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Analysis of the Draft Budgetary Plan of Ireland

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Ireland

{C(2020) 8509 final}

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EXECUTIVE SUMMARY

- After expanding by 5.6% in 2019, economic activity is forecast to contract by 2.4% in 2020 according to the Draft Budgetary Plan and by 2.3% according to the Commission 2020 autumn forecast. For 2021, the Draft Budgetary Plan projects real GDP to expand by 1.7%. In turn, the Commission projects GDP to grow by 2.9% in 2021.
- The Draft Budgetary Plan projects a general government deficit of 6.2% of GDP in 2020 and 5.7% in 2021. According to the Commission forecast, the government deficit is projected at 6.8% of GDP in 2020 and 5.8% in 2021. For the time being, since the submission of the Recovery and Resilience Plan and its subsequent approval are only expected to take place in 2021, the Commission forecast includes only 10% pre-financing of Recovery and Resilience Facility grants in the budgetary projections for 2021 and treats them as a financial transaction with no impact on the budget balance, but with a public debt-reducing impact. In the case of Ireland, the 10% pre-financing of Recovery and Resilience Facility grants is equivalent to EUR 138 million.
- On 20 May 2020, the Commission adopted a report under Article 126(3) TFEU analysing whether Ireland was compliant with the deficit criterion of the Treaty. Overall, the analysis suggested that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 was not fulfilled. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.
- Deficit-increasing measures adopted in 2020 to fight the pandemic and to cushion its adverse socio-economic effects amount to around 5.2% of GDP. They include extraordinary healthcare expenditure, wage subsidies to protect jobs, welfare payments, and supports for businesses most affected. Further liquidity measures and public guarantees, aimed to support firms, amount to around 2.2% of GDP and do not have an immediate budgetary impact. Overall, the measures taken by Ireland in 2020 were in line with the guidelines of the Commission Communication of 30 March 2020 on a coordinated economic response to the COVID-19 outbreak.
- In 2021, the planned measures to support the recovery of economic activity amount to around 2.0% of GDP and they largely consist of the extended supports announced in 2020, mainly on the expenditure side. Furthermore, the Draft Budgetary Plan sets aside a contingency reserve of 0.6% of GDP for additional expenditure that may arise next year in relation to the pandemic and a recovery fund of 0.9% of GDP for additional revenue and expenditure measures to address evolving challenges from both the pandemic and a change in EU-UK trading relations. Together, these measures amount to around 3.5% of GDP.
- General government debt stood at 57.4% of GDP at the end of 2019. According to the Draft Budgetary Plan, the public debt-to-GDP ratio is

projected to reach 62.6% in 2020 and to further increase to 66.6% in 2021. In its autumn forecast, the Commission projects the public debt-to-GDP ratio to reach 63.1% in 2020 and 66.0% in 2021.

- Overall, most of the measures set out in the Draft Budgetary Plan of Ireland are supporting economic activity against the background of considerable uncertainty. At the same time, it would be useful to regularly review the effectiveness of the support measures and stand ready to adapt them as necessary to changing circumstances.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2021 Draft Budgetary Plan of Ireland (hereafter called the Plan), which was submitted on 15 October 2020 in compliance with Regulation (EU) No 473/2013.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact and on 23 March 2020 the Ministers of Finance of the EU Member States agreed with the Commission assessment. The clause facilitates the coordination of budgetary policies in times of severe economic downturn. As indicated in the Annual Sustainable Growth Strategy 2021[1] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance[2], the activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective of each Member State, which should continue to provide targeted and temporary fiscal support in 2021, provided that this does not endanger fiscal sustainability in the medium term. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Public finances in 2021 are also expected to be influenced by the proposed establishment of the Recovery and Resilience Facility (RRF), alongside the proposal for the reinforced long-term budget of the EU for 2021-2027. RRF is envisaged to provide a total envelope of EUR 672.5 billion in loans and non-repayable financial support (grants) to support the implementation of investments and reforms in the EU Member States. The 2021 Draft Budgetary Plan of Ireland does not take into account the implementation of the reforms and investments, and their associated costs, envisaged under the RRF.

