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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

July 2017

Foreword

The Irish economy is growing at a healthy pace, generating employment and raising living standards. Indeed, it is noteworthy that for every 10 jobs lost during the recession, 7 have now been recovered. The Government will continue to work so that all of the jobs lost have been fully replaced.

Economic recovery, together with decisive policy action, mean that the public finances are now in much better shape. Next year the Government will ‘balance the books’, a major achievement given the collapse of tax revenue a decade ago. Tax receipts last year returned to their pre-crisis peak, but getting back to this position has involved significant sacrifices by the Irish people. This is why it is important that the mistakes of the past are never repeated. Moreover, notwithstanding the narrowing of the public deficit, public indebtedness remains high and must be reduced; this is why the Government is using the proceeds from the sale of its assets in AIB for debt reduction.

The central economic scenario – as set out in the Government’s Stability Programme Update published in April – is for continued solid growth over the medium term. Under this scenario, the economy is rapidly approaching a situation in which available resources are fully utilised and where capacity constraints are becoming binding.

However, continued economic growth cannot be taken for granted, with an international backdrop characterised by heightened levels of uncertainty. There is, for instance, no clarity regarding the terms of the future trading relationship between the European Union and the UK following the latter’s departure from the Union in early-2019. The economic policy stance in the US is another key source of uncertainty. The Irish economy is more exposed than most to such developments given our deep integration into the global economy and, in particular, our close economic ties with both the UK and US.

Against this highly uncertain background, the key challenge is to improve the resilience of the economy in order to minimise the economic and social fall-out from any adverse developments and to be in a position to take advantage of new opportunities. There are many dimensions to this and the Government is pro-actively working to address these.

First and foremost, it is imperative that the public finances remain on a sustainable path. The provision of additional public services must be sustainably financed; it is also important that budgetary policy does not generate overheating pressures in the economy and that the pro-cyclical policies of the past are not repeated. The scarring effects of the crisis are still clearly visible and are a lesson to us all.

Overall, therefore, budgetary strategy will be prioritised towards supporting sustainable economic growth, spreading the fruits of recovery more widely, ensuring that work pays and addressing bottlenecks in the economy. In terms of framing the budget, it is important to focus not just on the incremental change in public spending but on the totality of spending, which will be close to €60 billion next year.

Secondly, the increase in housing supply has failed to keep pace with the increase in demand and this imbalance has manifest itself in rising rental costs, higher house prices and pressure on social support for housing. The Government's strategy to address this market failure is set out in *Rebuilding Ireland*, published in July last year, with the aim of ensuring 25,000 additional units per annum by 2020. The root-cause of the problem is a lack of housing supply and addressing this is a key priority for Government. The strategy is currently being reviewed to assess whether and, if so, which additional measures are warranted.

The Government is also working to address other infrastructural bottlenecks and a Mid-Term Capital Review is underway in order to ensure that additional capital spending is fully aligned with economic and social priorities, including the objectives of the forthcoming *National Planning Framework*, and with the objective of enhancing the growth capacity of the economy.

Of course, economic growth is a means to an end and not an end in itself. It is a means of raising living standards and of generating resources to finance the provision of high-quality public services. In this regard, an additional €7.2 billion will be allocated to provide for public services between 2016 and 2021. The improvements to the public expenditure management framework in Ireland, notably the ongoing spending review, will ensure that the principles of value-for-money, effectiveness and sustainability are central considerations in the allocation of this additional funding, and indeed in relation to all resources.

It is also crucially important that the fruits of recovery are spread – both geographically and across different income groups – as evenly as possible. Fairness matters to this Government. Income tax reform will be a key element in supporting employment growth and retention, and in improving living standards. 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 will be targeted towards middle income earners, underpinned by the objective of making work pay.

In summary, the over-arching policy objectives are to:

- build upon the recovery that is now moving towards a more mature phase;
- continue to improve competitiveness, including through boosting productivity;
- enhance the resilience of the economy given potentially severe external challenges;
- spread the fruits of economic growth more widely; and
- provide first-class public services on a sustainable basis.

To achieve these objectives, the Government is implementing policies designed to ensure fiscal sustainability, to improve competitiveness and to enhance the growth capacity of the economy. The provision of world-class public services is a key goal of Government; but it cannot be achieved in one single budget. Instead we need steady, incremental progress on a year by year basis.

Paschal Donohoe T.D.
Minister for Finance
Minister for Public Expenditure and Reform

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Executive Summary

The Irish economy is growing at a healthy pace and approaching a situation in which resources are being fully utilised. It is important, in these circumstances, that budgetary policy 'leans against the wind' and does not contribute to overheating the economy. At the same time, it is important to address, in a sustainable manner, bottlenecks that have resulted from the faster-than-assumed pace of economic recovery, so that further improvements in living standards can be achieved. With this in mind, the Government is prioritising investment – in order to address the infrastructural gaps that have emerged in areas such as housing – this year and over the coming years. The Government is also acutely aware of the need to ensure that the taxation system is as growth-friendly as possible and will continue to work to improve efficiency in this area.

Next year, the Government will balance the books (in structural terms). This is a major achievement given the deterioration in the public finances a decade ago. Taking account of pre-committed expenditure and resources available for new expenditure measures, total gross voted expenditure is to grow by almost €2 billion or 3.4 per cent in 2018. This continues the Government's policy of implementing moderate and sustainable growth in overall expenditure to deliver improvements in our public services and infrastructure.

Fiscal space amounting to €1.2 billion is available for next year, consistent with achieving a balanced budget. Taking into account the full-year cost of measures introduced last year, in the absence of additional revenue-raising measures, this leaves around €500 million for new, discretionary measures next year. €300m of this amount is available for new expenditure increases, which when added to the pre-committed spending will bring the overall expenditure increase to €2 billion. This means that overall public spending will be around €60 billion next year and it is crucial that we focus on the totality of expenditure and not just incremental changes. In this regard, it should be recognised that the Spending Review currently underway will help re-prioritise expenditure and ensure that it is sustainable, efficient and effective.

We must be conscious of the uncertainty that currently defines the international economic situation with, for instance, no clarity on the post-Brexit trading regime between the UK and the EU. This uncertainty, together with the exposure of the Irish economy to external developments, puts a premium on adopting cautious budgetary policies. In this context, the Government will maintain a rainy day fund with an annual contribution of €500 million beginning in 2019, i.e. the year following the achievement of a balanced budget (in structural terms). The remaining €500 million (of the €1 billion originally envisaged for the rainy day fund) will be used to finance investment in physical and social infrastructure.

The Government will continue to reduce the debt-to-GDP ratio until the 60 per cent legal threshold is achieved and, thereafter, work towards reducing the ratio to 55 per cent of GDP. Once major capital projects have been completed, the Government will target a further reduction in the debt ratio to 45 per cent of GDP.

Chapter 1
Economic Strategy

1.1 Overarching Economic Strategy

The Government's overarching economic strategy is shaped by the defining features of the Irish economy. First and foremost, Ireland's economy is one of the most open in the world, with this openness reflected in trade – where exports amount to over 100 per cent of GDP – as well as in labour and capital flows. The latter are particularly relevant in an Irish context and are evident in the importance of foreign direct investment to our economy.

Secondly, Ireland is also a relatively small economy with, for instance, a population amounting to just 1 per cent of the total EU population. An important economic consequence of this is that the domestic market for goods and services is relatively small.

Of course, we have not always been receptive to openness, with inward-looking, protectionist policies pursued up to the late-1950s. The result of these policies was a depressed standard of living domestically combined with widespread outward migration.

The gradual opening of the economy to trade and investment from the 1960s onwards has been the key factor transforming Irish living standards in recent decades. Clearly, some major policy mistakes along the way – the inappropriate fiscal policies adopted in the 1980s and the mismanagement of the economy in the 2000s – had a depressing impact on living standards, but once these were corrected, income per capita in Ireland has converged to, and subsequently beyond, those of many advanced countries.

In recent decades, the pace of globalisation – i.e. the growth of world trade and the cross-border movement of capital and labour – has accelerated, and Ireland has benefitted enormously from this. Access to the Single European Market has also been crucial. We have successfully succeeded in moving the economy up the 'value chain' through, for instance, our investment in skills and human capital. This, in turn, has modernised the economy and boosted productivity, the latter being the key driver of living standards.

In light of the key role of trade and investment in the transformation of the Irish economy, the potential for any rowing back of global economic integration is a cause for concern to all of us in Ireland. The lessons from Irish economic history are clear – protectionism doesn't work.

In this regard, the Government's economic strategy will be to continue to promote openness to trade and investment. Internationally, the Government will continue to promote international co-operation, including through our role as a Member State of the European Union, and will work alongside multilateral organisations such as the OECD and IMF.

Domestically, the Government will work to ensure that Ireland remains an attractive location for enterprise, both indigenous and foreign, and will prioritise those policies that continue to re-position the Irish economy further up the 'value chain'. In particular, the focus of policy will continue to be on managing the public finances in a sensible manner, on remaining competitive, on addressing supply-side bottlenecks, and on reducing public debt to cushion against future shocks.

1.2 Strategy for Sustainable Growth

The Government's strategy for sustained growth over the medium-term is framed in the context of building upon our existing strengths and, at the same time, addressing new, emerging challenges. This broad strategy involves a range of essential mutually-reinforcing elements including:

- ensuring sound and sustainable public finances;
- managing public expenditure to ensure maximum return on taxpayer resources;
- increases in public capital investment in a targeted manner;
- reforming the taxation system to ensure it is growth-friendly;
- ensuring balanced regional growth;
- facilitating access to finance, especially for SMEs.

Ensuring sound and sustainable public finances

Sustainable public finances are essential for continued improvements in domestic living standards. The Government's short-term objective is to achieve a balanced budget in 2018 (after adjusting for the impact of the economic cycle). This is in line with the fiscal rules; but it is also the right thing to do. A balanced budget over the economic cycle ensures fiscal support for the economy in 'bad' times and reduces the risk of overheating in 'good' times, and, in doing so, helps to ensure long-term fiscal sustainability. For these reasons, achievement of the 'medium term objective' has been, and will continue to be, the key anchor for budgetary policy in Ireland.

While the debt-to-GDP ratio has fallen, this is solely due to the increase in GDP (including the exceptional growth rate in 2015). The stock of debt remains high, with the result that Ireland remains vulnerable to economic shocks which could emerge.

To ensure suitable fiscal buffers in the event of an economic downturn, the proposed rainy day fund will be maintained, although contributions to the fund (from 2019) will be reduced. At the same time, the Government will reassess the role of the Ireland Strategic Investment Fund (ISIF) which was established at a time when private investment was constrained and the banking system was restricted in its capacity to finance the real economy.

A review of the ISIF's investment strategy is currently ongoing. Preliminary results, while acknowledging stronger economic growth and an increased availability of private sector investment than was forecast at ISIF's establishment, indicate that ISIF has and continues to generate considerable economic impact. Based on cashflow modelling, ISIF has acknowledged that an element of the Fund's resources could be made available for Government to address other priorities. On this basis, Government will consider whether an element of the ISIF should be reoriented towards complementing the role of the rainy day fund, while also ensuring that the majority of the ISIF continues its statutory objective of investing for a commercial return and economic impact.

The Government will continue to reduce the debt-to-GDP ratio until the 60 per cent legal threshold is achieved and, thereafter, work towards reducing the ratio to 55 per cent of GDP. Thereafter, and once the major capital projects have been completed, the Government will target a further reduction in the debt ratio to 45 per cent of GDP.

Managing public expenditure to ensure maximum return on taxpayer resources

The aim of public expenditure policy is to balance the requirement for fiscal and economic sustainability with wider social, redistributive and growth-enhancing considerations. In this regard, significant, targeted investment in key public services and infrastructure can be made while maintaining sound public finances into the future. Indeed, continued economic growth and competitiveness depends on prudent investment in both physical and social capital.

Overall expenditure policy aims must be delivered by an effective and responsive 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. The most recent development in this regard is the ongoing spending review, which represents a systematic method of examining all day-to-day spending by Departments. The first in a three-year cycle of reviews, this new approach demonstrates the Government's ongoing commitment to deliver targeted, effective services for citizens through efficient and sustainable policies.

Targeted increases in public capital investment

Investment in public infrastructure is essential to support balanced regional growth and increase the capacity of the economy over the long-run. This need is being addressed by the Government through its commitment of an additional €5.14 billion to the €42 billion Capital Plan set out in the 2016 Summer Economic Statement.

Last year, €2.2 billion of the additional capital was allocated to the Government's initiatives aimed at tackling the housing crisis, as detailed in the *Action Plan for Housing and Homelessness*. Taking account of further allocations made in Budget 2017, approximately €2.65 billion remains to be allocated over the period 2018-2021.

The Department of Public Expenditure and Reform is conducting a Mid-Term Capital Review to ensure that this additional capital funding is aligned with national economic and social priorities, consistent with Programme for Partnership Government objectives, and helps to sustain the long-term growth potential of the Irish economy.

