the last five years with Health's share of current expenditure increasing since 2011 (24 per cent in 2011 to 26 per cent in 2016). The Government has committed to annual increases in the health budget to increase access to safe, timely care, through a focus on developing an enhanced primary care system, and guaranteeing the future sustainability of GP practices in rural Ireland and in disadvantaged urban areas. We will also implement a national obesity plan, improve waiting times and ensure there is a multi-faceted approach to the issue of mental health.

The issue of health funding is a major policy challenge internationally, not just in Ireland, with additional resources required to reflect longer life expectancy, technological developments and more expensive treatments and drugs. It is critical to strike a balance between the health needs of the population and the sustainability of the public finances.

Housing

The State plays a major role in the housing market. Its involvement ranges from setting standards, controlling planning and development, funding housing supply and related infrastructure, to regulating mortgages and rents, supporting affordable housing and taxation policy.

Housing supply is the central challenge. Analysis by the ESRI estimates that there is a requirement for around 25,000 houses per year. From 2011 to 2015, supply has averaged just over 10,000 units a year.

However, there is no quick fix to the housing supply problem. There is a need to identify actions that will have the greatest effect in removing blockages to increase supply and reduce the social housing waiting list. The State's *Action Plan for Housing* due to be published in the late summer will set out the details of how the state will tackle the housing supply and increase social housing provision. The *Action Plan* will be subject to key targets and deadlines and regular Cabinet review. Implementation will be overseen by the Taoiseach and his officials through the Cabinet Committee on Housing, with quarterly progress reports published.

Capital Spending

Investment in public infrastructure is vital for the medium and long-term competiveness of the economy as well as for underpinning social cohesion through the provision of vital services to people in the form of schools, public transport, housing, etc. Capital investment was curtailed significantly from the peak levels in 2009 although that level of expenditure was the culmination of unprecedented public capital spending to address long-standing infrastructural deficits. Nevertheless, there is a general consensus that investment as a proportion of the overall economy needs to increase to sustain the long-term growth potential of the Irish economy through the maintenance of existing infrastructure and to address new, emerging infrastructural deficits.

The review of the Capital Investment Plan, which was published last year, will be brought forward to 2017 with the expectation that emerging priorities will lead to an increase in capital investment in certain areas.

Pay Policy

In common with overall public expenditure, public service pay policy has demonstrated a strongly pro-cyclical bias over the last number of decades, with large increases in the numbers of public servants and the rates of remuneration during periods of economic growth, followed by difficult retrenchment in recession. This is fiscally unsustainable.

Between 2000 and 2008 the pay bill grew by €9 billion due to a 67,000 expansion in public service numbers and increases in pay rates through national wage agreements and other pay awards. Of the two it was the increases in the rates of remuneration that had the dominant impact, adding approximately €6.5 billion to the pay bill or 72 per cent of the increase.

Subsequently, from 2008 to 2014, a recruitment embargo and extraordinary emergency legislation were used to reduce the pay bill by €3.6 billion – through a 32,000 decrease in serving numbers and €2.2 billion under the Financial Emergency Measures in the Public Interest (FEMPI) Acts. These savings, although of severe impact to individuals, reversed only part of the increases of previous years, illustrating just how difficult it is to reduce the pay bill once additional numbers of public servants and/or higher rates of remuneration have been approved.

Over the last 3 years, within expenditure limits, the Government has been able to accommodate increasing numbers while commencing FEMPI restoration under the Lansdowne Road Agreement. Pressures are now growing for large scale expansion of front line public service numbers, accelerated FEMPI restoration, and general pay increases.

However, it must be remembered that increases in numbers of staff or rates of remuneration in one area, will impact not just on the pay bill as a whole, but also on the availability of funding in other vital public services. To balance these needs Government pay policy is clear:

- Where there is a demonstrated need – frontline staff numbers will be increased in a targeted and sustainable manner – for example with the Programme for Government commitment to increase the number of Garda.
- FEMPI restoration of pay has commenced under the Lansdowne Road Agreement - this sets out the framework and agreed pathway for pay restoration to 2018 for public servants that is affordable and achievable on a fiscally sustainable basis.
- Developments in pay will be informed by recommendations from the Pay Commission which is a commitment under the Programme for Government.

Annex 1
Fiscal Outlook: Updated for 2016 developments

Table A1: Revised baseline forecast 2016-2021 taking account of 2016 revenue & expenditure updates