On 20 May 2020, the Commission issued a report under Article 126(3) TFEU, as Ireland's general government deficit in 2020 was planned to exceed the 3% of GDP Treaty reference value. The report concluded that, after the assessment of all

[1] Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

[2] https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en

relevant factors, the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 was not fulfilled. In the context of the activation of the General Escape Clause, and in light of the exceptional uncertainty, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

As the debt ratio is projected to be 63.1% of GDP at the end of 2020, exceeding the 60% of GDP reference value of the Treaty, Ireland also needs to comply with the debt reduction benchmark.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The Irish economy has been deeply impacted by the COVID-19 pandemic. To contain it, the government introduced national lockdown measures in mid-March, which lasted until around mid-May. The lockdown and the ensuing health protocols after the lifting of restrictions have had a large impact on economic activity. After expanding by 5.6% in 2019, the Plan forecasts a GDP contraction of 2.4% in 2020. This amounts to an 8.1 percentage points upward revision to GDP growth compared to the 2020 Stability Programme for Ireland. For 2021, the Plan projects real GDP to expand by 1.7%. The macroeconomic and fiscal outlook continue to be affected by high uncertainty due to the COVID-19 pandemic.

According to the Plan, the abrupt drop in economic activity over the first two quarters of 2020 is set to be followed by a recovery in the third quarter that remains fragile, bypassing some sectors. Early indicators signal that private consumption increased sizeably over the summer as customers rushed to satisfy pent-up demand but it appears to have stabilised at a lower “new normal” since autumn. In turn, investment contracted sharply in the first half of 2020 and is projected to continue falling in the second half of the year as the recovery in construction is expected to be more than offset by falls in machinery, equipment and other investments. In 2021, the Draft Budgetary Plan expects the Irish economy to grow relatively modestly as it faces twin shocks – the pandemic and the absence of a free trade agreement with the UK in 2021. The government has implemented several discretionary fiscal measures to cushion the impact of the pandemic on the economy, to protect households and businesses most affected (see Section 4).

This scenario is fairly similar to the Commission forecast for 2020 but more pessimistic for 2021. According to the Commission forecast, GDP is projected to decline by 2.3% in 2020, before rebounding by 2.9% in 2021. Private consumption and investment are projected to lead the recovery in 2021, while the Plan envisages weaker growth of consumption and a further large contraction in investment. Linked to this, the Commission expects net exports to weigh on growth in 2021, while the Plan reflects an expectation of a positive contribution from net exports.

The macroeconomic outlook for Ireland is subject to downside risks due to the end of the transition period between the EU and the UK, with trade between them assumed to take place on WTO Most Favoured Nation terms as of 2021.

In its opinion, the Irish Fiscal Advisory Council endorsed the set of macroeconomic projections prepared by the Department of Finance for Budget 2021 covering the years 2020 and 2021 as falling within the range of appropriate forecasts[3]. It stressed this endorsement comes as the Irish economy faces on-going aforementioned challenges, hence there is very high uncertainty around any set of economic forecasts.

Table 1. Comparison of macroeconomic developments and forecasts

	2019	2020			2021		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	5.6	-10.5	-2.4	-2.3	6.0	1.7	2.9
Private consumption (% change)	3.2	-14.2	-7.5	-8.1	8.7	7.0	11.1
Gross fixed capital formation (% change)	74.9	-55.8	-39.9	-41.3	8.3	-25.7	15.3
Exports of goods and services (% change)	10.5	-7.7	1.9	0.7	7.5	1.0	1.7
Imports of goods and services (% change)	32.4	-24.1	-12.5	-14.1	8.2	-5.6	6.6
Contributions to real GDP growth:							
- Final domestic demand	22.9	-27.9	-19.1	-19.6	4.1	-5.3	7.2
- Change in inventories	0.1	0.0	0.0	0.4	0.0	0.0	0.0
- Net exports	-17.5	17.4	16.7	16.9	2.0	7.0	-4.3
Output gap[1]	1.9	-8.9	-1.0	-2.5	-4.8	-0.4	-1.9
Employment (% change)	2.9	-9.3	-13.7	-0.4	5.5	7.6	-3.6
Unemployment rate (%)	5.0	13.9	15.9	5.3	9.7	10.3	8.9
Labour productivity (% change)	2.6	-1.3	13.1	-1.9	0.6	-5.5	6.8
HICP inflation (%)	0.9	-0.6	-0.3	-0.5	0.4	0.4	0.3
GDP deflator (% change)	3.1	1.2	0.6	0.5	1.5	0.9	1.7
Comp. of employees (per head, % change)	3.5	-7.6	2.9	2.3	3.8	1.2	3.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-21.2	10.6	5.2	3.1	11.1	10.7	-1.2

