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Macroeconomic imbalances Country Report – Ireland 2015

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European Commission
Directorate-General for Economic and Financial Affairs

Macroeconomic imbalances

Country Report – Ireland 2015

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Results of in-depth reviews under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances

Ireland is experiencing *macroeconomic imbalances, which require decisive policy action and specific monitoring*. Ireland completed the EU-IMF financial assistance programme in 2013 and is currently subject to post-programme surveillance and European Semester surveillance. Despite a marked improvement in the economic outlook, risks related to the high levels of private and public sector indebtedness; remaining financial sector challenges, in particular with regard to the banks' profitability, and labour market adjustment marked by high structural unemployment, continue to deserve close attention.

Excerpt of country-specific findings on Ireland, COM(2015)85 final_ SWD(2015)27 final, 26.02.2015

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EXECUTIVE SUMMARY

The economic outlook has improved markedly. Exceptionally strong net exports made Ireland the fastest growing economy in the EU in 2014. Although the contribution from net exports is likely to moderate, strong investment growth and the recovery in private consumption should underpin real GDP growth of about 3.5% in 2015 and 2016. The recovery has been job-rich and unemployment fell to 10.6 % at the end of 2014. The better macroeconomic environment has buoyed tax revenue and helped achieve fiscal targets despite expenditure overruns compared to budget profiles. It has also helped improve bank performance and ease the deleveraging process. Market perceptions of Ireland have improved significantly amid a general improvement in financial market conditions. The spread over 10-year German bunds fell to about 80 basis points in early 2015, bolstering sovereign debt and banks.

This country report assesses Ireland's economy against the background of the Commission's Annual Growth Survey which recommends three main pillars for the EU's economic and social policy in 2015: investment, structural reforms, and fiscal responsibility. In line with the Investment Plan for Europe, it explores ways to maximise the impact of public resources and unlock private investment. Finally, it assesses Ireland in the light of the findings of the Alert Mechanism Report 2015, in which the Commission found it useful to examine further the persistence of imbalances or their unwinding. These are the main findings of the in-depth review in this country report:

- **Private sector indebtedness declined in 2014 but is still high and well above the EU average.** Corporate debt levels are inflated by the presence of multinationals, and SMEs have borne the brunt of the deleveraging among corporates. Deleveraging needs vary significantly among SMEs. High levels of debt are concentrated in a relatively small proportion of firms, while the majority are now either debt-free or able to service their debt. Debt repayments by households still outpace new borrowing as they continue to actively deleverage against a backdrop of resurgent economic growth and rising property prices.

- **Public sector debt remains above GDP, but is expected to fall pending continued budget consolidation efforts and sustained economic growth.** One-off factors accounted for most of the 12.5 percentage point drop in the debt-to-GDP ratio to 110.8 % in 2014. Public debt is mostly long-term and carries low interest rates reducing refinancing risks.

- **Financial sector challenges are diminishing as domestic banks have been restructured, downsized and recapitalised.** Profitability is still a problem, but it continues to improve and the banks' strengthened position was reflected in the results of the European Central Bank's comprehensive assessment. The regulatory and supervisory systems have been strengthened. However, the high share of non-performing loans is falling slowly, in particular in the mortgages and commercial loans.

- **The external accounts have strengthened considerably over the past few years.** The economy has regained competitiveness and the rebalancing between the tradable and non-tradable sectors seems to be nearing completion. Ireland's external accounts need to be interpreted with care, however, and although the net international investment position is falling, it remains highly negative.

- **The labour market situation has improved, but long-term unemployment remains a problem**. While the unemployment rate is now below the euro area average, the share of structural unemployment risks increasing. The adjustment need is compounded by the skills mismatches that have emerged with the rebalancing of the economy between the non-tradable and tradable sectors and by the difficulties in re-skilling or up-skilling workers.

This country report also analyses other macroeconomic and structural issues and the main findings are:

- **The healthcare sector is facing sustainability challenges.** Expenditure overruns have been recurrent in the past few years, which shows that while efficiency gains have been achieved in recent years, the health system may have reached a point beyond which containing expected cost increases would imply deeper structural reforms.

- **SME access to finance remains heavily reliant on bank lending** and the use of non-bank financing options is yet to develop.

- **The high proportion of people living in households with low work intensity generates social challenges.** Limited access to affordable and quality childcare is a barrier to increased female labour market participation.

Ireland has made some progress in addressing the country-specific recommendations the Council issued in 2014. Some progress was made in the areas of fiscal consolidation, the labour market, and non-performing loans restructuring. Budget 2015 complies with the Stability and Growth Pact, but the 2015 and 2016 deficit targets could have been more ambitious given strong economic growth, and expenditure ceilings still need to be strengthened. The introduction of training and activation programmes is progressing. Initiatives have been put in place to improve the financing conditions for SMEs. The restructuring of SMEs and household loans in arrears is ongoing. Some progress has been made in the area of healthcare, including in reducing public spending on pharmaceuticals. Limited progress has been made in tackling the low work intensity of households, with no progress on improving access to affordable and full-time childcare. Limited progress has been made towards reducing the cost of legal services, but some progress has been made on improving data collection systems in courts.

The country report reveals the policy challenges stemming from the analysis of macro-economic imbalances:

- **Private and public sector deleveraging has a further way to go.** Further deleveraging is necessary to ensure that debt levels are sustainable and do not weigh on the growth prospects. Strict adherence to the planned fiscal adjustment under the Excessive Deficit Procedure and subsequent progress towards achieving the medium-term budgetary objective would ensure that public finances are firmly set on a sustainable path. Further growth-friendly tax reforms, including broadening the tax base, would support the adjustment process.

- **Lowering the still high level of non-performing loans would imply further loan arrears resolution.** In particular, this would entail a constant monitoring of the sustainability of the solutions agreed between lenders and debtors. Making the credit registry operational in 2016 as planned would be an important step towards enabling lenders to make informed lending decisions.

- **Improving SME access to bank and non-bank finance is important for growth and promoting jobs and investment.** Accessible information about financing options is crucial for an increased use of public support schemes.

- **The labour market will continue to face adjustment needs for years to come**, even though employment growth has been sustained lately. Tackling skills mismatches fully would avoid higher structural unemployment, contribute to the sustainability of Ireland's growth model and improve social indicators.

Other challenges are:

- **Untapped efficiency gains can be reaped in the health system to meet future increases in demand for care.** Such gains would enable favourable health outcomes at an affordable cost to society.

- **The proportion of people living in low work intensity households is high**. The improved labour market situation alone is unlikely to solve the problem.

- **The cost of legal services remains high.** A new regulatory framework is in Parliament. Its final design and implementation will determine its effectiveness.

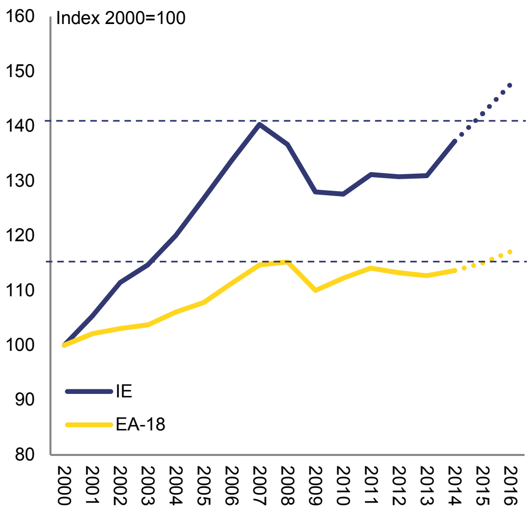
- **Weaknesses in network industries persist.** Addressing them in the current environment could prove challenging, particularly as far as the water sector is concerned.

1. SCENE SETTER - ECONOMIC SITUATION AND OUTLOOK

Growth and external position

Ireland becomes the fastest growing economy in the EU. The Irish economy reached a turning point in the latter part of 2013 and grew strongly in 2014, driven primarily by net exports and a strong recovery in investment (Graph 2.1 below). In the first three quarters of 2014, real GDP was up 4.9 % year-on-year, with net exports contributing 3.4 percentage points. Ireland's current account surplus was 5.7 % of GDP in the first nine months of 2014, underlining the strength of the country's competitiveness. The strength of these figures has taken observers by surprise. Both in bad and good times, Irish GDP has exhibited higher amplitude than the euro area. In 2015, Irish output could be back to its peak of 2007, one year earlier than that of the euro area as a whole.

Graph 1.1: **Real GDP, Ireland vs euro area**



Source: European Commission

Some uncertainty underlies net export figures and their contribution to the local economy. Economic dynamism remains reliant on multinational companies and connected exports. Competitiveness gains since the crisis coincided with a favourable business environment. Some of the strength in net exports is linked to a surge in contracted production ([1]), which has little impact on employment and tax revenues in Ireland. The future evolution of this form of production is uncertain, because it depends on the evolution of global value chains. This means that the exceptionally strong contribution from net exports may not be sustained.

Sustained growth is expected for 2015–16, albeit more moderate than the previous year. Real GDP growth is forecast to be resilient in 2015–16 at around 3.5 % each year ([2]). This will be lower than the exceptional growth rate achieved in 2014 but still above the EU average. Consumption is forecast to pick up from 2015, helped by rising employment, moderate wage growth and big drops in energy prices. However, exports and investment will remain important drivers of GDP growth over the period. Ireland will also continue to benefit from its strong trade links with the more dynamic US and UK markets and a weaker euro exchange rate.

Investment has picked up sharply as business confidence continues to recover. Real GDP growth has also been driven by the recovery in gross fixed capital formation. Aircraft purchases and intellectual property transactions by multinationals generate significant volatility in investment. Excluding these, investment has been strong across the board (up by 19.7 % year-on-year in the first three quarters of 2014) signalling improved business sentiment among small and medium-sized enterprises (SMEs) and continued expansion by multinationals. The purchasing managers index (PMI) has been above 55 since March 2014.

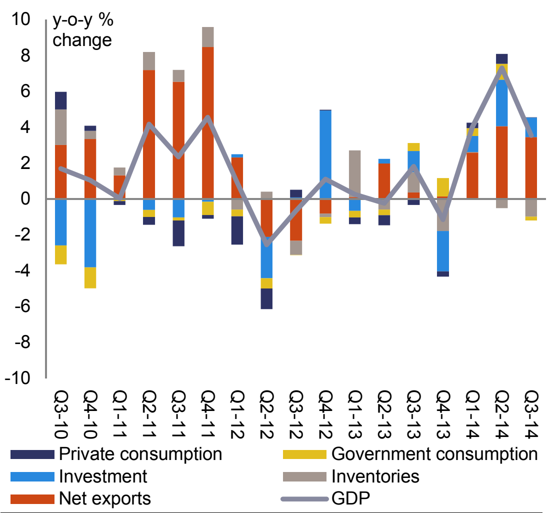
Consumption has remained subdued so far, in the context of ongoing deleveraging. Household spending, weaker than expected, did not pick up significantly in 2014 as high debt levels continued to weigh on the Irish private sector. However, some of this sluggishness is also explained by statistical effects on the split between volumes and prices. Positive trends in retail sales, tax receipts and employment all point to an underlying recovery in consumption — still limited but apparent in the nominal figures. Retail sales have been increasing since mid-2013 (Graph 2.2 below),

([1]) Contracted production refers to goods produced abroad on behalf of an entity resident in Ireland. The sale of goods is recorded as an Irish export and production inputs as Irish imports, under the European System of Accounts 2010.

([2]) European Commission 2015 Winter Forecast.

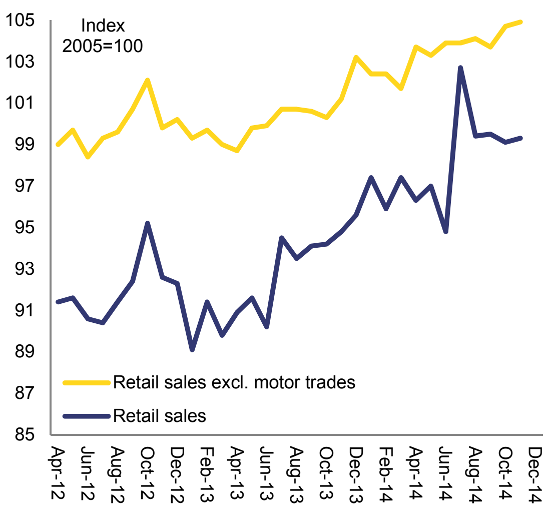
and consumer confidence improved sharply to a historic peak in December 2014.

Graph 1.2: **Contributions to GDP growth**



Source: Central Statistics Office of Ireland

Graph 1.3: **Retail sales in Ireland**



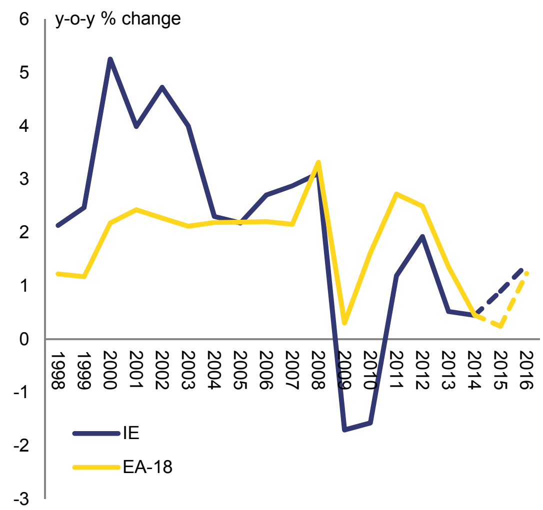
Source: Central Statistics Office of Ireland

The Investment Plan for Europe should give Ireland additional opportunities. The implementation of the Investment Plan for Europe should provide an additional boost to investment and growth from 2016 onwards. The impact of the plan for Ireland will depend on a number of factors. They include the volume of any contributions of Ireland to the Plan, the degree of participation by private investors and the characteristics of the specific projects selected by the European Fund for Strategic Investments.

Inflation and asset prices

Inflation remains subdued. Inflation remained lower than in the euro area for the sixth consecutive year in 2014 at 0.3 %, compared to 0.4 % in the euro area. Low energy prices have also put downward pressure on inflation recently and the harmonised index of consumer prices (HICP) fell by 0.3 % year-on-year in December 2014 (Graph 2.4 below). The increase in domestic demand and moderate wage increases should dispel inflationary expectations. Core inflation is forecast to exceed somewhat the euro area average in 2015–16, marking an end to the process of internal devaluation. That said, changes to the expected evolution of oil prices and unconventional monetary policy measures could alter this outlook.

Graph 1.4: **HICP inflation**

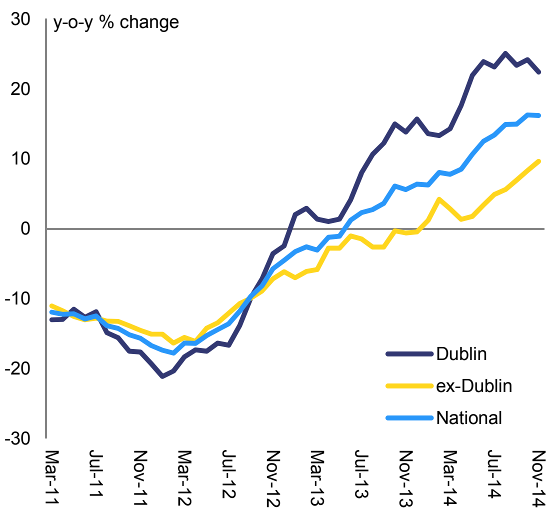


Source: European Commission

House prices have increased significantly but are still far from pre-crisis levels. In the housing market, pent-up demand and the low level of new construction have pushed up prices significantly, especially in urban areas. Residential property prices rose by 16.2 % year-on-year in November 2014 (Graph 2.5 below), with greater increases in Dublin than in the rest of Ireland — although the number of transactions remains small. The national property price index remains 37.9 % below its

2007 peak but if supply constraints persisted, they could exert significant upward pressure on residential prices. Commencement notices for new works and house completions have begun to rise from low levels but are not yet sufficient to satisfy demand. High accommodation prices in Dublin could also ultimately affect Ireland's position as an international business hub.

Graph 1.5: **Real estate prices**

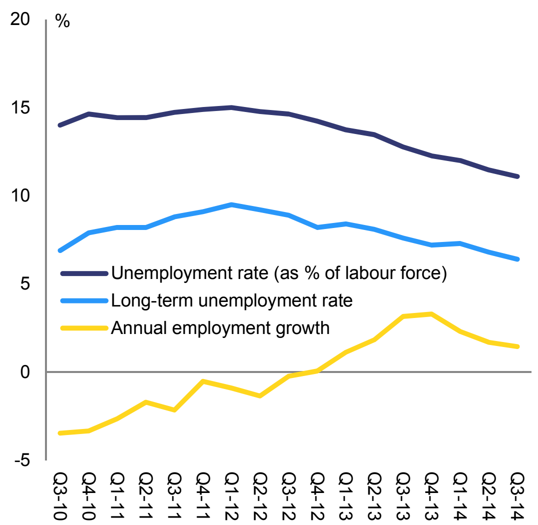


Source: Central Statistics Office of Ireland

Labour market and social inclusion

Growth has been rich in jobs although the unemployment rate remains high. The standardised unemployment rate has fallen steadily to 10.6 % in December 2014 from a peak of 15.1 % in February 2012. Long-term unemployment has also fallen significantly but remains very high at 46 % of all unemployment benefit claimants. Employment increased by 1.7 % year-on-year in the third quarter of 2014, with nearly 95 % of jobs created being full-time positions. This trend is expected to persist, albeit at a more moderate pace, given skills mismatches. SMEs and construction are expected to provide job opportunities for people with less sophisticated skills. Average unemployment is forecast to fall further to around 9.5 % in 2015 and remain above 8 % in 2016, putting a lid on wage inflation despite rising wage demands.

Graph 1.6: **Unemployment rates, employment growth**



Source: Central Statistics Office of Ireland

Social protection has helped to alleviate the rise in poverty that followed the crisis. Ireland is one of the countries where net social expenditure increased the most (as a share of the aggregate level of economic activity) following the 2007 crisis. In 2011, it amounted to nearly 22 % of GDP, according to the latest available data. As a result, the country did not experience the rise in inequality some other Member States did. Nevertheless, deprivation rates have continued to rise in the year to 2013, driven by sharp rises in rural areas. This suggests that improving labour market conditions in Dublin and other urban areas have yet to spread to the rest of the country. The risk of social exclusion is heightened by the high proportion of people living in households with low work intensity, which remains the highest in the EU.

Fiscal developments and taxation

Buoyant tax revenues have helped Ireland reach its fiscal targets despite expenditure overruns. The general government deficit is forecast to drop to 4.0 % of GDP in 2014, below the Excessive Deficit Procedure target for that year and down from 5.7 % in 2013. This reflects the effects of remarkable economic growth in 2014, additional windfall revenues and lower interest expenditure. Tax revenues increased by 9.2 % in 2014. Receipts from personal income tax and VAT also increased, mirroring improvements in the labour market and consumer confidence. While total government expenditure increased only very moderately in 2013, spending pressures intensified further at the end of 2014, mainly in healthcare, compared to the budget profile. Unlike in previous years, healthcare budget overruns were not offset by savings in other areas.

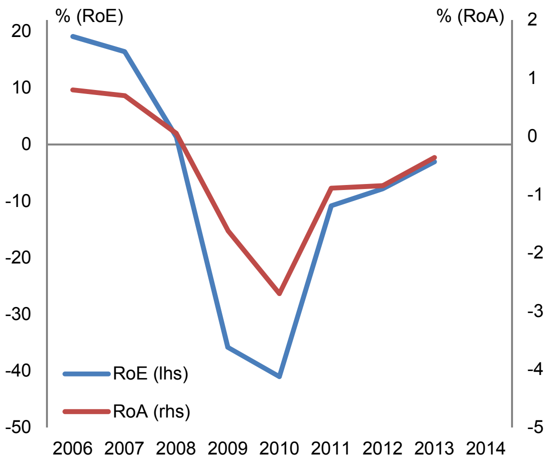
The fiscal position is expected to improve further in 2015, but some risks remain. Taking into account tax cuts and expenditure increases of around 0.5 % of GDP, the general government deficit is projected to bet 2.9 % of GDP in 2015. In 2016, it is forecast to be 3.1 % under a no-policy-change assumption. Risks associated with the deficit projections for 2015 and 2016 mainly relate to the sustainability of the favourable economic outlook and to persisting spending pressures linked to demographics and the public service payroll. The structural deficit is expected to decrease to around 2.4 % of GDP in 2016, from 3.5 % in 2013.

Public debt is high but falling. Gross general government debt is projected to fall to 106.6 % of GDP in 2016, down from 123.3 % in 2013. This marked improvement largely reflects the liquidation of the Irish Banking Resolution Corporation, along with ongoing economic growth. Starting in 2014, small primary surpluses should also help maintain the debt trajectory on a consistent downward path. Nonetheless, the high level of public debt continues to be one of the main vulnerabilities of the Irish economy.

Financial sector and credit supply

Bank performance has continued to improve but there are still considerable difficulties (Graph 2.7 below). Almost all of the participating Irish banks passed the asset quality review and the stress tests of the ECB's comprehensive assessment. Only Permanent TSB (PTSB) had a EUR 855 million capital shortfall in the adverse scenario of the test, which it is expected to fill with private capital. The results of the comprehensive assessment were in line with expectations and PTSB remains now the only loss-making domestic bank. The reliance of domestic banks on central bank funding has continued to decline, down to 3.9 % in September 2014, near the euro area average.

Graph 1.7: **Bank profitability**



(1) RoE: Return on Equity, RoA: Return on Assets
Source: IMF (refers to the whole banking sector in Ireland)

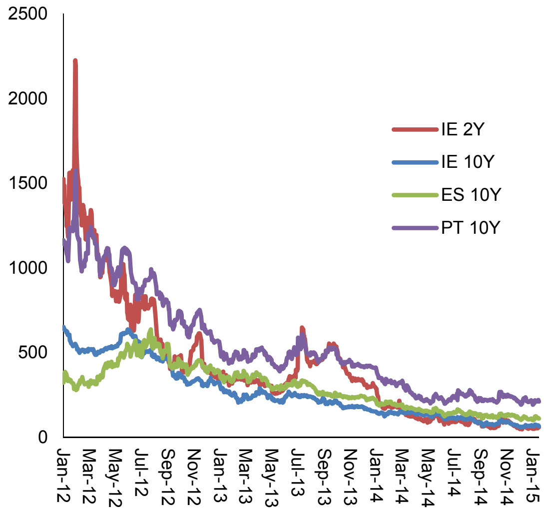
Net lending to the private sector remains weak, given mostly low demand for credit. Lending to businesses (non-financial corporations) declined by 8.1 % year-on-year in October 2014. Lending to households, for consumption and house purchases, also fell by 3.3 % year-on-year in the third quarter of 2014. Demand for credit remains subdued as deleveraging by the private sector continues. Though still at very high levels, private sector non-consolidated debt fell by 3.9 percentage points in the first quarter of 2014, to 298.3 % of GDP. In addition to demand issues, there might also be credit supply constraints, as lending rates are higher in Ireland than in the rest of the euro area.

The number of non-performing loans remains high but is gradually decreasing. In the three main domestic banks, it fell to 24.9 % of total loans in the third quarter of 2014, from a high of 27.1 % at the end of 2013. The number and value of mortgage accounts in arrears for over 90 days decreased by 4.5 % and 3.8 % respectively quarter-on-quarter. However, mortgage arrears stood at 19 % of total mortgage loan balances in Q3-2014. The increase in the build-up of longest-term arrears persisted, up to 9.6 % of total loan balances in Q3, from 9.2 % at the end of June.

Positive market conditions have bolstered the sovereign and the banks. Bank of Ireland successfully tapped the markets and raised EUR 750 million of tier 2 capital in June 2014. In

January 2015, the yield on 10-year Irish government bonds hit new lows of 1.03 % and the spread over German bonds fell to 63 bps (Graph 2.8 below). In early November 2014, the sovereign issued EUR 3.75 billion of 15-year bonds, the first such issuance since 2009. The yield of 2.49 % was a record low for this issuance. Also in December 2014, Standard & Poor's upgraded Ireland's long-term sovereign credit rating to A (from A-). The rating agency also confirmed its ratings of the Irish banks, upgrading Bank of Ireland's outlook to positive. In January 2015, amid strong demand, Allied Irish Banks issued EUR 750 million of a 7-year covered bond at a yield of 0.75 %, as funding costs for Irish banks continue to improve.

Graph 1.8: **Ten-year spreads over German bonds**



Source: iBoxx

Box 1.1: **Economic surveillance process**

The Commission's Annual Growth Survey, adopted in November 2014, started the 2015 European Semester, proposing that the EU pursue an integrated approach to economic policy built around three main pillars: boosting investment, accelerating structural reforms and pursuing responsible growth-friendly fiscal consolidation. The Annual Growth Survey also presented the process of streamlining the European Semester to increase the effectiveness of economic policy coordination at the EU level through greater accountability and by encouraging greater ownership by all actors.

In line with streamlining efforts this Country Report includes an In-Depth Review — as per Article 5 of Regulation No 1176/2011 — to determine whether macroeconomic imbalances still exist, as announced in the Commission's Alert Mechanism Report published on November 2014.

Based on the 2014 in-depth review for Ireland published in March 2014, the Commission concluded that Ireland was experiencing macroeconomic imbalances requiring specific monitoring and decisive policy action. In particular financial sector developments, private and public sector indebtedness and, linked to that, the high gross and net external liabilities and the situation of the labour market meant that risks were still present.

This country report includes an assessment of progress towards the implementation of the 2014 Country-Specific Recommendations adopted by the Council in July 2014. The Country-Specific Recommendations for Ireland concerned public finances and taxation, healthcare, the labour market, welfare, access to finance, the financial sector and the legal sector.

Table 1.1: **Key economic, financial and social indicators - Ireland**

							Forecast		
	2008	2009	2010	2011	2012	2013	2014	2015	2016
Real GDP (y-o-y)	-2.6	-6.4	-0.3	2.8	-0.3	0.2	4.8	3.5	3.6
Private consumption (y-o-y)	-0.2	-5.8	0.4	-1.1	-1.4	-0.4	0.5	2.4	1.8
Public consumption (y-o-y)	1.2	-2.6	-4.8	-2.2	-1.3	0.0	1.6	-0.1	2.9
Gross fixed capital formation (y-o-y)	-9.1	-18.9	-17.6	-2.2	5.2	-2.8	8.6	9.7	8.9
Exports of goods and services (y-o-y)	-0.9	-4.0	6.2	5.5	4.7	1.1	12.7	5.3	5.5
Imports of goods and services (y-o-y)	-2.6	-9.2	3.0	-0.6	6.9	0.6	12.2	5.6	6.0
Output gap	1.0	-4.6	-4.2	-1.3	-1.8	-2.5	-0.1	0.7	0.7
Contribution to GDP growth:									
Domestic demand (y-o-y)	-2.4	-7.9	-4.3	-1.3	-0.1	-0.6	1.8	2.6	2.8
Inventories (y-o-y)	-0.8	-1.0	0.5	0.7	-0.3	0.4	-0.1	0.0	0.0
Net exports (y-o-y)	1.1	3.4	3.2	5.7	-0.8	0.6	3.0	0.9	0.8
Current account balance (% of GDP), balance of payments	-5.64*	-2.32*	1.13*	1.23*	1.6	4.4	.	.	.
Trade balance (% of GDP), balance of payments	8.7	15.5	17.9	20.5	20.5	20.8	.	.	.
Terms of trade of goods and services (y-o-y)	-2.3	1.6	-1.4	-2.8	0.4	0.0	-0.7	-0.6	-0.6
Net international investment position (% of GDP)	0.0	0.0	0.0	0.0	-109.6	-102.1	.	.	.
Net external debt (% of GDP)	-159.6*	-212.2*	-294.4*	-329.3*	-396.7*	-425.3*	.	.	.
Gross external debt (% of GDP)	965.92	1045.1	1046.2	1010.8	963.5	936.3	.	.	.
Export performance vs advanced countries (% change over 5 years)	-10.9	3.5	-5.0	-4.8	-5.4	1.9	.	.	.
Export market share, goods and services (%)	1.1	1.3	1.1	1.0	1.0	1.1	.	.	.
Savings rate of households (net saving as percentage of net disposable income)	6.0	11.5	8.5	6.4	5.2	4.3	.	.	.
Private credit flow, consolidated, (% of GDP)	22.3	-5.0	2.5	16.4	-1.8	-5.8	.	.	.
Private sector debt, consolidated (% of GDP)	237.4	258.5	261.2	277.9	281.5	270.3	.	.	.
Deflated house price index (y-o-y)	-8.4	-12.8	-10.4	-15.4	-11.9	1.3	.	.	.
Residential investment (% of GDP)	8.3	4.7	3.1	2.4	1.9	2.0	.	.	.
Total financial sector liabilities, non-consolidated (y-o-y)	5.7	4.0	7.0	-0.6	-1.4	0.4	.	.	.
Tier 1 ratio[1]	.	.	.	.	.	.	.	.	.
Overall solvency ratio[2]	.	.	.	.	.	.	.	.	.
Gross total doubtful and non-performing loans (% of total debt instruments and total loans and advances)[2]	.	.	.	.	.	.	.	.	.
Change in employment (number of people, y-o-y)	-0.6	-7.8	-4.1	-1.8	-0.6	2.4	2.0	2.2	1.9
Unemployment rate	6.4	12.0	13.9	14.7	14.7	13.1	11.1	9.6	8.8
Long-term unemployment rate (% of active population)	1.7	3.5	6.8	8.7	9.1	7.9	.	.	.
Youth unemployment rate (% of active population in the same age group)	13.3	24.0	27.6	29.1	30.4	26.8	23.9	.	.
Activity rate (15-64 year-olds)	72.0	70.6	69.4	69.2	69.2	69.8	.	.	.
Young people not in employment, education or training (%)	14.9	18.6	19.2	18.8	18.7	16.1	.	.	.
People at risk of poverty or social exclusion (% of total population)	23.7	25.7	27.3	29.4	30.0	29.5	.	.	.
At-risk-of-poverty rate (% of total population)	15.5	15.0	15.2	15.2	15.7	14.1	.	.	.
Severe material deprivation rate (% of total population)	5.5	6.1	5.7	7.8	9.8	9.9	.	.	.
Number of people living in households with very low work-intensity (% of total population aged below 60)	13.7	20.0	22.9	24.2	23.4	23.9	.	.	.
GDP deflator (y-o-y)	-2.5	-3.9	-1.6	0.9	1.3	1.0	0.4	0.4	0.6
Harmonised index of consumer prices (HICP) (y-o-y)	3.1	-1.7	-1.6	1.2	1.9	0.5	0.3	0.3	1.3
Nominal compensation per employee (y-o-y)	5.2	-1.0	-3.8	1.2	0.8	2.0	-1.3	1.7	1.9
Labour productivity (real, person employed, y-o-y)	-2.0	1.6	3.9	4.6	0.3	-2.1	.	.	.
Unit labour costs (ULC) (whole economy, y-o-y)	7.4	-2.6	-7.4	-3.2	0.5	4.2	-3.9	0.4	0.3
Real unit labour costs (y-o-y)	10.1	1.4	-5.9	-4.1	-0.8	3.2	-4.3	0.0	-0.4
REER[3)] (ULC, y-o-y)	8.3	-4.9	-10.5	-3.6	-5.1	6.4	-5.0	-4.8	-0.6
REER[3)] (HICP, y-o-y)	1.2	-2.1	-7.8	-1.5	-3.6	1.2	0.8	-3.6	-0.3
General government balance (% of GDP)	-7.0	-13.9	-32.4	-12.6	-8.0	-5.7	-4.0	-2.9	-3.1
Structural budget balance (% of GDP)	.	.	-8.8	-8.0	-7.1	-4.8	-3.9	-3.4	-3.4
General government gross debt (% of GDP)	42.6	62.2	87.4	111.1	121.7	123.3	110.8	110.3	107.9

(1) Domestic banking groups and stand-alone banks.
(2) Domestic banking groups and stand-alone banks, foreign-controlled (EU and non-EU) subsidiaries and branches.
(3) Real effective exchange rate.
(*) Indicates BPM5 and/or ESA95.
Source: European Commission, 2015 winter forecast, ECB.