The report of the Mid-Term Capital Review will be published in July, and will inform final decisions by Government on revised capital allocations to be announced in the context of Budget 2018. The findings of the Review will also help inform a new longer term Capital Plan in support of the forthcoming new *National Planning Framework*.

From 2019 onwards, the Government will reduce the contribution to the rainy day fund by €500 million so that capital expenditure can be increased further. Such additional investment will be contingent upon the capacity of the economy to absorb the additional funding.

A growth-friendly taxation system

Taxation and economic growth are interdependent – GDP forms the vast bulk of the tax base while the level and design of the tax system impacts on the composition and development of GDP. Therefore it is important that the taxation system is 'growth-friendly'.

The taxation system can be made more efficient by *inter alia* improving the tax-mix i.e. by rebalancing the tax-mix away from taxes which significantly impact on growth prospects towards less distortionary taxes. The priority in recent years has been on reducing the disincentive effects from high marginal rates on labour, helping to ensure that the Government's objective of making work pay is achieved. The Government has introduced a number of measures including:

- Reductions in the three lowest rates of the USC such that the maximum marginal rate has been reduced to 49 per cent on income up to €70,044, down from 52 per cent on all income over €32,800 in 2014.
- A new Earned Income tax credit has been introduced and is available to self-employed individuals who have an active trade or profession and who do not have access to the PAYE tax credit.
- The development of a new SME-focussed share-based remuneration incentive was announced in Budget 2017 and is due to be introduced in Budget 2018. The purpose of the incentive is to assist small companies with growth potential in competing with larger, more established firms to attract and retain key staff.
- As part of the Budget 2017 expenditure package, improvements to the social welfare benefits available to the self-employed were announced. These include extending access to the invalidity pension and to treatment benefits, and allowing earlier access to the Back to Work Enterprise Allowance.

Ireland's corporation tax regime is another core part of our economic policy mix and is a long-standing anchor of our offering on foreign direct investment. Our headline rate of 12.5 per cent, our competitive regime, and our commitment to the OECD Base Erosion and Profit Shifting ('BEPS') process have been fundamental in achieving our corporate tax policy objectives over the last number of years. Ireland has committed to the BEPS process and is playing its full part in implementation. Ireland has already begun this process by introducing Country by Country reporting and an OECD compliant patent box. However, in the face of an ever evolving international tax landscape and recognising the importance that businesses place on certainty, it is imperative that Ireland maintains its commitment to sustaining an attractive, stable corporate tax regime. This will allow us to compete legitimately and to continue to promote genuine substantive investment.

The cornerstone of our competitive offering remains the 12.5 per cent corporation tax rate. The 12.5 per cent rate is supplemented with a best-in-class R&D tax credit and the recently introduced Knowledge Development Box ('KDB'). Both of these incentives are designed to attract real jobs and substance to Ireland, and are fully in line with agreed international best practices. The KDB was introduced at the beginning of 2016 to support all companies carrying out substantive innovative activities in Ireland.

Ensuring balanced regional growth

Achieving sustainable economic growth and development across Ireland's regions over the medium to long term is important for the overall social and economic fabric of the country. However, preparation of the *National Planning Framework* indicates that the form and focus of Ireland's future development – how we manage urban and rural development and change – is as important as comparisons between regions.

Alignment of investment and planning is the key to strategically influence future development patterns and achieve major public interest and policy goals, such as:

- Creating places of outstanding quality and vibrancy that people and investment are drawn towards and that, in turn, generate employment, economic output and innovation;
- Using this dynamic to enable the growth of city and town centres, but also of established suburban areas and smaller towns, that have underlying growth potential, but are under pressure from competing suburban and greenfield development;
- Delivering the homes, places of work, services and amenities that a modern economy and society needs;
- Ensuring that growth can be distributed regionally and focused to realise new potential; and
- Ensuring the right development takes place in the right locations and at the right time, addressing issues such as traffic congestion and shifting our mobility and energy systems to greener sources that will help us meet our binding climate change commitments.

The formation of the Government made the revitalisation and development of rural Ireland one of its key priorities. The *Programme for a Partnership Government* includes over 80 commitments across Government which aim to have a positive impact on rural Ireland.

In order to bring about the commitments in the *Programme for a Partnership Government*, along with other new initiatives to improve the social and economic fabric of rural Ireland, the Government has developed a new *Action Plan for Rural Development*. This new Action Plan, which was published in January of this year, identifies over 276 specific actions and assigns responsibility for delivery of each action to a Government Department or State agency to ensure that there is an integrated approach.

The Plan is one of the widest-ranging Action Plans delivered by Government, with a focus on advancing both the economic and social development of rural areas. Covering the three year period 2017-2019, the Plan is structured around the following five areas:

- Supporting sustainable and vibrant rural communities;
- Supporting enterprise and employment;
- Maximising our rural tourism and recreation potential;
- Fostering culture and creativity in rural communities; and
- Improving rural infrastructure and connectivity.

Facilitating access to finance

The Government recognises the crucial role played by small- and medium-sized enterprises (SMEs) in sustaining growth in employment and economic activity in Ireland. In order to support growth, Government policy remains focused on ensuring that all viable SMEs have access to an appropriate supply of credit from a diverse range of bank and non-bank sources. Encouragingly, new lending has been increasing since the beginning of 2014 with gross new lending to non-financial SMEs at €4.6 billion in 2016, a 35 per cent increase on 2015.

This has not happened by accident; the Government has developed a number of initiatives to ensure that the supply of credit in the market is sufficient to meet the existing and future needs of SMEs.

- The Strategic Banking Corporation of Ireland (SBCI) continues to support the SME sector. At present, the SBCI has 3 bank and 5 non-bank on-lending partners. To the end of March 2017, the SBCI has lent €657 million to 15,293 SMEs across the country.
- The Government has also continued enhancing awareness of State supports by developing and continuing to update the Supporting SMEs Online Tool which, following the introduction of county specific supports offered through individual local authorities and the Local Enterprise Office (LEO) network, now provides access to information on over 170 Government business supports across 30 Departments and agencies. There are an array of State supports targeted at supporting new-start-ups as well as supporting existing businesses to grow and scale-up.
- In 2017, the Department of Agriculture, Food and the Marine (DAFM), in conjunction with the SBCI, developed a €150 million Cash Flow Support Loan Scheme for Farmers to provide highly flexible loans at competitive rates. The purpose of the Scheme was to support farmers due to market difficulties and price volatility. This represented the first SBCI risk-sharing product and was intended as a proof of concept. Its success will allow the SBCI to pursue further risk sharing schemes.
- In December 2016 the Government established the Ireland-EIB Financing Group, to explore possible ways for Ireland to access additional EIB funding for projects that are economically necessary.

Box 1: Taking stock – key economic and fiscal developments

Economy

- GDP growth last year was 5.2 per cent, the highest rate in the European Union.
- The European Commission is forecasting that the Irish economy will be among the fastest growing economies in the European Union this year and next.
- Private consumption has increased by 10 per cent over the last three years and now exceeds its pre-crisis peak.
- Export growth remains solid with strong contributions from merchandise and service exports.

Labour Market

- Employment has increased by over 230,000 from its low point, a 13 per cent increase.
- Unemployment has fallen from a peak of over 15 per cent to 6.3 per cent in June, and is on track to fall below 6 per cent by the end of this year.
- The number of people unemployed for one year or more (long-term unemployed) is currently 78,700 - down from a peak of over 200,000 in Q1 2012.
- Net migration turned positive last year – for the first time since 2009.

Public Finances

- The underlying general government deficit has fallen from a peak of 11.5 per cent in 2009 to a projected 0.4 per cent this year.
- The interest rate on 10-year Irish government bonds remains very low, currently below 1 per cent.
- Gross government debt was 75.4 per cent of GDP last year, down from a peak of just under 120 per cent in 2012/2013.
- Net debt – excluding liquid and semi-liquid assets – was 66 per cent of GDP at end-2016.
- Irish sovereign debt has regained its ‘A’ category credit rating with all the major rating agencies.

Box 2: Broader indicators of success

The headline elements of our recent economic performance, in terms of indicators such as growth, deficit reduction and increased employment are both significant and well understood by now.

As our recovery enters a more mature phase, it is appropriate to provide a broader definition of economic success for the future. This should consider the pace of progress on key targets, improving the position of our public finances, developing more diverse sources of growth, improving the regulatory environment and achieving a well-functioning housing market.

Incremental Progress: Given the nature of the challenges that face us and the amount of the resources available, it must be recognised that incremental progress is real progress, albeit at a slower pace than would be desirable if we did not face resource, and indeed capacity, constraints.

Debt and deficit reduction: Our recent experience underlines the importance of a continuing ability to borrow to support economic activity, provision of public services and investment during periods of economic weakness. A clear corollary of this is that we need to reduce both our debt and our deficit when the economy is growing, and particularly when it is growing strongly, as at present. This will allow future uncertainties to be addressed with stronger budgetary foundations than in the past.

Importance of regulation: Along with the key foundations of a sound monetary policy and stable public finances, a modern advanced economy relies on a well-functioning regulatory environment for the banks and also for other key sectors of our economy. The considerable progress we have already made needs to be further developed.

Regulatory progress to date: Since the financial crisis, the financial regulatory environment has been completely overhauled at national and European level. The coming year will see these changes become the norm with strengthened supervisory powers driving the reduction of non-performing loans across Europe. In accomplishing this and other policy objectives, officials from the Central Bank of Ireland and the Single Supervision Mechanism (SSM) will be increasingly working as part of joint supervisory teams, which allow for the sharing of their expertise. In addition, the European wide Bank Recovery and Resolution Regime will be further enhanced in 2018 through banks' increasing their own funds and resources, which will protect taxpayers from future banking crises. Overall, these financial regulation changes will improve the resilience of the financial system to downturns and are continually being built on through changes in the culture of financial regulation, which has seen greater assertiveness and enforcement in regulatory decisions. At a national level, the State's bodies charged with the maintenance of economic and financial stability are continually enhancing coordination and critical challenge arrangements so as to improve risk mitigation actions and crisis management

Other reforms initiated during the crisis are now taking effect in the areas of legal services, medical services and pharmaceutical retailing. The Legal Services Regulation Act of 2015 represents an important milestone in the continuing process of reform of the regulation of the legal profession. In terms of the labour market, there have been significant developments over the past six years including the: expansion of training and employment supports; establishment of the Intreo office network; rollout of additional case management capacity in the form of the privately provided Job Path model; and implementation of other policies in the area of housing supports and childcare to address other barriers to employment.

Box 6 sets out a detailed description of measures to support labour market participation. The continued improvement of our regulatory infrastructure will play an important part in our future development strategy, and will complement continuing and considerable progress made in overall public service reform.

Diversity of growth: Our recent economic history underlines the difficulties that can be caused by over reliance on any particular sector, and consequently of the importance of having more diverse sources of growth. Overall economic growth is now better balanced between export led growth and domestic demand – with personal consumption now making a strong contribution, and projected to continue doing so. It is also notable that the sectoral composition of growth in the current recovery is more evenly balanced, by contrast with the construction driven growth of the previous decade. This is particularly evident in recent employment data, with increases evident across most of the sectors, and also in all regions of the country. Another important contrast with the previous decade is that economic activity is not reliant on the excessive credit expansion previously experienced. The continuation and further broadening of this diverse pattern is essential to underpin durable growth in future.

However, there are concentration risks, as outlined in the risk matrix of the Stability Programme Update 2017. In particular, it is noted that Ireland's industrial base is concentrated in a number of high–tech sectors – with the result that output and employment remain exposed to firm and sector specific shocks. This concentration is reflected in our corporation tax receipts – where the top 10 taxpayers contribute 37 per cent of this tax.

Housing market growth: A properly functioning housing market is also essential to our economic and social well-being. The increase in housing supply has failed to keep pace with the increase in demand and this imbalance has manifest itself in rising rental costs, higher house prices and pressure on social support for housing. The Government's strategy to address this market failure is set out in *Rebuilding Ireland*, published in July last year, with the aim of ensuring 25,000 additional units per annum by 2020. The plan comprises five pillars of concerted actions right across Government – addressing homelessness, accelerating social housing, building more homes, improving the rental sector and utilising existing housing. The root-cause of the problem is a lack of housing supply and addressing this is a key priority for Government. The strategy is currently being reviewed to assess whether and which additional measures are warranted.