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

On 20 July 2020 the Council addressed recommendations to Ireland in the context of the European Semester. In the area of public finances *and in line with the general escape clause*, the Council recommended Ireland to take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery, when economic conditions allow, Ireland should pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

3.1. Deficit developments

The Plan projects a headline deficit of 6.2% of GDP in 2020, a downward revision with respect to the Stability Programme of May 2020, where the deficit was planned at 7.4% of GDP. Around +0.8 percentage points of the revision in the government

[3] https://www.fiscalcouncil.ie/wp-content/uploads/2020/09/Endorsement-Letter-September-2020.pdf

balance are explained by a less severe economic contraction than expected in spring, largely influenced by the activities of multinational companies operating in Ireland. Around +3.3 percentage points are explained by higher-than-assumed revenue, whereas -2.9 percentage points are due to higher expenditure linked in particular to additional fiscal measures adopted by the government to cushion the impact of the pandemic on the economy. The Commission forecast projects a higher deficit in 2020, of 6.8% of GDP. The difference is partly due to the Commission's projections incorporating the six-week national lockdown announced on 19 October, after the submission of the Plan.

On the expenditure side, the Commission forecast expects that the lockdown will translate into more people availing of the COVID-19 related welfare supports, which will increase the overall cost of these measures compared to the estimates in the Plan (see Section 4).

The revenue-to-GDP ratio is slightly lower in the Commission forecast. This is largely due to the Commission projecting a worse performance in indirect taxes, mainly in VAT receipts, closer to the developments recorded over the first half of the year. In addition, it embeds the six-week national lockdown that is expected to weigh on private consumption and in turn on VAT receipts. The lockdown is also expected to increase the cost of some COVID-19 related revenue measures, further dampening total revenue (see Section 4).

For 2021, the Plan projects a deficit of 5.7% of GDP, an upward revision of 1.6 percentage points with respect to the 2020 Stability Programme. This mainly reflects additional government support against the backdrop of the ongoing pandemic as well as the assumption of a WTO Most Favoured Nation-based trading relationship between the EU and the UK from January 2021. The Plan does not include any revenue from or expenditure under the Recovery and Resilience Facility.

The Commission projects a similar headline deficit-to-GDP ratio of 5.8% in 2021. However, while the government balance is expected to be worse than in the Plan this is somewhat masked by a higher denominator (nominal GDP) in the Commission forecast (see Section 2).

The revenue-to-GDP ratio in 2021 is lower in the Commission forecast by 0.6 percentage points than in the Plan. This reflects both lower revenues – largely due to the 2020 base effect – and a higher denominator in the Commission forecast.

The expenditure-to-GDP ratio in 2021 declines in the Commission forecast while it remains stable in the projections of the Plan. However, both projections envisage the level of government expenditure to increase in 2021 compared to the previous year. The ratio's fall in the Commission forecast is solely due to the denominator effect. This is also the case for most of the expenditure categories when they are presented as a share of GDP in Table 2.

For the time being, since the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place in 2021, the Commission forecast assumes, in its budgetary projection for 2021, the 10% pre-financing of

Recovery and Resilience Facility grants[4] as a financial transaction with no impact on the budget balance in 2021, but with a public debt-reducing impact. In the case of Ireland, the 10% pre-financing of Recovery and Resilience Facility grants is equivalent to EUR 138 million. On the expenditure side, in line with its no-policy change assumption, the Commission forecast includes no expenditure related to the Recovery and Resilience Facility, as the corresponding measures were not sufficiently specified at the cut-off date of the forecast.[5] The evolution of the deficit in 2021 could turn out more favourable as a result of the higher growth from the implementation of measures financed by the Recovery and Resilience Facility.

[4] The amount of pre-financing is based on the Council Presidency compromise proposal for the RRF regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament.