Table 1.2: **Macroeconomic Imbalance Procedure: Scoreboard - Ireland**

			Thresholds	2008	2009	2010	2011	2012	2013
External imbalances and competitiveness	Current Account Balance (% of GDP)	3 year average	-4%/6%	-8.1	-8.4	-6.4	-4.2	-1.5	1.1
		p.m.: level year	-	-9.4	-6.6	-3.2	-2.7	1.6	4.4
	Net international investment position (% of GDP)		-35%	*-75.6*	*-92.4*	*-88.0*	*-112.2*	*-112.0*	*-104.9*
	Real effective exchange rate (REER) (42 industrial countries - HICP deflator)	% change (3 years)	±5% & ±11%	7.3	5.0	-5.4	-9.6	-12.2	-3.9
		p.m.: % y-o-y change	-	3.5	-1.6	-7.1	-1.1	-4.3	1.6
	Export Market shares	% change (5 years)	-6%	-21.2	-5.3	-13.0	-13.1	-14.3	-4.9
		p.m.: % y-o-y change	-	-8.4	16.0	-14.0	-6.2	0.0	1.7
	Nominal unit labour costs (ULC)	% change (3 years)	9% & 12%	17.0	10.1	-3.2	-12.8	-10.0	1.3
		p.m.: % y-o-y change	-	7.4	-2.6	-7.4	-3.2	0.5	4.2
Internal imbalances	Deflated House Prices (% y-o-y change)		6%	-8.5	-12.7	-10.4	-15.3	-11.9	0.3
	Private Sector Credit Flow as % of GDP, consolidated		14%	22.4	-5.0	2.6	16.3	-1.8	-5.7
	Private Sector Debt as % of GDP, consolidated		133%	237.4	258.5	261.1	277.9	281.5	266.3
	General Government Sector Debt as % of GDP		60%	42.6	62.2	87.4	111.1	121.7	123.3
	Unemployment Rate	3-year average	10%	5.2	7.7	10.8	13.5	14.4	14.2
		p.m.: level year	-	6.4	12.0	13.9	14.7	14.7	13.1
	Total Financial Sector Liabilities (% y-o-y change)		16.5%	6.2	3.5	6.3	-2.4	-1.5	1.0

Figures highlighted are the ones falling outside the threshold established by EC Alert Mechanism Report. For REER and ULC, the first threshold concerns Euro Area Member States.
(1) Figures in italic are according to the old standards (ESA95/BPM5).
(2) Export market shares data: the total world export is based on the 5th edition of the Balance of Payments Manual (BPM5).
(3) Current account balance has been revised downwards following methodological changes in the treatment of FDI investment income.
Source: European Commission.

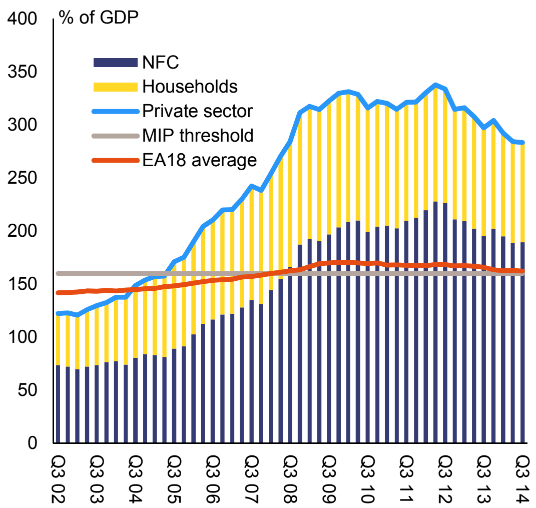
2. IMBALANCES, RISKS AND ADJUSTMENT

2.1. INDEBTEDNESS AND DELEVERAGING

Private sector debt and deleveraging

Private sector debt started to decline but is still considerably higher than the euro area average. Private sector non-consolidated debt amounted to EUR 515.3 billion (283.5 % of GDP) in the third quarter of 2014, down 10.6 % from a peak of EUR 576.6 billion in mid-2012. The correction begun since 2013 follows the excessive build-up between 2002 and 2011, when private indebtedness rose from about 120 % of GDP to over 320 % of GDP (Graph 2.1.1). Most of this increase can be attributed to the corporate sector amid expanding activity of multinationals and a growing number of SMEs taking on property-related debt. It grew by almost EUR 300 billion between 2002 and 2012 (a 276 % increase), while that of the household sector increased by about half of that amount (a 218 % increase).

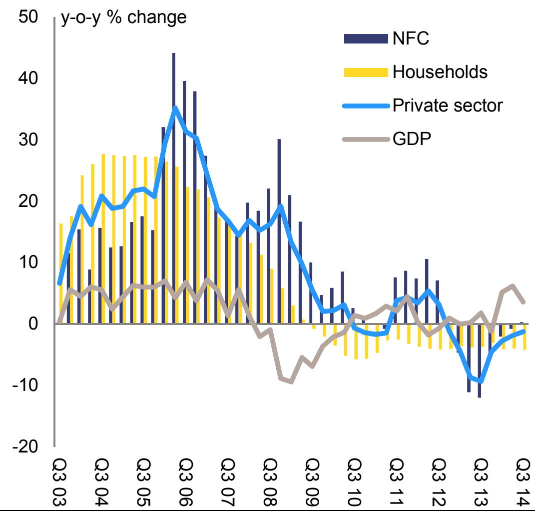
Graph 2.1.1: **Private sector debt**



(1) Quarterly Financial Accounts release on an ESA 2010 basis with reference from Q1 2012 to Q3 2014. Figures for the Non-Financial Corporation (NFC) sector are the sum of loans and securities other than shares. Figures for households are the sum of loans and other accounts receivable/payable. Data are non-consolidated. MIP threshold: threshold of the scoreboard used under the Macroeconomic Imbalances Procedure.
Source: Central Bank of Ireland, Central Statistics Office, European Commission

The deleveraging process started earlier among private households than in the corporate sector. The household debt-to-GDP ratio started declining in early 2010 while corporate indebtedness continued to rise for another two years (Graph 2.1.2). By the end of the third quarter of 2014, household debt had fallen to EUR 171.1 billion, down 19.5 % from its peak in late 2008. In contrast, corporate debt amounted to EUR 344.4 billion, down about 11.7 % from its peak in the second half of 2012. Despite notable improvements, the Irish private sector remains highly indebted. The estimated remaining deleveraging need is above 30 % of GDP, with obvious implications for the speed of recovery of private consumption and investment ([3]).

Graph 2.1.2: **Debt build-up and deleveraging trends**



(1) Quarterly Financial Accounts release on an ESA 2010 basis with reference from Q1 2012 to Q3 2014.
Source: Central Bank of Ireland, Central Statistics Office

Corporate deleveraging is accelerating but overall debt levels remain high, even excluding multinationals. Since Ireland's economy has a large multinational corporate sector, intra-group cross-border lending inflates corporate debt-to-GDP levels. The difference between consolidated and non-consolidated debt reflects this. In Ireland's case the difference is 26.3 % ([4]). According to the Commission's analysis ([5]),

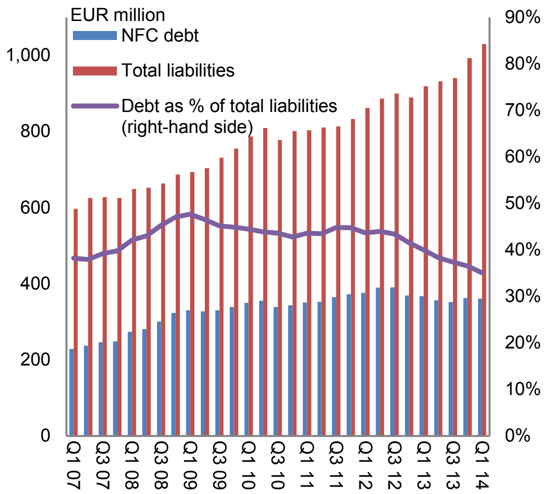
([3]) This based on a combination of methods using in-house work on debt sustainability and an IMF analysis of historical debt boom/bust episodes. Source: 'Private sector deleveraging: where do we stand?', Quarterly report on the euro area, October 2014,Vol 13 (2014), Issue 3.

([4]) Source: Eurostat. In 2013, the consolidated non-financial corporation debt-to-GDP ratio was 173.6 %. The non-consolidated ratio was 199.9 % .

([5]) Since there are no comparable aggregate data on cross-border inter-company lending, an estimate is constructed using sector financial accounts. It is based on the assumption that most consolidated loans held by multinationals account for over 50 % of the increase in corporate sector indebtedness. Since multinationals have access to international capital markets, they do not depend on domestic banks for financing. This decreases overall deleveraging pressure amid favourable market conditions and reduces economic and financial stability risk. However, even taking this into account, Irish corporate debt levels as a percentage of GDP continue to exceed the euro area average by about 80 %.

Improvements in corporate debt levels were achieved by reducing nominal debt and increasing the value of company assets. Among other things, the latter is due to valuation effects stemming from the surge in real estate property prices. Company assets measured by total liabilities ([6]) have increased by 20 % over the past two years, while the debt stock, albeit more volatile, has decreased by 4 % (Graph 2.1.3). Although falling, debt servicing costs are still comparatively high compared to the rest of the euro area, making further debt reduction difficult.

Graph 2.1.3: **Corporate leverage indicators**



(1) Total liabilities are used as a proxy for total assets.
Source: Central Bank of Ireland

SMEs seem to have borne the brunt of the deleveraging in the corporate sector. This is because SMEs were under greater financial stability pressure than multinationals. In contrast with the Irish-resident multinationals that maintain their intra-group funding practices and market borrowing practices, Irish companies, in particular SMEs, are focusing on loan repayments.

Indebtedness levels vary considerably depending on SME type and exposure to the property market. With high levels of debt concentrated in a relatively small proportion of companies, most do not suffer from excess leverage. According to the Central Bank of Ireland, a third of domestic SMEs have no debt at all and over 80 % can comfortably meet their debt servicing requirements, as their reasonably low debt-to-turnover ratios show. This means that much of the further corporate deleveraging need will have to be undertaken by those SMEs with high levels of debt. These companies are often exposed to property-related risks. This makes them vulnerable and more susceptible to default, especially in cases of negative equity. Even though the main lenders have stepped up their SME loan resolution efforts in line with the country-specific recommendation, this loan portfolio remains heavily impaired. About a quarter of all SME loans are in default (the third highest rate in the euro area). The wholesale and retail sector is the most exposed to loans in terms

Non-financial corporations are likely to be related to cross-border lending, the counterparts most likely foreign corporates (by virtue of the same assumption as for domestic entities).

([6]) Due to the limited availability of aggregate data on non-financial assets, the denominator (total liabilities) is used as a proxy for the total market value of assets in line with accounting principles.

of balance ([7]). Defaults occur most often in the construction and hotel/restaurant sectors. SMEs are now allowed to apply for creditor protection ("examinership" under Irish law) in the Circuit Court rather than the High Court, which lowers their procedural costs – albeit take-up has been low so far. The proposed Consumer Protection (Regulation of Credit Servicing Firms) Bill aims to include SMEs and ensure that their rights as borrowers are protected even in the case of loan portfolio sales to unregulated entities.

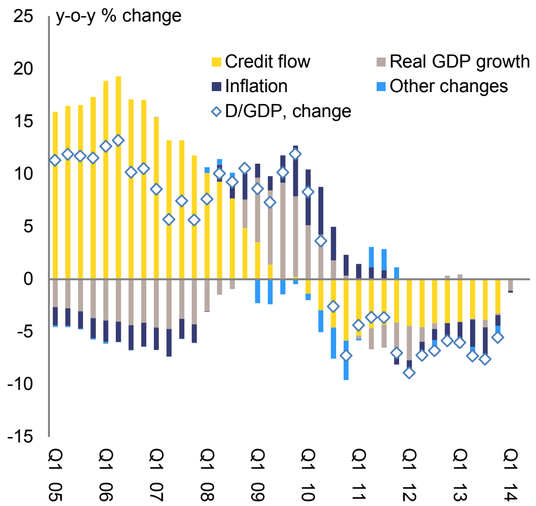
Investment growth is mainly financed by corporate foreign borrowing and retained profits, not domestic banks. The diversity of the corporate sector in Ireland means that different companies use different strategies. On one side, national account data show a strong recovery in investment over the past few quarters. On the other side, negative credit flows show that the financing is not coming from domestic banks. This means that most of the pick-up in investment so far can be attributed to the multinational sector that borrows abroad. In addition, since the turnaround in the economy has boosted business revenues, companies have also used growing profits for working capital purposes and to reduce debt.

Negative credit flow partly masks a pick-up in demand for new credit. In spite of the continued balance sheet repair, deleveraging pressures on the Irish non-financial corporate sector remain high due to the still elevated indebtedness levels. However, some domestic corporates seem to have stabilised their businesses and could be more likely to borrow for investment.

Household debt repayments still outpace new borrowing as they continue to pay down debt. Negative credit flows are the single largest contributor to household debt reduction (Graph 2.1.4). In spite of that, the sector remains among the most indebted in the euro area at 91.5 % of GDP. Survey data show that 56.8 % of Irish households are indebted, and 33.9 % of them have a mortgage on their main residence.

([7]) McCann, F. and McIndoe-Calder, T.: 'Property debt overhang: the case of Irish SMEs', Research technical paper, Central Bank of Ireland, 2014.

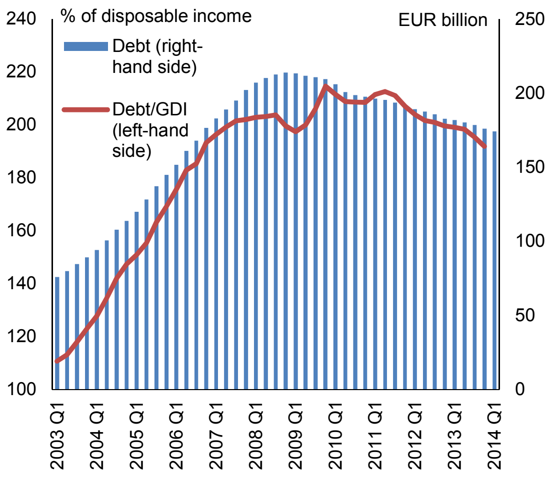
Graph 2.1.4: **Components of the household deleveraging process**



(1) D/GDP, change: change in the debt-to-GDP ratio
Source: European Commission

The impetus to further reduce household debt should continue with continued improvement in economic growth. Households have increased their savings to reduce debt. Household liabilities have been decreasing slowly but constantly since the onset of the crisis. At the end of 2014 they were at EUR 176 billion, a 19 % drop since their peak at the end of 2008. However, this was not matched by an increase in disposable income: as it remains subdued and consumption is still recovering, overall debt levels remain high (Graph 2.1.5). This is partly because average earnings remain relatively flat. Two thirds of all Irish mortgage holders continue to benefit from favourable 'tracker' interest rates that keep the cost of mortgage servicing low.

Graph 2.1.5: **Household debt sustainability**

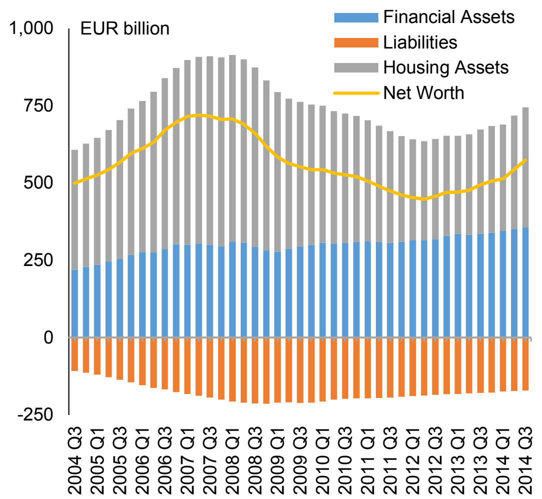


(1) Debt - to total loans of households. GDI - gross disposable income of households including non-profit institutions serving households.
Source: Central Bank of Ireland, European Central Bank

Cooperation between lenders and borrowers on debt restructuring improved. Initiatives such as the Central Bank of Ireland's Mortgage Arrears Resolution Targets and the regulatory reforms introduced during the programme helped improve cooperation between banks and debtors. Ambitious targets for concluded restructuring solutions for mortgages in arrears have been set for banks. Agreements continue to be monitored to ensure their sustainability. The restructuring solutions that banks have proposed generally offer more favourable repayment conditions and sometimes partial debt write-offs. The debt solutions offered by the Insolvency Service of Ireland represent another useful avenue for the most distressed debtors. However, little use is still being made of personal insolvency procedures and the reformed bankruptcy system, possibly on account of enhanced cooperation between debtors and lenders.

The increase in residential property prices increases households' net worth. Houses make up almost 53 % of the total value of all household assets. In 2014 national house prices, as measured by the residential property price index, increased by 16.3 % compared to the previous year. This upward trajectory brought household net worth to EUR 574 billion in the third quarter of 2014 (Graph 2.1.6), rising for the ninth consecutive quarter (an increase of 5 % over the quarter).

Graph 2.1.6: **Household net worth**



(1) Net worth is measured as the difference between the households' assets (housing and financial) and their liabilities.
Source: Central Bank of Ireland, Central Statistics Office

The recovery in property prices is particularly strong in Dublin. Residential property prices in Dublin rose 22.3 % in the year to December 2014, with sharp price rises in Dublin slowly spreading to the rest of the country. Supply shortages are driving these price rises. Household formation rates suggest an equilibrium level of new house construction of approximately 25 000 units a year ([8]), with demand strongest in Dublin. Only an estimated 11 000 units were completed nationally in 2014. New measures have been introduced by the Central Bank of Ireland to increase the resilience of the financial and household sectors to future credit-fuelled property price rises. Failing a stronger supply response however, prices look set to increase further. This could hamper competitiveness and make it difficult to afford housing. In May 2014 the authorities launched Construction 2020, a strategy for the construction sector. It addresses aspects such as planning, financing, taxation, standards and enforcement. Legislative proposals include a special levy on

([8]) Duffy, D., Byrne, D. and Fitzgerald, J., 'Alternative scenarios for new household formation in Ireland', Special Article in Quarterly Economic Commentary, Spring 2014, The Economic and Social Research Institute https://www.esri.ie/UserFiles/publications/QEC2014SPR_SA_Duffy.pdf vacant sites in urban areas and 'use it or lose it' planning permissions for developers. The government has also released additional funding to increase the supply of social and affordable housing and committed itself to earmarking EUR 2.2 billion for this purpose in the next three years. The introduction of real estate investment trusts ([9]) as investment vehicles whose shares can be traded freely also seems to have attracted new funds. This provides additional liquidity for the commercial real estate sector.

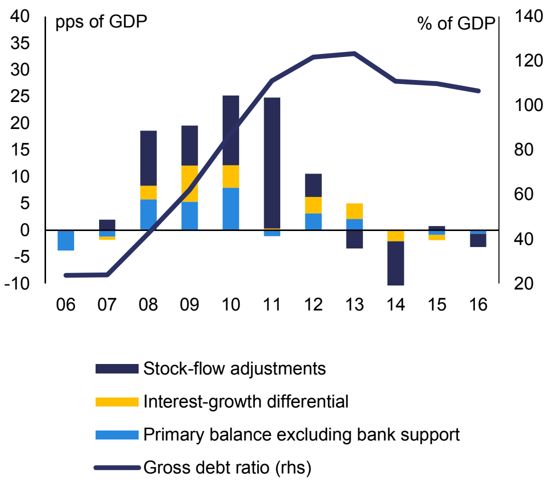
General government debt and deleveraging

Government gross debt is very high but has started to decline. For the first time since 2007, gross general government debt is estimated to have fallen to 110.8 % of GDP in 2014, down from 123.3 % of GDP a year before. The sharp drop is largely due to the liquidation of the Irish Bank Resolution Corporation ([10]). Based on the European Commission winter 2015 forecast, the debt-to-GDP ratio is projected to further decrease to around 110.3 % in 2015 and to 107.9 % in 2016 (Graph 2.1.7). This assumes robust economic growth of more than 3 % and a sizeable primary surplus of around 0.9 % of GDP in 2015 and 0.8 % of GDP in 2016. The debt projections are sensitive to variations in economic growth and to the expected size of the budgetary adjustment. Interest rate risks are low due to prudent debt management and low future refinancing needs.

([9]) These are investment companies that hold rental properties. Their appeal lies in the fact that the income or gains from the trust's property rental business are not subject to Irish corporation tax.

([10]) The Irish Bank Resolution Corporation (IBRC) was set up in July 2011 to merge and eventually wind down the former Anglo Irish Bank and the Irish Nationwide Building Society. The Irish government owns it. With the transition to ESA 2010 accounting rules it was reclassified as part of the general government sector. This reclassification added EUR 12.6 billion to government debt at the end of 2013.

Graph 2.1.7: **Contribution to change in gross government debt**

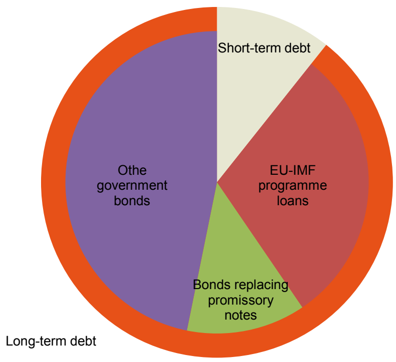


(1) Stock-flow adjustments include Irish Bank Resolution Corporation consolidation, banks supports funded by the National Pension Reserve Fund and bank support measures
Source: European Commission

Gross government debt is largely long-term and at low interest rates. Of gross government debt, 89.3 % has a residual maturity of more than one year. Around 33.4 % of that represents official loans from the EU-IMF programme partners (Graph 2.1.8). As of the end of 2014, average debt maturity was about 12 years ([11]). The average effective interest rate on government debt is estimated to be around 3.5 %. Compared to that of other EU Member States, this low rate reflects the high share of official debt and the currently very favourable market conditions in combination with long-dated government bonds at floating interest rates.

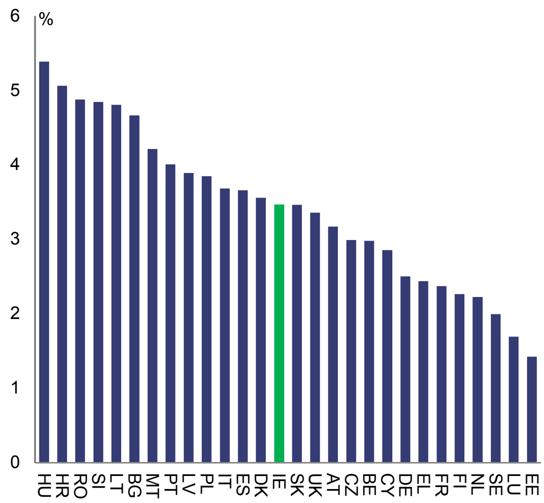
([11]) Data for the end of December take into account the repayment of EUR 9 billion of IMF loans, but do not yet reflect the extension of the European Financial Stabilisation Mechanism loan maturities (see Graph 3.1.9). Including the European Financial Stabilisation Mechanism loan maturity extension, the average maturity of long-term debt is estimated to be around 13 years.

Graph 2.1.8: **Breakdown of gross government debt (end of December 2014)**



(1) Short-term debt is debt with a residual maturity of less than one year
Source: Irish Department of Finance

Graph 2.1.9: **Average effective interest rates on government debt (2014)**

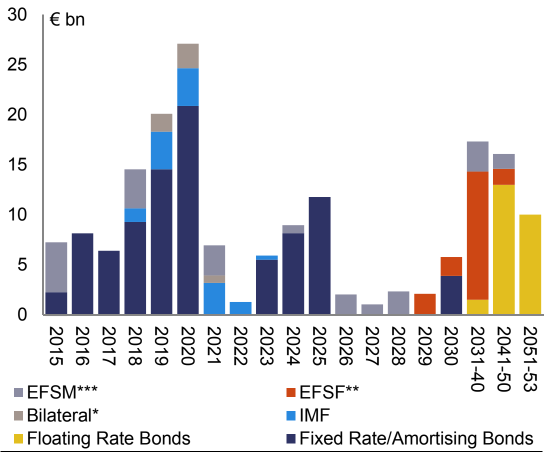


Source: European Commission

The maturity profile and the interest burden are expected to improve further with the refinancing of IMF loans. In 2014, the Irish authorities requested a waiver of the proportional early repayment clause in its loan agreements with the IMF and EU lenders to make an early repayment of XDR 15.7 (EUR 19.6 billion) of IMF loans. The request was motivated by the fact that market rates had fallen well below the interest costs on existing IMF loans (Graph 2.1.9). The EU lenders granted the waiver in December 2014. Ireland repaid EUR 9 billion of IMF loans in December 2014 and EUR 3.5 billion in February 2015. The Irish authorities expect to conclude the planned reimbursement by the end of 2015.

The authorities estimate savings on interest expenditure to be over EUR 1.5 billion over the lifetime of the reimbursed IMF loans, including hedging costs. The IMF loans are being replaced by government bonds with longer maturities (Graph 2.1.10). The National Treasury Management Agency raised EUR 3.75 billion from a new 15-year bond in November 2014 and EUR 4 billion in 30-year bonds in February 2015, at a yield close to 2 per cent. It plans to issue an additional EUR 8-11 billion of long-term bonds in 2015, including provisions for the remaining early repayment of IMF loans.

Graph 2.1.10: **Maturity profile of Ireland's long-term marketable and official debt (end of December 2014)**



(1) *Bilateral loans were provided by the United Kingdom, Sweden and Denmark. **European Financial Stability Facility loans reflect the maturity extensions agreed in June 2013. ***European Financial Stabilisation Mechanism (EFSM) loans are also subject to a seven year extension. It is not expected that Ireland will have to refinance any of its EFSM loans before 2027. However, the revised maturity dates of individual EFSM loans will only be determined as they approach their original maturity dates. The original EFSM maturities are reflected in the table above.
Source: NTMA

Sustained economic growth and further improvement of the budget balance are needed to keep the debt-to-GDP ratio on a firm downward path. The European Commission's latest debt sustainability analysis ([12]) shows that in the absence of further consolidation measures in 2016 and beyond, the general government debt-to-GDP ratio would stabilise at above 107 % (Graph 2.1.11). Under the Stability and Growth Pact scenario ([13]), i.e. assuming that the Irish Government complies with all the requirements of the Pact, gross government debt is projected to decline to around 80 % of GDP by 2025. Though still high, this is an improvement on earlier forecasts, mainly because of a stronger growth outlook and higher primary budget balances.