Chapter 2
Economic Developments and Outlook

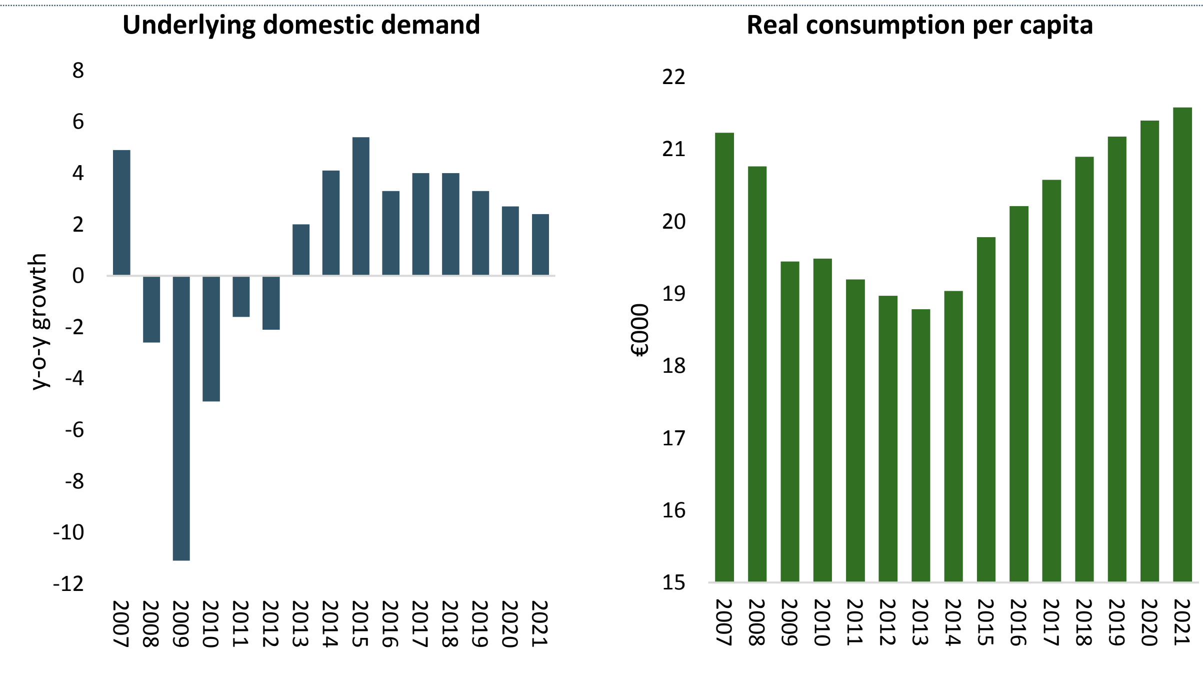
2.1 Economic Background

The recovery is now entering a more mature phase. Notwithstanding the well-known limitations with headline measures of economic activity, it is clear that the economic expansion has been very strong in recent years. Following a number of years of rebalancing, the composition of activity is also now more sustainable, with all sectors positively contributing to growth.

Indeed, it is also the case that the economy is rapidly approaching full employment. While not yet overheating, it is vital that policy not exacerbate the situation – the scarring effects of the last crisis are a reminder of this.

Domestic demand has played an increasingly significant role in driving the recovery in recent years with strong contributions from consumption and in particular investment spending. Developments in the latter have been dominated by the on-shoring of intangible assets and these are now the largest component of investment. However, underlying investment, i.e. excluding volatile components of investment such as aircraft and intangibles, has also rebounded sharply reflecting the pick-up in external demand and the acceleration in building and construction spending.

Figure 1: Recovery in domestic demand

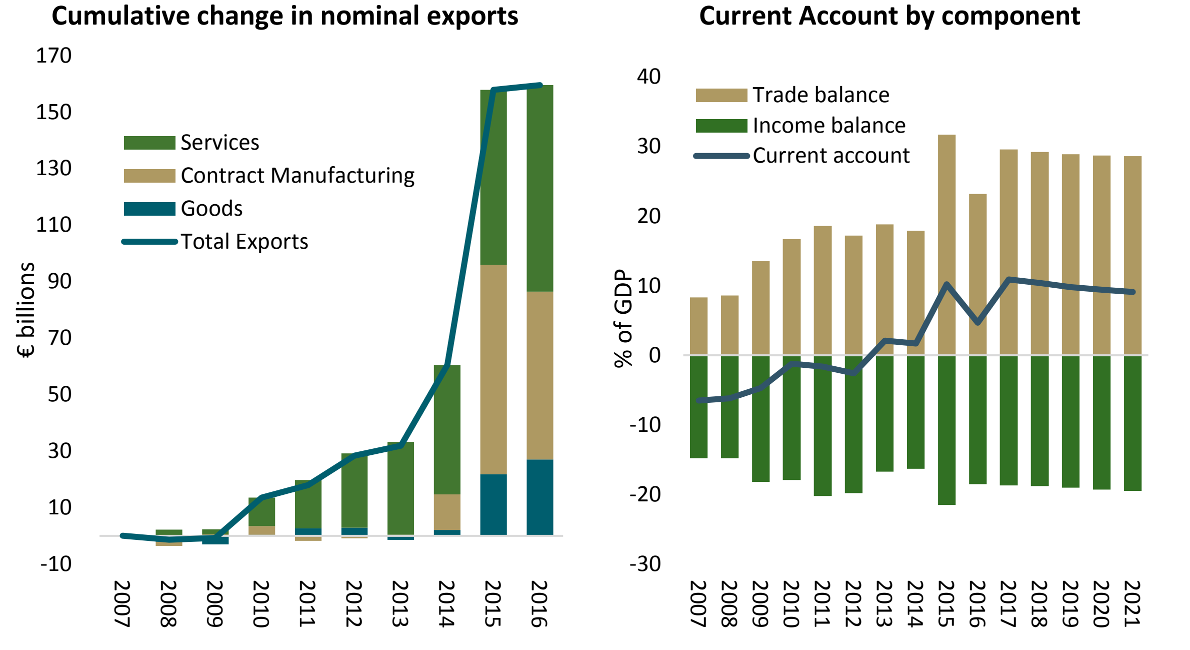


Source: CSO, Department of Finance

Real private consumption moved above its pre-crisis peak in the latter half of 2016 – though on a per capita basis it is still slightly below (figure 1) – following three years of robust growth supported by continued increases in disposable income, solid consumer confidence and "pent-up demand".

On the external side, while statistical issues such as contract manufacturing have distorted the headline figures, the strong performance of the exporting sector is evident with substantial gains recorded in both merchandise and service exports in recent years. As a result, Ireland continues to gain market share in an increasingly competitive world economy.

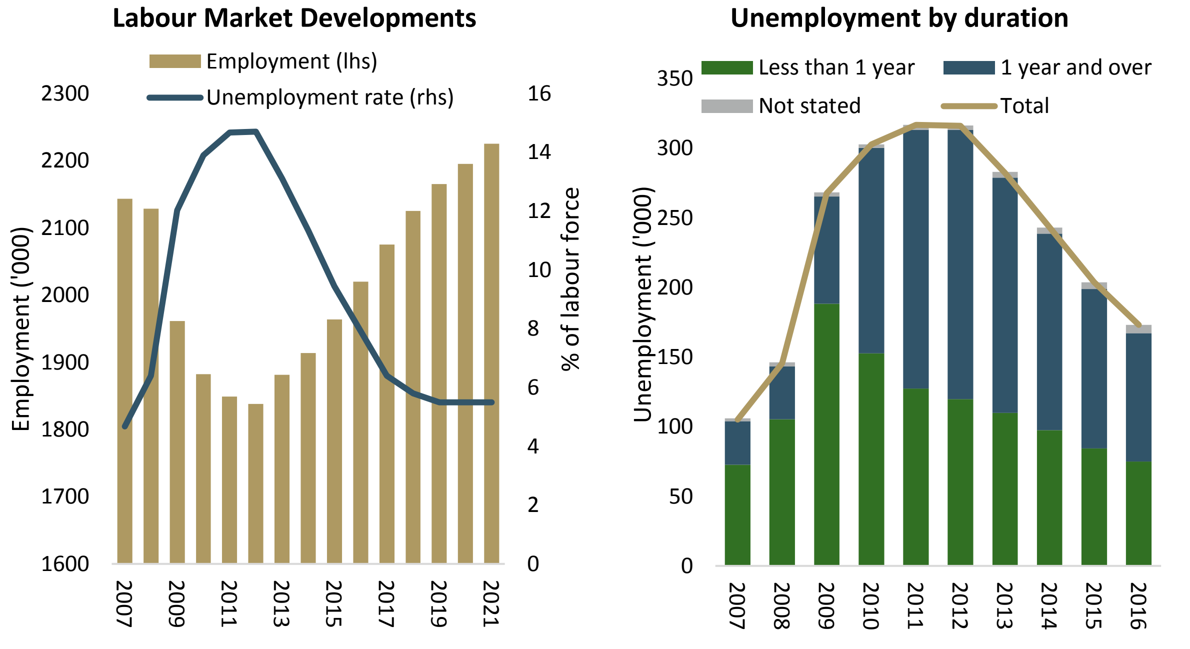
Figure 2: Recovery in the exporting sectors



Source: CSO, Department of Finance

The recovery is perhaps most evident in the labour market. Total employment, which has passed the two million mark, is at its highest level since 2008. This employment growth is now

Figure 3: Recovery in the labour market



Source: CSO, Department of Finance

better balanced across sectors and across the regions. Rising employment levels are reflected in falling unemployment which is now at 6.3 per cent, almost 9 percentage points below its peak. The fall in unemployment has also been broad based - with significant declines in both short and long-term unemployment - supported by labour market activation strategies including *inter alia* the *Action Plan for Jobs* and *Pathways to Work*. Following a number of years of significant outflows, net migration turned positive in 2016 reflecting the positive momentum in the labour market.

2.2 Economic Outlook: 2017

Forecasts produced by the Department of Finance were published in the Stability Programme Update 2017. High frequency indicators published since then broadly confirm the Department's outlook, and the (baseline) macroeconomic forecasts presented in this document are unchanged relative to the Stability Programme Update.

The economy is projected to grow by 4.3 per cent this year with strong contributions from both net exports and underlying domestic demand. Private consumption is forecast to grow at just under 3 per cent as improving labour market conditions continue to boost disposable income. Underlying investment is expected to remain robust driven by the recovery in the building and construction sector.

Export growth is forecast to accelerate this year to 5 per cent supported by a pick-up in external demand with Ireland's main trading partners – US, UK and the euro area – all expected to record reasonably solid growth this year.

A significant improvement in the trade balance will more than offset a modest increase in net factor outflows and, as a result, Ireland's current account as a share of GDP should return to double-digit territory this year. This means that *ceteris paribus* the nation as whole continues to reduce its net external liabilities.

The recovery in the labour market is set to continue with the level of employment forecast to increase by 55,000 (2.7 per cent) in 2017, while the unemployment rate should fall below 6 per cent by year-end.

Inflation is set to remain muted, with the harmonised index of consumer prices (HICP) measure of inflation projected to increase by just 0.6 per cent on average this year, as the lagged impact of the appreciation of the euro-sterling bilateral exchange rate continues to weigh on consumer prices.

The principal downside risks to this year's outlook relate to trading partner growth and the potential for further appreciation of the euro-sterling exchange rate during the Brexit negotiations, which would weight on Irish exports. On the other hand, the recovery in the euro area has been stronger than assumed and, if sustained, this could provide some upside potential.

2.3 Economic Outlook: 2018 and the medium term

The outlook for next year and over the medium term is relatively positive. The economy is projected to grow by 3.7 per cent in 2018 driven primarily by the ongoing recovery in the domestic economy, with the external sector set to make a significant, albeit more minor, positive contribution.

Over the medium-term, the economy is assumed to move broadly in line with its potential growth rate of around 3 per cent per annum. Consumption per capita is projected to exceed its pre-crisis peak towards the end of the forecast horizon while underlying investment as a share of GDP is assumed to revert to more normal levels. Export growth is expected to remain solid reflecting reasonably solid external demand and the favourable composition of Irish exports.

Table 1: Macroeconomic forecasts (as set out in the Stability Programme Update 2017)[1]

% change (unless stated)	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Economic Activity						
Real GDP	5.2	4.3	3.7	3.1	2.7	2.5
Real GNP	9.0	4.2	3.5	2.8	2.3	2.1
Balance of Payments						
Trade balance (per cent of GDP)	23.2	29.6	29.2	28.9	28.7	28.6
Current account (per cent of GDP)	4.7	10.9	10.4	9.8	9.4	9.1
Inflation						
HICP	-0.2	0.6	1.2	1.8	1.9	1.9
'Core' HICP	0.5	0.1	1.2	1.8	1.9	1.9
GDP deflator	-1.2	1.2	1.3	1.5	1.7	1.7
Labour Market						
Total Employment ('000)^	2,020	2,075	2,125	2,165	2,195	2,225
Employment	2.9	2.7	2.4	1.9	1.5	1.4
Unemployment (per cent)	7.9	6.4	5.8	5.5	5.5	5.5

^ Nearest 5,000.
Source: 2016 - CSO; 2017 to 2021 - Department of Finance.

Employment growth averaging just over 1½ per cent per annum is envisaged over the 2019-2021 period. This is consistent with the level of employment exceeding its pre-crisis peak by the end of this decade. The unemployment rate is expected to fall to 5½ per cent by 2019, remaining at this level over the remainder of the forecast horizon. The labour force is projected to increase throughout the forecast horizon supported by *inter alia* continued net inward migration and a pick-up in participation rates.