[5] The treatment of the Recovery and Resilience Facility (RRF) in the Commission's 2020 autumn forecast is explained in detail in Box I.4.3 of the European Commission's Economic Forecast Autumn 2020 (https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en.pdf). The forecast only incorporates those measures that are credibly announced and sufficiently detailed in the Draft Budgetary Plans, irrespective of whether they are planned to be part of Recovery and Resilience Plans. No financing from the RRF has been included on the revenue side of the budgetary projections. Only the pre-financing of RRF grants is included in the forecast for 2021. The assumptions on expenditure measures linked to the RRF in the Commission forecast are without prejudice to the assessment of the Recovery and Resilience Plans.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2019		2020			2021			Change: 2019-2021
	COM	DBP	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**25.0**	**25.0**	**23.1**	***24.1***	**23.9**	**23.5**	***24.7***	**24.1**	**-0.3**
of which:									
- Taxes on production and	7.7	7.7	7.0	*7.1*	6.6	7.4	*7.2*	6.9	-0.5
- Current taxes on income,	10.3	10.3	10.0	*10.7*	10.8	10.0	*10.7*	10.7	0.4
- Capital taxes	0.1	0.1	0.1	*0.1*	0.2	0.1	*0.1*	0.2	0.0
- Social contributions	4.5	4.5	4.1	*4.0*	4.1	4.0	*4.3*	4.2	-0.2
- Other (residual)	2.4	2.4	1.9	*2.2*	2.1	2.0	*2.4*	2.1	0.0
Expenditure	**24.5**	**24.5**	**30.4**	**30.3**	**30.6**	**27.5**	**30.4**	**29.9**	**5.9**
of which:									
- Primary expenditure	23.3	23.3	29.1	29.2	29.5	26.4	29.4	28.9	6.1
of which:									
Compensation of employees	6.5	6.5	7.7	7.0	7.0	7.4	7.2	7.1	0.7
Intermediate consumption	3.5	3.5	4.5	4.8	4.6	4.0	4.1	4.4	0.6
Social payments	8.9	8.9	11.1	11.2	11.2	10.0	10.7	10.4	1.8
Subsidies	0.5	0.5	1.2	1.8	2.1	0.5	1.3	1.2	0.8
Gross fixed capital formation	2.3	2.3	2.8	2.6	2.6	2.7	2.7	2.7	0.4
Other (residual)	1.6	1.6	1.8	1.8	1.9	1.8	3.4	3.2	1.8
- Interest expenditure	1.3	1.3	1.3	1.1	1.1	1.1	1.0	1.0	-0.3
General government balance (GGB)	**0.5**	**0.5**	**-7.4**	**-6.2**	**-6.8**	**-4.1**	**-5.7**	**-5.8**	**-6.2**
Primary balance	**1.8**	**1.8**	**-6.1**	**-5.1**	**-5.7**	**-3.0**	**-4.7**	**-4.9**	**-6.5**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**0.5**	**0.5**	**-7.4**	**-6.2**	**-6.8**	**-4.1**	**-5.7**	**-5.8**	**-6.2**
Output gap[1]	1.9	3.3	-8.9	-1.0	-2.5	-4.8	-0.4	-1.9	-3.7
Cyclically-adjusted balance[1]	-0.5	-1.2	-2.8	-5.7	-5.4	-1.6	-5.5	-4.8	-4.3
Structural balance (SB)[2]	**-0.5**	**-1.2**	**-2.8**	**-5.7**	**-5.4**	**-1.6**	**-5.5**	**-4.8**	**-4.3**
Structural primary balance[2]	0.8	0.1	-1.5	-4.6	-4.3	-0.5	-4.5	-3.9	-4.5

Notes:

[1] Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/Programme as recalculated by Commission on the basis of the DBP/Programme scenario using the commonly agreed methodology.

[2] Structural (primary) balance corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

Risks to the fiscal outlook in both the Plan and the Commission forecast are tilted to the downside. They mainly relate to uncertainties surrounding the macroeconomic outlook, the final size of the fiscal expansion to counter the crisis and the future trade relationship between the EU and the UK. Further risks relate to possible changes in the international corporate taxation environment, the sustainability of the high level of corporate income tax receipts and the potential materialisation of the public guarantees issued in response to the crisis. The potential under-achievement of legally binding climate and renewable energy targets in 2020 could be a risk, as it would imply a financial cost.