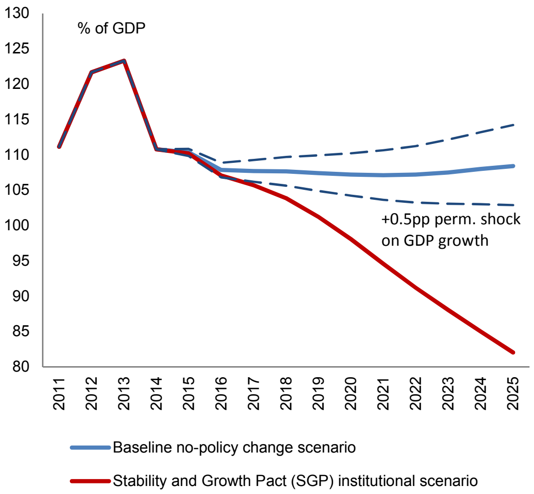
Long-term sustainability of public debt implies achieving significant primary surpluses. The Stability and Growth Pact scenario under the debt sustainability analysis is contingent upon Ireland sustaining structural primary surpluses of about 3 % of GDP (Graph 3.1.12). A robust fiscal framework would support such a path. While it did much to improve the fiscal framework and the quality and timeliness of fiscal data under the EU-IMF financial assistance programme, multi-annual expenditure ceilings are still open to discretionary changes (Section 4.3).

The sustainability of government debt remains vulnerable to macro-shocks. The European Commission's debt sustainability analysis also assesses the sensitivity of debt projections to changes in key economic variables. It shows that a negative shock to nominal GDP growth of 0.5 percentage points would increase the public debt-to-GDP ratio to about 114 % by 2025 under the no-policy-change assumption. By contrast, the sensitivity of government debt to a rise in interest rates on new borrowing is estimated to be low, given low future refinancing needs.

([12]) For more information on the Commission's methodology, see http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp200_en.pdf.

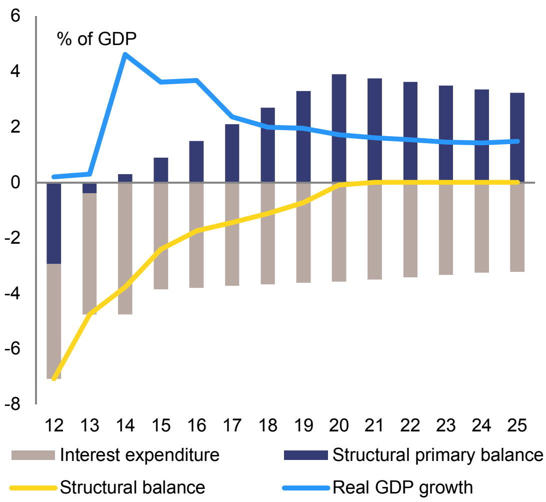
([13]) The SGP scenario assumes that for countries under excessive deficit procedure such as Ireland, a structural adjustment path in compliance with the fiscal effort recommended by the Council is maintained until the excessive deficit is corrected, and thereafter an annual structural consolidation effort of 0.5 percentage point of GDP or 0.6 percentage point if public debt exceeds 60 % of GDP is maintained until the medium-term objective is reached. The effort of 0.6 percentage point is used for illustrative purposes and does not prejudge the actual effort in excess of the 0.5 percentage point benchmark that will be required until the medium-term objective is achieved.

Graph 2.1.11: **Gross government debt projections**



(1) The Stability and Growth Pact scenario assumes a structural adjustment path in accordance with the fiscal effort recommended by the Council until the excessive deficit is corrected, and then an annual structural consolidation effort of 0.6 percentage points until the medium-term objective is reached.
Source: European Commission

Graph 2.1.12: **General government balance and real GDP growth**



(1) The Stability and Growth Pact scenario assumes a structural adjustment path in accordance with the fiscal effort recommended by the Council until the excessive deficit is corrected, and then an annual structural consolidation effort of 0.6 percentage point until the medium-term objective is reached.
Source: European Commission

Costs associated with demographic trends will put pressure on public finances. A progressively ageing population will be a feature of the next few decades. The proportion of Irish people aged 65 and over is expected to almost double by 2045. The combination of higher numbers of older people and falling numbers of people entering the working-age population should result in an increase in the old-age dependency ratio, even though the ratio will be sensitive to migration trends that are difficult to predict in the long run ([14]). These projected changes in the composition of the population could put pressure on public finances, with increasing demands to finance pensions, healthcare and long-term care needs. Pension reforms ([15]) have been implemented since the last age-related expenditure projections carried out jointly by the European Commission and the Economic Policy Committee. They are likely to have a positive impact on the long-term sustainability analysis, which will be updated later this year.

Government contingent liabilities remain significant but are declining. State guarantees were still substantial at 41.4 % of GDP in 2013, compared to the EU average of 9.8 % of GDP. Of these guarantees, 31.1 % of GDP in 2013 were contingent liabilities of the general government related to support granted to financial institutions (Table 2.1.1), compared to 6.4 % of GDP in the EU as a whole. Nonetheless, the ongoing repayment of the government-guaranteed bonds the National Asset Management Agency issued means that contingent liabilities are decreasing.

([14]) The 2015 Commission Ageing Report (underlying assumptions and projection methodologies) projects the old-age dependency ratio to increase to 27 % in 2025 from 19 % in 2013.
([15]) As a result of the pension reforms, the qualifying age for state pensions increased to 66 in 2014. It will increase to 67 in 2021 and then to 68 in 2028 (for more information on the new Single Public Service Pension Scheme, see the Department of Public Expenditure and Reform's web page: http://www.per.gov.ie/pensions/). The 2013 public service wage agreement included pension cuts for annual pensions above EUR 32,500 for new retirees from 31 August 2014.

Table 2.1.1: **Government contingent liabilities**

% of GDP	2013	2014
Public guarantees	66.9	32.1
of which linked to the financial sector		
Eligible Liabilities Guarantee	42.1	11.5
Exceptional Liquidity Assistance	9.3	-
National Asset Management Agency	14.7	19.8
other	0.8	0.8

Source: Irish Department of Finance

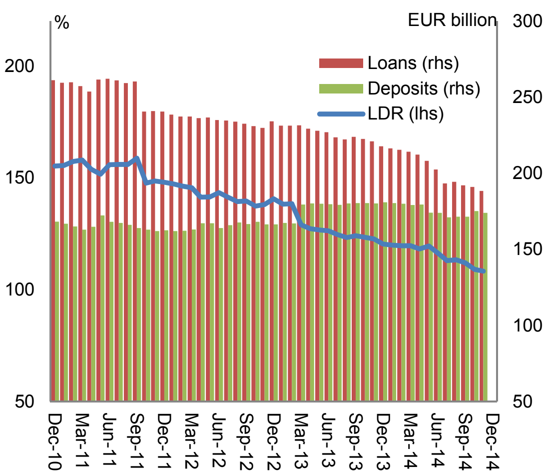
Overall, while the debt-to-GDP ratio has started to decline there are still challenges to the long-term sustainability of public finances. Based on current information, the Irish Goverment's budgetary targets for 2015 and beyond are in line with the Council Recommendation, and would ensure a declining debt-to-GDP ratio. However, debt projections are fairly sensitive to growth shocks and possible deviations from the fiscal adjustment path. An ageing population is also projected to increase health care and long-term care costs.

2.2. FINANCIAL SECTOR CHALLENGES

Banking sector restructuring

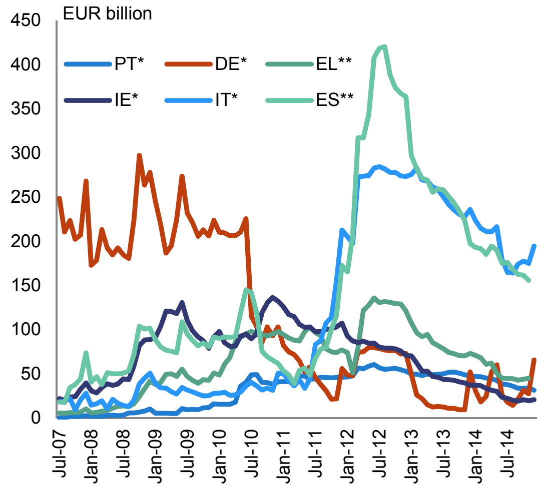
Ireland has made good progress in restructuring, downsizing and recapitalising its domestic banks. It has made good progress in addressing the significant imbalances in the banking sector. Since the end of 2010, two banks were merged and two others resolved. The European Commission has approved the restructuring plans of the two largest main domestic banks, Allied Irish Bank (AIB) and Bank of Ireland (BOI). All the domestic banks fulfilled stringent conditions to downsize their balance sheets to sustainable levels under the EU-IMF financial assistance programme which ended at the end of 2013. Their total assets have come down from around 220 % of GDP at the end of 2010 to about 158 % of GDP in 2014, with a greater focus on the domestic market. Average loan-to-deposit ratios have decreased from 155 % in late 2010 to 99.5 % in November 2014 (Graph 2.2.1). As a result, banks' funding profiles have normalised, with stable deposits, full access to markets funding and less reliance on central bank funding (Graph 2.2.2).

Graph 2.2.1: **Loan-to-deposit ratio (LDR)**



Source: Central Bank of Ireland

Graph 2.2.2: **Eurosystem borrowing**

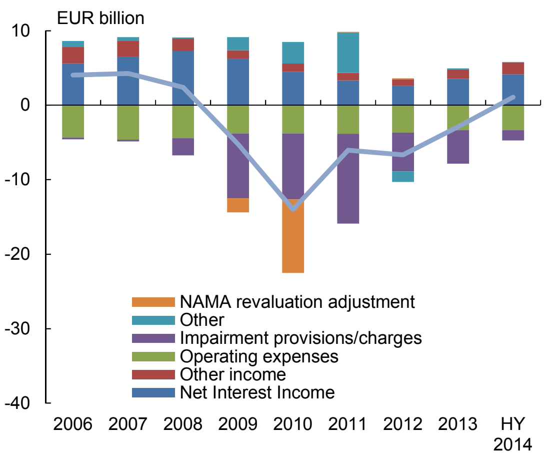


(1) Data up to December 2014 (for ES and EL: data up to Nov 2014)
(2) *related to monetary policy operations denominated in EUR **total to domestic monetary financial institutions or not further specified
Source: National central banks

The profitability of domestic banks continues to improve. In the first half of 2014, Allied Irish Banks and Bank of Ireland became profitable, with post-provision profits of EUR 437 million and EUR 399 million respectively. Over the same period, Permanent TSB reduced its losses before one-off exceptional items to EUR 172 million. Tracker mortgages ([16]) continue to weigh on the bank's profitability however. Impairment charges have decreased; while operating expenses stayed relatively flat (Graph 3.2.3).

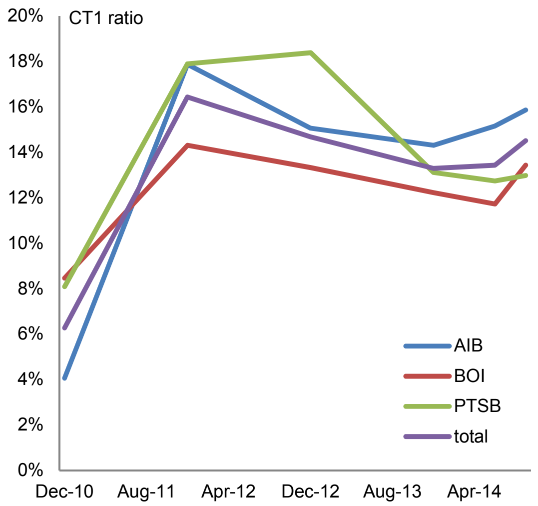
([16]) Tracker mortgages are low-yielding legacy loans where the interest rate is set at a low fixed margin above European Central Bank or Bank of England policy rates.

Graph 2.2.3: **Components of domestic bank profitability**



(1) 2014 figures are annualised
Source: Annual and semi-annual reports of Irish domestic banks

Graph 2.2.4: **Domestic bank capital positions**



(1) CT1 Ratio: Regulatory Core Tier 1 capital to risk-weighted assets
Source: Central Bank of Ireland

The results of the ECB's comprehensive assessment reflected the domestic banks' strengthened position (Graph 2.2.4). All the Irish banks passed the asset quality review and the three-year baseline stress tests scenario of the assessment (Table 2.2.1). Only Permanent TSB showed a EUR 855 million capital shortfall in the adverse scenario of the stress test. The adjustments identified in the asset quality review for the Irish banks were modest, since the banks' balance sheets had already been assessed towards the end of the EU-IMF financial assistance programme. Nevertheless, despite recent declines, the high share of non-performing loans and incidence of mortgage arrears continues to weigh on the Irish banking sector.

Table 2.2.1: **Results of the comprehensive assessment**

	AIB*	AIB**	BOI	PTSB
CET1 ratio (2013)	15.0%	15.0%	12.4%	13.1%
AQR adjusted CET1 ratio (2013)	14.6%	14.6%	11.8%	12.8%
Adjusted CET1, baseline (2016)	12.4%	15.9%	13.2%	8.8%
Adjusted CET1, adverse scenario (2016)	6.9%	10.3%	9.3%	1.0%
Fully loaded CET1, baseline (2016)	1.7%		7.9%	6.3%
Fully loaded CET1, adverse scen. (2016)	-3.6%		2.9%	-2.8%
Non-performing exposures ratio (2013)	22.3%		14.3%	17.9%
Coverage for non-performing exp. (2013)	44.4%		48.2%	41.4%

(1) *Static balance sheet approach **Dynamic balance sheet approach
(2) CET stands for Common Equity Tier
Source: Central Bank of Ireland

The restructuring of Permanent TSB continues. To fill the capital gap the comprehensive assessment identified, the bank submitted its capital plan to the Single Supervisory Mechanism for review. Permanent TSB has nine months from the date of publication of the results of the comprehensive assessment to implement the capital plan. The bank has publically stated that recapitalisation will draw on private sources. The Commission is also currently reviewing the bank's updated restructuring plan. Permanent TSB, 99.2 % state-owned, is taking advantage of the existing strong demand for Irish assets to attract private investors. It is improving its lending margins and prospects for write-backs as the Irish economy continues to recover ([17]). Nonetheless, the bank will have to pay back some of its EUR 2.3 billion of state aid over the coming years and its structural balance sheet issues, with a large amount of low-yielding tracker mortgages, will be difficult for the bank's management to deal with. Overall, it is expected to tap into the private capital markets in the first half of 2015. However, unlike the other large Irish banks, Permanent TSB's capital structure will not be very much affected by the gradual phasing out of existing capital instruments such as preference shares or deferred tax assets.

([17]) Permanent TSB still conservatively assumes 55 % peak-to-trough house price decline in its mortgage provision models versus an actual decline of about 41 %.

Banking regulation and supervision

The regulatory and supervisory systems have been reformed to address imbalances in banks. In addition to many other key regulatory reforms implemented under the EU-IMF financial assistance programme, 2013 legislation gave the Central Bank of Ireland extensive powers to source information, conduct on-site inspections, issue regulations and take direct remedial and enforcement action. The Central Bank Supervision and Enforcement Act 2013 also gave the Central Bank power to request an independent auditor assessment on banks' financial accounts. Under the Single Supervisory Mechanism, joint supervisory teams will do the routine supervision of major institutions. The teams will be made up of staff from the ECB and the Central Bank of Ireland.

The phasing in of new capital requirements will challenge the main domestic banks. This is due to their low profitability and the fact that Bank of Ireland, and particularly Allied Irish Banks, have large holdings of deferred tax assets and government preference shares that will gradually be deducted from capital ([18]). Rapid improvements in profitability will be crucial to enable banks to use their deferred tax assets and generate internal capital. Converting existing preference shares into common equity tier 1 (CET 1) eligible instruments (i.e. common shares) could also improve Allied Irish Banks' and Bank of Ireland's fully-loaded Basel III capital ratios.

New prudential measures by the Central Bank of Ireland aim to contain mortgage and housing risks. While the national property price index remains 37.9 % below its 2007 peak, house prices are increasing rapidly in Ireland (by 16.2 % year-on-year in November 2014), and especially in Dublin. This is mainly due to supply shortages. The number of loans issued at high loan-to-value ratios has also been increasing recently. The amount of loans issued at over 80 % loan-to-value has increased to 50 % of new loans issued in 2013. Against this background, the Central Bank of Ireland introduced proportionate limits on the amount of new lending at high loan-to-value and loan-to-income levels. It did so to make banks and households more resilient to potential future credit-induced housing bubbles and reduce the risk of borrower default. Following extensive consultation, the final set of rules made certain concessions to first-time buyers ([19]). In the short-term these measures may curtail lending volumes and thus possibly keep bank profitability down. However, over the medium to long term, the housing market should adjust and credit risk should decline.

The setting up of a central credit register continues and will help supervision and credit decisions. The lack of a statutory central credit register in Ireland makes supervision, credit underwriting and internal risk management more difficult in the run-up to a crisis, contributing to the build-up of severe imbalances. The planned introduction of a central credit register continues to progress, albeit slowly. The Credit Reporting Act 2013 was enacted in December 2013. The current timeline envisages the register's being operational in the latter part of 2016. It will enable lenders to carry out a more thorough evaluation of a borrower's ability to pay back by providing a database on the total amount of individual and SME debt. The availability of borrowers' total indebtedness data would also enable the potential introduction of macro-prudential measures involving debt-to-income and debt-service-to-income ratios.

Non-performing loans

The high stock of non-performing loans is slowly declining. They fell to 24.9 % of total loans of the three main domestic banks in the third quarter of 2014, from a high of 27.1 % at the end

([18]) In Ireland, this involves a phasing out of the counting of deferred tax assets towards common equity tier 1 capital by 10 % annually from 2015 until end 2023 for Allied Irish Banks and Bank of Ireland (Permanent TSB also recognised EUR 414 million of deferred tax assets in 2013). Pursuant to the Capital Requirement Regulation, preference shares subscribed by the government will no longer count as regulatory capital own funds, after 1 January 2018.

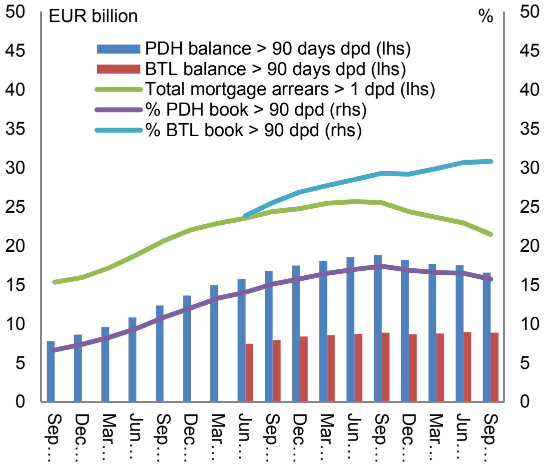
([19]) For principal dwelling housing, new loans above a loan-to-value ratio of 80 % will be limited to 15 % of the value of the flow of new housing loans in the year, and a cap of 20 % will apply for new loans above 3.5 times the borrower's income. First time buyers may be granted up to 90 % loan-to-value financing on the first EUR 220 000 of any mortgage, although the bank will still need to comply with the general loan-to-value limit. For buy-to-let purchases, the value of loans issued above 70 % loan-to-value will be limited to 10 % of the total value of new lending.

of 2013. The decrease reflects the improved macroeconomic environment, in particular reduced unemployment, better GDP growth prospects and the improved net wealth of households and companies amid growing asset prices, especially property prices. These variables are generally considered to be the main drivers of non-performing loans.

Mortgage arrears continue to fall steadily. Central Bank of Ireland data for the third quarter of 2014 show that the number of accounts in arrears for over 90 days decreased by 4.5 % quarter-on-quarter. Their value decreased by 3.8 % quarter-on-quarter. However, mortgages in arrears stood at 19 % of total mortgage loan balances in the third quarter of 2014, down from 19.9 % in the third quarter of 2013 (Graph 2.2.5). The persistent increase in the build-up of longest-term arrears (over 720 days) continued, increasing to 9.6 % of total loan balances in the third quarter (from 9.2 % at the end of June 2014). The buy-to-let sub-category remains more problematic with 30.8 % of total balances in arrears in the third quarter. This is higher than principal dwelling houses arrears that stood at 15.7 % in the same period. After recent increases, however, buy-to-let accounts in arrears decreased by 0.4 % quarter-on-quarter in the third quarter of 2014.

The banks continue to meet their mortgage arrears resolution targets. In September 2014, all banks had met and exceeded the target of proposing sustainable restructuring solutions to at least 80 % of mortgage holders in arrears of more than 90 days and concluding 40 % of them. More than the minimum required, in 75 % of concluded solutions, mortgage holders were meeting the terms of the new arrangement. Half of the proposed solutions involved restructuring, while the other half involve legal proceedings that may end in repossession. The number of restructured accounts increased in the third quarter of 2014 by 7.8 % quarter-on-quarter for principal dwelling housing, and 4.8 % quarter-on-quarter for buy-to-let. The number of repossessions in the third quarter increased by almost 7.5 % quarter-on-quarter to 2027 properties (Graph 2.2.6), but remains relatively low, with a greater proportion of buy-to-let properties than primary dwelling housing being repossessed.

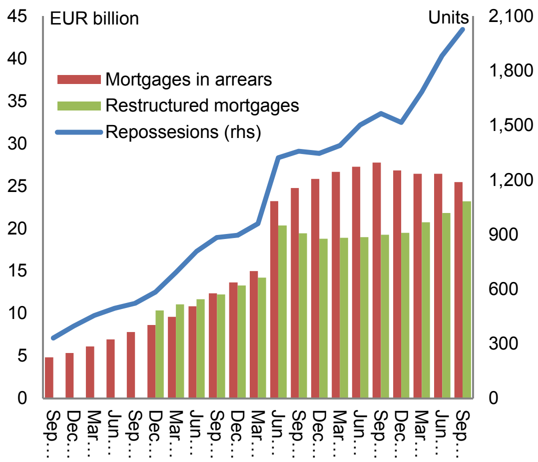
Graph 2.2.5: **Mortgage arrears**



(1) PDH: primary dwelling housing; BTL: buy-to-lets; dpd: days past due
Source: Central Bank of Ireland

Ireland has made progress in implementing sustainable restructuring solutions. There are still some discrepancies in the way banks classify restructured loans. An audit was carried out on the Q4-2013 arrears resolution targets outcomes and another audit is being carried on the Q2-2014 outcomes of two banks. They show that there has been a reliance on standard forbearance techniques involving rescheduling principal or interest payments rather than lowering both. Examples include temporary switches to interest-only mortgages, extending the term of the mortgage and arrears capitalisation. The latter type of restructuring has displayed a high propensity to re-default. Banks continue to rely heavily on legal proceedings in concluded solutions as a way of convincing customers in arrears to engage with them. As a result, there have been indications that the courts system is experiencing some backlogs, as shown by the more frequent adjournments and prolonged proceedings. Finally, rising rents have led to more use of rent receivership solutions for buy-to-let loans in arrears.

Graph 2.2.6: **Mortgage restructuring**



Source: Central Bank of Ireland

Commercial loan restructuring and disposal continue, though they still make up most non-performing loans. The banks are making progress in reaching their non-public commercial loan (including SME) restructuring targets. They aimed to have had almost all of them restructured by the end of 2014. Lenders have noted a recovery of cash-flows in certain SME sectors. The distressed commercial portion of the banks' loan books is slowly decreasing, through a combination of asset sales, restructures and write-offs. The National Asset Management Agency (the bad bank tasked with the work-out of distressed commercial real estate exposures transferred by banks) is ahead of schedule with EUR 18.7 billion of assets disposed of at the end of December 2014 (about 28 % of which are Irish), taking advantage of strong market demand. The Consumer Protection (Regulation of Credit Servicing Firms) Bill was published in January 2015. The bill aims to address concerns regarding the protection of borrowers when loans are sold to entities unregulated by the Central Bank of Ireland. Under the discussion in the Irish Parliament, the bill would extend the existing protection of borrowers by regulating credit servicing firms. These firms would need to manage or administer the credit agreement with the consumer or SME on behalf of the unregulated buyer.

Overall, Ireland has made some progress in the implementing the Council Recommendations, including those on non-performing loans. As described above, Ireland has made considerable progress on mortgage arrears resolution. However, it has made less progress in developing guidelines on the sustainability of solutions and publishing data on banks' SME/commercial arrears. Ireland has also yet to develop a strategy to address the issue of commercial real-estate arrears ([20]), although progress with restructuring some of these is being monitored under the commercial loan resolution targets ([21]). The National Asset Management Agency is accelerating asset disposals, taking advantage of strong market demand. The introduction of a central credit register is underway.

([20]) It is, however, important to note that the bulk of banks' distressed commercial real estate exposures built-up in the run up to the crisis have been addressed through transfers to the National Asset Management Agency that is ahead of targets for their work-out, and the special liquidation of the Irish Bank Resolution Corporation which resulted in sizeable disposals of commercial real estate loans to private buyers.

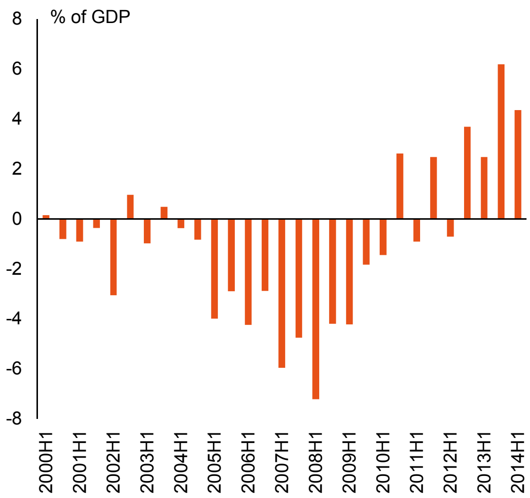
([21]) Given different practices of portfolio segmentation by banks, it is challenging to assess whether residual commercial real estate exposures on banks' balance sheets that do not have SME/corporate debtor connections are in fact subject to central bank restructuring targets.

2.3. COMPETITIVENESS AND EXTERNAL SUSTAINABILITY

Current account and competitiveness

Large current account surpluses have become the norm. The major external imbalances that characterised Ireland in the 2000s seem firmly behind it. Following substantial deficits since 2000, the current account balance has turned positive again since the second half of 2010, driven mostly by increasingly large trade surpluses (graph 2.3.1). A number of underlying factors explain the sharp turnaround, with the large presence of multinational companies in Ireland complicating the understanding of the external accounts. Headline numbers therefore need to be interpreted carefully.

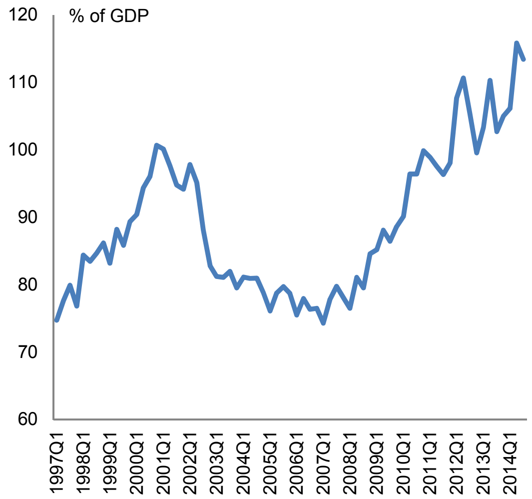
Graph 2.3.1: **Current account balances**



Source: Central Statistics Office

Competitiveness gains and demand shifts have contributed to external rebalancing. Ireland has long had a very open economy, with exports exceeding 80% of GDP as far back as the late 1980s (graph 2.3.2). The economic boom of the 2000s, however, led to a significant decrease in the export ratio as domestic demand surged to unsustainable levels and the non-tradable sector boomed, undermining the country's competitiveness. The adjustment process of the past few years entailed a significant reallocation of resources away from an oversized construction sector to the tradable sector, a sharp contraction in domestic demand and renewed impetus in exports as a result of competitiveness gains.

Graph 2.3.2: **Exports of goods and services**

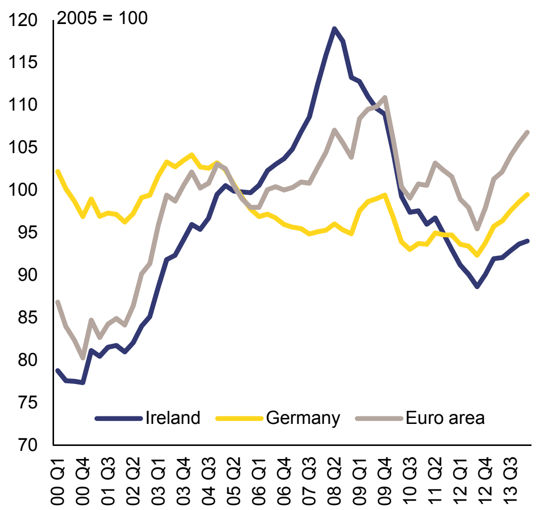


Source: Central Statistics Office

The rebalancing process between the tradable and non-tradable sectors seems to be nearing completion. Indications are that the reallocation of resources has reached a 'natural' limit ([22]) sufficient to put Ireland on a sustainable path. Ireland's unit-labour-cost-based real effective exchange rate is now moving broadly in line with Germany but still outperforming the euro area's rate (graph 2.3.3). This contrasts sharply with the period between mid-2008 and mid-2012 when Ireland's adjustment was much faster than that of other euro area Member States. With investment and private consumption having now passed their turning point, domestic demand has stopped contracting and the share of net exports in GDP has stabilised at around 22 % (graph 2.3.4). This remains very high by historical standards and could indicate that there may have been some overshooting in the rebalancing process between the tradable and non-tradable sectors.