€ million	2015	2016	2017	2018	2019	2020	2021
CURRENT BUDGET							
Expenditure							
Gross Voted Current Expenditure	50,845	51,870	52,575	53,195	53,600	54,030	54,490
Non-Voted (Central Fund) Expenditure	9,775	9,845	9,405	9,485	9,310	9,140	8,545
Gross Current Expenditure	**60,620**	**61,720**	**61,985**	**62,685**	**62,910**	**63,170**	**63,030**
less Expenditure Receipts and Balances	11,500	11,410	11,510	11,510	11,510	11,510	11,510
Net Current Expenditure	**49,120**	**50,305**	**50,470**	**51,170**	**51,400**	**51,660**	**51,520**
Receipts							
Tax Revenue	45,600	48,135	49,215	53,925	55,435	58,015	60,760
Non-Tax Revenue	3,515	3,375	2,175	2,075	2,100	2,090	1,985
Net Current Revenue	**49,115**	**51,510**	**51,390**	**56,000**	**57,540**	**60,105**	**62,740**
CURRENT BUDGET BALANCE	**-5**	**1,205**	**920**	**4,830**	**6,140**	**8,445**	**11,220**
CAPITAL BUDGET							
Expenditure							
Gross Voted Capital	3,825	3,965	4,130	4,390	4,735	5,140	5,540
Non-Voted Expenditure	1,645	1,065	1,140	1,140	1,135	1,130	860
Gross Capital Expenditure	**5,470**	**5,035**	**5,270**	**5,530**	**5,870**	**6,270**	**6,400**
less Capital Receipts	310	275	305	305	305	305	305
Net Capital Expenditure	**5,160**	**4,760**	**4,965**	**5,225**	**5,565**	**5,965**	**6,100**
Capital Resources	**5,105**	**2,430**	**910**	**960**	**960**	**945**	**955**
CAPITAL BUDGET BALANCE	**-55**	**-2,330**	**-4,055**	**-4,265**	**-4,605**	**-5,020**	**-5,145**
EXCHEQUER BALANCE	**-60**	**-1,125**	**-3,135**	**565**	**1,530**	**3,425**	**6,075**
GENERAL GOVERNMENT BALANCE	**-4,935**	**-2,015**	**-865**	**1,155**	**3,355**	**5,840**	**8,435**
% of GDP	*-2.3%*	*-0.9%*	*-0.4%*	*0.5%*	*1.3%*	*2.1%*	*2.9%*

Source: Department of Finance. Note figures may not sum due to rounding
- This table provides a fiscal update to the baseline 2016 position as previously set out on a no policy-change basis in the SPU. Updates to the 2016 fiscal position are followed-through in the subsequent years out to 2021.
- 2016 Gross Voted Current Expenditure has increased by €540 million.
- It is currently assumed that c.40 per cent of the additional 2016 tax revenues of €900 million are one-off and do not enter the base for 2017 or successive years.
- Appropriations-in-Aid (current) have been re-estimated as €100 million higher from 2017.
- An expenditure-neutral technical reclassification of PPP unitary payments from current to capital has been made as compared to SPU.

Table A2: Application of the budget rule on a no policy change basis

€ billions	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Fiscal developments						
1. General government expenditure[1]	74.4	75.2	76.2	77.0	77.5	78.0
2. Interest expenditure	6.3	6.3	6.1	6.0	5.8	5.4
3. Expenditure co-financed by EU	0.4	0.5	0.5	0.5	0.6	0.6
4. Gross fixed capital formation (GFCF)	4.0	4.0	4.2	4.8	5.1	5.5
5. Smoothed 4-year GFCF	3.8	4.0	4.0	4.2	4.5	4.9
6. Cyclical unemployment expenditure	-0.2	-0.2	-0.3	-0.5	-0.7	-0.8
7. Corrected expenditure aggregate [1-2-3-(4-5)-6]	67.8	68.6	69.6	70.4	71.3	72.2
8. Discretionary revenue measures (DRM)	-0.7	0.1	0.5	0.4	0.4	0.4
9. Corrected expenditure growth %	0.4	1.0	0.9	0.6	0.6	0.7
Macro-economic developments[2]						
Reference rate of potential growth	1.9	3.3	3.4	3.6	3.7	3.7
GDP deflator	1.7	1.2	1.3	1.3	1.3	1.3
Convergence margin	1.8	2.0	2.1	0.0	0.0	0.0
Permitted expenditure growth %	1.8	2.5	2.6	4.9	5.0	5.1
10. Permitted expenditure €bns	69.4	69.5	70.3	73.0	74.0	74.9
11. Gross fiscal space [10t-7t-1]		1.7	1.8	3.4	3.6	3.6
12. Adjustment for DRM's (8)		-0.1	-0.5	-0.4	-0.4	-0.4
Public Capital Programme		*0.2*	*0.4*	*0.8*	*1.2*	*1.6*
13. of which fiscal space used		0.0	0.1	0.2	0.3	0.3
14. Lansdowne Road Agreement		0.3	0.3	-	-	-
15. Voted expenditure incl. demographics		0.4	0.3	0.4	0.4	0.5
16. Other[3]		0.0	0.4	0.3	0.2	0.1
17. Total Pre-committed expenditures [13+14+15+16]		**0.8**	**1.1**	**0.9**	**0.9**	**1.0**
Net fiscal space remaining [11-12-17]		**1.0**	**1.2**	**3.0**	**3.1**	**3.0**

Notes:
1. General government expenditure takes account of the 540m increase in expenditure profiled for 2016 in line with the revised estimates process. This amount has a permanent impact on the spending base each year from 2016 onwards.
DRMs unchanged relative to Budget 2016.
2. 2017 values for the reference rate and convergence margin are frozen based on European Commission Spring 2016 estimates. Values for 2018 onwards are estimates based on SPU 2016 projections adjusted for the new 2016 spending base. Values for each year from 2018 onwards are estimates and will not be formally set until Spring of the preceding year and remain subject to change.
3. Other includes Non-Voted and other general government commitments.
- Figures may not sum due to rounding.

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