The recalculated structural balance according to the data in the Plan[6] is expected to slightly improve in 2021 from the previous year, in line with Commission forecast. However, a mechanical reading of traditional indicators is not well suited at the current juncture to assessing the fiscal stance. The introduction and subsequent withdrawal of sizeable temporary emergency measures distort the picture, as the corresponding changes in the level of public spending from one year to the next affect the indicators used to assess the fiscal stance. Excluding the temporary emergency measures from the calculation of the fiscal stance indicators provides a more representative assessment of the underlying fiscal support to economic activity.[7]

The Plan includes an increase in the carbon tax by EUR 7.5 per ton of CO2 to EUR 33.5, which is expected to raise EUR 147 million in a full year (0.04% of GDP). The proceeds from this measure are expected to be ring-fenced for climate action measures.[8] Furthermore, the Finance Act 2020 provides a legislative basis to increase the tax each year by EUR 7.50 up to 2029 and by EUR 6.50 in 2030 to achieve a rate of EUR 100/t of CO2.[9]

3.2. Debt developments

The Plan estimates the general government debt-to-GDP ratio to increase by 5.2 percentage points in 2020 compared to the previous year, reaching 62.6%. The increase is driven by the negative primary government balance and the decline in the economic activity projected in 2020. Compared to the projections in the 2020 Stability Programme, the expected improvement in the debt-to-GDP ratio in 2020, by 6.5 percentage points, is primarily due to the denominator effect, as GDP growth is expected to be stronger than previously estimated (see Section 2). In addition, the primary balance was revised upwards compared with the 2020 Stability Programme. The stock-flow adjustments are expected to have a positive impact on the debt, as the government plans to use various resources to fund part of the deficit. These include cash reserves, surplus payments by the National Asset Management Agency and resources in the Rainy Day Fund, in total amounting to 2.1% of GDP. On the other hand, GDP is inflated by the activities of multinationals, overstating the actual strength of the domestic economy. Alternative metrics that control for the effects of multinationals' activities, such as the debt-to-modified GNI (GNI*)[10] ratio, which reached 95.6% in 2019, show that public debt remains very high in Ireland. On a

[6] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology. The estimates of the structural budget balance are affected by high uncertainty due to the economic consequences of the COVID-19 pandemic.

[7] The measure of the output gap is complicated in the face of a sharp economic turnaround and very high level of economic uncertainty.

[8] More details on these measures can be found in the report of Department of Public Expenditure and Reform (2020), "Budget 2021. The Use of Carbon Tax Funds 2021", October 2020, available at: https://www.gov.ie/en/publication/2d664-taxation-measures/

[9] Finance Bill 2020 available at : https://www.gov.ie/en/publication/3b879-finance-bill-2020/

[10] Modified Gross National Income (GNI*) reflects the income of Irish residents more accurately than GDP. It differs from actual GNI in that it excludes, *inter alia*, the depreciation of foreign-owned, but Irish resident, capital assets (notably intellectual property and assets associated with aircraft for leasing) and the undistributed profits of firms that have re-domiciled to Ireland.

GNI* basis, the Plan projects public debt to rise to 107.8% in 2020, an increase of 12.2 percentage points compared to last year.

Table 3. Debt developments

(% of GDP)	2019	2020			2021		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**57.4**	**69.1**	**62.6**	**63.1**	**68.4**	**66.6**	**66.0**
Change in the ratio	-5.6	11.7	5.2	5.7	-0.7	4.1	3.0
Contributions[2]:							
1. Primary balance	**-1.8**	**6.1**	**5.1**	**5.7**	**3.0**	**4.7**	**4.9**
2. "Snow-ball" effect	**-3.8**	**7.2**	**2.1**	**2.2**	**-3.7**	**-0.6**	**-1.8**
Of which:							
Interest expenditure	1.3	1.3	1.1	1.1	1.1	1.0	1.0
Real growth effect	-3.2	6.6	1.4	1.4	-3.9	-1.0	-1.8
Inflation effect	-1.8	-0.8	-0.4	-0.3	-1.0	-0.5	-1.0
3. Stock-flow adjustment	**0.0**	**-1.6**	**-2.0**	**-2.1**	**0.1**	**-0.1**	**0.0**
Of which:							
Cash/accruals difference		0.5	0.9		0.2	0.1	
Net accumulation of financial		-1.5	-2.9		-0.7	-0.1	
of which privatisation proceeds		0.0	0.0		0.0	0.0	
Valuation effect & residual		0.0	0.0		0.0	0.0	