While there are both upside and downside risks to the central scenario, downside risks dominate at present. Consequently, a continuation of robust growth cannot be taken for granted as there are a number of significant challenges facing the Irish economy over the coming years. Principal among these are the UK's exit from the European Union (Box 4

[1] Updated macroeconomic forecasts will be published with Budget 2018 in October.

illustrates the scale of this challenge in more detail), the uncertainty associated with the policy stance in the US and rising protectionist sentiment internationally. A more comprehensive assessment of risks is set out in chapter 4 of the Stability Programme Update 2017.[2] On the upside, the recovery in domestic demand could be stronger than anticipated, in particular, private consumption and investment in the construction sector could accelerate more rapidly than in the baseline scenario. However, this could also increase the likelihood of the emergence of overheating pressures over the medium-term.

While momentum in the economy remains strong, there are several clouds on the horizon. Perhaps the darkest cloud relates to Brexit and the uncertainty attached to the post-exit nature of the trading arrangements between the UK and the EU. This means that medium term forecasts for the Irish economy are subject to considerable uncertainty. However, joint research by the Department of Finance and the ESRI demonstrates that the impact on the Irish economy from Brexit will be severe in the medium to long term. More specifically, under a 'hard' Brexit scenario, the level of Irish output is projected to be approximately 3½ per cent lower relative to a no-Brexit baseline five years after a UK exit. The medium term forecasts take into account, in so far as possible, the estimated impact of this shock to the economy. Revised forecasts will be published by the Department once there is greater certainty on the various economic issues.

Brexit, of course, is not the only uncertainty. While the recovery in the euro area economy is clearly a positive development, it brings with it the possibility that the stance of monetary policy could begin to change. Indeed, this perception has been one factor behind the appreciation of the euro in recent weeks. The appreciation vis-à-vis sterling is of particular concern.

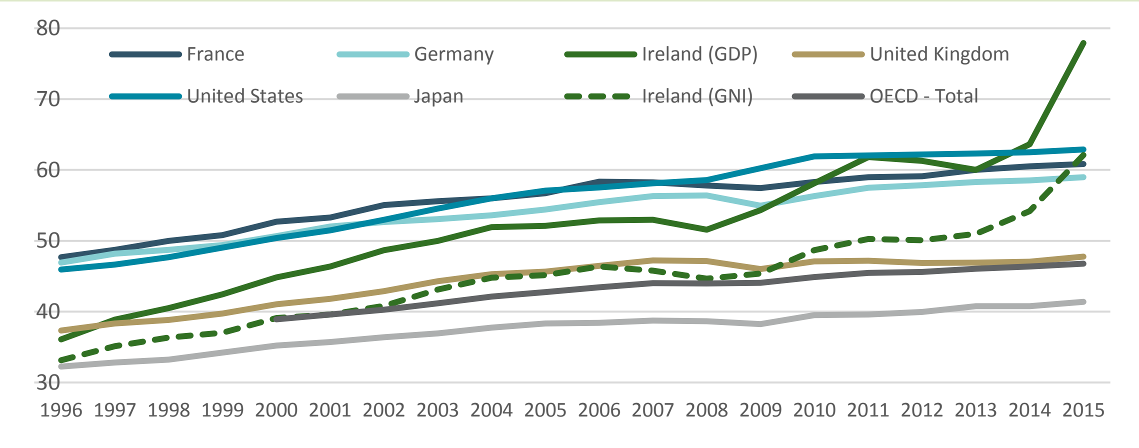
[2] http://www.finance.gov.ie/sites/default/files/170502%20Final%20SPU%202017.pdf

Box 3: Productivity and sustainable economic growth

Productivity reflects the ability of economies to produce more output by better combining inputs and is generally regarded as the ultimate engine of sustained economic growth. Countries cannot solely rely on capital and labour to improve living standards in the long run, with returns to capital investments constrained by diminishing returns, and labour constrained by demographic factors and skill mismatches. The contribution from the labour channel will be further limited as Ireland moves towards full employment, a very welcome situation, though one which emphasises the need to focus on productivity as a mechanism to continue to improve living standards.

Notwithstanding the 2015 level shift in GDP (see below), for a number of years Ireland has had one of the highest levels of labour productivity of OECD economies, when measured on a GDP per hour worked basis. However on a GNI basis, which strips out some - though not all - of the impacts of the foreign owned sector, Ireland's labour productivity (prior to the 2015 level shift) was below a number of 'frontier' economies, though still above the UK, Japan and the OECD average.

GDP Per Hour Worked, 1996-2015 (USD constant prices- 2010 PPPs)



Source: Conference Board and AMECO

At the aggregate level, Ireland's productivity performance is driven in large part by certain high-tech sectors (ICT and Manufacturing) and, within these sectors, by highly productive, and mostly foreign owned, firms. International firm-level analysis by the OECD has found that despite a global slowdown in aggregate productivity growth over the last decade, a small group of firms at the global frontier experienced strong productivity growth throughout the 2000s[3]. However, amongst lagging firms, there has been almost no productivity growth, and little evidence of catch-up with frontier firms, indicating that a breakdown in the diffusion of knowledge and innovations between firms, and/or a misallocation of resources might be giving rise to the so-called global productivity slowdown. On foot of these cross country findings, firm level productivity dynamics in Ireland are currently being analysed by the Department of Finance, in conjunction with the OECD, using CSO micro-data. It is hoped that by analysing detailed firm level data, the underlying drivers of aggregate productivity in Ireland can be better understood, and appropriate polices tailored to maximize aggregate productivity growth in Ireland in the years ahead

[3] Andrews, D., C. Criscuolo and P. Gal (2015), "Frontier firms, technology diffusion and public policy: micro evidence from OECD countries", OECD Productivity Working Papers, No. 2

Box 4: Brexit – cross-country sectoral exposures to the UK

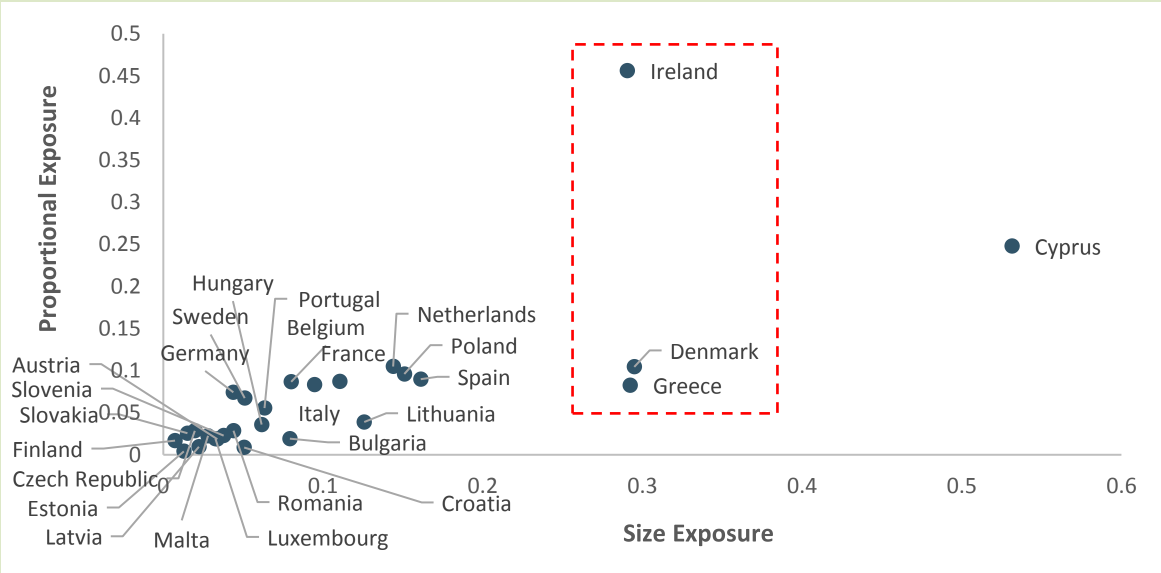
As part of a process of getting Ireland 'Brexit ready' in Budget 2017, the Department of Finance published a sectoral economic exposure analysis paper.[4] This paper introduced the concepts of size exposure and proportional exposure to quantify different dimensions of the trade exposure of sectors of the Irish economy to the UK. Size exposure is the proportion of a country's UK exports accounted for by a particular sector. Proportional exposure is the proportion of a sector's total exports that go to the UK. The analysis showed that while the agri-food and pharma-chem sectors had similar size exposures, the agri-food sector was much more exposed on the proportional exposure dimension due to the very high concentration of its exports that go to the UK.

Using data from the United Nations Conference on Trade and Development (UNCTAD) database these exposure measures are now applied to other EU member states to compare Ireland's sectoral exposures to the UK in an EU-27 context. The figure below shows this analysis for the Food and Live animals sector in each country.

As can be seen Ireland is a substantial outlier in comparison to other member states. It is evident from the size exposure measure that Ireland, Denmark and Greece have a similar share with this sector accounting for approximately 30 per cent of their UK goods trade. The outlier status of Ireland is driven mainly by the proportional exposure measure which shows that the UK accounts for over 45 per cent of the exports of this sector with most other countries being below 10 per cent on this measure.

This analysis suggests that, relative to other member states, this sector of Ireland's economy is disproportionately exposed to any potential trade disruption caused by the UK's exit of the EU.

Food and Live Animals Export Exposure to the UK (2015)



Source: UNCTAD Statistics External Trade Goods data. Department of Finance analysis

[4] See UK EU Exit – An Exposure Analysis of Sectors of the Irish Economy

Chapter 3
Budgetary Strategy

3.1 Background

The central assumption underpinning the conduct of fiscal policy is that Ireland remains on course to achieve its medium term budgetary objective (MTO) of a structural budget balance in 2018. This development follows nearly a decade of sustained fiscal effort underpinned by consolidation measures on both the revenue and expenditure sides. Sustainable public finances are a necessary pre-condition for economic growth and prosperity and the Government will not repeat the pro-cyclical mistakes of the past. The fiscal architecture under the Stability and Growth Pact provides the institutional framework to facilitate the conduct of domestic fiscal policy in a prudent, sustainable manner.

However, despite this progress, fiscal challenges and risks still remain with a number of potential headwinds on the horizon. Externally, given our high level of global integration, issues such as the impact of Brexit and the potential for international policy changes to impact upon corporation tax are paramount. Domestically, a number of risks exist, including mounting expectations regarding budgetary policy. Clearly not all of these can be met and the Government will prioritise in the areas where needs are greatest.

Given these and other potential risks, our elevated debt level represents a clear vulnerability and reduces our fiscal capacity in the event of a shock. The recently published *Annual Report on Public Debt in Ireland*[5] highlights that despite an improvement in our headline debt-to-GDP ratio to 75 per cent last year, this measure is heavily distorted by developments to the GDP denominator. Post the economic and fiscal crisis Ireland has earned a strong reputation for budgetary discipline. Accordingly, the challenge is to embed these behaviours into our policy-making and institutions so as to ensure a continuation of sustainable and prudent fiscal policy.

3.2 Fiscal Developments to-date in 2017

In the year to end-June, cumulative tax receipts are up by a solid 4.0 per cent, albeit marginally (0.5 per cent) behind expectations. In general, the second quarter saw an improvement in performance across the major tax headings which, in turn, underpins the decision to leave the 2017 tax projection unaltered at this stage. Under the direct tax headings, income tax receipts are just 2.3 per cent off profile, with corporation taxes ahead of target, whilst on the indirect side a very strong VAT performance more than offsets a shortfall in excise receipts.

The estimate for non-tax revenue remains unchanged from the SPU, with capital resources updated for the €3.4 billion in AIB share disposal receipts. While Exchequer-positive, its statistical treatment as a financial transaction means this does not improve this year's general government deficit. It is the policy of the Government that these proceeds are directed towards reducing debt in order to address the current and future debt servicing burden.

