COUNCIL OF THE EUROPEAN UNION

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION with a view to bringing to an end the situation of an excessive deficit in Ireland

COUNCIL RECOMMENDATION

of

with a view to bringing to an end
the situation of an excessive deficit in Ireland

(2010/…/EU)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) in conjunction with Article 126(13) thereof;

Having regard to the recommendation from the Commission, Whereas:

(1) According to Article 126(1) of the Treaty on the Functioning of the European Union Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings and to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that, in particular, the economic and budgetary background was taken into account fully in all steps in the excessive deficit procedure (EDP). In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(4) According to Article 3(5) of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[1], if effective action has been taken in compliance with a Recommendation under Article 126(7) of the Treaty and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that Recommendation, the Council may decide, on a recommendation from the Commission, to adopt a revised Recommendation under Article 126(7) of the Treaty.

(5) On 27 April 2009, the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community, that an excessive deficit existed in Ireland[2], and issued recommendations to correct the excessive deficit by 2013 at the latest. The Council also set a deadline of 27 October 2009 for effective action to be taken[3].

(6) On 2 December 2009, the Council concluded that the Irish authorities had taken effective action in compliance with the Council recommendations of 27 April 2009 but that unexpected adverse economic events with major unfavourable consequences for government finances could be considered to have occurred in Ireland. The Council therefore adopted a revised Recommendation under Article 126(7) of the Treaty, postponing the deadline for the correction of the excessive deficit to 2014[4].

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1 OJ L 209, 2.8.1997, p. 6.

2 Council Decision 2009/416/EC of 27 April 2009 on the existence of an excessive deficit in Ireland (OJ L 135, 30.5.2009, p. 23.).

3 Council document st7836/09. Not yet published in the *Official Journal;* available in the public register at www.consilium.europa.eu

4 Council document st15763/09. Not yet published in the *Official Journal;* available in the public register at www.consilium.europa.eu

(7) On 13 July 2010, the Council concluded that the Irish authorities had taken effective action in compliance with the Council recommendations[1].

(8) According to the Commission services' autumn 2009 forecasts, which provided the basis for the Council's December 2009 recommendations issued to Ireland under Article 104(7) of the Treaty, real GDP was expected to contract by 1,4 % in 2010, followed by an expansion by 2,6 % in 2011. According to the Commission services' autumn 2010 forecasts and the most recent assessment made by the Commission services, the decline in output in 2010 is now expected to have stood at just 0,2 %. However, the economic outlook has worsened over the last months, with real GDP growth now projected at 0,9 % in 2011 and 1,9 % in 2012 in the Commission services' autumn 2010 forecast. Moreover, the impact of the crisis on the financial sector has turned out to be much more pronounced than anticipated. The support measures deemed necessary to preserve financial stability and restore confidence in the banking sector and thereby support the economy's return to sustainable growth have a very large additional budgetary cost. Due to the unforeseen capital injections in the banking sector and an increase in the sovereign funding costs, interest expenditure relative to GDP is projected to increase by 2,3 percentage points (pps.) by 2014 compared to the projections in the December 2009 Stability Programme.

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[1] Council document st12620/10. Not yet published.

(9) As a consequence, the fiscal situation is significantly worse than expected, with the Commission services' autumn 2010 forecast projecting the headline general government deficit to reach 32,3 % of GDP in 2010. This reflects the large one-off banking sector support measures. Without these measures, the deficit would have been expected to amount to 12,5 % of GDP in 2010. This is worse than the 11,6 % of GDP projected in the December 2009 Stability Programme update, but markedly better than the 14,7 % of GDP projected on the basis of a no-policy-change assumption in the Commission services' autumn 2009 forecast underlying the December 2009 Council Recommendation. Relative to this no-policy-change path, and in line with the December 2009 Council Recommendation, a fiscal consolidation package of 2½ % of GDP was included in the budget for 2010, and fully implemented. The cyclically-adjusted deficit, net of one-off effects, is estimated to have widened by 1¼ percentage points of GDP to around 11 % of GDP in 2010. However, this reflects developments in revenue elasticities during the deep recession rather than discretionary measures. On the contrary, large consolidation packages have been adopted since mid-2008, amounting to some 9 % of GDP in 2009-2010.

(10) The Irish economy is projected to record lower growth rates in the immediate post-crisis period compared to the pre-crisis boom period. In the Commission services' autumn 2010 forecast, real GDP growth is projected at 0,9 % in 2011 and 1,9 % in 2012. According to current Commission projections, real GDP growth of 2,5 % in 2013, 3,0 % in 2014 and 3,0 % in 2015 is expected. Price developments are also expected to be moderate. Nominal GDP is projected to increase by 1,3 % in 2011 and 2,7 % in 2012 in the Commission services' autumn 2010 forecast, while increases by 3,8 % in 2013, 4,6 % in 2014 and 4,8 % in 2015 are expected according to current Commission projections. Given these macroeconomic assumptions, reducing the government deficit to below 3 % of GDP by 2015 would require an improvement in the structural balance of at least 9½ % of GDP over the period 2011-2015.

(11) Overall, in view of the above considerations, unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred after the adoption of the Recommendation under Article 126(7) of the Treaty. Moreover, the conclusion reached by the Council on 13 July 2010 that Ireland had taken action representing adequate progress towards the correction of the excessive deficit remains valid. Finally, the higher starting point for the government deficit, compounded by the worse macroeconomic outlook, and higher-than-foreseen interest expenditures make the achievement of the initial deficit reduction path unfeasible. Against this background, revised recommendations under Article 126(7) of the Treaty extending the deadline for the correction of the excessive deficit by one year to 2015 are justified.