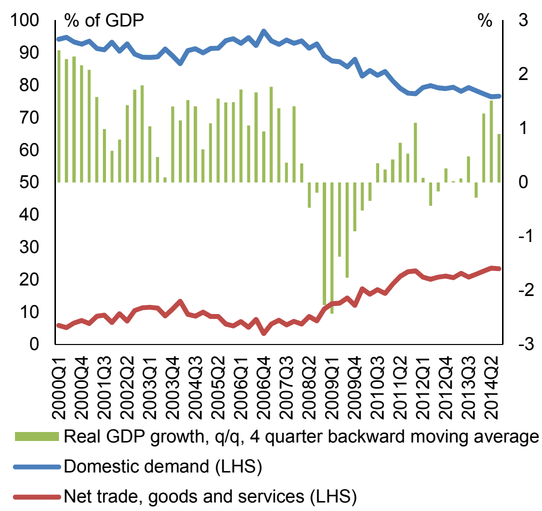
([22]) In particular, the proportion of people working in the export-oriented sectors should reach an upper limit at some point, as rising income and demand from workers operating in the export sector should fuel demand for non-tradables.

Graph 2.3.3: **Real effective exchange rate, 2005=100**



Source: European Commission

Graph 2.3.4: **Demand composition of GDP and GDP growth**



Source: Central Statistics Office

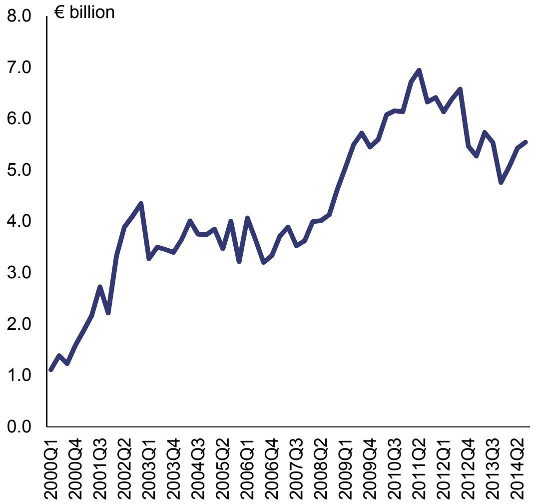
Ireland continues to draw investments by large multinational companies. The strong export performance over the past few decades owes much to Ireland's ability to attract multinational companies. Exports of pharmaceuticals, information technology, business and financial services for example, represent a large proportion of total exports and are almost entirely driven by multinational companies. However, data on net foreign direct investment inflows need to be interpreted carefully because certain transactions do not generate new operational investments in Ireland. Foreign investments in Ireland have regained momentum in the past couple of years. This is reflected in the number of projects completed with support from IDA Ireland, the entity responsible for attracting and facilitating foreign investment.

Shifts in multinational companies' operations greatly affect Ireland. Business decisions by multinational companies in Ireland are determined not only by country-specific factors, but also by the dynamics of global value chains and regulatory determinants, including in particular the interplay between tax regimes and bilateral tax treaties. Evolutions in global value chains have significantly affected Ireland's economy in the past and will continue to do so in the future, at times bringing about significant changes in the structure of output in a short period of time. ([23]) Multinational companies drive Irleand's export performance, provide a significant amount of high-skilled employment and generate a substantial share of national value added, particularly in manufacturing. Their activities also impact Ireland's balance of payments and international investment position to such an extent that it is difficult to disentangle underlying trends from specific issues.

The 'patent cliff' has been bridged. There were concerns in 2012 and 2013 that the expiration of patents on certain blockbuster drugs could trigger a general decline in the pharmaceutical industry, causing a sharp and sustained fall in exports. The patent cliff did in fact generate a steep drop in exports between their peak in Q2-2012 and the trough in Q3-2013. However, renewed investment and diversification put pharmaceutical exports on a rising trend again throughout 2014, allaying earlier fears (graph 2.3.5).

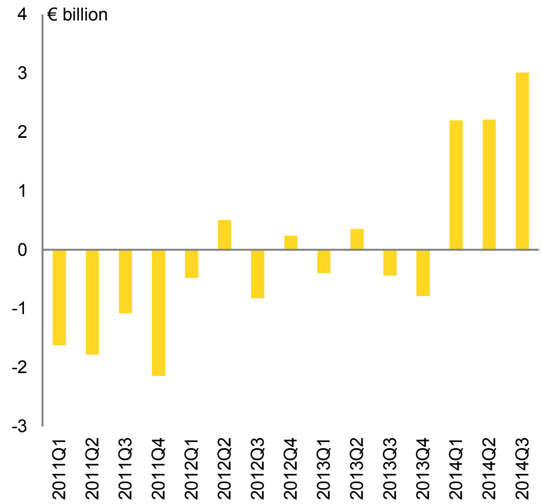
([23]) Production of computers by multinational companies represented a large share of as recently as the early 2000s, but has now dropped to near-insignificance.

Graph 2.3.5: **Exports of pharmaceutical products**



Source: Central Statistics Office

Graph 2.3.6: **Difference in net exports (balance of payments vs. customs)**



Source: Central Statistics Office

Contracted manufacturing inflates recent export figures. A small number of multinational companies appear to have used contracted manufacturing more in recent quarters. Under such contracts, products manufactured overseas for Irish-resident firms are accounted as Irish exports once shipped to a third country, even if they never transit through Ireland. Although such operations should result in a countervailing service import, they increased the contribution of net exports to GDP in 2014, artificially inflating the current account surplus. This recent development has resulted in a disconnect between customs-based trade data and balance of payments-based data. The difference between net merchandise exports on balance of payments and customs bases, which used to fluctuate around zero, has become significantly positive since the first quarter of 2014 (graph 2.3.6).

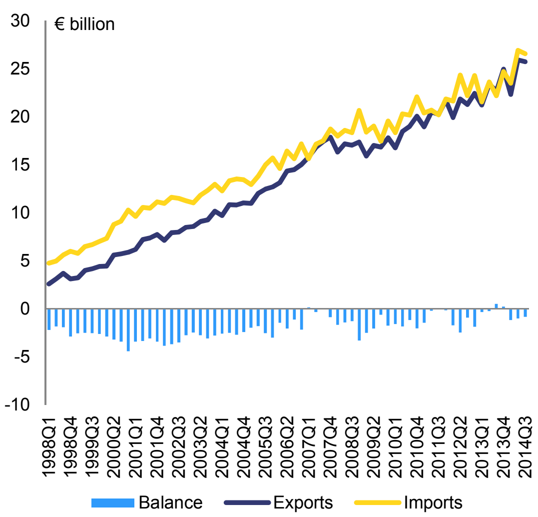
The full and medium-term impact of contracted manufacturing remains unclear. The business decisions underlying the rise in contract manufacturing are not entirely known. The extent to which a boost to current account and national accounts data through merchandise trade could/will be counterbalanced by rising services imports is also unclear at this stage. Neither is it known if this situation will be long-lasting or if it could extend to a wider set of companies. In any case, it will be an issue to monitor when analysing future trends in the current account balance, in addition to the impact of re-domiciled public limited companies. ([24])

Services exports have surged, but so have imports. Services export growth has far outpaced goods exports growth in the past few decades as large multinational companies have increasingly used Ireland as a base for providing ICT, business and financial services. Imports of services, however, have increased nearly as rapidly in the same period, with rising payments on royalties and licences. As a result, Ireland's balance on services remains in deficit, even though it is now close to balance compared to sizeable deficits during most of the 1990s and 2000s (graph 2.3.7). Its strong merchandise trade performance therefore remains

([24]) Everett (2012) and Fitzgerald (2013) first analysed the issue of re-domiciled public limited companiess and their impact on the current account. It is also discussed in the 2014 in-depth review of Ireland.

the driving force behind the current account surplus.

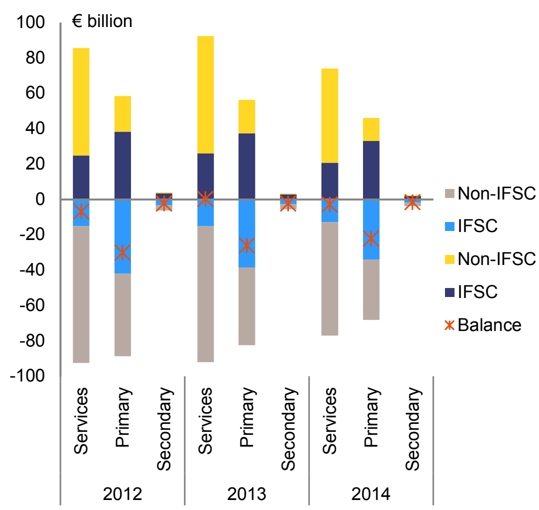
Graph 2.3.7: **Services exports, imports and balance**



Source: Central Statistics Office

Offshore financial services are a strong generator of net exports. Ireland's rise as a services exporter must also be considered in the light of the International Financial Services Centre. More than 500 companies operate in the International Financial Services Centre, directly employing over 30,000 people. ([25]) It generated net services exports of around EUR 10 billion in 2012 and 2013, and EUR 7.8 billion in the first three quarters of 2014. In contrast, non-International Financial Services Centre companies generated net imports of services of EUR 16.5 billion, EUR 10.4 billion and EUR 10.8 billion, respectively, in the same periods. Similarly, while International Financial Services Centre companies generate broadly balanced net primary income, the rest of the Irish economy is a large net payer of primary income to the rest of the world. Net non-International Financial Services Centre primary payments represented an average of around EUR 25 billion in 2012–2014, reflecting the high profitability of multinational companies (graph 2.3.8).

Graph 2.3.8: **International Financial Services Centre and non-International Financial Services Centre trade in services, primary and secondary income flows**

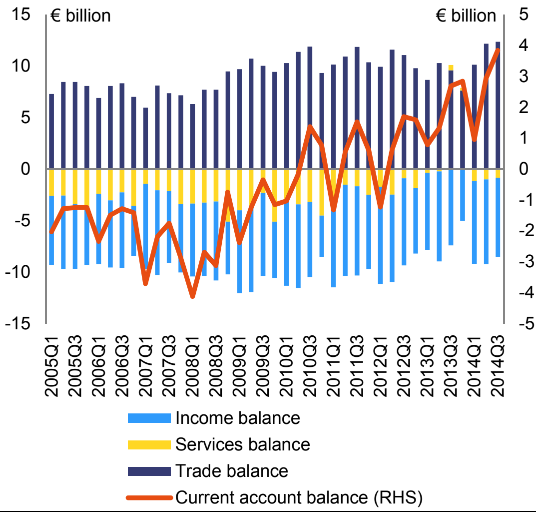


Source: CSO

Ireland's current account position is strong. The rebalancing and regained competitiveness of the past few years, together with the economy's sound fundamentals in terms of the business environment, the regulatory framework and skills, have led to a robust and lasting turnaround in the current account position (graph 2.3.9). Despite the rise of Ireland as an international services platform, merchandise trade continues to be the driving force behind the current account surplus. Multinational companies also continue to vastly dominate flows in the current and financial accounts. The nature of some of their operations also makes it hard to identify underlying patterns and economic impacts. They also make Ireland more susceptible to potential swings than most other economies.

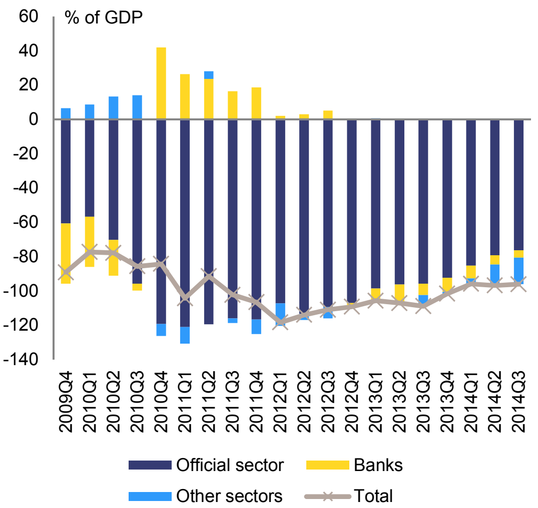
([25]) Key activities in the International Financial Services Centre include fund and asset management, banking, insurance, aircraft leasing, securitisation, and corporate treasury.

Graph 2.3.9: **Current account balance**



Source: Central Statistics Office

Graph 2.3.10: **Net international investment position by institutional sector**



Source: Central Statistics Office

External assets and liabilities

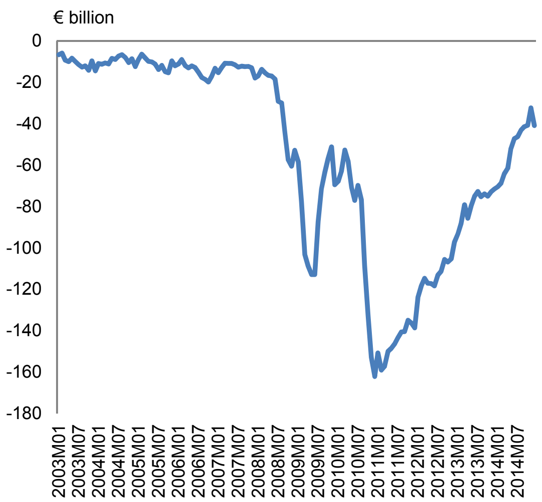
Net external liabilities remain large. Ireland had a negative net international investment position of EUR 176.5 billion (about 96% of estimated 2014 GDP) at the end of Q3-2014. This was down from a peak of EUR 204.4 billion (118% of GDP) in Q1-2012 (graph 2.3.10). Although the official sector (government and central bank) accounts for most of this net position, the country's international investment position has developed in contrasting ways in recent quarters. The large multinational companies sector and Ireland's International Financial Services Centre also have large gross asset and liabilities positions liable to generate significant swings in the net international investment position, including through valuation effects

Public sector debt remains the main reason for Ireland's negative net international investment position. A large proportion of government debt is held abroad, either by foreign bond holders or as debt owed to official creditors, mainly the European Financial Stabilisation Mechanism, European Financial Stability Facility and the International Monetary Fund. As of Q3-2014, general government gross external liabilities represented about 73% of estimated 2014 GDP. Although foreign assets partly compensate for this, the general government's negative net international investment position is significant enough that it accounts for most of the overall position.

General government external liabilities are stabilising. Given the openness of Ireland's economy, including in terms of access to financial markets for government funding, the general government's large negative net international investment position is unlikely to be reduced at an accelerated pace in the years ahead. Yet, it has stabilised in recent quarters on the back of declining government deficits and the emergence of a small primary surplus in 2014. It is expected to fall only gradually in the coming years, in line with Ireland's efforts to ensure long-term fiscal sustainability and put public debt on a firm downward trajectory (Section 3.1.1). The composition of this debt, however, will again shift towards liabilities towards private creditors. The early repayment of XDR 15.7 billion of loans to the International Monetary Fund will speed up the process this year.

Target 2 balances fall. In contrast with the general government, the Central Bank of Ireland has sharply reduced its net and gross external liabilities, mainly Target 2 balances ([26]).This was made possible by the end of the emergency liquidity assistance provided to domestic banks, the conversion of promissory notes, the near-completion of the deleveraging process of domestic banks and regained access to international financial markets for the government and domestic banks alike. As of the end of 2014, Target 2 balances amounted to EUR 40.9 billion, down from a peak of EUR 162 billion at the end of 2010 (graph 2.3.11).

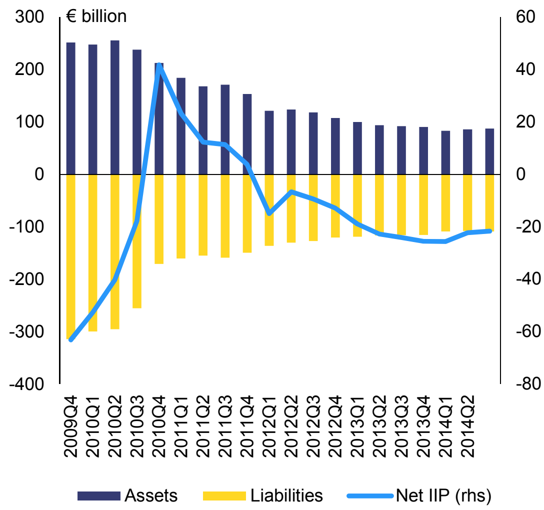
Graph 2.3.11: **Target 2 balances**



Source: Central Bank of Ireland

The net international investment position of domestic banks is stabilising. Before 2007, domestic banks had accumulated large external liabilities that enabled them to fuel the housing market boom and acquire assets abroad. The restructuring of the banking sector in recent years has caused a rapid fall in the external assets and liabilities of domestic banks, including by transferring some positions to the public sector. The external liabilities of domestic banks stabilised in the first three quarters of 2014 at around EUR 110 billion, a third of their position at the end of 2009. External assets also stabilised and shrunk in similar proportion, from EUR 251 billion to around EUR 85 billion (graph 2.3.12). Once an important force behind the evolution of Ireland's international investment position, domestic banks have therefore become significantly less so.

Graph 2.3.12: **External assets and liabilities of domestic banks**

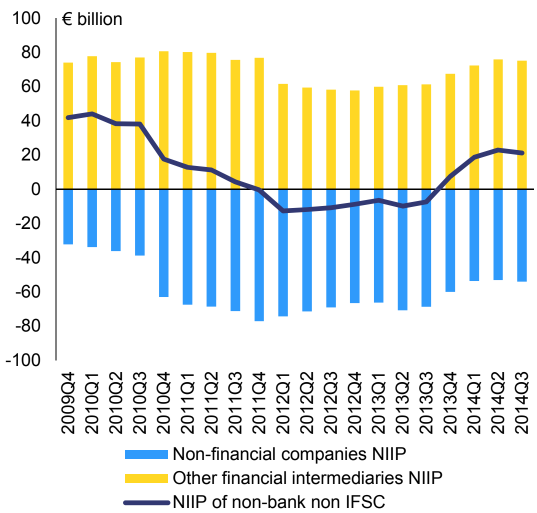


Source: Central Statistics Office

Business entities outside the International Financial Services Centre have broadly compensating net international investment positions. Non-bank financial intermediaries outside the International Financial Services Centre, including insurance companies, owned net external assets worth EUR 75 billion at the end of Q3-2014. This position has been relatively stable in the past few years, with external liabilities typically small. In contrast, the net international investment position of non-financial companies (mainly multinational companies) has been negative in the past few years (graph 2.3.13).

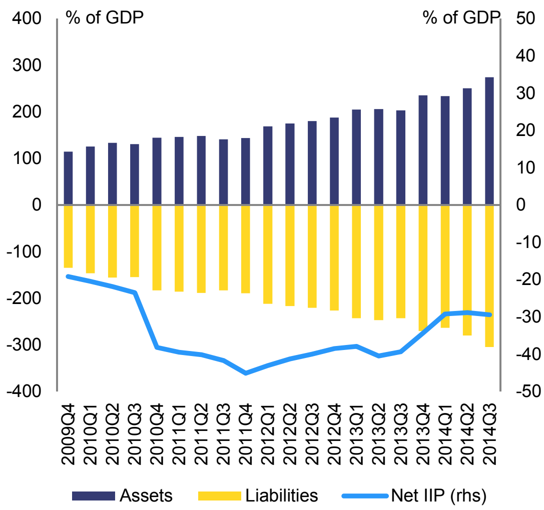
([26]) TARGET2 is the real-time gross settlement system owned and operated by the Eurosystem. See ECB website.

Graph 2.3.13: **International investment position of non-financial companies and non-bank financial intermediaries (outside the International Financial Services Centre)**



Source: Central Statistics Office

Graph 2.3.14: **International investment position of non-financial companies**



Source: Central Statistics Office

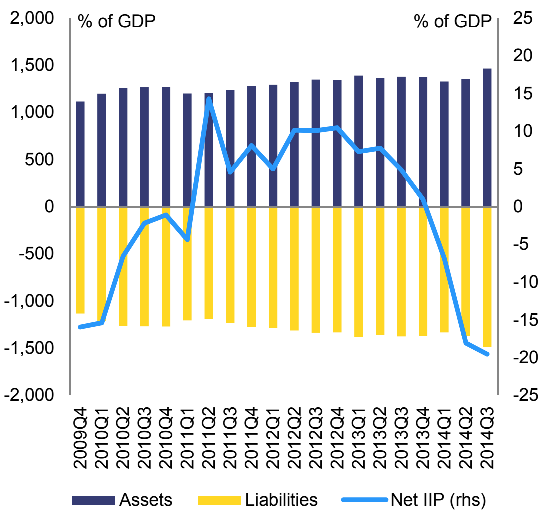
The external positions of multinational companies are very large. The net international investment position of the corporate sector outside the International Financial Services Centre (mainly multinational companies) has been negative in the past few years, but decreased to EUR 54 billion at the end of Q3 2014. This is mainly because multinational companies finance most of their Irish operations abroad, including through intra-company loans and reinvested earnings. In contrast to that of non-bank financial intermediaries, their net position hides much larger assets and liabilities, amounting to almost 300 % of GDP (graph 2.3.14). The size of their liabilities relative to the Irish economy, together with their large external assets, also show that multinational companies use Ireland to finance operations in the rest of the EU. It is therefore not possible to distinguish the amount of net liabilities that are directly related to Irish-based operations only.

The nature of the external assets and liabilities of multinational companies differ. As of Q3-2014, resident entities outside the International Financial Services Centre held most of their assets abroad in the form of direct investments (64.9 % of the total), including intra-company loans. The re-domiciliation of public limited companies contributed to increasing resident holdings of direct investment abroad, but the situation now appears to have stabilised. Portfolio investments, in turn, accounted for another 20.3 % of resident's external assets. Direct investment accounted for only 25.9 % of total liabilities, with more volatile portfolio investments and other forms of instruments accounting for 59.9 % and 34.7 % of the total, respectively. This type of mismatch between assets and liabilities could potentially expose Ireland to risks related to the transactions of multinational companies.

The gross positions of the International Financial Services Centre swamp those of the rest of the economy. External assets and liabilities of the International Financial Services Centre are exceptionally large in relation to the size of the Irish economy. As of Q3-2014, gross external assets and liabilities each represented almost 1500 % of GDP, by far exceeding even the positions of non-International Financial Services Centre multinational companies. The net position has nevertheless remained relatively small over the past few years, hovering around plus and minus

15 % of GDP (graph 2.3.15). As a result of the type of activities by International Financial Services Centre companies, external assets and liabilities are mainly held as portfolio investments. ([27]) The nature of portfolio holdings makes asset price variations more likely and potentially larger than for other types of assets. The size of gross positions means that relatively modest variations in asset prices are susceptible to have a significant impact on Ireland's overall net international investment position. However, the Irish economy and its external accounts are by and large sheltered from such variations as assets and liabilities refer to foreign entities.

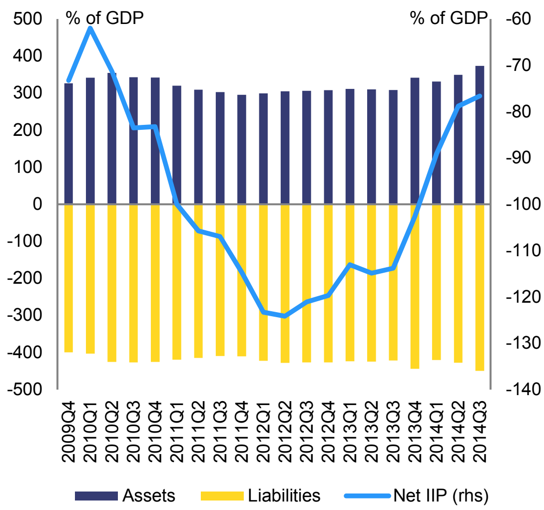
Graph 2.3.15: **International investment position of International Financial Services Centre**



Source: Central Statistics Office

([27]) Portfolio investments represented 67.7% of total external assets and 73.5% of total external liabilities as of Q3 2014. Direct investment assets and liabilities are marginal among International Financial Services Centre companies.

Graph 2.3.16: **International investment position of non-International Financial Services Centre sectors**



Source: Central Statistics Office

The core net international investment position has strengthened recently. Abstracting from the holdings of the International Financial Services Centre, Ireland's net international investment position strengthened significantly over the past few quarters, falling from a negative position of 124.2 % of GDP in Q2-2012 to 76.7 % of estimated GDP in Q3-2014 (graph 2.3.16). This is consistent with the significant rebalancing of the economy in the aftermath of the crisis and the remarkable shift from a current account deficit of EUR 10 billion in 20007–2008 to a surplus of EUR 7.7 billion in the first three quarters of 2014. The remaining sizeable negative net international investment position is mostly due to the legacy effects of the economic and banking crisis on government external debt. It should fall in parallel with Ireland's efforts to reduce fiscal imbalances by moving back towards the 60 % of GDP debt rule under the Stability and Growth Pact.

2.4. STRUCTURAL CHALLENGES IN THE LABOUR MARKET AND SKILLS MISMATCHES

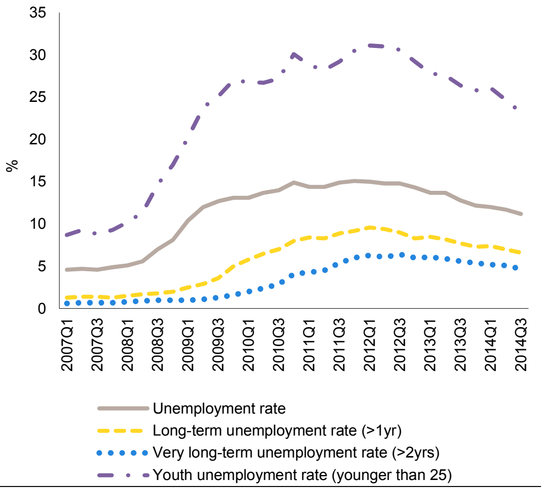
The labour market continues to adjust. The crisis caused large-scale unemployment with associated adverse social consequences. The rebalancing between the tradable and non-tradable sectors has created skills mismatches that risk increasing structural unemployment. The authorities have dealt with the situation by putting active labour market policies in place, revamping the further education and training sector and stimulating job creation.

Labour market challenges and rebalancing

The collapse of the property market and the ensuing financial and economic crisis led to a sharp deterioration in labour market indicators. Unemployment surged from an average of 4.1 % in 2000–07 to a peak of 14.9 % in early 2012.

The labour market reached a turning point in 2013 with renewed job creation in the private sector, modest rises in participation levels and modest falls in the unemployment rate. These improvements continued in 2014 with the employment rate (15-64 age group) at 62.2 % in Q3-2014, up just over 1 percentage point from 2013. The unemployment rate (15-74 age group) fell from 13.1 % in Q3-2013 to 11.4 % in 2014. Long-term unemployment has fallen gradually with the strengthening of the labour market, although it remains high at 7 % in 2014. Youth unemployment (15-24 age group) has fallen significantly from its peak of 33 % in mid-2012 to 21.9 % in Q4-2014. The number of young jobseekers (15-24) with very low skill levels has also fallen from 50.4 % in 2012 to 40.8 % in 2013 is a positive development. The situation is also improving for young people not in employment, education nor training, with the rate dropping from 18.7 % in 2012 to 16.1 % in 2013. These improvements in labour market indicators are encouraging signs that the policy measures put in place over the past few years are paying off. At 10.7 % (15-74 age group) in Q4-2014, however, the unemployment rate is still more than double its pre-crisis level (Graph 2.4.1).

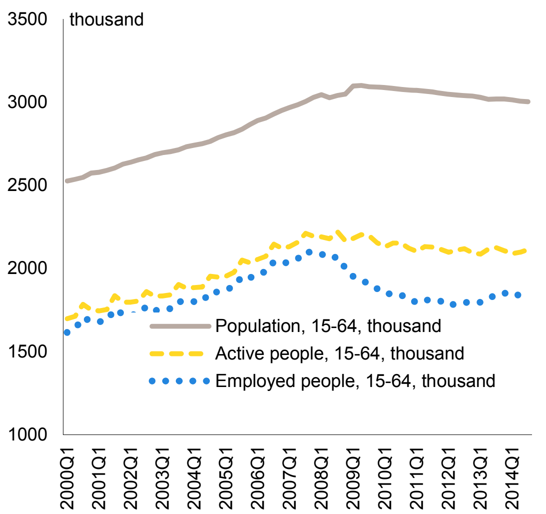
Graph 2.4.1: **Unemployment rate, long-term unemployment rate and youth unemployment rate**



Source: European Commission

The adjustment of the Irish labour market has been supported by both migration and wage developments. In the run-up to the crisis strong labour demand attracted significant labour migration. In contrast, the proportion of foreigners born in another Member State in the working-age population decreased between 2008 and 2013. Partly as a result of this, the total working-age population has decreased since 2009 (Graph 2.4.2).