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Stability Programme 2020 (SP); Draft Budgetary Plan for 2021 (DBP); Commission 2020 autumn forecast (COM); Commission calculations

In 2021, the Plan indicates that the government debt-to-GDP ratio will increase to 66.6%, due mainly to the projected negative primary balance. This is somewhat lower than projected in the 2020 Stability Programme mainly due to the upward revision in the GDP. However, the debt-to-GNI* ratio is projected to rise to 114.7% in 2021, an increase of 6.9 percentage points compared to the previous year.

The Commission forecast projects a broadly similar evolution for the debt ratio.

4. MEASURES UNDERPINNING THE DRAFT BUDGETARY PLAN

The Draft Budgetary Plan focuses on the policy response undertaken in the context of the COVID-19 outbreak in 2020 and the measures planned to sustain the recovery in 2021. Supportive fiscal measures should be tailored to the specific situation of each Member State, but as a rule, they should be well targeted and temporary. Their use and effectiveness should be regularly reviewed by the national authorities. Depending on the development of the pandemic, emergency fiscal measures should be adjusted and combined with other measures that improve economic fundamentals, support the green and digital transition and have a positive impact on demand.

4.1. Measures in 2020

In response to the COVID-19 pandemic, and as part of a coordinated Union approach, in 2020 Ireland adopted timely budgetary measures to increase the capacity of its health system, contain the pandemic, and provide relief to those individuals and businesses that have been particularly affected. According to the Plan, those measures have a direct budgetary cost of around 4.9% of GDP. They include income supports (3.0% of GDP) such as employment wage subsidy schemes aimed at preserving the link between the employer and employee (i.e. the Temporary Wage Subsidy Scheme and its successor, the Employment Wage Subsidy Scheme, that covers also seasonal and new hires) and COVID-19 related unemployment support (Pandemic Unemployment Benefit) for those who lost their job due to the pandemic; additional expenditure (0.6% of GDP) to increase the capacity and accessibility of the healthcare system; various supports for businesses particularly affected and allocations for government departments (1.3% of GDP), including a restart fund for micro and small enterprises, commercial rates write-offs, grants, a Covid Restrictions Support Scheme in the form of cash payments for businesses that had to close or significantly reduce trading, VAT rate reduction from 13.5% to 9% for the tourism and hospitality sector, six-month reduction in the standard rate of VAT from 23% to 21% and support for capital works and for the reopening of schools.

In addition, Ireland announced measures that, while not having any immediate direct impact on the deficit, contribute to providing liquidity support to businesses, of around 2.2% of GDP. Those measures include: debt warehousing for small and large businesses (0.6% of GDP); accelerated tax-loss relief for firms and self-employed (0.2% of GDP), which allows firms to bring forward (in 2020) loss relief that they would have been entitled to claim in 2021; a pandemic stabilisation and recovery fund (0.6% of GDP), which will make capital available to medium and large enterprises; various loan schemes and other repayable advances (0.3% of GDP) and credit guarantee schemes (0.6% of GDP with a cap of 0.5% of GDP). By 15 October 2020, the take-up of liquidity guarantees is estimated at around 1.3% (around 0.01% of GDP).[11]

Overall, the measures taken by Ireland in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

All of the above measures have been included in the Commission forecast. However, because the Commission forecast also incorporates the six-week national lockdown announced on 19 October, some measures have been estimated to have a higher cost in 2020 compared to the Plan (see Section 3). These relate to the welfare supports and the Covid Restrictions Support Scheme. Furthermore, the Commission forecast also includes increases to the income supports that were announced after

[11] The take-up refers to the Credit Guarantee Scheme of EUR 2 billion that has been introduced on the 7 September, for which the state provides 80% State guarantee on lending. Information on the take-up: https://www.oireachtas.ie/en/debates/question/2020-10-15/15/?highlight%5B0%5D=covid

the publication of the Draft Budgetary Plan. Overall, the additional cost linked to these changes is estimated at around 0.3% of GDP.[12]

4.2. Measures in 2021

For 2021, the Plan largely incorporates the extended COVID-19 related supports announced in 2020 and additional contingency funds, in total amounting to 3.5% of GDP.