The forecast for non-voted expenditure remains in-line with the recently published SPU forecast. While non-voted expenditure is currently under profile in the year-to-date, this is

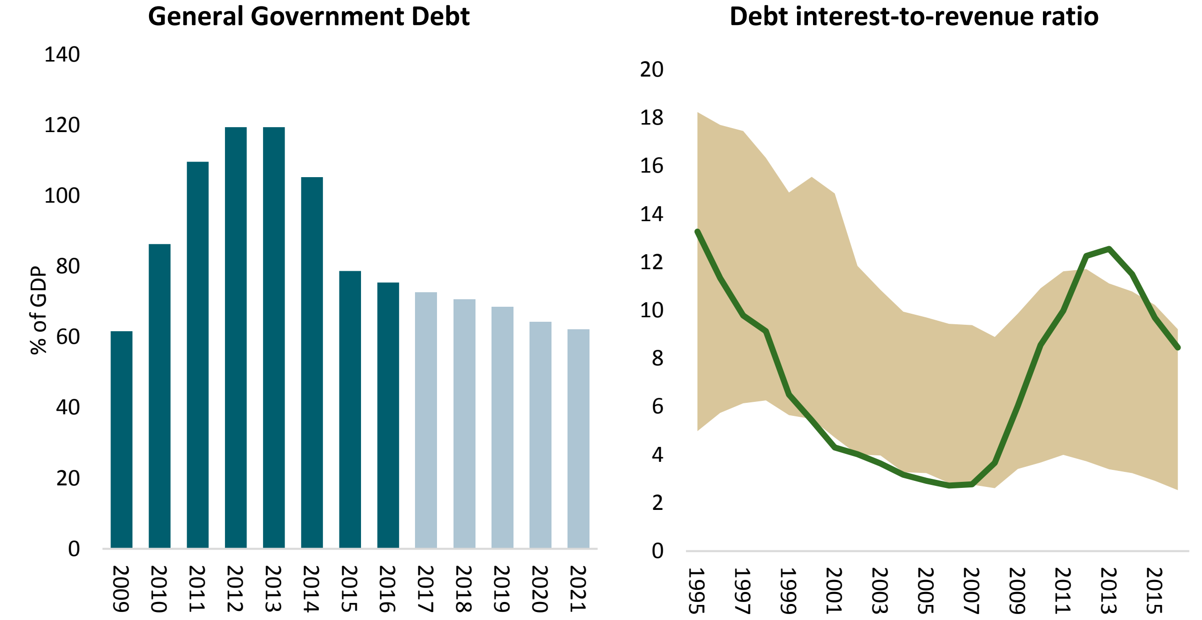
[5] Annual Report on Public Debt in Ireland, Department of Finance, June 2017.

mainly due to timing issues surrounding our contribution to the EU Budget which are likely to unwind as the year progresses.

In relation to voted expenditure developments, Departments are managing public expenditure within their allocations for the year. Total gross voted expenditure of €27.5 billion to end-June was €322 million (1.2 per cent) below profile. Specifically, both gross voted current and capital expenditure were €265 million (1.0 per cent) and €57 million (3.6 per cent) respectively below expectations. The Mid-Year Expenditure Report will review the expenditure position at the end of the first half of the year and outline any emerging trends at that stage.

As outlined in the Stability Programme Update there is an additional cost of €0.12 billion arising this year from the decision to bring forward to April, from September, a pay increase due under the Lansdowne Road Agreement. This cost is to be met from available public resources taking into account the scope for reallocation of expenditure. The extent to which Departments are in a position to meet this additional cost will only be determined later in the year. The Government will monitor the position closely and will consider how best to meet any additional funding requirements where the need arises.

Figure 4: Fiscal developments



Shaded area shows the 25-75 percentile range for EU28; the green line shows the evolution of Irish position.
Source: CSO, Department of Finance

Box 5: Expenditure benchmark compliance 2017

Forecast expenditure, as set out in Budget 2017, implied a breach of the expenditure benchmark (EB) pillar of the preventive arm of approximately €200m (0.1 per cent of GDP).

The 2017 Stability Programme Update, published in April, incorporated the 2016 outturn as compiled by the Central Statistics Office (CSO) for the Excessive Deficit Procedure (the so called Maastricht returns). As noted previously revisions to gross fixed capital formation affect the EB assessment in subsequent years due to the smoothing of capital formation.[6]

In addition to the CSO data, surveys of the Local Authorities, other general government bodies, and data from the NTMA and DPER are used to update the Department's estimates for 2017 and later years.

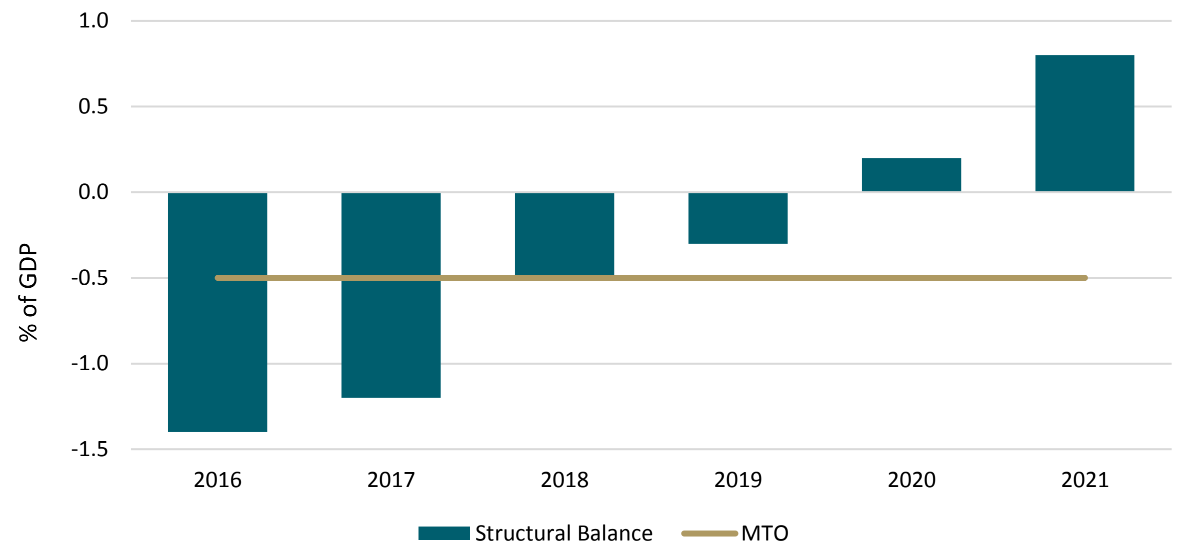
The EB assessment is performed by comparing the change in expenditure year-on-year with the trend growth rate of the economy. Therefore, revisions to expenditure components in either this or the previous year can change the compliance outcome.

Revisions to the level of general government expenditure (including gross fixed capital formation) for 2016, the capital smoothing into 2017 and changes to both cyclical unemployment expenditure and the GDP deflator have resulted in a projected breach of €450m (0.2 per cent of GDP). This is below the Commission's 0.25 per cent of GDP threshold to be deemed a 'significant deviation'.

Separately the Commission has also assessed compliance with the EB. The approach taken in its assessment suggests a retrospective application of a methodological change that was agreed in late 2016 to the EB, whereby one-offs such as the technical, upward revision by Eurostat to Ireland's 2015 expenditure base, arising from the statistical treatment of an AIB-related share transaction, provided an additional buffer for the calculation of Ireland's compliance in 2016 with the EB. Under this methodology the Commission has set out deviations under the EB pillar in both 2016 and 2017. It is the Government's position that such a retrospective implementation goes against the legitimate expectations of the Member States and there is ongoing engagement with the Commission on this issue.

[6] Expenditure on capital formation is averaged over a four year period meaning that an increase in spending will only use ¼ of the available fiscal space as compared to an equivalent increase in current spending in the same year.

Figure 5. Structural Balance and MTO



Source: Department of Finance

3.3 Fiscal Strategy

In the Stability Programme Update of April 2016, the Government defined Ireland's MTO as a structural deficit of 0.5 per cent of GDP. It is projected this will be achieved next year by ensuring that growth in expenditure is limited to what can be considered sustainable. This means that growth in public spending, net of discretionary revenue measures, is maintained below the trend economic growth rate. In practical budgetary terms this is reflected in the setting of the annual government expenditure ceiling.

Upon achievement of the MTO, public expenditure growth, net of discretionary measures, can 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 a counter-cyclical context, 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, 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 in Section 3.4 shows the available resources that would ensure compliance with the expenditure benchmark rule of the preventive arm of the Pact.

3.4 Fiscal Space 2018

In terms of the preparations for Budget 2018, there is significant carry-over from prior years which impacts upon the available fiscal resources. Table 2 illustrates the distribution of the indicative €1.2 billion in fiscal space available for next year (as estimated for Budget 2017) and indicates that this would represent a nominal €1.5 billion package in Budget 2018. However, this position is adjusted for the carry-forward from existing budgetary policy measures totalling €0.65 billion and a further €0.33 billion in capital commitments for the Action Plan on Housing. Accordingly, this implies that of the fiscal space, prior to update in this Summer Economic Statement, approximately €0.53 billion is available for a Budget 2018 package. It should be noted that this amount is before taking into consideration the additional costs of €0.18 billion arising from the proposed Public Service Stability Agreement 2018-2020, recently agreed by Government and subject to approval by the membership of the public service unions and staff associations. This estimate of fiscal space is updated in Section 3.5 to take account of updated, post Budget 2017 inputs and will be reviewed as part of the budgetary process.

Table 2: Impact of Budget 2017 on available fiscal space

€billions	**Current**	**Capital^**	**Revenue**	**Total**
a. Net 2018 Indicative Fiscal Space as per Budget 2017	*0.61*	0.19	0.39	1.2
… Translates into				
b. Nominal Budget 2018 package~	0.61	0.5	0.39	1.5
Less impact of policy decisions pre SPU				
c. Carry-over of pre-committed Budget measures	**0.47**	**0.00**	**0.17**	**0.65**
d. Nominal Resources available for B2018 package [b-c]	**0.14**	**0.50**	**0.22**	**0.86**
Less impact of other significant policy commitments				
e. Action Plan for Housing		0.33		
f. **Remaining Nominal Resources for new B2018 Initiatives [d-e]** #	**0.14**	**0.18**	**0.22**	**0.53**

Note rounding may affect totals
^Majority of this fiscal space is already utilised due to capital formation increase in recent years.
~Capital smoothing increases nominal amount available
As outlined above, this does not account for additional cost from the extension of the LRA.

3.5 Updated projection of Fiscal Space 2018-2021

Updated projections of fiscal space out to 2021 are set out in table 3. These reflect changes in the reference rate and the revised forecasts for GDP deflators arising from the European Commission's 2017 Spring Economic Forecast[7]. No changes are made to the previously agreed expenditure and tax reduction fiscal space allocations set out in the SES 2016 for the years 2019 to 2021.

The Commission set out a requirement of nominal growth in net primary government expenditure of 2.4 per cent *(Row e*) for 2018 in its draft Council Recommendations[8]. This reflects an adjustment to potential growth rates to exclude the 2015 GDP surge. Applying this to the corrected general government expenditure aggregate for the previous year (*f*) provides (*g*) and then, taking account of the projected discretionary revenue measures *(h),* the indicative adjusted fiscal space is approximately €2.1bn (*i*) in 2018.

[7] https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/spring-2017-economic-forecast_en
[8] https://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-507-F1-EN-MAIN-PART-1.PDF

Table 3: Calculation of Fiscal Space

	2018 as at Budget 2017	2018	2019	2020	2021
a. Reference Rate[1] %	*3.1*	3.5	3.6	3.5	3.4
b. Convergence Margin %	*1.7*	2.3	0.0	0.0	0.0
c. Applicable benchmark % [a-b]	*1.5*	1.2	3.6	3.5	3.4
d. GDP Deflator %	*1.1*	1.3	1.5	1.7	1.7
e. Permitted Expenditure Growth %	*2.6*	2.4	5.1	5.2	5.1
f. Corrected General Government Expenditure Aggregate (year t-1) €bn	*69.7*	69.5	71.1	73.2	75.6
g. **Gross Fiscal Space €bn** [e*f/100]	***1.8***	**1.7**	**3.6**	**3.8**	**3.8**
h. Discretionary Revenue Measures €bn	***0.5***	0.5	0.5	0.5	0.5
i. Adjusted Fiscal Space €bn [g+h]	*2.3*	2.1	4.1	4.3	4.4
j. Pre-committed Expenditure[2] €bn	*0.8*	0.6	0.6	0.6	0.8
k. Other[3] €bn	*0.3*	0.2	0.4	0.3	0.2
l. Revised Net Fiscal Space €bn [i-j-k]	***1.2***	**1.3**	**3.2**	**3.4**	**3.4**

Note: Rounding may affect totals.
1. Reference rate values from 2017 onwards using an interpolated linear average for 2015 (not the 25 per cent potential growth figure for 2015).
2. Pre-committed expenditure covering voted expenditure (including demographics), capital commitments and central fund. Nominal Public Capital Plan adjusted for capital smoothing to show use of fiscal space. Does not include the extension of the Lansdowne Road Agreement.
3. Other includes non-voted and other general government commitments.

Based on this level of fiscal space and accounting for the pre-committed expenditure (*j+k*), there is a positive margin[9] of €150m under the assessment of the expenditure benchmark. However any additional expenditure to the €1.2bn of net fiscal space outlined in Budget 2017, without offsetting measures, jeopardises the achievement of the MTO, which represents the baseline fiscal assumption for next year. Accordingly, the net fiscal space at €1.2 billion ensures the achievement of the MTO. The impact of abolishing water charges[10] has not been included in projected general government revenue and this will affect the structural balance forecast for 2018. However, this along with a range of other 'moving parts' will be considered as part of the overall fiscal arithmetic to be updated for Budget 2018 in October.

3.6 Fiscal Space over the medium-term

The calculation of available fiscal space needs to be conducted in a discrete manner, as set out in table 3 above. However revisions to the expenditure base and, in particular, revisions to gross fixed capital formation can have knock-on effects over the forecast horizon. Accordingly, use of the resulting fiscal space needs to be assessed separately.