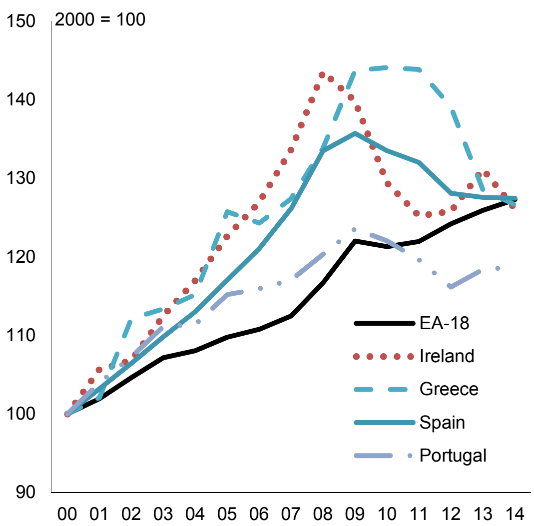
Graph 2.4.2: **Working-age population, active and employed people**



Source: European Commission

Wage developments also supported labour market adjustment. While in the pre-crisis period Irish wage increases were among the highest in the EU, its post-crisis adjustment has also proceeded rapidly. As a result, the accumulated growth of Irish nominal unit labour costs between 2000 and 2014 matches the euro area average (Graph 2.4.3).

Graph 2.4.3: **Nominal unit labour costs, total economy**



Source: European Commission

Long-term unemployment remains a serious concern, with the risk that cyclical unemployment could become structural. Long-term unemployment has fallen with the strengthening of the labour market, but it remains high at 6.6 % in Q3-2014, representing almost 60 % of total unemployment. Almost 5 % of the workforce has been out of work for more than 24 months. This partly reflects the difficulties that redundant workers with construction-sector skills have in transferring to other types of employment. It is also a mechanical consequence of the gradual nature of the recovery following a period of severe job-shedding during the downturn. The high prevalence of long-term and very long-term unemployment means that the workers affected are at great risk of losing tangible and intangible skills. This could have a lasting effect on their ability to regain employment.

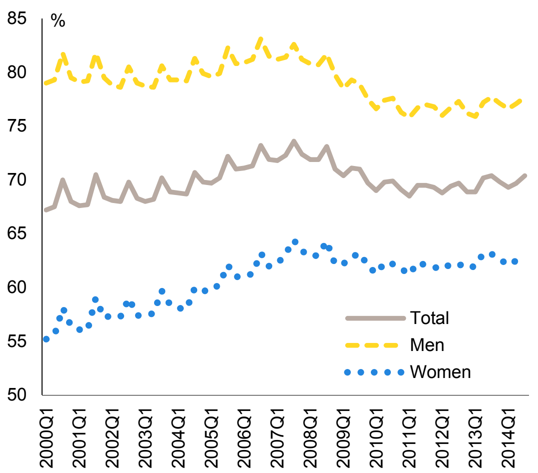
Despite recent improvements, important challenges remain in relation to youth unemployment. The youth unemployment rate and the rate of people who are not in employment, education or training are still very high and above the EU average. Additionally, among those who are not in employment, education or training, a rising proportion is also not active in the labour force ([28]). A worrying trend in the Irish youth labour market is the increase in involuntary part-time work, which stands at 41.4 % of those aged 15-24 in temporary employment (compared with 37.5 % in the EU as a whole). This trend, along with a 20 percentage points increase in part-time employment as a percentage of total employment for those aged 15-24 ([29]), points to increasing labour market segmentation for young people.

Unemployment figures understate the effect of the crisis on the labour market since many workers who lost their jobs, especially men, became inactive. The activity rate of men fell by 4 percentage points from its pre-crisis peak to about 78 % in 2014. The activity rate of women held strong through the same period, but its pre-crisis growth has come to a halt. Overall, the number of economically active people has decreased slightly since 2009 (Graph 2.4.4). This partly reflects the decline in the working-age population, but also the withdrawal of some workers from the labour market through discouragement effects.

([28]) 2012: 46 %, 2013: 48.45 %. In total this cohort comprises 7.8 % of the 15-24 year old population. This group is defined as individuals who are not in employment, education or training and are not active in the labour force.

([29]) Eurostat 2013: 2008: 26.6 % (EU28: 26.2 %), 2013: 46.6 % (EU28: 31.9 %).

Graph 2.4.4: **Labour market participation rates (ages 15-64)**

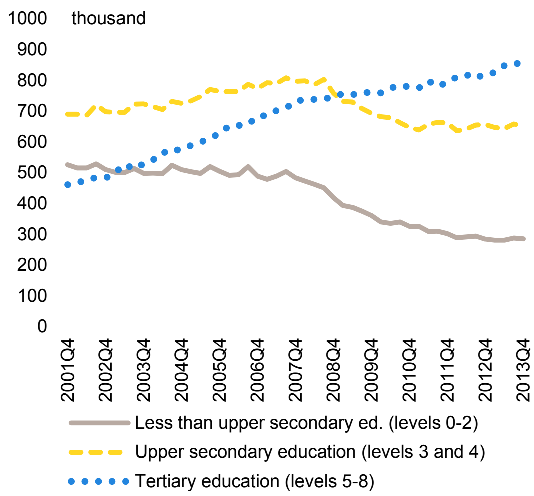


Source: European Commission

Both the crisis and the recovery affected sectors and skill groups differentially. The crisis hit the construction sector disproportionately. In the first two years of the crisis, some 200 000 jobs were shed in the construction sector. It also affected the public sector, with employment falling by 24 500 (6.2 %) over three years to Q3-2014. A drop of 6 000 jobs occurred in the year to Q3-2014, bringing the total number of employees in the public sector to 370 300. Conversely, the number of employees in the private sector increased by 67 800 over the three years to Q3 2014 with an increase of about 26 000 over the last four quarters of the period. High-skilled sectors of the economy fuelled this growth. The ICT sector in Ireland grew, year-on-year, at a rate of 16 % during the 12 months to July 2014. Professional, scientific and technical activities increased by 5.9 % in the same period.

Skills mismatches have emerged with the rebalancing of the economy. Since the recovery was strongest in skill-intensive sectors, it opened up job opportunities mostly for high-skilled workers. While total employment of those with tertiary education has continued to increase, total employment of those with less than tertiary education has only stabilised during the recovery (Graph 2.4.5). The unemployment rates also show how the different effects of the recovery across skill groups. For those with at most lower secondary education, the unemployment rate was at 21.2 % in Q3 2014. It fell below 14 % for those with upper secondary education and below 7 % for those with tertiary or a higher level of education (Graph 2.4.6).

Graph 2.4.5: **Employment by educational attainment**

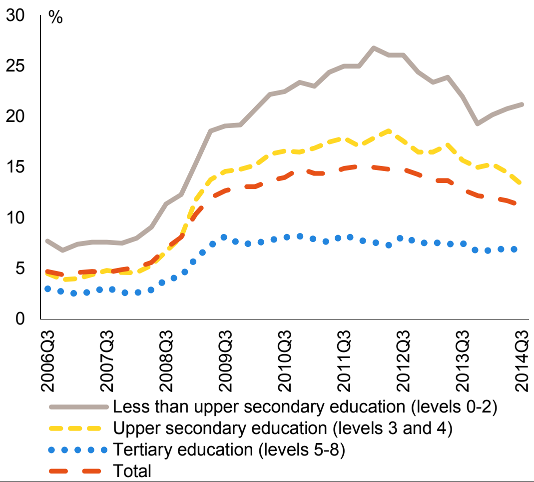


Source: European Commission

Ireland has digital skills gaps. Some 42 % of the workforce has few or no digital skills. Ireland suffers from a shortage of skilled ICT professionals. Demand is high, with over 30 % of companies employing ICT professionals. Supply is not keeping pace with demand. In 2014, over 50 % of companies that recruited or tried to recruit ICT professionals reported difficulties doing so, one of the highest rates in Europe ([30]). Ireland has nevertheless been proactive in addressing its digital skills gaps. With the help of relevant stakeholders, it has developed an ICT Skills Action Plan for the period 2014–18. The three main aims of the plan are to increase graduate numbers, enhance ICT capacity, improve awareness in the education system and attract foreign talent.

([30]) Eurostat, Survey on ICT usage and eCommerce.

Graph 2.4.6: **Unemployment rate by educational attainment (ages 15-64)**



Source: European Commission

There have been positive developments in basic and tertiary education in Ireland. In the 2012 Programme for International Student Assessment (PISA) tests Ireland scored below the EU benchmark of 15 % for low achievers in reading and science (9.6 % and 11.1 % respectively). It scored slightly above the benchmark in relation to mathematics (16.9 %). Early school leaving has been falling consistently since 2009 (11.7 %) to a rate of 8.4 % in 2013, over 3 percentage points below the EU average of 12 % in 2013. Tertiary education attainment also continues to rise. Ireland's tertiary education attainment rate for 30-34 year olds was 52.6 % in 2013, up from 51.1 % in 2012. While this represents the highest rate in the EU28, it is still short of Ireland's Europe 2020 target of 60 % of the 30-34 year old population with a tertiary education qualification by 2020. Enrolments are projected to continue to increase over the next decade as the number of students grows and the national strategy to improve access, flexibility and lifelong learning is rolled out.

At the same time, re-skilling and up-skilling are a challenge for the education and training system. The further education and training system has been ineffective in providing the types of skills that the rebalanced Irish economy needs. It also failed to give the unemployed valuable and relevant re-skilling and up-skilling opportunities. Traditionally, the apprenticeship system in Ireland has been heavily geared towards the construction sector. The authorities have recognised the need to reform further education and training. Reforms have been put in place to ensure the creation of a system that is more responsive and relevant to labour market needs (Box 2.4.1).

It is difficult for lower socio-economic groups to access tertiary education. Young people from a lower socio-economic background are less likely to attend university given poor educational attainment at secondary school. A number of studies ([31]) have looked at the impact of social class on higher education participation. They have found persistent evidence of social inequalities in higher education participation and that financial constraints are a major explanatory factor. The abolition of fees for higher education has not been enough to narrow the social class-related gap in higher education participation.

Policy responses

There are concerns about the effectiveness of existing activation policies and training programmes. The effectiveness of some of the training programmes available to the unemployed is unclear. There is evidence that the largest programme, the Community Employment Scheme, is ineffective. Past participation on Community Employment was found to increase a claimant's probability of falling back into long-term unemployment ([32]). With respect to *JobBridge*, existing evaluation evidence points to some positive effects, particularly where training is

([31]) Smyth, E. (1999) 'Educational inequalities among school leavers in Ireland 1979–1994' in The Economic and Social Review 30; McCoy, S., Byrne, D., O'Connell, P., Kelly, E. and Doherty, C. (2010a), 'Hidden disadvantage? A Study on the Low Participation in Higher Education by the Non-manual Group', Dublin Higher Education Authority; O'Connell, P.J., Clancy, D. and McCoy, S. (2006) 'Who went to college? Socio-economic inequality in entry to higher education in the Republic of Ireland in 2004' in Higher Education Quarterly 60; McCoy, S. and Smyth, E. (2011), 'Higher education expansion and differentiation in the Republic of Ireland' in Higher Education 61; Cullinan, J., Flannery, D., Walsh, S., McCoy, S. (2013), 'Distance effects, social class and the decision to participate in higher education in Ireland' in The Economic and Social Review 44.

([32]) O'Connell, P., McGuinness, S. and Kelly, E., 'A Statistical Profiling Model of Long-term Unemployment Risk in Ireland', The Economic & Social Review, 2012 Vol. 43(1) pp. 135-164.

heavily focused on existing labour market demand ([33]).

Activation policies are underachieving due to limited capacities in the employment service. There are currently around 500 jobseekers per caseworker in the Public Employment Service, a ratio well above what is considered best practice. Allocation of additional resources and efforts to tackle long-term unemployment, through the roll-out of the *JobPath* initiative, will see the caseload fall closer to 200 cases per member of staff. This will also help to reduce the high rates of households with low work intensity, given 52.7 % of the total unemployed come from such households.

It will still take some time before the first effects of *JobPath* have an impact on the labour market. Referrals to the providers are expected to start only in the beginning of the second half of 2015. Since a comprehensive monitoring and evaluation framework is being put in place only now, it is difficult to assess ex ante the programme's effectiveness. It remains to be seen how the private sector approach will differ from that of the Public Employment Services, what profile of claimants they will be working with, and their ability to harness links with employers and provide more effective services (with both activation and social inclusion components). The effective rolling out of the programme to tackle long-term unemployment will be necessary to meet ambitious numerical targets.

More measures need to be implemented, within the Youth Guarantee, to improve the situation of young people. Currently, there is a nine-month waiting period for young people who have been assessed to have a medium or high probability of exiting unemployment. The Council Recommendation on establishing a Youth Guarantee recommends young people receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within four months of becoming unemployed or leaving formal education to avoid scarring effects. Ireland also lacks a more comprehensive outreach strategy regarding, specifically, people not in employment, education nor training who are not active in the labour force. The data on involuntary temporary employment as a result of employer uncertainty arising from the financial and economic crisis also shows the importance of providing good-quality offers of employment or education, traineeships or apprenticeships relevant to labour market needs and leading to permanent jobs.

Further education, training and apprenticeship reforms are progressing in the right direction. The Further Education and Training Authority, SOLAS, has put a strategy in place to ensure programmes are efficient and relevant, link the provision of training to labour market needs and facilitate the movement of the long-term unemployed back into work. This includes setting up referral protocols between education and training boards and *Intreo* offices (single points of contact for all employment and income supports). A sound oversight system has been put in place to ensure that the rollout of the strategy and services plan is successful.

Ongoing reforms to the apprenticeship system will continue to be employer-led and should ensure the alignment of education and training provision with the needs of the labour market. The Apprenticeship Council has been given the task of extending apprenticeship opportunities to new sectors of the economy. Currently only a limited number of trades provide apprenticeship opportunities. Carrying out a 'sustainability test' that takes into account the evidence of labour market needs and future strategic economic priorities, future demand for apprenticeships and the progression routes for apprentices, should help enhance the labour market relevance of proposals. The first results of this initiative will not be seen before the end of 2015.

([33]) Indecon (2013), 'Indecon's Evaluation of Jobbridge' http://www.welfare.ie/en/downloads/indecon-report-on-evaluation-of-jobbridge.pdf; McGuinness, S., O'Connell, P. & Kelly, E. (2014), 'One Dummy Won't Get it: The Impact of Training Programme Type and Duration on the Employment Chances of the Unemployed in Ireland', Economic and Social Review, 2014, Vol. 545(3), pp. 425-450.

Box 2.4.1: Policy responses to labour market challenges and skills mismatches

Activation policies continue to be enhanced under the Pathways to Work strategy. Social welfare and public employment services are being integrated in one-stop-shops (*Intreo*), linking benefit entitlements more closely with the activation services. Currently, 44 *Intreo* offices have been opened and all remaining offices are planned to be opened in early 2015. The latest version of the strategy, launched in October 2014, outlines further new measures, including: enhanced engagement, profiling and sanctioning of beneficiaries and the Employment and Youth Activation Charter, which asks employers to commit to interviewing at least 50 % of candidates for a position from the Live Register. In Budget 2015, Pathways to Work is estimated to provide 300 000 places in work and training at a cost of EUR 1.6 billion.

Jobpath will be rolled out in 2015 to address long-term unemployment and help those furthest from the labour market. An employment activation programme, it will provide 1 000 additional staff across approximately 100 different outlets across the country dealing with an estimated 100 000 long-term unemployed jobseekers. It is expected to begin in the first 6 months of 2015. Costs have been estimated at EUR 340 million with the gross benefit savings estimated at EUR 525 million. The government has also committed to providing at least 57 000 education and training places for long term unemployed people during 2014 and 2015.

Implementation of the Youth Guarantee is continuing. Approximately 16 400 of the 28 000 plus places available under the Youth Guarantee had been taken up at the end of October 2014. New Youth Guarantee measures were announced in November 2014, including a Youth Developmental Internship which will offer a young person aged 18 to 24, an internship of between six to nine months and participants will receive a EUR 50 top-up of their weekly social security payment. The first intake is expected in March 2015. In order to further address youth unemployment, the *JobsPlus* scheme (an employer incentive to encourage employers to hire individuals on the live register who have been unemployed for over 12 months) has been revised and employers can receive the same incentive to employ an individual under 25 who has been unemployed for over 4 months.

Ireland continued to reform the further education and training system and apprenticeships. The new Further Education and Training Authority (SOLAS) and the 16 Education and Training Boards were established in 2013 and all training centres vested in SOLAS were transferred to their respective Education and Training Board by July 2014. In May 2014 SOLAS published its three-year corporate strategy and a five-year strategy for the development and delivery of an integrated further education and training system.

SOLAS published the first annual Further Education and Training Services plan in May 2014. It shows how each Education and Training Board will be delivering the overall budget to make provision for learners. The document clearly sets out data relating to the local demographics of each of the 16 Education and Training Boards and details the programmes and courses it will deliver, as well as target learner profiles and the National Framework of Qualifications levels that will be achieved. This annual service planning also involves consultation with employers and local *Intreo* offices.

Following on from the Apprenticeship Review an Apprenticeship Implementation Plan was published in June 2014. As part of this plan a new Apprenticeship Council was established in November 2014 with members from among employers, trade unions, government and relevant state agencies. In January 2015 the Apprenticeship Council issued a call for proposals from employers and education and training providers to develop new apprenticeships in areas outside the current apprenticeship trades and to advise on the implementation of new apprenticeships.

The Action Plan for Jobs coordinates efforts to foster job creation. The first Action Plan for Jobs was launched in 2012 to coordinate job-creation initiatives across all government Departments. The latest iteration of the plan was published in January 2015 and sets out initiatives that includes a National Talent Drive with a focus on strengthening employability of learners and enhancing employer engagement at all levels.

Given continued efforts to strengthen the skills base, the implementation of the new Junior Cycle would be a major development in school education. Current proposals would gradually replace the Junior Certificate Examinations with a combination of central assessment and school-based model of assessment with an emphasis on the quality of students' learning experience. Schools will be expected to deliver a programme that enables students to develop a wide range of skills. These include critical thinking skills and basic skills such as numeracy and literacy. Major changes have been made to initial teacher education programmes, with literacy and numeracy units now part of the national teacher induction programme. School self-evaluation has been rolled out and new requirements have been introduced on standardised testing, including the return of aggregate data to the Department of Education and Skills.

A new national access plan for higher education to increase the participation of disadvantaged students is being drawn up. Due to be finalised in early 2015, it will identify new targets for broadening access and contain recommendations on helping disadvantaged students participate in higher education. They include targeted interventions in disadvantaged neighbourhood schools to increase the numbers of their students attending university and helping those who do make it to university when they get there.

The labour market situation has improved recently. Overall, Ireland has made some progress in addressing the Council Recommendation and the authorities' efforts to address labour market challenges have started to pay off. Unemployment is on a firm downward trend. The institutional mechanisms are being put in place that should contribute to adequate labour market activation policies and provision of re-skilling or up-skilling training opportunities to address skills mismatches.

3. OTHER STRUCTURAL ISSUES

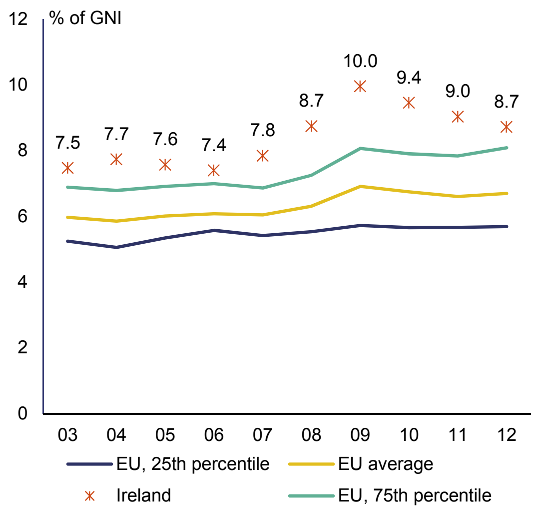
3.1. HEALTHCARE SYSTEM

Ireland's healthcare sector is atypical among EU Member States. Health insurance and the delivery of healthcare are organised under a two-tiered structure of public and private systems. The private system covers the highest share of the population among EU countries for supplementary health services. All residents are eligible for a core set of public services, including hospital care, but full public health coverage is means-tested and restricted to a subset of the population. There are also intermediate levels of public coverage depending on circumstances. This complicates the rules defining entitlements to health services. In addition, there are numerous interactions, both intended and unintended, between the public and private systems. For example, doctors can treat both public and private patients in public hospitals.

Public expenditure on healthcare is comparatively high in Ireland. In spite of the relatively favourable demographics, public healthcare expenditure represented 8.7 % of gross national income in 2012, compared with the EU average of 7.3 %. ([34]) This ratio was down from a peak of 10.0 % in 2009 after years of increases in the 2000s and following efforts to contain healthcare costs as part of the measures to restore the sustainability of public finances (graph 3.1.1). Nevertheless, public healthcare expenditure remains fairly dynamic. In the past several years, outturns regularly exceeded the profiles set out in successive government budget plans.

([34]) Given Ireland's economic structure and the large negative net factor income flows generated by multinational companies, the share of expenditure in terms of gross national income is a more appropriate benchmark than the GDP share. If GDP is used, healthcare expenditure represents a share of 7.1 %. This is below the EU average of 7.3 % and places Ireland 11th instead of 3rd in the ranking.

Graph 3.1.1: **Public healthcare expenditure, Ireland and EU**



Source: European Commission

Population health outcomes are comparable to those of the rest of the EU. In spite of higher public expenditure on health, population health status indicators such as life expectancy and infant mortality are by and large no better than in the rest of the EU. The number of hospital beds and doctors per resident is comparatively low. A number of observers ([35]) have also independently pointed out that while efficiency gains have been achieved in recent years, the Irish health system may have passed an 'inflection point' making deeper long-term structural reforms necessary in order to contain expected cost increases.

Demographic trends are set to put additional pressure on health expenditure. While Ireland's demographic structure is currently favourable, its population is ageing rapidly. This will put significant pressure on healthcare expenditure between now and 2060, as recognised in the government's Comprehensive Expenditure Report 2015 - 2017.

Ireland has begun to implement a wide range of reforms in the healthcare sector. Initial reforms focused on securing savings as part of the fiscal consolidation efforts. In November 2012, the authorities published the *Future Health* strategy,

([35]) See for instance Burke et al (2014), http://www.healthpolicyjrnl.com/article/S0168-8510(14)00166-3/fulltext an ambitious medium-term plan to reform the sector based on four pillars: (1) health and well-being; (2) service reform through an integrated model of care; (3) structural reform; and (4) financial reform. *Future Health* set an end-goal of transforming the two-tiered system into a system based on universal health insurance partly supported by general taxation.

The transition towards universal health insurance is being slowed down. A White Paper on the subject was published in April 2014, stating the government's aim to complete the reform by 2019. Since then, the authorities have decided to postpone the introduction of universal health insurance without announcing a new target date. They are still moving ahead with other reforms and the progressive completion of the building blocks for universal health insurance. These include the e-health strategy ([36]), financial reforms, the 'money follows the patient' activity-based funding model for hospitals and making savings on public pharmaceuticals expenditure through structural measures. All of these reforms were launched under the EU-IMF financial assistance programme.

Universal health insurance postponement could have consequences for the private insurance sector. There may be concerns about the impact of possible announcement effects on the voluntary health insurance market, for which the introduction of lifetime community rating is planned. The roll-out of free general practitioner care for certain age groups planned for this year, an intermediate step towards introducing universal health insurance, will also require close monitoring of related budget impacts.

Several strands of reforms have moved ahead regardless of universal health insurance postponement. A Council Recommendation issued under the 2014 European Semester called for progress on all the universal health insurance building blocks in 2014. Some progress has been made in making the delivery of high-quality healthcare services more cost-effective.

([36]) As indicated in the e-health Strategy for Ireland (2013), e-health 'involves the integration of all information and knowledge sources involved in the delivery of healthcare via information technology-based systems. This includes patients and their records, caregivers and their systems, monitoring devices and sensors, management and administrative functions.'

Some structural cost-saving measures are being implemented in public expenditure on pharmaceuticals. While recent reforms to bring down prices from very high levels have worked, public spending on pharmaceuticals remains well above the EU average. Negotiations under the mid-term review of the 2012 agreement between the Department of Health/Health Service Executive and the industry body representing patent-protected medicines were due to start in the summer of 2014. However, these have been delayed and the mid-term review is still ongoing. This puts the achievement of any further significant savings in 2015 at significant risk. For off-patent medicines, the introduction of interchangeable groups is almost complete. The generics penetration rate is now close to 70% in volume terms of publicly-covered outpatient use. This has resulted in substantial cost savings and there may be only limited scope to further improve value-for-money in this market segment. Finally, as regards medicinal products, the inclusion of 'cost-effective prescribing behaviour' as a key priority with actions forthcoming in 2015 should further assist value-for-money gains.

Financial reforms and e-health have faced delays. Financial management systems reforms have yet to be completed. A key deliverable is the introduction of a common chart of accounts across the hospital sector, which has not yet been achieved. The introduction of an activity-based funding model for budget allocations in statutory hospitals has begun on a shadow basis, but a full switch to activity-based funding to make the hospital sector more efficient, will take some years to complete. The timeline for the roll-out of the first phase of individual health identifiers has also been delayed, even though governance arrangements for setting up of e-health Ireland have progressed, with the appointment of a new Chief Information Officer and budget planning to support the first phase of deliverables. A full system of health identifiers is necessary for wider hospital funding reform.

3.2. IMPROVING ACCESS TO FINANCE AND SME DEVELOPMENT

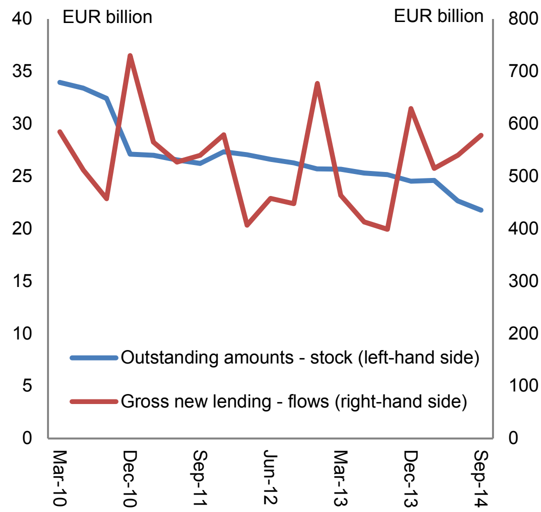
SME access to finance

The improved macroeconomic environment has found its way to the SME sector, enabling firms to stabilise their businesses after a prolonged period of distress. According to the Red C SME Credit Demand Survey, almost half of the surveyed firms reported a higher turnover between March and September 2014. Profits were recorded in about 56 % of the firms (up from 51 % for the preceding six months). Although the outlook is now more positive ([37]), most firms are cautious on new investment projects. Different strategies are being pursued by SMEs. While some firms still need to refinance their debt with new borrowing, a growing number are using retained earnings for working capital purposes. New investment prospects have improved over the past six months, with some enterprises renewing their inventories and others (about 11 % of SMEs surveyed) looking to expand. About 30 % of SMEs have increased their staff since the end of March.

Less credit is extended and less credit is sought, but the outlook might be changing. The level of outstanding bank credit to SMEs has been in decline since 2012 (Graph 3.2.1). The stock reduced by 8 % in the first two quarters of 2014. This is consistent with the deleveraging trend described in Section 3.1.1 and the focus of SMEs on the stabilisation and consolidation of business activity. Compared with the rising levels of investment that were observed in 2014, it further confirms the view that the recovery in Ireland is still largely driven by SMEs internal funds and by multinationals financed abroad (including by parent companies and through market issuance). Annual SME lending flows (a series reporting on new credit facilities drawn down by SMEs during the quarter), albeit volatile, shows a moderate recovery in the second half of 2014.

([37]) 58 % of SMEs surveyed expressed the belief that the business climate in Ireland would improve in the next six months.

Graph 3.2.1: **Outstanding credit to SMEs**



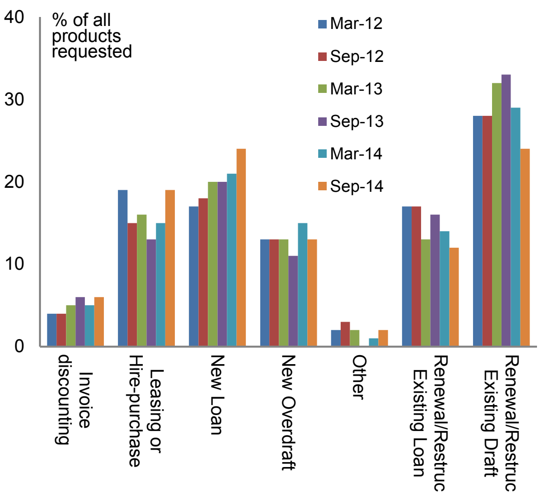
(1) Data refers to credit advanced by all credit institutions resident in Ireland, including foreign subsidiaries and branches.
Source: Central Bank of Ireland

Subdued credit demand is showing signs of recovery. As shown by the RedC Survey, from March 2013 to September 2014 SMEs demanded less bank credit. This was the case for all sectors except for manufacturing, where credit demand remained constant. The lack of need for credit has been given as the main reason for SMEs generally not applying for credit (81 %). Indicating a possible reversal of this trend, in the third quarter of 2014 the banks themselves reported an increase in demand across all enterprise sizes and loan maturities ([38]).The type of products that firms requested (Graph 3.2.2) could indicate that what drove overall credit demand down was fewer requests for renewals and overdrafts. Applications for new loans and leasing or hire-purchase agreements increased however (to 24 % of total products requested from 21 % at the end of March). As a further sign of stabilisation, renewals and overdraft products sought did not include requests for additional funds (the sizes of facilities remained unchanged) in almost half of cases. When they did, the additional amount needed was smaller than observed over the previous period.