Expenditure measures imply a budgetary impact of around 1.8% of GDP. They include an Employment Wage Subsidy Scheme, which encourages the retention of workers by solvent businesses, and the Pandemic Unemployment Payment have been extended until the end of March 2021, at an estimated cost of 0.9% of GDP in 2021. Further carryover costs relate to the funding of public transport while employees are encouraged to work from home (0.1% of GDP). Other smaller measures relate to the *stay-and-spend* scheme, which provides income tax credits on expenditure on holiday accommodation and 'eat in' food and drink, and an interest reduction on tax liabilities (together around 0.05% of GDP). The Plan also includes expenditure of around 0.1% of GDP – partly an extension of measures announced in 2020 – related to the reopening of schools, additional capacity and staffing, labour activation measures and support for people to upskill and re-enter the workforce. Some of the liquidity supports introduced in 2020 will also, and only partly, carry over into 2021. Revenue measures imply a budgetary impact of 0.2% of GDP. The reduced VAT rate in support for the tourism and hospitality sectors is set to continue until the end of 2021 and the reduced standard VAT rate until the end of March 2021 (together amounting to around 0.1% of GDP).

Ongoing support for the healthcare sector to deal with the pandemic was also allocated, amounting to 0.5% of GDP. In addition, expenditure in the healthcare sector is set to increase by a further 0.5% of GDP in 2021 reflecting the government's plan to implement the long-term Sláintecare programme that would address weaknesses in the healthcare system that were identified prior to the pandemic.

The government set aside a contingency reserve of EUR 2.1 billion (0.6% of GDP) for additional expenditure that may arise next year in relation to the pandemic, which can be allocated, among others, to further income supports, health expenditure and to cover costs in the education sector. In turn, the Recovery Fund of EUR 3.4 billion (0.9% of GDP) would allow for revenue and expenditure measures to support the economy in response to evolving pressures from both the pandemic and a change in EU-UK trading relations. The fund would also cover the extension of the COVID Restrictions Support Scheme for businesses most affected that is set to continue until the end of March 2021.

According to the Commission forecast, the COVID-19 related measures are temporary.

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[12] The estimations are based on sensitivity analysis provided by the Department of Public Expenditure and Reform, "Budget 2021, Forecasting Jobseeker Numbers & Expenditure 2021", October 2020, available at https://www.gov.ie/en/collection/62f05-budget-publications/. The estimations also benefited from discussions with the Ministry of Finance.

The Plan announces an increase of 2% in gross salaries across the public service, at an annual cost of 0.1% of GDP[13], which entails expenditure of a permanent nature. Additional longer-term expenditure relates to planned staff increases in various departments. However, the Plan does not provide an overall estimate, on net basis, of this expenditure.

Capital expenditure included in the Plan is in line with Ireland's overarching investment strategy, namely Project Ireland 2040. In addition, it includes temporary capital allocation in relation to the pandemic for various government departments of around 0.1% of GDP.

The measures in the Plan and the contingency funds are included in the Commission forecast. Ireland's tax system does not index the income tax bands for inflation and the Plan treats this measure, and the related additional revenue, as discretionary. However, the Commission forecast considers the non-indexation to be of a permanent nature and therefore it does not include it as a discretionary measure.

Overall, based on the information presented in the Draft Budgetary Plan and taking into account the Commission 2020 autumn forecast, the measures planned by Ireland in 2021 are supporting economic activity against the background of considerable uncertainty.

At the same time, it would be useful to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

It is anticipated that Ireland will submit its Recovery and Resilience Plan. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament.

[13] Under the Public Service Stability Agreement 2018-2020, available at: https://www.gov.ie/en/publication/432f22-public-service-stability-agreement-2018-2020/?referrer=/en/public-service-pay-policy/public-service-stability-agreement