As outlined in the *Programme for a Partnership Government*, SES 2016 set out an indicative allocation of fiscal space on a 2:1 ratio between public spending increases and taxation reductions. A provision for a contingency reserve/rainy day fund of €1 billion per annum post-2018 was also included in the SES 2016. Table 4 updates this on an illustrative basis, starting

[9] See Table 4 – 'e. Margin of compliance with EB'
[10] Given the prevailing statutory situation no assumptions have been made in relation to the budgetary impact of the abolition of water charges. It should be noted that there is no direct fiscal space impact for 2018. Furthermore any potential refund of water charges has not been accounted for in the forecasts.

from the revised estimates of net fiscal space, to show the reallocation of €0.5 billion from the rainy day fund to additional expenditure on capital formation. Capital expenditure has been disaggregated into capital grants and gross fixed capital formation (GFCF). Under the expenditure benchmark the latter is subject to a 4 year smoothing. The corresponding nominal increase in GFCF is shown in (f). No assumptions have been made regarding the allocation of the additional fiscal space between expenditure increases and/or taxation reductions, giving rise to (e).

It must be remembered that use of the available fiscal space, while compliant with the expenditure benchmark pillar, must be considered under the structural balance rule in relation to both the achievement and maintenance of the MTO.

Table 4: Indicative allocation of estimated available net fiscal space

€ billions	**2018**	**2019**	**2020**	**2021**
a. Net Fiscal Space[1]	1.3	3.2	3.4	3.4
SES 2016 allocations of Fiscal Space[2]:				
b. Expenditure	0.79	1.51	1.72	1.75
b(i). Current	*0.61*	*0.95*	*1.02*	*0.98*
b(ii). Capital Grants	*0.00*	*0.18*	*0.20*	*0.21*
b(iii). Gross Fixed Capital Formation[3]	*0.19*	*0.38*	*0.50*	*0.56*
c. Taxation	0.39	0.59	0.62	0.61
d. Contingency Reserve/Rainy Day Fund[4]	0.00	0.50	0.50	0.50
(e).* Margin of compliance with EB *[a-b-c-d]	***0.15[5]***	***0.6***	***0.6***	***0.5***
(*f*). Nominal increase in GFCF	0.50	0.75	0.50	0.50
g. Total expt & tax package [b(i)+b(ii)+c+f]	**1.5**	**3.0**	**2.8**	**2.8**

Note: Rounding may affect totals.

1. Net fiscal space derived in compliance with the expenditure benchmark.
2. SES 2016 set out an indicative allocation of available fiscal space on a 2:1 ratio between public spending increases and taxation reductions, as outlined in the *Programme for a Partnership Government.*
3. The expenditure benchmark allows for a 4 year smoothing of expenditure on gross fixed capital formation.
4. SES 2016 set out a provision for a rainy day fund/contingency reserve following the achievement of the MTO in 2018.
5. As noted earlier, the €0.15 billion margin under the EB in 2018 cannot be used without jeopardising achievement of the MTO next year.

Previous taxation-related fiscal space of €0.39 billion is available for possible tax reductions in 2018. However, €0.17 billion of this is pre-committed to the carry-forward from Budget 2017 tax measures, which means in net terms €0.22 billion is available for new taxation measures.

Any additional expenditure measures and tax reduction proposals will require additional discretionary measures unless compensating expenditure reductions are identified. The forthcoming Tax Strategy Group papers will set out potential options for revenue increases and reductions.

3.7 Debt 45 per cent target

In Budget 2017 the Government indicated a new debt-to-GDP target of 45 per cent of GDP. Following an opportunity to take stock of policy priorities, it has been decided to amend this target to 55 per cent of GDP with the extra flexibility this entails being directed at boosting potential output through increasing expenditure on capital formation. However the SGP 60 per cent debt-to-GDP threshold will still be achieved in 2022 as before. Thereafter, and once major capital projects have been completed, the Government will target a further reduction in the debt ratio to 45 per cent of GDP.

3.8 Rainy Day Fund

As part of the SES 2016, the Government announced, subject to achieving the MTO in 2018, its intention to establish a contingency reserve/rainy day fund with effect from 2019. The crisis years clearly demonstrated that volatility in the Irish economic cycle can be much more pronounced than elsewhere due to the open nature of the Irish economy. As such, the rainy day fund would provide a prudent counter-cyclical buffer, with annual transfers from the Exchequer to the rainy day fund expected following the achievement of the MTO, projected to be next year.

The allocations to the rainy day fund would have no impact on the general government balance as they are classified as a financial transaction. However, Government has decided to increase capital expenditure by €0.5 billion in each of 2019, 2020 and 2021, in order to increase cumulative capital expenditure by €1.5 billion over the period. In gross voted capital terms, this will increase the total available for 2018 to 2021 from €25.3 billion to €26.8 billion. As a result, gross voted capital of nearly €7.8 billion in 2021 will be 85 per cent higher than the outturn of €4.2 billion in 2016.

Notwithstanding this increase, the MTO will be maintained in 2019 and subsequent years. In turn, the contingency reserve/rainy day fund allocation will be reduced to €500 million per annum, down from €1.0 billion per annum originally planned.

Table 5: Budgetary Projections 2016-2021

€ million	2016	2017	2018	2019	2020	2021
CURRENT BUDGET						
Expenditure						
Gross Voted Current	51,770	53,530	54,755	56,110	57,560	59,000
Non-Voted (Central Fund)*	9,575	9,405	9,815	9,615	9,575	8,840
Gross Current Expenditure	**61,345**	**62,935**	**64,570**	**65,725**	**67,135**	**67,840**
less A-in-A's# and Balances	11,720	11,850	11,920	11,985	12,080	12,170
Net Current Expenditure	**49,620**	**51,090**	**52,650**	**53,740**	**55,055**	**55,675**
Receipts						
Tax Revenue	47,865	50,620	53,540	56,385	59,125	61,995
Non-Tax Revenue	3,105	2,790	2,060	1,670	1,635	1,470
Net Current Revenue	**50,970**	**53,410**	**55,600**	**58,060**	**60,760**	**63,465**
CURRENT BUDGET BALANCE	**1,345**	**2,320**	**2,950**	**4,320**	**5,705**	**7,790**
CAPITAL BUDGET						
Expenditure						
Gross Voted Capital	4,215	4,540	5,295	6,570	7,175	7,785
Non-Voted Capital (Central Fund)*	1,140	1,100	1,110	1,100	1,100	1,100
Gross Capital Expenditure	**5,355**	**5,645**	**6,405**	**7,670**	**8,275**	**8,885**
less A-in-A's#	275	255	270	270	270	270
Net Capital Expenditure	**5,080**	**5,385**	**6,135**	**7,400**	**8,005**	**8,615**
Capital Resources	**2,720**	**4,450**	**960**	**1,240**	**950**	**960**
CAPITAL BUDGET BALANCE	**-2,360**	**-940**	**-5,180**	**-6,165**	**-7,055**	**-7,655**
Contingency Reserve / RDF**	0	0	0	500	500	500
EXCHEQUER BALANCE	**-1,015**	**1,385**	**-2,225**	**-2,345**	**-1,850**	**-365**
GEN GOVT BALANCE (GGB)	**-1,525**	**-1,210**	**-355**	**-175**	**1,300**	**2,810**
GGB % of GDP	**-0.6**	**-0.4**	**-0.1**	**-0.1**	**0.4**	**0.8**
Structural Balance % of potential GDP~	**-1.4**	**-1.2**	**-0.5**	**-0.3**	**0.2**	**0.8**
Structural Effort (pp)	**0.5**	**0.3**	**0.6**	**0.2**	**0.6**	**0.6**
GG debt % of GDP	**75.4**	**72.7**	**70.6**	**68.5**	**64.3**	**62.1**
GDP nominal €billions^	**265.8**	**280.6**	**294.7**	**308.2**	**321.6**	**335.1**

Source: Department of Finance
Figures are rounded to the nearest €5 million, which may affect totals.
Note: Fiscal forecasts are presented on an ex-post basis
* The Central Fund, provided for under the Constitution, is except where provided otherwise by law, the destination of all State revenues and the source of all Government spending.
# Appropriations-in-Aid have been re-estimated as €40 million higher from 2018 offsetting technical changes to Gross Current Expt.
** This does not reflect the indicative fiscal space available pending decisions regarding the Rainy Day Fund / Contingency Reserve. See Annex 1 – Deviation in year t € bn.

Chapter 4
Public Expenditure Strategy

As part of the *Programme for a Partnership Government*, the Government has emphasised the need for the continuation of a prudent and responsible approach to expenditure policy. This has become even more important following the UK's decision to trigger article 50 and exit the EU. However, the continued strong performance of the economy underpins real increases in public spending on a fiscally sustainable basis to deliver both on economic priorities and also on the social goals for a fairer and more inclusive society. Indeed, continued economic growth and competitiveness depends on continued investment in both physical and social capital.

This chapter discusses how significant, targeted investment in key public services and infrastructure can be made in a manner fully consistent with respecting the parameters within the preventive arm of the Stability and Growth Pact. This chapter, therefore, briefly discusses expenditure priorities in this context and reflects the redistributive and growth-enhancing objectives of public spending. In addition, it highlights the requirement for continued emphasis on the effectiveness and impact of existing spending which will be examined as part of the Spending Review 2017 and the Review of the Capital Plan.

4.1 Context for Public Expenditure

Fiscal policy has shifted dramatically throughout the last number of years in Ireland. Following the boom-bust cycle that characterised the first 15 years of this century, Ireland has now returned to a place where it is possible to increase expenditure in a balanced and sustainable fashion.

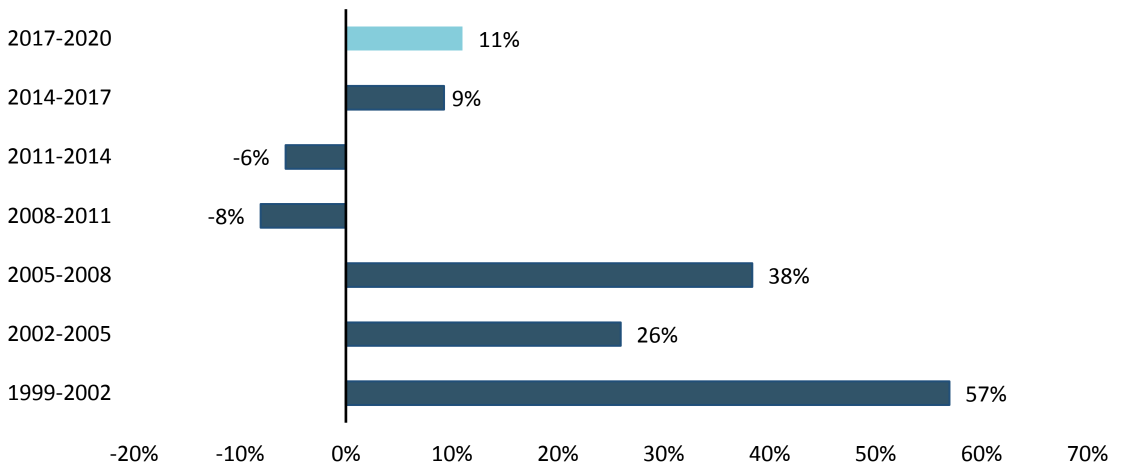
In the early years of this century, expenditure growth was consistently very high, with the typical expenditure growth rates greater than 10 per cent per annum between 2000 and 2008. Over these years, there was an unprecedented increase in total gross voted expenditure from €26 billion in 2000 to €62 billion in 2008, on the basis of unsustainable growth in tax revenues fuelled by the economic boom. The conduct of fiscal policy over that period played a major role in Ireland's subsequent economic and fiscal collapse.

Following this, between 2009 and 2014, gross voted expenditure decreased by €9 billion as successive Governments sought to bring the public finances under control against the backdrop of a severe national and international recession. It was essential to secure sustainable public finances to successfully exit the EU-IMF Programme and re-establish market access. In total, €30 billion of consolidation measures were implemented over the period with expenditure accounting for two-thirds of the overall adjustment.

In implementing expenditure reductions, the priority was to adopt a targeted approach in order to safeguard key public services and social supports, including support for the unemployed, to the greatest extent possible at a time of significantly increased demand. A detailed analysis of the policy decisions taken during the consolidation period in the context of increasing demand for public services and social services is included in a paper published on the IGEES website.[11]

From 2015 onwards, against the backdrop of a sustained improvement in economic conditions, and in recognition of the need for increased public services and public investment, expenditure has increased by an average of 3 per cent annually. This Government has committed to continue following a sustainable path for increases to services and investment, to ensure the long-term sustainability of Ireland's public finances and to ensure compliance with Ireland's obligations under the Stability and Growth Pact. The projected level of expenditure growth over the next three years on this basis is illustrated in the figure below, at 11 per cent or 3.5 per cent per annum.