([38]) ECB/EC Survey of Access to Finance of Small and Medium-sized Enterprises (SAFE), Irish responses, October 2014; http://www.centralbank.ie/mpolbo/mpolicy/Documents/Comment%20on%20Irish%20Results%20October%202014.pdf.

This means that the ability of SMEs to service their debts is improving.

Graph 3.2.2: **Bank products requested by SMEs**

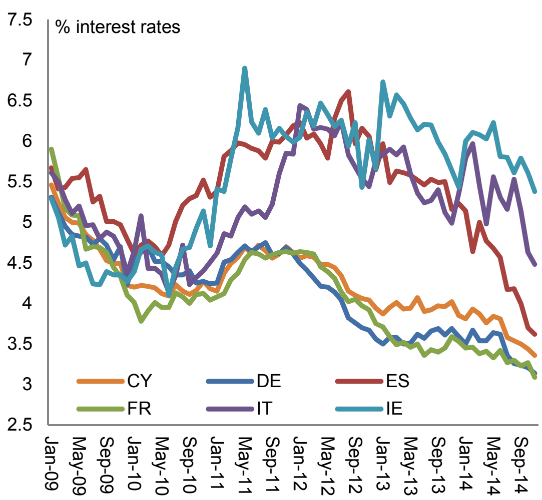


Source: RedC SME Credit Demand Survey

SMEs seeking credit are facing fewer rejections by banks, but also higher interest rates than the euro area average. Survey data shows that SMEs are becoming less worried about access to finance, although this is still a major concern for around a third. According to the RedC Survey, rejection rates for credit applications have fallen to about 14 % ([39]) and SMEs have a more positive perception of the banks' willingness to provide credit, causing the number of discouraged potential borrowers to fall. However, some SME organisations say that the overall bank rejection rate is as high as 38 %. Interest rates for new corporate loans of up to EUR 1 million in value, used as a for proxy SME lending, are also higher for Irish SMEs than for most of their euro area counterparts (Graph 3.2.3). On average, they are also markedly higher than the rates for larger firms. This is due to the banks' efforts to increase their interest margins on new lending to improve profitability. It is because low-yielding legacy assets account for large shares of their balance sheets. It could also be a result of the concentration of SME lending markets, in increase since 2013.

Certain collateral requirements and credit application processes may be discouraging for some SMEs. According to the RedC survey, at the end of September 2014, collateral such as buildings, machinery and land was still required for over 40 % of loan applications, putting businesses with a different asset structure at a disadvantage. The Irish Business and Employers Confederation said that banks have improved their sectoral understanding and their ability to base lending decisions on projected cash flows, but called for further efforts. Personal guarantees are becoming less of a prerequisite for credit too (38 % at the end of September, compared to 44 % at the end of March). The upper limit for referring refusals to the Credit Review Office has been increased to EUR 3 million. The SME stakeholders' feedback that the Central Bank of Ireland gathered as part of the consultation on the Review of the Code of Conduct for Business Lending to Small and Medium Enterprises revealed a need for more clarity on the lenders' application process. This referred especially to the information required and the criteria for determining the ability to repay, as well as reasons for credit refusal and appeal rights, including recourse to the Credit Review Office.

Graph 3.2.3: **Interest rates on SME loans - comparative overview**



Source: Central Bank of Ireland, European Central Bank

Demand for non-bank credit by SMEs remains subdued despite a number of SME financing initiatives (Table 3.2.1). As shown by the latest September 2014 RedC SME Credit Demand

([39]) The RedC Survey puts the rejection rate at 14 % for the period between March and September 2014, while the SAFE survey puts it at 10.4 % for the period between April and September 2014. The Irish Small and Medium Entreprises Association Quarterly Bank Watch survey refers to the fourth quarter of 2014.

Survey, the number of SMEs aware of existing government support schemes and the Credit Review Office has decreased. The sometimes greater complexity of non-bank borrowing schemes could deter a number of companies. The Credit Review Office also points to a need for further efforts to be made to improve the financial management skills of SMEs. Although the amount of bank financing has decreased, Irish enterprises and SMEs in particular remain heavily reliant on banks for financing. There is therefore further scope for the development of non-bank financing alternatives in Ireland, for both equity and debt instruments, to help SMEs diversify their funding sources. This was also one of the cornerstones of the Commission's Investment Plan for Europe announced in November 2014 ([40]). It is among the priorities on which ongoing Commission work on developing a Capital Markets Union is based ([41]). The recent changes to the Irish Alternative Investment Fund rulebook also aim to support non-bank lending by allowing loan origination by qualifying investment funds within a prudential framework (Box 4.2.1).

The Strategic Banking Corporation of Ireland and the existing support funds aim to diversify the sources and types of funding for Irish SMEs. The goal of the newly established Strategic Banking Corporation of Ireland is to lower funding costs for SMEs by increasing the number of lenders offering SME loans and providing new products with a longer duration and flexible repayment periods. The Strategic Banking Corporation of Ireland (which does not have a bank license) has lower funding costs and this cost benefit will have to be passed on to SMEs. This will partly address the relevant Council Recommendation. It was launched in October 2014, with a full roll-out of products expected in the first quarter of 2015 and the inclusion of new non-bank lenders in the market later in the year. It sources funds from the German development bank KfW, the Ireland Strategic Investment Fund and the EIB and makes them available to SMEs through on-lenders, including retail banks and non-banks. The Strategic Banking Corporation of Ireland secured an initial amount of EUR 800 million in funds, of which EUR 550 million are guaranteed by the government. A maximum of EUR 5 billion could be given by the state provided there is demand for it.

([40]) Investment Plan for Europe, http://ec.europa.eu/priorities/jobs-growth-investment/plan/.

([41]) Green paper: *Building a Capital Markets Union*, http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper_en.pdf

Box 3.2.1: Regulating loan origination by investment funds

The Central Bank of Ireland revised its Alternative Investment Fund rulebook to create a special loan origination regime for qualifying alternative investment funds from 1 October 2014. Ireland has a large investment fund industry (with a net asset value of about EUR 1.1 trillion as at end-2013) Some funds had already been active in secondary loan markets through assignments or purchases from banks, though not in origination (i.e. direct primary lending to firms or projects), which was prohibited. Following a lengthy consultation period and discussions with the industry in 2013, the Central Bank of Ireland decided to revise applicable regulations to strike an appropriate balance between allowing alternative financing options for companies to complement the bank funding channel and addressing 'shadow-banking' concerns. Regulatory cooperation with the European Systemic Risk Board and European Securities and Markets Authority during 2014 identified several potential risks, including (i) regulatory arbitrage and an un-level playing field vis-a-vis the banking sector; (ii) possible runs on investment funds; (iii) contagion risk through interconnectedness with banks and (iv) excess credit growth and pro-cyclicality.

The reforms to the Central Bank of Ireland's alternative investment fund rulebook were thus geared towards addressing potential financial stability risks associated with loan origination by investment funds. In addition to the rules enshrined in the Alternative Investment Fund Manager Directive qualifying alternative investment funds must comply with detailed risk disclosure requirements in their prospectuses and in periodic reports (to investors and competent and macro-prudential authorities) and liquidity and diversification requirements (the regulations impose a maximum exposure limit to a single issuer or group of 25 % of net assets). They must also apply rigorous credit-granting, monitoring, valuation and management processes (also for concentration risk) and restrict their activities to a single strategy focused on lending and participating in securitisations. Given the relative illiquidity of loan assets and to address possible risks of runs, qualifying alternative investment funds must also be closed-ended, limit leverage to 200 % and comply with stress testing requirements in addition to those in the Alternative Investment Fund Managers Directive. Finally, to adequately deal with contagion risks through interconnectedness with banks and to ensure that incentives are aligned, alternative investment funds can only purchase or participate in loans originated by banks if the banks retain at least 5 % economic interest in such transactions (in line with minimum risk retention requirements for banks under the Capital Requirements Regulation and Capital Requirements Directive). The funds should also independently value and regularly stress-test these exposures, and continuously monitor banks' net economic interest over the lifetime of each loan in which they are invested.

The regulatory requirements for loan-originating alternative investment funds could potentially dampen prospects for material credit extension through this non-bank channel. To date the Central Bank of Ireland has not authorised any such funds in Ireland, though the new rules have only been in effect since October and there has been considerable interest from promoters and the fund management industry. In response to industry concerns regarding the limitations to portfolio compositions applicable to loan-originating alternative investment funds, the Central Bank of Ireland has clarified that loans of different levels of seniority (e.g. subordinated and mezzanine debt) are allowed, that equity can be held if it is part of a distressed loan work-out scenario and that bonds and derivatives are acceptable for treasury management and hedging purposes. However, expectations about a material impact of this regime on credit supply in Ireland are rather muted, also given the intentions of interested industry participants expressed before and during the consultation process. Based on exchanges with stakeholders, the authorities consider that many potential new investments stemming from loan-originating alternative investment funds could be allocated to European borrowers outside Ireland.

The EU recently introduced provisions explicitly allowing certain types of alternative investment funds to grant loans to qualifying undertakings. Such provisions are included in the EU Venture Capital Fund Managers and EU Social Entrepreneurship Fund Managers Regulations and are also included in the European Long-term Investment Fund Regulation. European long-term investment funds – which must be managed by asset managers authorised under the Alternative Investment Fund Managers Directive – may grant loans to qualifying portfolio undertakings. If a fund is set up following the rules of the European Long Term Investment Fund Regulation (e.g. rules on diversification, leverage or transparency), it can be

(Continued on the next page)

Box (continued)

marketed everywhere in the EU without additional barriers. Given the European long-term investment funds framework will soon come into effect (publication of the European long-term investment funds rules in the Official Journal is expected in the first semester of 2015), it will provide a safe and well regulated environment available throughout the EU for granting loans through investment funds.

Additional resources have been put in place to support SME lending, marking some progress in addressing the Council Recommendation. Two SME funds, co-financed by the National Pensions Reserve Fund, are lending with a growing number of projects in the pipeline. The mandate of a third National Pensions Reserve Fund, the Turnaround Fund, was not renewed at the end of 2014. This was due to the limited pool of underperforming/distressed businesses eligible as turnaround investment cases amid a continued economic recovery. The Action Plan for Jobs 2015 announced a reconfigured Credit Guarantee Scheme and a simplified operation of the Microenterprise Loan Fund. Regarding the latter, the extent of rejections (43 %) appears to suggest some scope for improvement ([42]). An SME Online Tool was also launched to increase awareness among SMEs of available business supports, backed by a communications campaign showcasing the online guide. 23 % of enterprises were aware of this online tool in September 2014, following its launch in May. However, awareness and knowledge of SME funding options remains quite low overall. The Irish central credit register, set to become operational in late 2016 (and in 2017 for corporate credit), should support lending by making it easier to assess the creditworthiness of borrowers.The value of credit registers as a way of improving both banks' and supervisors' risk assessments has been recognised in over half of EU Member States that have established them to date. This will also be an important component of calibrating some macro-prudential measures (e.g. total debt-to-income and debt-service-to-income ratios).

SME development

Legislative changes are focused on making it easier to do business. Ireland has modified several tax incentives to further encourage investment in SMEs. These include changes to the tax credit scheme for research and development ([43]) and the removal of the high earners restriction from the Employment and Investment Incentive ([44]). The latter should incentivise high earners to invest more in eligible companies. Ireland has moved up four positions to 13th place in the World Bank's global ranking on the ease of doing business and was among the ten top improvers in 2013/2014. However performance has dropped in a number of specific areas (access to credit, construction permits and enforcing contracts). The Companies Act 2014 passed by the Oireachtas (Parliament) at the end of December 2014 is due to come into effect on 1 June 2015. It should reduce red tape by simplifying many existing company law requirements, for example reducing the time and cost of setting up a business, providing legal power to borrow money and allowing the establishment of companies with one director. Legislation which facilitates and reduces the cost of creditor protection for SMEs ([45]) became applicable in July 2014. Despite this, only five SMEs had sought the appointment of an examiner through the Circuit Court until November 2014. Ireland also ranks as the best in the EU and 6th in the world in terms of

([42]) Microfinance Ireland Progress Report Q3 2014, http://www.djei.ie/enterprise/smes/MicrofinanceIrelandProgressReportQ32014.pdf.

([43]) A 25 % tax credit for qualifying research and development expenditure is available for companies carrying out qualifying research and development undertaken within the European Economic Area.

([44]) The Employment and Investment Incentive is a tax incentive (deduction) to encourage investment in businesses. It applies to investments in new ordinary share capital in the majority of small and medium sized trading companies, with the exception of certain sectors. It can be used for investments in companies that are not listed on the official list of a stock exchange or on an unlisted securities market of a stock exchange. http://www.revenue.ie/en/tax/it/leaflets/it55.html.

([45]) Under Irish law, examinership allows a company that is experiencing financial difficulties a period of protection from creditor action during which a third party (the examiner) has an opportunity to study the affairs of the company and, if there is a prospect for the continuation of the company, to draw up a plan for its continuation. Before the legislative change which allocated competence to the Circuit Court, a High Court procedure was necessary which entailed higher legal costs.

the ease of paying taxes. Improvements continue to be made to the system, with increased provision of e-services and on-line service platforms. A roll-out the Integrated Licensing Application Service is due to take place in the first quarter of 2015 for retail licenses, after some tender-related delays. Stakeholders have signalled the need to further improve the existing Regulatory Impact Assessment procedures, emphasising their varying quality across departments, a lack of cost/benefit analyses, as well as timing and accessibility issues ([46]).

Centralised public procurement might be a deterrent for SMEs. The streamlining of public procurement procedures through the establishment of the Office of Government Procurement as a central purchasing body sought to reduce government costs. It has actively promoted public-private programmes for the training and education of SMEs. However, it may also have generated new challenges for SMEs in seeking procurement contracts. This is mostly due to the frequent use of framework contracts that only consortia of SMEs are large enough to access. The government has sought to address this issue through a number of measures announced in the 2014 Action Plan for Jobs, among them a review of Public Works Contracts. Circular 10/14 published in April 2014 recommended a number of actions by procurement authorities to facilitate SME participation. The eTenders platform has also helped increase transparency and streamline procedures. A new Tender Advisory Service was announced in December 2014 to enable potential suppliers to raise concerns about a particular live tender process. This is due to be piloted as from February 2015. An SME Working Group has also been set up to assist the Office of Government Procurement in developing and monitoring strategies for SME access to procurement.

There is further scope for domestic innovation to grow. Ireland has made significant progress towards achieving its national research and development intensity target for 2020 of 2.0 % of GDP. It performs relatively well in terms of innovation outputs, both in the innovation output indicator and on the Innovation Union Scoreboard. This is mainly due to its economic structure, geared towards several high-tech manufacturing sectors and knowledge-intensive services. However, research and development activity is largely carried out by foreign multinationals and there have been limited spillovers to SMEs. Concerns remain regarding the lack of innovative activities by Irish SMEs ([47]), insufficient commercialisation of research results and the low availability of finance for innovative companies ([48]).

([46]) Consultation on civil service accountability and performance, Irish Business and Employers Confederation (IBEC) submission, March 2014.

([47]) 2013/2014 European Commission Annual Report on European SMEs, http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2014/annual-report-smes-2014_en.pdf

([48]) 2013/2014 European Commission Annual Report on European SMEs.

Table 3.2.1: **Overview of SME credit policy initiatives**

Policy measure	Date	Additional credit volume	Jobs protected/created
Credit Review Office (CRO), set up to mediate on disputes between lenders and prospective SME borrowers who have been refused credit.	Q2 2010	€29.7mn overturned (Oct 2014)	2,091 (Oct 2014)
Microfinance Ireland extending loans between €2,000 and €25,000 to firms with less than 10 employees	Q3 2012	€90mn (over 10 year horizon); €6.3mn approved to Dec 2014	932 (Dec 2014)
SME Credit Guarantee Scheme (CGS), providing a State guarantee to accredited Lenders of 75% on eligible SME loans or Performance Bonds .	Q4 2012	About €22mn loans sanctioned (Dec 2014)	981 (Dec 2014)
Provision of finance via NPRF to SMEs through partnership with private sector investors, comprising one credit fund (Bluebay Mid Market Fund - €200mn NPRF commitment; €450mn total fund size) and one equity fund (Carlyle SME Restructuring and Growth Fund - €125mn from NPRF, €275mn total). The third, Better Capital SME Turnaround Fund - €50mn from NPRF, €100mn total did not have its mandate renewed at end-2014.	Q1 2013	€450mn credit and €275mn equity. SME Credit Fund completed loan transactions totalling approxmiately €173mn. SME Equity Fund: two investments have closed (Dec 2014).	100 (Dec 2014)
The Strategic Banking Corporation of Ireland (SBCI) aims to increase the number of lenders offering SME finance as well as to provide new products with longer duration and flexible repayment periods and potentially lowering the cost of SME financing (via on-lenders).	Q1 2015	€800mn in funds, of which €550mn are guaranteed by the government. Growth potential of up to €5bn.	n/a

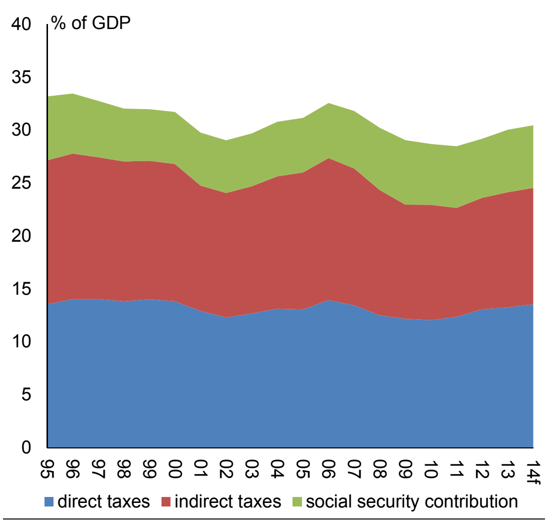
Source: Department of Jobs, Enterprise & Innovation, Department of Finance, Credit Review Office

3.3. TAXATION AND FISCAL FRAMEWORK

Taxation

Ireland's tax burden has marginally increased, but remains low compared to the EU average. The overall tax burden is estimated to have increased to 30.9 % of GDP in 2014 from 28.7% of GDP in 2012 (Graph 3.3.1). The ratio is relatively low, however, at almost 10 percentage points below the EU average of 40.1 % ([49]). Indirect tax revenues as a percentage of GDP are the third lowest in the EU, with value-added tax revenue well below the EU average. Direct taxes are the 10th highest in the EU at 13.5 % of GDP. The personal income tax system is very progressive and the tax wedge in 2013 for the average-wage worker was around 26.6 %, significantly below the EU average and one of the lowest among Member States. Social contributions are the second lowest in the EU, largely due to the small employers' contributions, which represent less than half the EU average.

Graph 3.3.1: **Tax burden**



Source: European Commission

Tax measures in Budget 2015 focused on tax cuts. Rather than using the revenue windfall to accelerate debt reduction, as recommended by the Council under the ongoing Excessive Deficit Procedure, the authorities took advantage of the stronger-than-expected economic environment to introduce a range of tax cuts and reliefs in Budget 2015. Measures include: (i) income tax reductions through a combination of higher income thresholds and changes in tax rates ([50]); and (ii) higher tax incentives for R&D and the creation of intangibles. They also include a variety of minor revenue-increasing adjustments to tax expenditures and some increases in excise duties. Overall, the net impact on revenues is estimated to be negative at around 0.25 % of GDP.

The tax wedge on labour is set to decline somewhat. The planned personal income tax reductions in Budget 2015 will decrease the tax wedge on labour, but only by a small margin. For workers (single people without children) with a gross income of EUR 35 000, net income is estimated to increase by 1.4 %. The overall effect tends to be slightly progressive, with net income gains as a proportion of earnings decreasing along the income distribution for the main categories of taxpayers.

The authorities announced changes to the tax residency rules as part of Budget 2015. The possibility to apply the so-called double Irish tax scheme will disappear with immediate effect for new companies and will vanish after six years for existing companies. The full impact of the changes to Irish tax rules may not be fully apparent in the near term, but they have the potential to broaden the tax base, even if it may take some time to assess their full impact.

Tax incentives for the SME sector are variously targeted but appear to lack overall cohesion. Various lending schemes have been introduced to support business start-ups, notably for the SME sector (Section 4.2). Perhaps due to the constraints imposed by fiscal consolidation tax incentives have developed in a fragmented manner. Boosting

([49]) The tax burden as a percentage of gross national income (GNI) might be a more appropriate benchmark in the case of Ireland given the large presence of multinational companies and their share of gross value added in the economy. In 2014, the tax-to-GNI ratio was at 43.1 % in Ireland, compared with 48.2% on average in the EU.

([50]) Budget 2015 increases the band at which the standard-rate income tax rate applies by EUR 1,000 (from EUR 32,800 to EUR 33,800 for single individuals and from EUR 41,800 to EUR 42,800 for married one earner couples). At the same time, the top marginal income tax rate is cut from 41 % to 40 %. Changes to the Universal Social Charge also apply as of 2015. In particular, the exemption threshold is increased to EUR 12,012. Contribution rates are reduced for low-income earners, while at the same time an increased rate of 8 % applies to high-income earners (above EUR 70,044). These changes are designed to support employment and job creation and make the system more progressive.

productive investment remains a priority, however, as gross fixed capital formation fell sharply during the crisis and remains well below the EU average in spite of the recovery in investment in 2014.

The yield on the value-added tax is low in comparison with other Member States ([51]) as a result of the large value-added tax policy gap. The value-added tax policy gap measures the additional revenues that could in principle be collected if a uniform rate applied to all consumption, abstracting from compliance issues, which are limited in Ireland. In turn, the use of reduced rates and exemptions on value-added taxes ([52]) is high and generates a large value-added tax policy gap. Only four Member States have bigger policy gaps than Ireland. According to a range of studies ([53]), at any given level of the tax burden, a system in which indirect taxes account for a large share of total revenue – e.g. a system making limited use of reduced rates, exceptions and exemptions on value-added tax, in line with the European directive – is less distortive and more growth-friendly than a system with a large share of direct taxes. There appears to be no process for evaluating the costs and benefits of reduced rates on value-added tax, in sharp contrast with the systematic evaluation principles to be applied to income tax expenditures as per the October 2014 Guidelines for Tax Expenditure Evaluation.

Revenues from immovable properties are lower than the EU average. Recurrent taxes on immovable property are considered among the least harmful to growth ([54]). In the context of the EU-IMF financial assistance programme, residential property taxation has shifted from a transaction tax to a recurrent tax based on residential property values ([55]). The effectiveness of the new system is also proved by the high compliance ratio of the new property tax (around 95 %). While government revenues from immovable property as a percentage of GDP are projected to increase slightly (from 0.9 % in 2012 to nearly 1.1% in 2014), the yield from the property tax is still relatively low compared to other Member States (Graph 3.3.2). Moreover, the base is reduced by the exclusion of some non-residential properties, in particular development land and derelict sites, in spite of the emerging supply constraints on the housing market (section 4.1). It is also currently based on a self-assessment of property prices at historic values. Values are to be re-evaluated in 2016, although a property register with cadastral values might be put in place. The possibility for the local authorities to vary, within limits, as of 2015, the basic local property tax rate, could further limit tax revenues ([56]).

([51]) VAT revenues amounted to 6.2 % of GDP in 2012, which is the fourth lowest level in the EU.

([52]) The reduced rate of 9% in the tourism sector (temporarily introduced until December 2014) has been further prolonged with Budget 2015. A 13.5 % reduced rate applies to various services, newspapers, building works and household energy and fuels, whereas other goods and services, such as children clothes and transport, are zero-rated. Reduced rates and exemptions not only lead to revenue losses, but are considered a poor instrument of redistribution, since they are not targeted to specific categories of recipients.

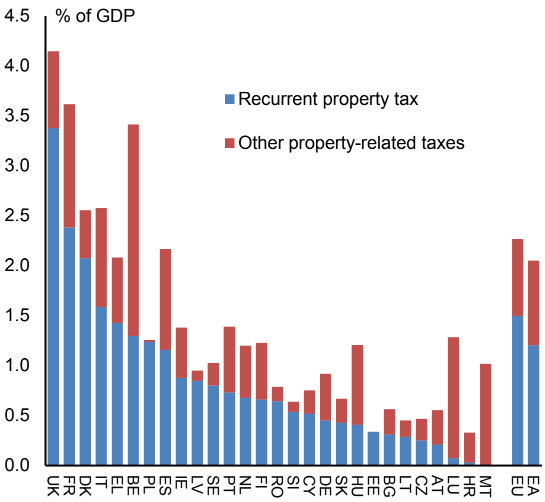
([53]) See for example: OECD (2010). Tax policy reform and economic growth (No. 20). OECD Tax Policy Studies. OECD Publishing; or OECD (2013), Tax Administration 2013, Comparative information on OECD and other advanced and emerging economies. OECD Publishing.

([54]) See, for example, Arnold, J.M., B. Brys, C. Heady, A. Johansson, C. Schwellnus and L. Vartia (2011), 'Tax Policy for Economic Recovery and Growth', Economic Journal, 121 (550), F59-F80.

([55]) A Local Property Tax – as from July 2013 – replaced the flat non-principal private residence charge (as from 2014) and the household charge. The Local Property Tax is based on a system of valuation bands, and is charged at a rate of 0.18 % for properties valued below € 1 million, and 0.25% on the excess value. Thus, it clearly increases the fairness of the property tax system compared to the repealed charges.

([56]) The 'local factor adjustment' allows local authorities to vary the basic local property tax rate on residential properties in their administrative area (the basic rates of local property tax are 0.18 % and 0.25 %). These rates can be increased or decreased by up to 15 % (both rates must be adjusted by the same amount). Fourteen local authorities have reduced the local property tax rate for 2015. The reductions range from 1.5 % to 15 %. The Irish Revenue authority estimates a negative impact of the variations on local property tax of EUR 45 million approximately.

Graph 3.3.2: **Revenues from property taxes (2012)**



(1) Ordered by revenue from recurrent property taxes. 'Other taxes on property' include taxes on net wealth, inheritance, gifts and other property items as well as financial and capital transactions. Data do not include personal income tax on imputed rents.
Source: European Commission

Revenues from environmental taxes represented 2.5 % of GDP in 2012, compared to 2.4 % of GDP in the EU. The role of environmentally related fiscal measures has been strengthened in the past five years ([57]). Limited additional changes were introduced in the budget for 2015, except for measures such as extending the accelerated capital allowances scheme for energy-efficient equipment for another three years. Peat used for electricity generation (subject to the emission trading system) is exempt from the carbon tax, but its extraction remains subsidised ([58]). Reduced rates of value-added tax on energy products (at 13.5 %) may also conflict with overall energy and climate policy objectives. They effectively decrease incentives to reduce energy consumption or improve energy efficiency. There appears to be no overall policy of reviewing value-added tax rates and excise duty to ensure continued alignment with environmental considerations.

Overall, some progress has been made in addressing the recommendation to broaden the tax base and enhance the growth and environmental friendliness of the tax system. Yet, there are further opportunities to tap into more growth-friendly taxes, notably on consumption and property. In addition, there appears to be no process of evaluating the costs and benefits of reduced value-added tax rates despite a significant value-added tax policy gap, while environmental taxation generates distortive subsidies making it harder to achieve environmental objectives.

Fiscal framework

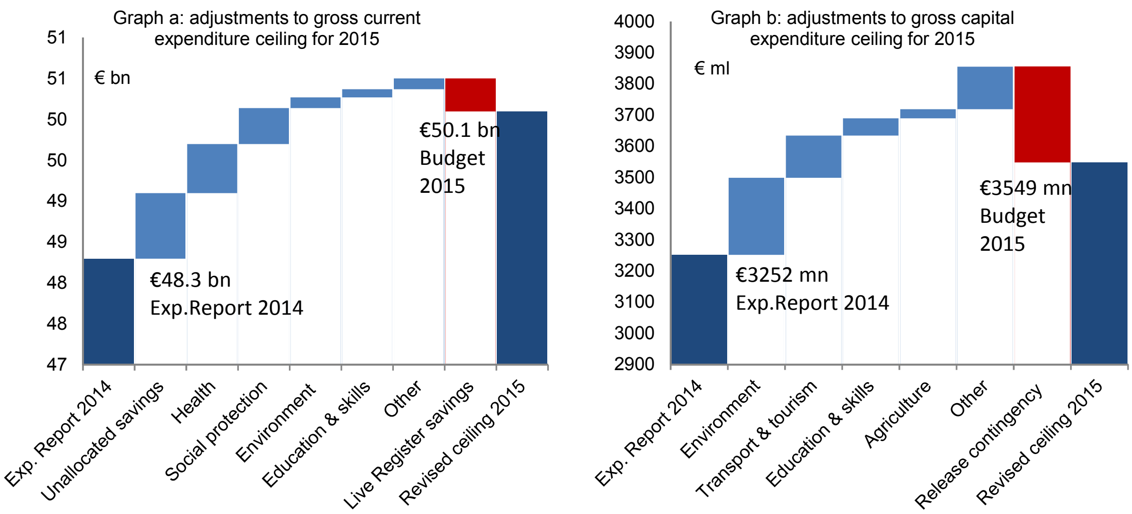
Major reforms to the fiscal framework have been undertaken in the context of the EU-IMF financial assistance programme. The new rules and procedures, in particular the medium-term expenditure framework, if implemented effectively, provide a potential safeguard against pro-cyclical fiscal policy and are crucial for fiscal sustainability. However, despite the timely presentation of a multiannual budgetary planning, and the introduction in 2013 of a medium-term expenditure framework – including three-year ministerial expenditure ceilings – the fiscal framework does not provide information about the broad budgetary measures underlying the medium term expenditure targets.