(12) Gross public debt increased from 25 % of GDP in 2007 to 65,5 % of GDP at the end of 2009, thereby breaching the 60 %-of-GDP reference value of the Treaty. The ratio is projected to increase to 97,4 % of GDP at the end of 2010 in the Commission services' autumn 2010 forecasts. The increase relative to the low pre-crisis level has been fuelled by a large primary general government deficit emerging in the course of the crisis. Measures to support the vulnerable banking sector made a significant contribution to the increase in deficit and debt in 2009 and 2010 of around 22½ percentage points of GDP in cumulative terms over the two years. Moreover, increased interest payments are feeding into debt developments. Achieving a revised deficit reduction path leading to a deficit below 3 % of GDP in 2015 would imply that the debt ratio would stabilise in 2013 and start declining thereafter. Debt dynamics are affected by several below-the-line operations, which are projected to increase the debt-to-GDP ratio by 5,3 pps. of GDP in 2011, 0,8 pps. in 2012, and to reduce it by 1,3 pps. in 2013, 1,1 pps. in 2014 and 1 percentage point in 2015. These include projected capital injections into banks and reductions in cash reserves in 2011, as well as differences between accrued and cash interest payments.

(13) On 24 November 2010, the Irish authorities published a comprehensive National Recovery Plan 2011-2014 setting out detailed fiscal consolidation plans aiming at putting gross public debt on a firm downward path by reducing the deficit over the horizon of the plan. An overall consolidation effort of EUR 15 billion (15 000 million) is envisaged over the period, effectively doubling the adjustment of EUR 7,5 billion foreseen in the December 2009 Stability Programme update. The adjustment is clearly frontloaded, with a EUR 6 billion consolidation package planned for 2011. It is foreseen that two-thirds of the adjustment should be made on the expenditure side. The plan also sets out structural reforms, notably in the labour market. Moreover, the authorities have developed a comprehensive strategy to overhaul the financial sector. The strategy aims at restoring confidence in the sector by achieving a substantial downsizing of the sector, isolating the viable parts of the system and returning the sector to healthy functionality, supported by adequate recapitalisation measures.

(14) In order to further enhance the credibility of the medium-term consolidation strategy, it will be crucial to address the weaknesses of the budgetary framework. Ireland should adopt and implement the fiscal rule that any additional unplanned revenues in 2011-2015 will be allocated to deficit and debt reduction. In accordance with the proposal set out in the National Recovery Plan 2011-2014, Ireland should establish a budgetary advisory council to provide an independent assessment of the Government's budgetary position and forecasts. Finally, the adoption of a fiscal responsibility law introducing a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area would support the planned adjustment. This should be accomplished taking into account any revised economic governance reforms at the level of the Union, and build on reforms already in place.

(15) The long-term budgetary impact of ageing in Ireland is above the average in the Union, mainly as a result of a relatively high projected increase in pension expenditure over the coming decades. The budgetary position in 2010 compounds the budgetary impact of population ageing on the sustainability gap. Improving the primary balance over the medium term and further reforms would contribute to reducing the risk to the long-term sustainability of public finances.

(16) Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the updates of the Irish stability programme which will be prepared between 2011 and 2015 could usefully be devoted to this issue. Moreover, monitoring of fiscal targets should be undertaken in line with the provisions of the financial assistance programme for Ireland as set out in Council Decision […] of 7 December 2010 on granting Union financial assistance to Ireland[*],

HEREBY RECOMMENDS:

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[*] OJ: please insert the number and publication reference of doc. st17211/10.

1. Recognising that Ireland's worsening budgetary position in 2010 resulted from the impact of the financial crisis on government revenue and the financial sector, requiring the implementation of very large financial sector support measures, the Irish authorities should put an end to the present excessive deficit situation by 2015.

2. The Irish authorities should bring the general government deficit below 3 % of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the Irish authorities should:

   (a) implement measures such that the general government deficit does not exceed 10,6 % of projected GDP in 2011, 8,6 % of GDP in 2012, 7,5 % of GDP in 2013, 5,1 % of GDP in 2014 and 2,9 % of GDP in 2015, where the projected annual deficit path does not incorporate the possible direct effect of potential bank support measures in the context of the government's financial sector strategy as set out in the Memorandum of Economic and Financial Polices and specified in the Memorandum of Understanding to be signed by the Commission and the Irish authorities. Ireland should stand ready to take additional consolidation measures to ensure reducing the deficit to below 3 % of GDP in 2015 in case downside risks to the deficit targets materialise. Further, this path is consistent with the preliminary view of the Commission (Eurostat) on the ESA95 accounting treatment of time of recording of interest payments on promissory notes payable to Anglo Irish Bank[1], such that a revision of that view would result in a revision of the deficit path;

[1] See http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/methodology/advice_member_states

(b) achieve an improvement in the structural balance of at least 9½ % of GDP over the period 2011-2015.

3. In addition, the Irish authorities should seize opportunities, including from better economic conditions, to accelerate reducing the gross debt ratio towards the 60 %- of-GDP reference value.

4. To limit risks to the adjustment, Ireland should establish a budgetary advisory council to provide an independent assessment of the Government's budgetary position and forecasts. Ireland should adopt a fiscal responsibility law introducing a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area.

5. To reduce the risks to the long-term sustainability of public finances, the Irish authorities should pursue further reforms to the social security system.

The Council hereby establishes a deadline of 7 June 2011 for the Irish government to take effective action to specify the measures that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2010 forecast.

The Irish authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2011 and 2015.

Further, the Council invites the Irish authorities to implement reforms with a view to raising potential GDP growth. In addition, Ireland is invited to foster a swift adjustment to sustainable medium-term growth by productivity-enhancing measures and appropriate wage policies to help restore competitiveness.

This Recommendation is addressed to Ireland.

Done at Brussels,

For the Council

The President