Figure 6: Gross Voted Expenditure: Three-Year Growth Intervals



Source: Department of Public Expenditure and Reform

However, significant expenditure challenges remain that have the potential to jeopardise the maintenance of fiscal stability. As the economic recovery continues and the economy performs strongly, there are considerable expenditure pressures and strong expectations for higher levels of public spending. The pressure to rapidly increase public investment, notwithstanding emerging capacity issues, to fully unwind the FEMPI pay measures and to meet the increasing demographic costs will have to be managed whilst also complying with our obligations under the Stability and Growth Pact and the Fiscal Responsibility Acts 2012 and 2013. This is especially pertinent in the context of external challenges to be faced though the UK's decision to leave the EU.

An ongoing, systematic, programme of assessment and evaluation of how we spend public funds is, therefore, essential to ensure that limited resources provide much needed public services and social infrastructure. This has commenced in 2017 through the initiation of the

[11] R. Scott and Bedogni, J; *Fiscal Consolidation 2008-2014: The Irish Experience*; IGEES, 2017. http://igees.gov.ie/the-irish-experience-fiscal-consolidation-2008-2014/

Spending Review process. This 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 Expenditure Strategy

The continuing reforms to the budgetary process and frequent reviews of expenditure aim to broaden the dialogue and encourage real debate on expenditure priorities in an environment of constrained resources in light of Ireland's obligations under the Stability and Growth Pact. Given the scale of the available expenditure envelope within the fiscal rules, there is a continuing need for a strong focus on prioritisation of Government expenditure both in the short- and medium-term.

The Programme for a Partnership Government commits to building a strong economy while delivering a fair society and restoring much needed social infrastructure. These goals are, in principle, mutually reinforcing, with sustainable growth required for continued public service delivery and well directed public service and investment initiatives supporting a strong economy. The challenge is to ensure that, in practice, all expenditure decisions and ongoing expenditure programmes are based on clear objectives and deliver clear value-for-money in terms of their impact and efficiency.

The following sections of this Chapter discuss the reforms to the budgetary process and some of the key areas of expenditure policy over the short- to medium-term.

Spending Review 2017

The Spending Review for 2017, referred to above, commenced in January this year. In contrast to the Comprehensive Reviews of Expenditure undertaken in 2011 and 2014, this year's Review is the first round of a three-year cycle that will take place annually up to 2019. The totality of day-to-day Departmental expenditure will be examined over this three-year Review cycle.

In addition to the changes in the structure of the review process, this year's Review differs in focus from earlier reviews. Recent reviews of expenditure, including the Special Group Report in 2009 and both Comprehensive Reviews of Expenditure, were conducted at a time when Ireland was about to enter, or already in, an Excessive Deficit Procedure (EDP) under the corrective arm of the Stability and Growth Pact (SGP). As Ireland is now in the preventive arm of the SGP, this year's review will take place against a different fiscal and economic landscape.

Moderate, sustainable expenditure growth is now planned over the medium-term, however the realisation of particular significant risks may clearly impact adversely on the Exchequer's capacity to continue to increase spending. As such, the purpose of the Spending Review is focused on prioritising between multiple demands rather than on the need to reduce overall public spending – as arose during the period of consolidation. This approach will continue to draw on the principles of sustainability, efficiency and effectiveness in examining public spending. Each of the areas being reviewed will be assessed by reference to these principles, as much as possible, with the findings and analysis reported in a suite of published Spending Review papers in due course.

The Spending Review 2017 papers will develop the evidence base to allow for a more complete comparison of existing expenditure policies and new proposals. The ongoing examination and re-prioritisation of funding is a key element of good public expenditure management. The expenditure review supports this re-prioritisation by systematically assessing expenditure and improving the evidential foundation for such funding changes.

It is intended that the main results of Spending Review 2017 will be published in advance of *Budget 2018*.

Capital Review 2017

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 citizens.

The expenditure allocations for capital investment decreased very significantly over the crisis period reflecting the need to restore the stability of the public finances.

The *Capital Plan "Building on Recovery"* of 2015, set out a €42 billion framework to address our priority capital needs up to 2021. In the Summer Economic Statement last year, this Government committed an additional €5.14 billion to the €42 billion *Capital Plan*.

Therefore, after an extended period of retrenchment in terms of public capital spending, there has been a concerted effort to prioritise increases for capital allocations, but in a focused manner through the development of the *Capital Plan*. For example, capital expenditure will have increased by 26 per cent in 2017 over the expenditure levels in 2014, this compares with an 8 per cent increase in current expenditure in the same time period.

Last year, €2.2 billion of the additional capital was allocated to the Government's initiatives aimed at tackling the housing crisis, as detailed in the *Action Plan on Housing and Homelessness*. Taking account of further allocations made in Budget 2017, there is approximately €2.65 billion in additional resources to be allocated over the 2018-2021 period.

The *Capital Plan* is now being reviewed to ensure that capital spending remains strictly aligned with national economic and social priorities, consistent with *Programme for Partnership Government* objectives. This includes examining how available capital funds can best be allocated to underpin sustainable medium-term economic growth and future growth potential.

As part of the review, a public consultation has also been undertaken and public capital investment proposals invited from Departments. These will be assessed with a view to making recommendations to Government in Q3 2017, to inform final decisions by Government on revised capital allocations. These will be announced in the context of Budget 2018, and feed into a longer term Capital Plan in support of the forthcoming National Planning Framework.

Budgetary Reform Process

In recent years, significant reforms have been implemented to Ireland's budgetary framework to embed sound expenditure management practice consistent with best international practice. These are intended to permit a more open budgetary process, allow stronger dialogue with the Dáil and facilitate the continued central role of Government in the development of expenditure proposals, consistent with the maintenance of stable and sustainable public finances.

The annual expenditure process now starts in June with a National Economic Dialogue to facilitate an open and inclusive exchange on the competing economic and social priorities facing Government, along with the publication of this Statement, which sets out the key parameters for the conduct of expenditure policy, alongside the Department of Finance's macroeconomic projections and assessment of the fiscal outlook and constraints over the medium term. Further developments in the reformed expenditure process include the Minister for Public Expenditure & Reform publishing a Mid-Year Expenditure Report. This presents the baseline for Departmental expenditure and provides the starting point for examination of expenditure priorities by the Oireachtas.

Finally, last year the Oireachtas Committee on Budgetary Oversight was established and work is underway this year to establish a Parliamentary Budget Office. These additional reforms will further improve the formulation, oversight and discussion of fiscal policy in Ireland and help enhance the quality of the public finances.

Management of Public Expenditure

The introduction of indicative multi-annual expenditure ceilings was a key element of the Medium-Term Expenditure Framework (MTEF), introduced by the Department of Public Expenditure and Reform in 2013. The introduction of these ceilings has provided greater clarity regarding the additional resources available to Departments over a three-year period in respect of, for example, expected demographic developments. This is intended to facilitate a more strategic approach to resource allocation by emphasising the prioritisation of key policy areas and services while operating within overall expenditure restrictions. Other important reforms introduced include Comprehensive Reviews of Expenditure (CREs), greater emphasis on tools to support evaluation such as the Public Spending Code, the establishment of the Irish Government Economic and Evaluation Service (IGEES) and performance budgeting initiative. As discussed above, a new Spending Review for 2017 is currently underway which will support the delivery of the Estimates 2018 process.

The implementation of the Ministerial Expenditure Ceilings should be considered in the wider context of meeting key fiscal targets, while managing emerging expenditure pressures (e.g. demographics) and Government priorities. The MTEF has been an important mechanism in ensuring compliance with the prevailing fiscal requirements and, given the recent elimination of Ireland's excessive deficit, in this it has been effective. The current fiscal environment, 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. These issues were discussed in detail in chapter 3 of the Mid-Year Expenditure Report 2016.

As evidenced by the moderate, prudent and sustainable increases in public expenditure over recent years, the introduction of expenditure ceilings – as part of a series of reforms introduced in the Medium-Term Expenditure Framework (MTEF) – has been a major innovation in strengthening expenditure control playing a major role in restoring the stability of the public finances.

4.3 Public Sector Reform

Over the last six years, Public Service Reform has played a key role in Ireland's economic recovery. The current phase of Public Service Reform came to a close in 2016 and a Final Progress Report on this phase is currently being prepared. Reform remains a key priority for this Government and the Department of Public Expenditure and Reform is now preparing for a new Public Service Reform Framework for 2020 to be published later this year.

The first Public Service Reform Plan was published in November 2011. With fiscal adjustment the key driver at the time the focus of that plan was mainly of efficiency and cost containment. The second Public Service Reform Plan which covered the period 2014-2016 maintained a focus on efficiency but had the overarching objective of better outcomes for stakeholders.

It is now time to move from a stage of reform to one of development and continuous improvement. The next phase of public service reform is being shaped with this vision in mind. The new framework will set out a series of actions to be delivered out to 2020 which will both build on the achievements of the last six years and respond to new challenges.

The framework will be structured to support two overarching goals:

- To provide better outcomes for the public; and
- To build resilient and agile public service organisations.

The new reform programme aims to build a stronger link between expenditure and reform in bringing about better public service delivery, including digital delivery, driving innovation and building capability in our organisations and people.

Today's uncertain and unpredictable external environment poses significant challenges for Ireland. We need a robust and agile public service which contributes to our economic development, ensures delivery of quality services and allows Ireland to compete and thrive in a time of accelerating change. The new Framework will focus primarily on our customers – the Irish public. It will focus on enabling better delivery and engagement using new tools such as increased digitisation and better data-sharing. Implementation of the new Framework will result in a more effective and efficient public service, this is crucial for the management of the public finances and for job creation.

Preparation of the Framework has involved a wide-ranging process of engagement with representatives from across the civil and public service. This included the Reform and Innovation Network, the Senior Officials Group on Social Policy and Public Service Reform, external experts and academics on public administration, and the OECD. Significantly, the OECD were commissioned to conduct a review on the impact of the 2014-16 Public Service Reform Plan with a view to building on past experience and informing future plans. This OECD review will be launched in mid-July alongside a public consultation on the new framework.

In tandem with the development of the new framework, work is also continuing on implementing the comprehensive programme of reform under the Civil Service Renewal Plan and other sectoral reform programmes.

4.4 Other Sectoral Issues

The Labour Market

The period 2012 to Q1 2017 has been characterised by continuous improvements in the labour market. Unemployment, as measured by the Quarterly National Household Survey (QNHS), has fallen 55 per cent from Q1 2012 to Q1 2017. This has been accompanied by a 38 per cent reduction in the number of people on the Live Register. The long-term unemployed cohort also declined significantly, falling by 61 per cent over the same period. This decline in unemployment has been accompanied by an increase in employment with growth of over 230,000 or 13 per cent since the low-point in 2012.

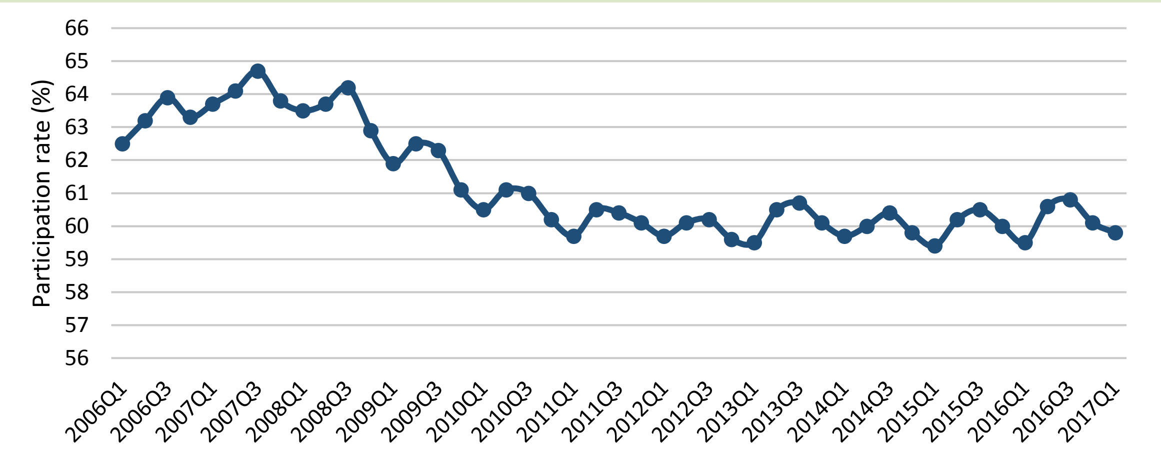
As the recovery period becomes more established, the policy environment must adapt to the evolving employment challenge of supporting greater labour force participation. A discussion of the labour force participation challenge is discussed in Box 6.

Box 6: The labour force participation challenge and the policy response to this challenge

The Participation Challenge

Ireland's participation rate declined over the period 2007 to 2012 falling from 63 per cent to 60 per cent and it has remained broadly stable at 2012 levels over the recovery period. At end Q1 2017, there were 2.19 million people in the labour force, which represents a labour force participation rate (LFPR) of 59.8 per cent (CSO, ILO participation rate). The number of non-participants in the labour force stands at 1.47 million.