The Irish fiscal framework has benefited from the expertise and independence of the Irish Fiscal Advisory Council. Pursuant to Regulation (EU) No 472/2013 (part of the 'Two-Pack'), the task of assessing the macroeconomic forecast underpinning the annual budget plans and the Stability Programme was assigned to the Irish Fiscal Advisory Council in the Fiscal Responsibility Act of 2012 and 2013. In practice, the macroeconomic forecasts underpinning the 2014 and 2015 Budget Laws were endorsed. The Irish Fiscal Advisory Council, was also given the mandate of independently providing an assessment of, and commenting publicly on, whether the national budgetary objectives are met and comply with the numerical fiscal rules introduced by the Fiscal Responsibility Act. Its financial and functional independence is ensured by primary legislation and has been underscored in the advice given so far.

([57]) Eunomia Research & Consulting with Aarhus University and IEEP, Study on Environmental Fiscal Reform Potential in 14 EU Member States, Draft final report 22.10.14

([58]) Subsidising peat extraction for electricity generation results in substantial inefficiencies, as it is significantly less costly to finance electricity from renewable sources than generating the same amount of electricity from peat.

Graph 3.3.3: **Expenditure ceiling reconciliation for 2015**



Source: Comprehensive Expenditure Report 2015-2017

Reporting standards have improved. The authorities have started publishing new fiscal reports covering the general government sector and complementing existing fragmented reports by individual government entities.

However, the medium-term budgetary plans could be undermined by regular changes to government expenditure ceilings. Under current rules the government has considerable discretion to change expenditure ceilings (see Graph 3.3.2). This weakens medium-term budgetary plans. As a result, the current set-up falls somewhat short of the Council Recommendation asking Ireland to 'ensure the binding nature of the government expenditure ceiling including by limiting the statutory scope for discretionary changes'. Previous Commission reports called on the Irish authorities to strengthen the credibility of the medium-term expenditure plans by limiting changes to the expenditure ceilings to predefined exceptional circumstances specified in the internal circular 15/13 ([59]).

Limited progress has been made in addressing the parts of the Council Recommendation relating to the fiscal framework. Although the fiscal framework has been strengthened significantly in recent years, in particular with the adoption of the Fiscal Responsibility Act, some weaknesses remain. These led the Council to recommend in June 2014 that Ireland better define broad budgetary measures underlying the medium-term fiscal targets and ensure the binding nature of its expenditure ceiling including by limiting the statutory scope for discretionary changes. No changes were made in this regard in 2014.

([59]) The circular does not in practice restrain the government from making discretionary changes to the ceilings. Transparency could be improved by justifying in more detail the rationale behind adjustments. This could still allow for flexibility within the binding overarching constraint of the expenditure benchmark, considering for instance changes to the projections underlying the budgetary targets.

3.4. LEGAL SERVICES AND JUSTICE REFORMS

Legal services costs have yet to adjust. Ireland's Competition Authority highlighted price and competition issues in the provision of legal services as far back as 2006. As legal services are an input to all sectors of the economy, including the tradable goods sector, their cost has a bearing on Ireland's competitiveness. In its report, the authority provided a number of recommendations on reforming the regulatory framework for the sector to enhance competition and bring about a reduction in high legal services costs affecting not only businesses but also citizens.

Legal services reform is a long-standing project. Given the importance of reducing legal services costs in supporting Ireland's competitiveness and promote SME growth, the authorities committed under the EU-IMF financial assistance programme to introduce a new regulatory framework for the sector. In this context, they published the Legal Services Regulation Bill in October 2011, building on a number of recommendations from the Competition Authority's 2006 report.

The regulatory model is to be overhauled. The Bill aims to reshape the essentially self-regulated structure of the legal profession by establishing an independent regulatory authority, improve access and competition, and make legal costs more transparent and less expensive for consumers and businesses. Among other things, it provides for the establishment of legal partnerships between solicitors and barristers and possible multi-disciplinary practices bringing together barristers, solicitors and other professional service providers (such as accountants) or even services of non-professional nature. It should also address restrictions on advertising by solicitors and barristers, for which an infringement procedure (2013/2192) under the Services Directive is ongoing.

Vested interests have strongly opposed the Bill from the outset. Progress towards its enactment was therefore slow and could not be completed by the time of Ireland's exit from the EU-IMF programme at the end of 2013. Since then, a significant number of amendments have been introduced, some to strengthen the independence of the Board of the Legal Services Regulatory Authority, some to address specific concerns of the legal profession. A country-specific recommendation was also addressed to Ireland in the context of the 2014 European Semester calling for the enactment of the Bill by the end of that year.

Delays in the process persist. Progress towards enactment remained slow in the second half of 2014 due to ongoing pressures from vested interests. The authorities agreed to reopen the issue of multidisciplinary practices and finalised the amendments to be considered at the resumption of Dáil Report Stage, to take place in early 2015. The removal of the 'solicitor's lien', part of the 2014 Council Recommendation, will not be included in the Bill. ([60])

Significant amendments have been tabled. The amendments will require the future Legal Services Regulatory Authority to conduct research and consultations on multidisciplinary practices ([61]) before issuing a recommendation to the Minister, who will then determine whether the section of the legislation on multidisciplinary practices should be commenced or not. Although the authorities indicate that their intention remains to allow multidisciplinary practices, uncertainty on this matter has increased significantly as the recommendation from the Legal Services Regulatory Authority may well go in the opposite direction. In contrast, legal partnerships appear to be safeguarded. Direct access to barrister is also included for non-contentious matters, although research and consultations will take place before considering whether to include contentious matters.

The Bill might soon be enacted. The authorities confirmed on a number of occasions their intention to have the Bill enacted in early 2015 and ensure that the Legal Services Regulatory Authority is in operation by the middle of the year. Budget 2015 has earmarked EUR 500 000 to help set up the Authority.

Justice reforms are progressing. Besides the reform of the regulatory framework for the profession, the country-specific recommendation

([60]) The 'solicitor's lien' is the practice whereby a solicitor may retain possession of a client's file pending receipt of payment, frustrating attempts by a client to switch solicitors. The practice was found to be anticompetitive in the Competition Authority's 2006 report.

([61]) The process should be split between a six-month research phase and a six-month consultation period.

also urged Ireland to improve data collection systems as an enabler of quality and efficiency of judicial proceedings. In 2014, Ireland carried out an important reform of the judicial system, setting up the New Court of Appeal between the High Court and the Supreme Court. This should help resolve long delays in having appeals heard by the Supreme Court. ([62]) In addition, the scope of the jurisdiction of Circuit Courts and of Districts Courts has been extended. ([63])

The authorities have taken measures to improve data collection systems on judicial proceedings. These measures remain to be completed for some courts and areas of the justice system. In addition, there is no regular evaluation system and there are no defined quality standards or specialised court staff in charge of quality policy. Budgetary restrictions and the relatively low number of judges make it all the more important to step up the measures to support the quality of the justice system, in particular with regard to extending online case management. This is currently only available for some case categories, the evaluation of court activities and courts communication policies. The new Mediation Bill is yet to be submitted to parliament. ([64])

The implementation of the country-specific recommendation is progressing at varying speed. Overall, limited progress has been made so far on the implementation of the CSR related to the Legal Services Regulation Bill. Some progress has been made on data collection systems, however.

([62]) The clearance rate for civil and commercial cases at second instance courts in 2013 was 88.7%. See Study of the European Commission for the Efficiency of Justice (CEPEJ) prepared in view of the 2015 EU Justice Scoreboard (to be published in early March)

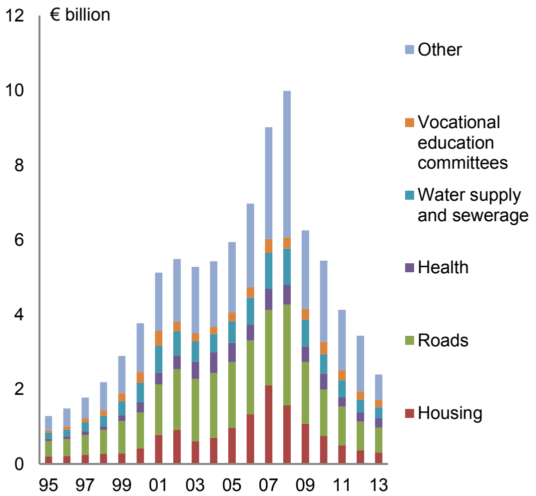
([63]) The Courts and Civil Law (Miscellaneous Provisions) Act 2013 extends the jurisdiction of the Circuit Court to EUR 75 000 and of the District Court to EUR 15 000. In regard to personal injury actions, the revised monetary jurisdiction limit of the Circuit Court will be EUR 60 000.

([64]) The Draft General Scheme of Mediation Bill was published in 2012. The publication of the Bill has been delayed several times.

3.5. INFRASTRUCTURE AND CLIMATE

Weaknesses in key infrastructure sectors remain. Ireland invested significantly in public infrastructure in the late 1990s and the first part of the 2000s when property taxes boosted government revenue. General government gross fixed capital formation averaged 4 % of GDP during the period 2000–2008. This investment push focused on roads and housing, with significant investments also in water supply and sewerage and health. Public investment has nevertheless fallen sharply during the past six years to an estimated 1.5 % of GDP in 2014. As a result, key weaknesses in infrastructure remain that affect the growth potential, the efficient use of resources and action against climate change.

Graph 3.5.1: **Public sector gross fixed capital formation by area**



Source: Central Statistics Office

Water infrastructure

The water sector is in urgent need of investment. Until Irish Water was set up in January 2014, the water sector was run by 34 local authorities each operating over small geographic areas and running their own investment programmes, financed mainly from general government funds. Water charges were imposed on non-domestic users but collection rates were low, and domestic users were not charged at all. ([65]) As a result, investment in water supply and treatment infrastructure was insufficient. ([66]) It is estimated that almost 50 % of clean water is currently wasted through leaks, while treatment facilities are insufficient and give rise to serious environmental concerns ([67]). Water supply problems (boil notices, reduced pressure and others) are also recurrent, including in the main cities.

Weaknesses in water infrastructure have far-reaching consequences. These weaknesses raise concerns not only from an environmental and social perspective, but also from a growth perspective as water supply is a key input to some major industries in Ireland, including the pharmaceutical sector. Insufficient water supply and treatment capacity has also recently constrained the development of new residential projects in Dublin, where demand is largest. ([68]) Yet, the insufficient housing supply response has contributed lately to rising house prices and rents in Dublin, with adverse social and competitiveness effects.

Water sector reforms were initiated in 2011. Ireland considered policies to fundamentally reform the water sector in the National Recovery Plan 2011–2014 already. This process was integrated in the EU-IMF programme of financial assistance, under which Ireland committed itself to re-organising the sector around a fully publicly owned national utility (Irish Water) and to introducing charges for domestic users to incentivise a more sensible use of the resource and ensure more sustainable financing for the sector. Reforms have been progressing since 2011, culminating with the setting up of Irish Water and the planned introduction of charges for households in the last quarter of 2014.

([65]) So far, and until water charges for domestic users were introduced, costs have been covered through general taxation, with transfers from the central government to the local authorities. Such transfers will continue in the foreseeable future because charges will not fully cover Irish Water's costs.

([66]) The investment shortfall was explained in the Irish Water: Phase 1 Report drawn up in 2011 to plan the reform programme.

([67]) Environmental Protection Agency (2014). *Focus on Urban Waste Water Treatment 2013.*

([68]) The Dublin City Development Plan 2011–2017 indicates that the city's water supply is currently operating at capacity, frustrating efforts to plan further residential developments. Irish Water's Draft Water Services Strategic Plan published in February 2015 also raises the same issue.

The structure and level of charges planned initially have been modified. In November 2014, the government announced revisions to the structure and level of charges compared with what had been determined by the Commission for Energy Regulation. The core of the reforms remains, however, and the authorities publicly committed to Irish Water operating the sector as a 100 % state-owned national utility under the regulatory oversight of the Commission for Energy Regulation. They also indicated that the installation of meters would proceed as planned. The latest decisions raise some concerns, however:

- **Infrastructure investment:** Irish Water will remain dependent on central government funding for some time and the prospects of the company becoming self-funded have become more distant. Although the latest decisions do not affect its capital spending programme to the end of 2016 as approved by the regulator, the extent to which Irish Water will be in a position to fund and borrow on the markets for much-needed capital investment is unclear.

- **Conservation objectives:** capping domestic water charges at low levels provides weaker incentives to conserve water than under the original plan for most households, even those with a meter.

- **Fiscal implications:** fiscal risk arises from the uncertainty surrounding the pending Eurostat ruling on whether Irish Water complies with the market test under European System of Accounting 2010 rules.

ICT infrastructure

A strong ICT infrastructure is of key importance for the Irish economy. The surge in services exports (Section 3.3) would not have been possible without a good ICT infrastructure and the digital economy has strongly contributed to growth and job creation in recent years. Several inter-related factors contribute to the performance of digital markets, including broadband internet, digital skills, e-government and integration of digital technologies by businesses. ([69])

Broadband coverage can improve. Fixed broadband covers 96 % of households, only slightly below the EU average of 97 %. In 2013, 54 % of homes were covered with speeds of at least 30 Mbps (next generation access), compared with 62 % on average in the EU. This also represented a 12 percentage point increase in next generation access coverage over the previous year. Ireland is still a long way from achieving the Digital Agenda target of 100 % coverage of fixed broadband above 30 Mbps by 2020. In addition, fibre coverage is low 1.7 %. Fibre connection is critical for higher speeds. The National Broadband Plan 2012 outlines the government's policy on the delivery of high-speed broadband services and specifies targets for delivery and roll-out. These targets are in line with the Digital Agenda targets.

Energy infrastructure

Ireland is vulnerable to gas supply interruptions. Gas is the primary fuel for electricity generation (50 %), followed by coal (20 %), renewables (19 %) and peat (9 %). The UK is the only source of gas imports through two parallel subsea pipelines. The safety of supply is a concern given both interconnectors experienced outages in the winter of 2012/13. Ireland also does not comply with the 'N-1 rule', i.e. the ability to continue providing gas to domestic (or high-priority) customers when faced with the loss of the major gas import route. There are projects to allow bi-directional gas flows from Northern Ireland to Great Britain and from Ireland to the UK that have received the label of projects of common interest, but implementation is yet to be started.

Renewables play an increasing role in electricity production. The main expansion of renewables has taken place in the electricity sector. Renewable energy sources for electricity represented 19.6 % of the total in 2012, with wind energy the main contributor (almost 80 % of the total). The share of renewable energy reached 7.3 % of final energy consumption in 2013, which is above the interim target of 7 % for 2013/2014. Ireland is thus on track to achieve its 16 % renewable energy target by 2020. Such an increase would help reduce

([69]) As regards the five main drivers of the digital economy, Ireland ranks 18th among Member States on connectivity, 7th on human capital, 17th as regards the use of internet, 3rd in integration of digital technologies by business and 9th in digital public services.

energy dependency and Ireland aims to reach the overall renewables target by achieving by 2020 a 40% renewables (mostly wind) share in electricity generation. Increasing the proportion of wind energy in electricity production poses both market and technical challenges, including technical adaptation in energy networks and systems (such as smart meters). To a small extent, Ireland relies on electricity imports from the UK. Work is in progress on the feasibility of a new France-Ireland interconnection and on Ireland-UK electricity interconnections. The 'North Atlantic Green Zone Project' has already received financial aid under Connection Europe Facility.

Climate

Ireland is not on track to reach its greenhouse gas emission reduction targets. It is committed to reducing its greenhouse gas emissions in the non-emissions trading system sector by 20 % between 2005 and 2020. According to the latest national projections it is likely to miss this target by a wide margin, with the authorities expecting emissions to decrease only by 3% in 2020 compared with 2005. Emissions in the agricultural sector, the largest non-emissions trading system sector in terms of greenhouse gas emissions, are expected to remain stable between 2005 and 2020. Emissions in transport, the second largest non-emissions trading system sector in terms of emissions, are expected to increase significantly between 2005 and 2020. This is mainly due to the lack of public transport, including the underdevelopment of rail and the lack of infrastructure to make it possible to reach national targets on electric mobility. Although Ireland has a carbon tax in place, it is not linked to the evolution of energy prices and it is not consistent across different energy carriers and climate pollutants (methane and nitrous oxide emissions, for example, are not taxed like carbon).

Policies to address climate-related commitments are insufficient. The government prepared the main parts of a Bill on climate action and low carbon development. It has also adopted a renewable energy strategy, a second energy efficiency national action plan, an agricultural, food sector-specific economic development strategy, and taken measures to improve the household segregation of food waste. However, no progress was made in identifying how Ireland commits itself to meeting its existing, binding climate and energy targets for the period up to 2020 in an integrated way and how best to use the earmarked, available EU support for the structural development needed in the different areas.

3.6. SOCIAL POLICIES

Social transfers sheltered the most vulnerable and reduced poverty rates throughout the crisis. In spite of this and an improving labour market situation, significant challenges remain.

The high proportion of people living in households with low work intensity generates serious social challenges. At 23.9 %, it is currently the highest in the EU and more than double the EU average of 10.8 %. The rate was higher than the EU average prior to the crisis and surged from 14.3% in 2007 to 24.2% in 2011, before falling to 23.4% in 2012 ([70]). This increase has been attributed to a combination of factors, such as the increase in unemployment, changes in household structure and other factors – for instance, having a disability or having caring responsibilities. An important feature of Ireland's jobless households is the likelihood that they have children. The rate of children living in jobless households in Ireland is 17.7 % (2013). This rate is the highest in the EU and significantly above the EU average of 11.2%. While fewer than 30 % of adults in jobless households live with children in other EU-15 countries, 56 % do so in Ireland. Low work intensity is particularly severe among single adult households with children, and the proportion of children living in households with low work intensity is nearly three times the EU average. This increases the risk of social exclusion of children, particularly those in lone-parent households, with the overall at-risk-of-poverty and social exclusion rate for children increasing from 26.2% in 2007 to 33.9 % in 2013. Studies also show ([71]) that there is a wide range of household joblessness in need of tailor-made measures going beyond labour market activation interventions.

Absolute poverty, including amongst children, is increasing. The severe material deprivation rate (measured as four or more items of experienced deprivation) rose sharply between 2011 (7.8 %) and 2013 (9.9 %) and is now above the EU average of 9.6 %. Severe material deprivation among children has also increased. It almost doubled since 2008 (6.8 %) to 13.4% in 2013, above the EU average of 11.1 %. However, the most recent available European Union statistics on Income and Living Conditions, for the year 2013, indicate that relative poverty has started to fall in Ireland. The at-risk-of-poverty rate was 14.1 %, down from 15.7% in 2012 and 2.5 percentage points below the EU average. Similarly, for children (aged 0-17) the at-risk-of-poverty rate fell from 18% in 2012 to 16 % in 2013 and is over 4 percentage points below the EU average of 20.2 %.

The limited availability and high cost of childcare remains a significant barrier to increased female labour market participation. The employment rate for women rose in the year from 60.5 % in Q3-2013 to 61.3 % in Q3-2014. However, it still remains over 10 percentage points lower than the rate for men (with the gender employment gap actually increasing between Q3-2012 and Q3-2014) and over 2 percentage points lower than the EU average. Single-parent households and households with three or more children have much lower employment rates and lower work intensity when they are in employment ([72]). According to 2013 figures, the average fee for childcare nationally was EUR 152 per child per week, amounting to almost EUR 16 000 per year for a two-child family. As a percentage of wages, childcare costs are higher than in any other EU country ([73]).

Access to full-time childcare is limited and the quality of services remains a problem. The most recent comparable EU data, from 2011, shows that Ireland had not reached the Barcelona target of a 33 % coverage rate for children under three as only 21 % of children under three had formal childcare arrangements. Childcare coverage had fallen significantly below EU averages for formal

([70]) The 2012 European Union statistics on Income and Living Conditions indicates a rate of 23.4 % for low work intensity households in Ireland. Irish authorities have conducted further research into the measurement and there is a disparity when comparing EU Statistics on Income and Living Conditions data and Labour Force Survey data. The latter indicates a rate of closer to 17 % in Ireland and this would still be the second highest rate of very low work intensity households in the EU in 2012. While differences between the two surveys are common across EU member states, the magnitude is much larger in Ireland. The issue will be studied further in order to diminish divergences between the indicators.

([71]) *Jobless Households: An Exploration of the Issues*, No. 137 June 2014, National Economic and Social Council (NESC).

([72]) According to the 2011 census, 25.8 % of all families with children in Ireland are one-parent families, with 86.5 % of them headed by a woman.

([73]) 'Economic Policy Reforms: Going for Growth' http://www.oecd.org/inclusive-growth/Economic%20Policy%20Reforms%202013%20Going%20for%20Growth.pdf. See chapter 4, structural policy indicators, Chart 4.9.

childcare for i) between 1 and 29 hours (10 % compared with the EU average of 15 %) and ii) 30 or more hours (11 % compared with the EU average of 15 %). Currently, there is no comprehensive monitoring system for assessing the quality of childcare services. The findings from various sources ([74]) indicate that there is variable quality in terms of compliance with (minimum standard) pre-school regulations, qualification levels of staff, in particular in centre-based services, and shortcomings in pre-school curricula.

Ireland has made some progress in tackling the low work intensity of households. The authorities have begun to address inactivity traps by altering the operation of some welfare entitlements. The family income supplement, a weekly tax-free top-up payment for employees on low pay with children, is now payable for a continuous 52 weeks for eligible claimants regardless of a change in circumstances, such as an increase in weekly earnings. Previously the payment was discontinued as soon as a claimant moved above the upper limit. The authorities are also in the process of reforming welfare entitlements for housing and piloting a housing assistance payment to replace the rent supplement. This change should address the 'cliff edge' effect for rent supplement claimants who lose their entitlement as soon as they become employed for over 30 hours a week.

In a move to address child poverty, Ireland focused on fiscal measures. Budget 2015 announced a EUR 5 increase in child benefit which brings the rate to EUR 135 per month per child. A further increase of EUR 5 is envisaged in 2016. This represents a strengthening of child benefit as it was previously decreased from EUR 166 to EUR 130. A universal payment, it is not means-dependent. The increase will affect approximately 1.17 million children. The question remains on the prioritisation of spending with no actual progress in investment in more universal early childhood education and care services. In addition, the 2013–16 Area-based Childhood Programme targets investments to improve parental wellbeing, education and child health. It also targets development outcomes for children and families living in disadvantaged areas. The authorities are currently evaluating the initial phase of the programme's implementation.

Limited progress has been made in relation to improving access to more affordable and full-time childcare, particularly for low-income families. Budget 2015 announced the introduction of the back to work family dividend to address childcare and other costs associated with returning to work, such as transport. The dividend will allow families to retain the full qualified child increase of EUR 29.8 a week per child for the first 12 months after returning to work and 50 % of the payment in the second year. The impact of this initiative is likely to be limited because the cost of full-time childcare ranges from EUR 210 a week for an infant to EUR 53 a week for a primary school age child.

The Department of Children and Youth Affairs estimates that approximately 100 000 children benefit from support under a range of available childcare programmes. The Early Childhood Care and Education Scheme was announced in 2010, introducing the free pre-school year which provides 15 hours a week of childcare for 38 weeks a year. There is no progress in extending the daily coverage of this provision and no further steps have been taken to introduce a second free year which the authorities have committed to introducing by 2020. The community childcare subvention for low-income families offers support for recipients of social welfare payments and some participants in employment schemes. The training and employment childcare programmes, the umbrella for all childcare education and training support funding schemes, offer only a few thousand subsidised places.

The scattered provisions for childcare support are complicated and difficult to navigate. The shortcomings of current provisions relate mainly to a combination of low payment rates for childcare providers, limited knowledge of the scheme and practical obstacles to accessing after-school care (geographical or administrative). In an attempt to increase the quality of services, a new National Quality Support Service will commence in 2015 with a limited budget and small staff. No budget was allocated to up-skill childcare staff beyond

([74]) Hanafin, S. (2014), *Report on the Quality of Pre-school Services: Analysis of pre-school inspection reports.* Dublin: Tusla, Child and Family Agency; Start Strong (2014) 'Childcare: Business or Profession'; Neylon, G. (2014) 'An analysis of Irish pre-school practice and pedagogy using the early childhood environmental four curricular subscales', in Irish Educational Studies, Vol.33, No. 1.

minimum qualifications. Childcare programmes generally fail to have a significant impact on increasing access to affordable and quality childcare, particularly for low-income families. The recently set up inter-departmental group on childcare might be seen as a platform to develop more comprehensive solutions to this problem.

ANNEX A

Overview Table

Commitments	Summary assessment ([75])
2014 Country-specific recommendations (CSRs)	
CSR 1: Fully implement the 2014 budget and ensure the correction of the excessive deficit in a sustainable manner by 2015 through underpinning the budgetary strategy with additional structural measures while achieving the structural adjustment effort specified in the Council Recommendation under the Excessive Deficit Procedure. After the correction of the excessive deficit, pursue a structural adjustment towards the medium-term objective of at least 0,5 % of GDP each year, and more in good economic conditions or if needed to ensure that the debt rule is met in order to put the high general government debt ratio on a sustained downward path. Enhance the credibility of the fiscal adjustment strategy, effectively implement multi-annual budgetary planning and define broad budgetary measures underlying the medium-term fiscal targets. Ensure the binding nature of the government expenditure ceiling including by limiting the statutory scope for discretionary changes. To support fiscal consolidation, consideration should be given to raising revenues through broadening the tax base. Enhance the growth and environmental friendliness of the tax system.	Ireland has made **some progress** in addressing CSR 1 (this overall evaluation excludes an assessment of compliance with the Stability and Growth Pact): • No progress: no changes have been made to the legal framework for expenditure ceilings. • Some progress: starting in 2015 for new companies, and following a transition period until the end of 2020 for established ones, companies registered in Ireland will be treated as resident for tax purposes regardless of ownership structure, thereby scheduling an end to the 'double Irish' system and potentially broadening the tax base. No other measures have been taken to broaden the tax base, and little has been done to enhance the growth and environmental friendliness of the tax system.
CSR 2: Advance the reform of the healthcare sector initiated under the Future Health strategic framework to increase cost-effectiveness. Pursue additional measures to reduce pharmaceutical spending, including through more frequent price realignment exercise for patented medicines, increased generic penetration and improved prescribing practices. Reform the financial management systems of the national health authority to streamline systems across all providers and to support better claims	Ireland has made **some progress** in addressing CSR 2: • Some progress: the Health (Pricing and Supply of Medical Goods) Act 2013 provided for the establishment of a system of internal reference pricing, with internal reference pricing now established for 36 molecules. Generics penetration increased to around 70% in volume by Q3-2014. The mid-term review of the framework

([75]) The following categories are used to assess progress in implementing the 2014 CSRs of the Council Recommendation:
No progress: The Member State has neither announced nor adopted any measures to address the CSR. This category also applies if a Member State has commissioned a study group to evaluate possible measures.
Limited progress: The Member State has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk.
Some progress: The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases.
Substantial progress: The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the CSR.
Fully addressed: The Member State has adopted and implemented measures that address the CSR appropriately.

management. Roll out individual health identifiers starting by the end of the first quarter of 2015 at the latest.	agreement with the Irish Pharmaceutical Healthcare Association (IPHA) on the supply terms, conditions and prices of medicines has begun but not finished. The authorities are asking for a widening of the reference basket, alignment to the lowest price instead of the average price, and more frequent realignments. The outcome of the review is not yet known. The rules on pricing realignment for patented medicines have not been changed. • Some progress: an activity-based funding model for budget allocations in statutory hospitals has been introduced on a shadow basis, but a full switch to activity-based funding will take some years to complete. • Some progress: the timeline for the roll-out of the first phase of individual health identifiers has been delayed, but the Health Identifiers Act 2014 was enacted in July 2014 and the Chief Information Officer in charge of leading the work has been recruited. The first phase of deliverables is being supported by budget planning.
CSR 3: Pursue further improvements in active labour market policies, with a particular focus on the long-term unemployed, the low-skilled and, in line with the objectives of a youth guarantee, young people. Advance the ongoing reform of the further education and training (FET) system, employment support schemes and apprenticeship programmes. Offer more workplace training; improve and ensure the relevance of FET courses and apprenticeships with respect to labour market needs. Increase the level and quality of support services provided by the Intreo labour offices. Put in place a seamless FET referrals system between Intreo offices and Education and Training Boards.	Ireland has made **some progress** in addressing CSR 3: • Some progress: a new version of *Pathways to Work*, the strategy setting out Ireland's reform of activation and training services, was published in October 2014. It sets out new actions to be implemented in the coming year as well as quantitative targets, with a greater emphasis on long-term and youth unemployment. *Pathways to Work* 2015 specifies new measures for implementating the Youth Guarantee. There was some delay in setting up the *JobPath* initiative, but it is going ahead and the contracts with the two providers have now been signed. When fully implemented, it will enable a large number of long-term unemployed to benefit from activation services provided by private contractors. • Some progress: all training centres under the management of SOLAS have been consolidated under their respective

	Education and Training Boards, and SOLAS recently published its three-year corporate strategy and a five-year strategy for developing and delivering an integrated further education and training sector. • Some progress: there are about 550 case officers dealing with jobseekers in *Intreo* offices. There are 44 *Intreo* offices now open, but there have been some delays in opening the remaining 16. • Some progress: protocols have been put in place between Education and Training Boards and *Intreo* offices.
CSR 4: Tackle low work intensity of households and address the poverty risk of children through tapered withdrawal of benefits and supplementary payments upon return to employment. Facilitate female labour market participation by improving access to more affordable and full-time childcare, particularly for low income families.	Ireland has made **limited progress** in addressing CSR 4: • Limited progress: Budget 2015 announced that Child Benefit payments will increase by EUR 5 a month throughout 2015. This is not likely to have a significant impact as an individual measure but may help matters as part of a series of announced measures that includes: (1) reforms to the Back to Work Family Dividend; and (2) the establishment of a Low Pay Commission as an independent statutory body that will make annual recommendations to the government on the appropriate level of the minimum wage and related matters. The Housing Supplement is gradually being replaced with the Housing Assistance Payment in order to reduce the disincentive to return to work arising from housing subsidies for the unemployed. • No progress was made in improving access to more affordable and full-time childcare.
CSR 5: Advance policies for the SME sector including initiatives to address the availability of bank and non-bank financing and debt restructuring issues, while avoiding risks to public finances and financial stability. Advance initiatives to improve SME's access to bank credit and non-bank finance. Introduce a monitoring system for SME lending in the banking sector.	Ireland has made **some progress** in addressing CSR 5: • Some progress: the legislation to replace the National Pensions Reserve Fund (NPRF) with the Ireland Strategic Investment Fund was enacted in July 2014. The mandate of the Ireland Strategic Investment Fund is to invest on a commercial basis to support economic

In parallel, work to ensure that available non-bank credit facilities, including the three SME funds co-funded by the National Pensions Reserve Fund, Microfinance Ireland and the temporary loan guarantee scheme, are better utilised. Promote the use of these and other non-bank schemes by SMEs. Enhance the Credit Review Office's visibility and capabilities in mediating disputes between banks and prospective SME borrowers who have been refused credit.	activity in Ireland. It will focus in part on SMEs and manage assets worth EUR 7 billion (4% of GDP). The recently established state development corporation for SMEs, the Strategic Banking Corporation of Ireland was launched in October 2014 to provide loans through existing credit institutions, with a full roll-out of products expected in the first quarter of 2015. The Strategic Banking Corporation of Ireland secured an initial amount of EUR 800 million in funds, of which EUR 550 million are guaranteed by the government. • Substantial progress: The authorities publish quarterly data on bank lending to SMEs, but no longer have a formal target-based system to monitor lending to SMEs though it is closely watched. • Some progress: Two SME funds, co-financed by the National Pensions Reserve Fund (NPRF), are lending with a growing number of projects in the pipeline. The mandate of a third NPRF fund, the Turnaround Fund, was not renewed at the end of 2014 due to the limited pool of underperforming/distressed businesses eligible as turnaround investment cases amid a continued economic recovery. The Action for Jobs 2015 announced a reconfigured Credit Guarantee Scheme and a simplified operation of the Microenterprise Loan Fund. A supporting SMEs Online Tool was launched to increase awareness among SMEs of available business supports. A communications campaign is being run to showcase the website. • Some progress: Permanent TSB has agreed to participate in the Credit Review Office process since it will begin lending to SMEs. The upper limit for referring refusals to the Credit Review Office has been increased to EUR 3 million. As the latest RedC SME Credit Demand Survey (September 2014) shows, there are still issues with the visibility and usage of non-bank schemes and of the Credit Review Office for appeals against credit refusals.

	Awareness and knowledge of SME funding options remains low.
CSR 6: Monitor banks' performance against the mortgage arrears restructuring targets. Announce ambitious targets for the third and fourth quarters of 2014 for the principal mortgage banks to propose and conclude restructuring solutions for mortgage loans in arrears of more than 90 days, with a view to substantially resolving mortgage arrears by the end of 2014. Continue to assess the sustainability of the concluded restructuring arrangements through audits and targeted on-site reviews. Develop guidelines for the durability of solutions. Publish regular data on banks' SME loan portfolios in arrears to enhance transparency. Develop a strategy to address distressed commercial real-estate exposures. Establish a central credit registry.	Ireland has made **some progress** in addressing CSR 6: • Full implementation: the Central Bank of Ireland continues to monitor banks' performance against the mortgage arrears restructuring targets. • Full implementation: in June 2014, the Central Bank of Ireland announced new targets for the third and fourth quarters of 2014. For the third quarter of 2014, the banks reached and even exceededed the targets, with an encouraging 91 % of solutions meeting the terms. Audits are taking place of the banks' mortgage arrears resolution targets Q2-2014 returns. • Substantial progress: the Central Bank of Ireland continues to assess the sustainability of the concluded restructuring arrangements through audits and on-site reviews. • No progress was made in developing guidelines for the durability of solutions. • No progress was made in publishing regular data on the banks' SME loan portfolios in arrears. • Limited progress: the National Asset Management Agency is ahead of schedule with EUR 18.7 billion of asset disposals at end-December 2014 (28 % of which are disposals of Irish assets), taking advantage of strong market demand. • Limited progress: the Credit Reporting Act, 2013 came into force in January 2014. Work on the central credit register has been well underway since January 2014, but the current timeline envisages some delay with the register being operational in late 2016 for consumer credit, and subsequently for commercial credit.
CSR 7: Reduce the cost of legal proceedings and services and foster competition, including by	Ireland has made **limited progress** in

adopting the Legal Services Regulation Bill by the end of 2014, including its provision allowing the establishment of multi-disciplinary practices, and by seeking to remove the solicitor's lien. Monitor its impact, including on the costs of legal services. Take executive steps to ensure that the Legal Services Regulatory Authority is operational without delay and that it meets its obligations under the legislation, including in terms of publishing regulations or guidelines for multi-disciplinary practices and the resolution of complaints. Improve data collection systems to enhance the monitoring and evaluation of the efficiency of judicial proceedings to identify issues in need of reform.	addressing CSR 7: • Limited progress: the authorities have indicated that the Legal Services Regulation Bill should pass Dáil Report Stage in early 2015 and proceed to the Seanad soon after that. Progress towards enactment therefore continues to be slow. Indications were initially that the Bill would proceed to Report Stage (the final stage in the Dáil l before being sent to the Seanad) before the summer recess, but this did not happen. Recurrent long delays have been experienced in the past and seem to be happening again after some acceleration in the process in early 2014. • No progress: the Bill will not include a provision to remove the solicitor's lien. • No progress: the Bill needs to be enacted first and it will take time before its impact can be assessed. • Limited progress: Budget 2015 allocated EUR 500 000 towards setting up the Legal Services Regulatory Authority. • Some progress: the authorities have taken measures to improve systems to collect data collection on judicial proceedings. The implementation of these measures remains to be completed for some courts and areas of the justice system.
Europe 2020 (national targets and progress)	
Employment rate target: between 69 % and 71 %	The employment rate (Eurostat definition, age group 20-64) increased to 67.5 % in Q3 2014 compared with an average of 63.7 % in 2011–12. Concurrently, the unemployment rate (Eurostat definition, age group 20-64) is on a firm declining trend, falling to 11.1 % in Q3 2014 compared with an average of 14.4 % in 2011–12.
R&D investment target: 2.0 % of GDP	Ireland has set itself a national R&D intensity target for 2020 of 2.0 % of GDP. It has made very significant progress towards reaching this target. Investment in R&D grew steadily until the

	financial crisis. Between 2002 and 2013 R&D intensity increased from 1.1 % in 2002 to 1.28 % in 2007 and 1.74 % in 2013. The first increase reflects considerable real growth of the volume of investment as this came at a time of strong economic growth, while the latter increase in R&D intensity reflects the economic contraction. Public sector R&D intensity in 2013 was 0.44 % and business R&D intensity 1.2 %. While Ireland has maintained public spending on research at 2010 nominal levels, this constitutes a decrease in real terms. Business expenditure on R&D, which has been evolving more favourably than public expenditures in recent years, has been supported indirectly by an R&D tax credit scheme which has seen a large uptake.
Reduction of greenhouse gas (GHG) emissions in sectors that are not covered by the Emission Trading System by 20 % compared to 2005 levels.	Non-Emission Trading System greenhouse gas emissions decreased by 12 % between 2005 and 2013. According to the latest national projections submitted to the European Commission that take existing measures into account, it is expected that Ireland will miss the target, with 2020 emissions expected to be 2 % lower than 2005 emissions (i.e. a projected shortfall of 18 percentage points).
Renewable energy target: 16 % proportion of renewable energy in total gross energy consumption in 2020.	The proportion of renewable energy was 7.2 % in 2012. Although this is in line with the linear trajectory up to 2020, the existing policy, market and budget framework appears to be insufficient to enable Ireland to gradually achieve the 2020 objective.
Energy efficiency target	The second national Irish energy efficiency action plan aims to achieve 20 % energy savings in 2020 (as compared to 2005). The European Commission's reference scenario projects a 1 % decrease in gross primary energy consumption in 2030 compared to 2005.
Early school leaving target: 8 %	The early-school-leaving rate was 11.5 % in 2010, 10.8 % in 2011, 9.7 % in 2012 and 8.4 % in 2013. There has been a consistent positive trend in recent years, with Ireland performing better than the EU-28 average (8.4 % and 11.9 % respectively in 2013). It is

	on track to reach the target of 8 %.
Tertiary education attainment target: 60 %	The tertiary education attainment rate was 50.1 % in 2010, 49.7 % in 2011, 51.1 % in 2012 and 52.6 % in 2013. With the exception of 2011, it has been consistently increasing and Ireland currently has the highest tertiary education attainment rate in the EU. Further participation in tertiary education can be sought by improving access for students from disadvantaged backgrounds and addressing the gender imbalance (57.9 % of women against 44 % of men in 2012).
To reduce the number experiencing consistent poverty to 4 % by 2016 (interim target) and to 2 % or less by 2020, from the 2010 baseline rate of 6.2 %, which will lift at least 200 000 people out of the risk of poverty and exclusion between 2012 and 2020 (revised target).	The number of people at risk of poverty or social exclusion increased from a pre-crisis level of 1.05 million in 2008 to 1.36 million in 2013. Achieving the national target remains ambitious.

ANNEX B

Standard Tables

Table AB.1: **Macroeconomic indicators**

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015	2016
Core indicators									
GDP growth rate	9.6	4.9	0.2	2.8	-0.3	0.2	4.8	3.5	3.6
Output gap [1]	2.1	0.9	0.0	-1.3	-1.8	-2.5	-0.1	0.7	0.7
HICP (annual % change)	2.7	3.4	1.1	1.2	1.9	0.5	0.3	0.3	1.3
Domestic demand (annual % change) [2]	8.9	5.5	-1.3	-0.7	-0.6	-0.3	2.2	3.3	3.6
Unemployment rate (% of labour force) [3]	7.8	4.4	8.3	14.7	14.7	13.1	11.1	9.6	8.8
Gross fixed capital formation (% of GDP)	22.3	25.5	23.3	14.5	15.6	15.2	15.9	17.1	18.4
Gross national saving (% of GDP)	24.1	23.3	19.4	16.0	17.6	20.5	22.4	23.2	23.6
General government (% of GDP)									
Net lending (+) or net borrowing (-)	2.1	0.8	-10.1	-12.6	-8.0	-5.7	-4.0	-2.9	-3.1
Gross debt	53.3	29.8	48.0	111.1	121.7	123.3	110.8	110.3	107.9
Net financial assets	n.a.	-10.1	-17.1	-62.1	-79.1	n.a.	n.a.	n.a.	n.a.
Total revenue	37.2	34.0	35.1	33.5	34.2	34.8	35.1	34.5	33.9
Total expenditure	35.1	33.2	45.1	46.1	42.2	40.5	39.1	37.4	36.9
of which: Interest	3.2	1.2	1.7	3.4	4.1	4.4	4.1	3.9	3.8
Corporations (% of GDP)									
Net lending (+) or net borrowing (-)	n.a.	n.a.	8.8	12.0	6.2	10.3	10.7	10.4	10.9
Net financial assets; non-financial corporations	n.a.	-85.1	-97.3	-129.8	-133.8	n.a.	n.a.	n.a.	n.a.
Net financial assets; financial corporations	n.a.	15.7	-1.4	2.9	14.8	n.a.	n.a.	n.a.	n.a.
Gross capital formation	n.a.	n.a.	7.2	5.4	5.6	6.3	5.6	6.1	6.5
Gross operating surplus	n.a.	n.a.	30.1	33.5	32.9	32.2	32.7	33.0	33.7
Households and NPISH (% of GDP)									
Net lending (+) or net borrowing (-)	n.a.	n.a.	-2.3	2.7	2.3	1.6	-0.3	-0.9	-1.5
Net financial assets	n.a.	83.9	57.5	70.7	81.0	n.a.	n.a.	n.a.	n.a.
Gross wages and salaries	n.a.	n.a.	39.2	37.2	37.0	36.5	36.0	35.9	35.7
Net property income	n.a.	n.a.	0.8	0.7	1.2	1.3	0.2	-0.4	-1.3
Current transfers received	n.a.	n.a.	15.9	18.2	17.9	18.1	16.9	15.9	15.5
Gross saving	n.a.	n.a.	6.0	5.7	5.1	4.7	3.5	3.3	3.1
Rest of the world (% of GDP)									
Net lending (+) or net borrowing (-)	2.2	-1.3	-4.1	0.2	0.9	3.8	5.7	5.1	4.3
Net financial assets	n.a.	20.9	61.6	116.2	116.1	n.a.	n.a.	n.a.	n.a.
Net exports of goods and services	12.0	14.5	11.8	20.3	20.5	20.8	21.9	21.7	21.1
Net primary income from the rest of the world	-10.6	-15.2	-14.6	-18.7	-17.4	-14.9	-15.2	-15.4	-15.7
Net capital transactions	1.0	0.3	0.1	0.1	0.0	0.1	0.7	0.5	0.4
Tradable sector	50.5	46.7	43.8	48.8	48.8	47.5	n.a.	n.a.	n.a.
Non-tradable sector	38.5	41.9	46.0	43.4	43.4	44.4	n.a.	n.a.	n.a.
of which: Building and construction sector	5.8	7.2	5.5	1.4	1.6	1.6	n.a.	n.a.	n.a.

(1) The output gap constitutes the gap between the actual and potential gross domestic product at 2010 market prices.
(2) The indicator of domestic demand includes stocks.
(3) Unemployed persons are all those who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.
Source: European Commission 2015 winter forecast, Commission calculations.

Table AB.2: **Financial market indicators**

	2009	2010	2011	2012	2013	2014
Total assets of the banking sector (% of GDP)[1]	1006.9	965.9	807.8	713.7	619.9	638.1
Share of assets of the five largest banks (% of total assets)	52.6	49.9	46.7	46.4	47.8	n.a.
Foreign ownership of banking system (% of total assets)	40.4	33.8	37.4	35.7	35.6	n.a.
Financial soundness indicators:						
- non-performing loans (% of total loans)[2]	9.8	12.5	16.1	24.6	25.3	25.3
- capital adequacy ratio (%)[2]	12.8	14.5	18.9	19.2	20.4	20.4
- return on equity (%)[2]	-35.8	-41.0	-10.8	-7.8	-6.8	-6.8
Bank loans to the private sector (year-on-year % change)[1]	-5.6	-12.3	-4.7	-2.6	-6.8	-7.5
Lending for house purchase (year-on-year % change)[1]	-4.1	-2.5	-0.9	6.6	-1.7	-3.8
Loan to deposit ratio[1]	162.0	140.8	133.4	128.7	113.3	99.5
Central Bank liquidity as % of liabilities[3]	9.0	18.3	18.4	16.6	6.9	3.6
Private debt (% of GDP)	258.5	261.2	277.9	281.5	266.4	n.a.
Gross external debt (% of GDP)[4] - public	46.5	50.8	63.6	76.3	76.7	77.9
- private	606.7	680.1	695.6	691.8	714.3	709.0
Long-term interest rate spread versus Bund (basis points)*	200.3	299.6	699.3	467.7	222.0	120.4
Credit default swap spreads for sovereign securities (5-year)*	189.8	267.2	673.9	406.0	120.4	53.5

(1) Latest data November 2014.
(2) Latest data Q4 2013. Basel II.
(3) Latest data September 2014.
(4) Latest data June 2014. Monetary authorities, monetary and financial institutions are not included.
(*) Measured in basis points.
Source: IMF (financial soundness indicators); European Commission (long-term interest rates); World Bank (gross external debt); ECB (all other indicators).

Table AB.3: **Taxation indicators**

	2002	2006	2008	2010	2011	2012
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	28.3	32.1	29.5	28.0	28.2	28.7
Breakdown by economic function (% of GDP)[1]						
Consumption	11.0	11.5	10.9	10.3	9.8	10.0
of which:						
- VAT	7.0	7.7	7.3	6.4	6.0	6.2
- excise duties on tobacco and alcohol	1.6	1.2	1.2	1.3	1.2	1.2
- energy	1.3	1.2	1.2	1.4	1.4	1.3
- other (residual)	1.1	1.3	1.1	1.3	1.2	1.3
Labour employed	9.9	10.4	11.2	11.4	11.9	12.1
Labour non-employed	0.1	0.1	0.1	0.1	0.2	0.2
Capital and business income	5.6	7.1	5.2	4.3	4.1	4.3
Stocks of capital/wealth	1.7	3.1	2.2	1.9	2.2	2.2
p.m. Environmental taxes[2]	2.4	2.5	2.4	2.6	2.5	2.5
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	60.3	67.9	55.9	48.8	47.2	45.6

(1) Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), 'Taxation trends in the European Union', for a more detailed explanation.
(2) This category comprises taxes on energy, transport and pollution and resources included in taxes on consumption and capital.
(3) VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative scale of cross-border shopping (including trade in financial services) compared to domestic consumption also influences the value of the ratio, notably for smaller economies. For a more detailed discussion, see European Commission (2012), 'Tax Reforms in EU Member States', and OECD (2014), 'Consumption tax trends'.
Source: European Commission.

Table AB.4: **Labour market and social indicators**

	2008	2009	2010	2011	2012	2013	2014
Employment rate (% of population aged 20-64)	72.3	66.9	64.6	63.8	63.7	65.5	66.7
Employment growth (% change from previous year)	-0.6	-7.8	-4.1	-1.8	-0.6	2.4	1.8
Employment rate of women (% of female population aged 20-64)	64.1	61.8	60.2	59.4	59.4	60.3	60.9
Employment rate of men (% of male population aged 20-64)	80.4	72.1	69.1	68.2	68.1	70.9	72.7
Employment rate of older workers (% of population aged 55-64)	53.7	51.3	50.2	50.0	49.3	51.3	52.8
Part-time employment (% of total employment, age 15 years and over)	18.6	21.5	22.7	23.6	24.0	24.1	23.7
Part-time employment of women (% of women employment, age 15 years and over)	32.4	34.0	34.9	35.7	35.4	35.6	35.1
Part-time employment of men (% of men employment, age 15 years and over)	7.8	10.9	12.1	13.1	14.1	14.3	14.1
Fixed term employment (% of employees with a fixed term contract, age 15 years and over)	8.5	8.8	9.6	10.2	10.2	10.0	9.4
Transitions from temporary to permanent employment	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Unemployment rate[1] (% of labour force, age group 15-74)	6.4	12.0	13.9	14.7	14.7	13.1	11.4
Long-term unemployment rate[2] (% of labour force)	1.7	3.5	6.8	8.7	9.1	7.9	7.0
Youth unemployment rate (% of youth labour force aged 15-24)	13.3	24.0	27.6	29.1	30.4	26.8	23.9
Youth NEET rate (% of population aged 15-24)	14.9	18.6	19.2	18.8	18.7	16.1	n.a.
Early leavers from education and training (% of pop. aged 18-24 with at most lower sec. educ. and not in further education or training)	11.3	11.7	11.5	10.8	9.7	8.4	n.a.
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	46.1	48.9	50.1	49.7	51.1	52.6	n.a.
Formal childcare (from 1 to 29 hours; % over the population aged less than 3 years)	16.0	15.0	21.0	10.0	n.a.	n.a.	n.a.
Formal childcare (30 hours or over; % over the population aged less than 3 years)	8.0	5.0	8.0	11.0	n.a.	n.a.	n.a.
Labour productivity per person employed (annual % change)	-2.0	1.6	3.9	4.6	0.3	-2.1	2.7
Hours worked per person employed (annual % change)	-1.1	-1.7	-0.6	0.0	0.2	0.5	1.0
Labour productivity per hour worked (annual % change; constant prices)	-0.9	3.4	4.5	4.6	0.0	-2.6	1.7
Compensation per employee (annual % change; constant prices)	7.9	3.0	-2.2	0.3	-0.6	1.0	-1.7
Nominal unit labour cost growth (annual % change)	6.8	-2.6	-6.7	-4.0	0.0	1.0	n.a.
Real unit labour cost growth (annual % change)	10.0	1.3	-5.3	-4.6	-0.6	0.6	n.a.

(1) Unemployed persons are all those who were not employed, but had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. Data on the unemployment rate of 2014 includes the last release by Eurostat in early February 2015.
(2) Long-term unemployed are persons who have been unemployed for at least 12 months.
Source: European Commission (EU Labour Force Survey and European National Accounts).

Table AB.5: **Expenditure on social protection benefits (% of GDP)**

	2007	2008	2009	2010	2011	2012
Sickness/healthcare	6.7	7.9	9.8	11.4	12.8	15.1
Invalidity	0.9	1.1	1.3	1.4	1.3	1.3
Old age and survivors	4.7	5.5	6.3	6.7	6.7	6.9
Family/children	2.6	3.1	3.6	3.5	3.4	3.4
Unemployment	1.4	1.8	3.0	3.8	3.7	3.6
Housing and social exclusion n.e.c.	0.1	0.2	0.2	0.6	0.6	0.5
Total	16.9	20.0	24.9	27.7	28.7	31.0
of which: means-tested benefits	4.2	5.0	6.5	7.8	8.2	8.3
Social inclusion indicators	2008	2009	2010	2011	2012	2013
People at risk of poverty or social exclusion[1] (% of total population)	23.7	25.7	27.3	29.4	30.0	29.5
Children at risk of poverty or social exclusion (% of people aged 0-17)	26.6	31.4	34.1	34.1	33.1	33.9
Elderly at risk of poverty or social exclusion (% of people aged 65+)	22.5	17.9	11.3	13.8	14.7	13.3
At-risk-of-poverty rate[2] (% of total population)	15.5	15.0	15.2	15.2	15.7	14.1
Severe material deprivation rate[3] (% of total population)	5.5	6.1	5.7	7.8	9.8	9.9
Proportion of people living in low work intensity households[4] (% of people aged 0-59)	13.7	20.0	22.9	24.2	23.4	23.9
In-work at-risk-of-poverty rate (% of persons employed)	6.5	5.3	5.5	5.6	5.4	4.5
Impact of social transfers (excluding pensions) on reducing poverty	54.4	60.0	61.9	61.6	60.1	63.4
Poverty thresholds, expressed in national currency at constant prices[5]	13418.1	12700.3	11801.4	11532.8	11028.2	10807.6
Gross disposable income (households)	98634.0	91922.0	87374.0	85579.0	84597.0	n.a.
Relative median poverty risk gap (60% of median equivalised income, age: total)	17.7	16.2	15.5	17.5	19.1	17.4
Inequality of income distribution (S80/S20 income quintile share ratio)	4.4	4.2	4.7	4.6	4.7	4.5

(1) People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in households with zero or very low work intensity (LWI).
(2) At-risk-of-poverty rate (AROP): proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.
(3) Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.
(4) People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20 % of their total work-time potential in the previous 12 months.
(5) For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices (HICP) = 100 in 2006 (2007 survey refers to 2006 incomes).
(6) 2014 data refer to the average of the first three quarters.
Source: For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

Table AB.6: **Product market performance and policy indicators**

	2004-08	2009	2010	2011	2012	2013	2014
Labour productivity[1] in total economy (annual growth in %)	0.0	2.4	4.5	2.5	1.4	-2.8	n.a.
Labour productivity[1] in manufacturing (annual growth in %)	1.6	5.6	11.9	6.5	0.4	-3.8	n.a.
Labour productivity[1] in electricity, gas (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	na	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	-1.7	10.0	-3.5	-3.5	-0.2	11.6	n.a.
Labour productivity[1] in the wholesale and retail sector (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity[1] in the information and communication sector (annual growth in %)	14.1	4.8	7.9	6.5	5.7	-7.7	n.a.
Patent intensity in manufacturing[2] (EPO patent applications divided by gross value added of the sector)	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.
Policy indicators	**2004-08**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Enforcing contracts[3] (days)	515	515	515	650	650	650	650
Time to start a business[3] (days)	15.0	13	13	13	10	10	6
R&D expenditure (% of GDP)	1.2	1.6	1.6	1.5	1.6	n.a.	n.a.
Total public expenditure on education (% of GDP)	4.9	6.4	6.4	6.2	n.a.	n.a.	n.a.
(Index: 0=not regulated; 6=most regulated)	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Product market regulation[4], overall	1.35	n.a.	n.a.	n.a.	n.a.	1.45	n.a.
Product market regulation[4], retail	1.53	n.a.	n.a.	n.a.	n.a.	1.53	n.a.
Product market regulation[4], professional services	1.25	n.a.	n.a.	n.a.	n.a.	1.25	n.a.
Product market regulation[4], network industries[5]	2.49	2.47	2.25	2.21	2.21	2.21	n.a.

(1) Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.
(2) Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.
(3) The methodologies, including the assumptions, for this indicator are presented in detail here: http://www.doingbusiness.org/methodology.
(4) Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are presented in detail here: http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm
(5) Aggregate OECD indicators of regulation in energy, transport and communications (ETCR).
Source: European Commission; World Bank - Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators)

Table AB.7: **Green Growth**

Green growth performance		2003-2007	2008	2009	2010	2011	2012
Macroeconomic							
Energy intensity	kgoe / €	0.09	0.09	0.09	0.09	0.08	0.08
Carbon intensity	kg / €	0.42	0.39	0.38	0.38	0.35	0.35
Resource intensity (reciprocal of resource productivity)	kg / €	1.29	1.11	0.96	0.88	0.74	n.a.
Waste intensity	kg / €	n.a.	0.13	n.a.	0.12	n.a.	0.12
Energy balance of trade	% GDP	-1.8	-3.2	-2.4	-3.0	-3.5	-3.2
Energy weight in HICP	%	7.9	9.2	8.8	9.3	10.5	12.7
Difference between energy price change and inflation	%	6.6	5.6	-4.1	3.3	8.4	7.9
Ratio of environmental taxes to labour taxes	ratio	24.1%	21.4%	20.3%	22.4%	20.7%	20.4%
Ratio of environmental taxes to total taxes	ratio	8.1%	8.1%	8.4%	9.2%	8.9%	8.7%
Sectoral							
Industry energy intensity	kgoe / €	0.08	0.08	0.07	0.07	0.07	0.07
Share of energy-intensive industries in the economy	% GDP	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.14	0.12	0.11	0.12	0.14
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.04	0.03	0.03	0.04	0.04
Public R&D for energy	% GDP	n.a.	0.02	0.02	0.02	0.01	0.00
Public R&D for the environment	% GDP	n.a.	0.01	0.01	0.01	0.01	0.01
Recycling rate of municipal waste	ratio	30.4%	36.2%	37.3%	39.5%	43.0%	52.4%
Share of GHG emissions covered by ETS*	%	n.a.	30.1	27.8	28.2	27.5	29.1
Transport energy intensity	kgoe / €	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Transport carbon intensity	kg / €	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	89.6	90.6	88.8	86.5	89.6	84.8
Diversification of oil import sources	HHI	0.50	0.48	0.54	0.50	0.49	0.43
Diversification of energy mix	HHI	n.a.	0.39	0.38	0.38	0.36	0.34
Renewable energy share of energy mix	%	2.3	3.6	4.5	4.4	5.8	5.9

Country-specific notes:
2013 is not included in the table due to lack of data.
General explanation of the table items:
All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)
Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
Resource intensity: Domestic material consumption (in kg) divided by GDP (in EUR)
Waste intensity: waste (in kg) divided by GDP (in EUR)
Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Energy weight in HICP: the proportion of "energy" items in the consumption basket used for the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)
Environmental taxes over labour or total taxes: from DG TAXUD's database 'Taxation trends in the European Union'
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices for medium-sized industrial users: consumption band 500–2000MWh and 10000–100000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of recycled municipal waste to total municipal waste
Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP
"Proportion of GHG emissions covered by ETS: based on greenhouse gas emissions (excl LULUCF) as reported by Member States to the European Environment Agency "
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2005 EUR)
Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector
Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels
Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin
Diversification of the energy mix: Herfindahl index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
Renewable energy share of energy mix: %-share of gross inland energy consumption, expressed in tonne oil equivalents
* European Commission and European Environment Agency
** For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.
*** For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.
Source: European Commission unless indicated otherwise; European Commission elaborations indicated below

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