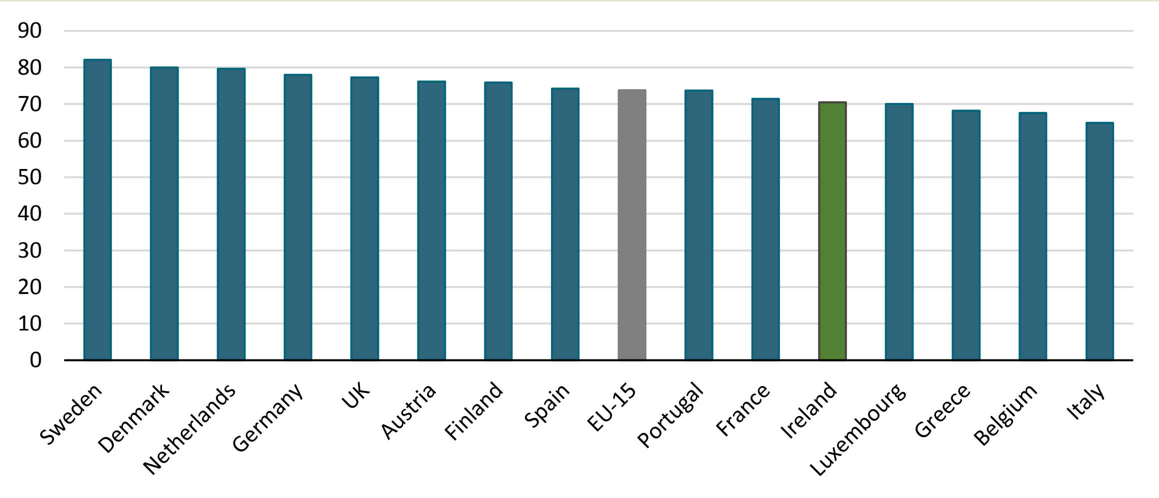
Labour Force Participation Rate (ILO definition 15-74 yrs.), 2006 Q1 - 2017 Q1



Source: QNHS

As the figure below illustrates, Irish participation rates for the 15-64 year cohort were 3.3 percentage points below the EU-average in 2016 (see figure 2). When the youth cohort (less than 25 years) is excluded for 2016, Ireland remains below the EU average for both male and female labour force participation.

International Comparison of Participation Rates, 15-64 years, 2016



Source: Eurostat

In order to address this decline in participation within a constantly evolving labour market, policy must be focused on:

- **The short- to medium-term challeng**e: Improving labour force participation by encouraging discouraged workers to return to the labour market. This can be achieved by continuing to support employment transitions, in particular through the case management and activation system.

- **The longer-term challenge:** Boosting labour force participation both in terms of the current stock of people outside the labour force and ensuring others, especially among the youth cohort, do not flow into inactivity. Reforms should be focused on removing the multitude of employment barriers faced by those furthest from the labour market.

The Policy Response - Labour Market Activation

In terms of activation policy, there has been significant developments over the past six years including the:

- expansion of training and employment supports;

- establishment of the Intreo office network;

- rollout of additional case management capacity in the form of the privately provided JobPath model; and implementation of other policies in the area of housing supports and childcare to address other barriers to employment.

Peak levels of investment of the order of €1.1 billion was reached in 2015. However with improvements in labour market conditions and the Live Register, demand for places on employment support schemes is now falling. This presents an opportunity for greater targeting of supports for those furthest from the labour market.

The direction of future policy is guided by a number of strategies, including:

- The publication of *Pathways to Work 2016-2020* reflects the next steps in guiding activation policy in a recovered and evolving labour market;
- A *Comprehensive Employment Strategy for People with Disabilities* sets out a roadmap to ensure people with disabilities, who are able to, and want to work are supported and enabled to do so; and
- An *Action Plan for Jobless Households* to be launched by Government in the coming months.

(i) Pathways to Work 2016-2020

Labour market policy is guided by the Pathways to Work Strategy, which seeks to ensure that as many jobs as possible go to people on the Live Register. The latest Strategy reflects the changed labour market context with the primary purpose of activation policies now to support the filling of vacancies as quickly as possible; and to increase active labour market participation of all working-age people.

Over the next few years therefore, the aim of the Strategy is to deliver enhanced engagement with jobseekers, develop closer links with employers, and ensure that positive incentives are in place for people to take-up job opportunities. In addition, the scope of activation services will expand beyond jobseekers with the aim of boosting participation in the labour market for other groups such as people with disabilities and lone parents.

(ii) Comprehensive Employment Strategy for People with Disabilities

The Government's Strategy was launched in 2015 to address the underrepresentation of people with disabilities in the labour force. It provides a cross-government approach focusing on actions by different Departments and State Agencies in a concerted effort to address the barriers and challenges impacting on the employment of people with disabilities.

(iii) Action Plan for Jobless Households

The Department of Social Protection is currently finalising an Action Plan for Jobless Households. The aim of this Action Plan is to bring together a range of measures to help tackle the multitude of barriers to employment faced by different cohorts of the labour force. The headline actions include:

1. Extension of proactive engagement services to non-jobseekers (groups of inactive working-age adults);
2. Improving incentives and removing barriers for people transitioning from welfare to employment including through the rollout of the Housing Assistance Payment and the Single Affordable Childcare Scheme.

Health

The provision of quality healthcare is a key Government priority and this has been reflected in budgetary policy over the last three years, with Health expenditure increasing by 14 per cent since 2014 (this is against 9 per cent growth in overall expenditure in the same period). The Government has committed to annual increases in the health budget to improve access to safe and timely care, through a focus on developing an enhanced primary care system. Furthermore, the Government will also continue to manage medicine costs to provide budget sustainability and provide continuity of supply of essential medicines.

This level of increased investment has brought funding for the health service to the highest ever level. On a per capita basis, we are today spending around 5% more on healthcare than in 2009. At the end of 2013 the number of whole-time equivalents (WTEs) employed by the HSE was 97,001. This number had increased by over 11,200 or 11 per cent to 108,224. Of these new recruits, approximately 10,000 or 90 per cent, are additional frontline staff, including 1,426 doctors and 2,267 nurses.

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 meeting the health needs of the population and the sustainability of the public finances. In this context a key issue is management and reconfiguration of resources to ensure the effective delivery of services within the available resources.

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.

Rebuilding Ireland – An Action Plan for Housing and Homelessness was launched in July 2016 with the objective of ensuring that everyone can access a home either on their own or with appropriate State support. The plan comprises five pillars of concerted actions right across Government – addressing homelessness, accelerating social housing, building more homes, improving the rental sector and utilising existing housing.

Supported by Exchequer funding of €5.35 billion over the period 2016-2021, the range of actions being progressed through Rebuilding Ireland will contribute to the increased supply of homes across all tenures and will create the conditions required for the restoration of a more sustainable and normally functioning housing market.

The need to increase housing supply was the main challenge facing the housing sector following the economic crisis. Measures under the plan will facilitate an increase in the supply of housing to 25,000 houses or more annually to meet housing needs. From 12,666 units in 2015 , the supply of housing reached just under 15,000 in 2016 and is forecast to increase around 18,500 this year and to between 20,000 and 21,000 units in 2018.

Funding of €226 million under the Local Infrastructure Housing Activation Fund measure approved in March 2017 for 34 key projects will provide enabling public infrastructure works to facilitate the delivery of some 20,000 private housing units on these sites by 2021, with potential for up to 70,000 homes by 2027.

The Plan will deliver 47,000 social housing units over the period 2016 to 2021. It is estimated that over 26,000 units will be delivered via construction, while 11,000 will be acquired by local authorities and approved housing bodies directly from the market or the Housing Agency, with a portion of these being newly built units. The remaining 10,000 units will be leased by local authorities and approved housing bodies.

Social housing needs will be addressed through a combination of new builds, the return of vacant houses to the stock and measures such as the Housing Assistance Payment which enables households in need of housing to secure accommodation in the private rented market. In 2016, just over 19,000 households had their social housing needs met and it is expected that 21,000 households will be housed this year.

Public Service Pay Bill

There are two core drivers of the public service pay bill: the numbers of public servants employed and the rates at which they are remunerated. Expenditure pressures exist with respect to both.

On the numbers side, enhanced public services have a staffing component: extra nurses, doctors, special needs assistants, teachers and Gardaí in terms of frontline public service provision. Filling the gaps left by the recruitment moratorium reduces the strain on frontline services, and public servants, enhancing the capacity to improve service delivery. Since the end of the moratorium in 2015, public service numbers have grown by more than 3 per cent per year on average, equating to an annual increase of circa 8,000 per year and adding an additional €0.4 billion to the pay bill. Going forward, more modest growth of 1 per cent per annum in numbers (inclusive of demographics) is likely to be the maximum affordable. *The Revised Estimates Volume 2017* has provision for circa 315,000 public servants (full-time equivalents).

On the rates side, public service unions seek the reversal of the pay cuts over the crisis period, a critical component of the budgetary consolidation imposed during the financial emergency, in line with the economic recovery.

Already included in the expenditure ceilings in 2018 are amounts for additional staff in the health and education sectors to deal with demographics (€0.12 billion) and an agreed amount of €0.3 billion for pay increases as part of the Lansdowne Road Agreement.

However, these twin demands of numbers and rates must be balanced with the other Government expenditure priorities such as housing, childcare, pensions, enterprise supports and infrastructure. Therefore, strong planning and monitoring of the pay bill is required to ensure that increases are proportionate, appropriate and sustainable.

Given this context, from the Government's perspective there were a number of key objectives in the negotiations with public service unions and staff representative associations in order to secure agreement on an extension of the Lansdowne Road Agreement. These objectives were to, (i) Secure a public service pay agreement that is fair, fiscally sustainable and provides certainty and industrial peace in the public service for three years out to 2020, (ii) Provide a programme to exit the FEMPI legislation as it impacts on remuneration of public servants (iii) Provide for an additional permanent Superannuation Contribution of €550m from public servants towards securing the sustainability of public service pensions now and into the future and (iv) Enable the continued provision of the improved productivity provisions (principally additional hours) provided by previous Agreements out to 2020.

Following detailed and complex negotiations, facilitated by the Workplace Relations Commission, the terms of a proposed Agreement were commended to the parties by the Workplace Relations Commission. Having met the Government's key objectives the proposed Agreement has been approved by Government and is now subject to ratification by the Unions and Associations representing public servants. The proposed agreement would run from 2018 to 2020 and has a cost over that period of €887 million. The Agreement provides for pay increases of between 7.4% and 6.2% to different income groups over three years through salary increases and raising the threshold for the Pension Related Deduction.

Annex 1

Table A1: Assessment of Expenditure Benchmark

€ billions unless otherwise stated	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Fiscal Developments						
1. General Government Expenditure	74.6	76.4	78.4	81.0	82.9	84.6
2. Interest Expenditure	6.2	6.0	6.0	5.8	5.6	5.3
3. Expenditure co-financed by EU	0.4	0.5	0.6	0.6	0.6	0.7
4. Gross Fixed Capital Formation (GFCF)	4.9	5.3	6.0	7.2	7.5	7.9
5. Annual Average GFCF (t-3 to t)	4.2	4.7	5.1	5.8	6.5	7.1
6. Cyclical Unemployment Expenditure	-0.1	-0.3	-0.1	0.0	0.0	0.0
7. Discretionary Revenue Measures (DRM)	-0.8	0.0	0.1	-0.1	-0.2	-0.3
8. Corrected Expenditure Aggregate [1-2-3-(4-5)-6]	67.4	69.5	71.2	73.2	75.7	77.9
9. Corrected Expenditure Aggregate net of DRMs [7-8]	68.2	69.6	71.1	73.4	75.9	78.2
Macro-Economic Developments[1]						
10. Net Public Expenditure Annual Growth % [100*(9-8)/8]	0.5	3.1	2.3	3.1	3.6	3.4
11. GDP Deflator (% change)	1.7	1.2	1.3	1.5	1.7	1.7
12. Expenditure Aggregate, Annual Growth in % (real) [100*((1+10/100)/(1+12/100)-1)]	-1.2	1.9	1.0	1.6	1.9	1.7
13. Expenditure Benchmark growth rate (Reference rate - convergence margin)	0.0	1.3	1.2	3.6	3.5	3.4
Deviation in year t €bn (Negative = breach of EB) [8*(12-13)/100]	**0.8**	**-0.5**	**0.1**	**1.4**	**1.2**	**1.3**
Nominal GDP	265.8	280.6	294.7	308.2	321.6	335.1
Deviation in year t %GDP (Negative = breach of EB)	0.3	-0.2	0.0	0.5	0.4	0.4
Average deviation in t-1 and t % of GDP		0.1	-0.1	0.2	0.4	0.4

Note: Rounding may affect totals.
1. Reference rate values from 2017 onwards using an interpolated linear average for 2015 (not the 25 per cent potential growth figure for 2015).

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