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Recommendation for a

COUNCIL RECOMMENDATION TO IRELAND

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

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission;

Whereas:

- (1) According to Article 104 of the Treaty 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 as well as 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 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) The Council has decided on [XX April 2009], based on data notified by the Irish authorities for 2008, in accordance with Article 104(6), that an excessive deficit exists in Ireland.
- (5) In accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure¹ (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances, and to request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of 0.5% of GDP as a benchmark. In deciding whether special circumstances exist, “relevant factors” as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account.

¹ OJ L 209, 2.8.1997, p. 6.

- (6) In line with the greater flexibility in the application of the EDP introduced with the 2005 reform of the Stability and Growth Pact, special circumstances are deemed to exist in the case of Ireland, notably on account of the size of the required adjustment but especially the very weak economic background. In particular, the large excess over the reference value in 2008 (the deficit stood at 6.3% of GDP) and further widening of the deficit expected in 2009 - in spite of the government's consolidation efforts – are due to the impact on revenues of the broad-based downturn amid the difficult international economic and financial situation, and in particular the ongoing housing market correction, as well as the increase in social spending in response to the quick rise in unemployment. The current recession is expected to be followed by a gradually strengthening recovery and a return to positive growth after 2010 but to a growth rate well below that observed in the years preceding the recession. The existence of special circumstances authorises the Council to allow the correction of the excessive deficit in a medium-term framework.
- (7) The January 2009 addendum to the October 2008 update of the stability programme envisages a reduction of the deficit below the 3% of GDP reference value by 2013. The reduction would start after a targeted widening of the deficit to 9.5% of GDP in 2009. Taking as a starting point the targeted deficit for 2009, a reduction below the reference value by 2013 would, according to the addendum, require a cumulative nominal adjustment of around 7% of GDP over the period 2010-2013 (or 1¾% of GDP per year on average) and 6% of GDP in structural terms². In its opinion of 10 March 2009 on the Irish stability programme and its addendum, the Council concluded that the budgetary targets are subject to downside risks throughout the programme period due to the lack of information on the envisaged measures to support the planned consolidation after 2009 and the growth assumptions underlying the macroeconomic scenario, which appear to be favourable, especially in the outer years of the programme, with an average growth rate of 2.9% over the period 2011-2013.
- (8) Bearing in mind the need to act promptly to address the fiscal situation in Ireland, and in accordance with the path for deficit reduction as specified in the January 2009 addendum to the October 2008 stability programme – on which the Council gave its opinion on 10 March 2009 – aiming at correcting the excessive deficit by 2013 is appropriate. In 2009, the deficit target should be achieved. Even after adjusting the Commission services' January 2009 interim forecast for the impact of the additional consolidation measures announced in February 2009, further consolidation efforts will be necessary to achieve the 2009 target, also in view of recent evidence on further weakening economic activity and tax revenue. Thereafter, additional annual efforts going beyond those foreseen in the stability programme addendum might be necessary to bring the deficit below the 3% of GDP reference value by 2013, if downside risks to the budgetary targets were to materialize. This adjustment path would be consistent with Art. 3(4) of Council Regulation (EC) No 1467/97. This path would also be instrumental to ensure that the rise in the debt ratio comes to a halt. However, contingent liabilities arising from the financial crisis, in particular from capital

² The structural balance (i.e. cyclically-adjusted balance excluding one-off and other temporary measures) is calculated by the Commission services using the information in the addendum. According to the Commission services, the 2009 deficit target includes a deficit-reducing one-off measure of 0.3% of GDP. The Irish authorities do not classify this measure as a one-off. The cumulative structural improvement over the 2010-2013 period according to the programme (i.e. without the one-off) amounts to 5¾% of GDP.

injections into banks and the government's bank guarantees (if called), could lead to more adverse debt developments.

- (9) The strategy's credibility hinges on the timely specification of the consolidation measures to achieve this consolidation path. Given the scale of the required adjustment, a broad-based consolidation effort will be necessary, addressing both the expenditure and the revenue side of the budget. In this context, the government has established a Commission on taxation and a "Special Review Group on Public Service Expenditure and Numbers" to examine the Irish taxation system and public expenditure programmes, respectively, and make recommendations for their improvement. The reports of these committees are expected in the summer of 2009. Implementing reforms to reduce current expenditure over the coming years will be necessary, while public investment priorities could be reconsidered in the light of the changed economic environment. At the same time, broadening the narrow Irish tax base and aligning reduced expenditure levels with sustainable revenue streams will be essential.
- (10) In order to further enhance the credibility of the medium-term consolidation strategy, it will be crucial to address the weaknesses of the Irish budgetary framework. In particular, budgetary targets for the years beyond that covered by the budget, especially expenditure envelopes, can be changed in subsequent budgets. As already highlighted in the March 2009 Council opinion on the stability programme update, risks to the adjustment should be limited by strengthening the binding nature of its medium-term budgetary framework as well as closely monitoring adherence to the budgetary targets throughout the year.
- (11) Enhanced surveillance under the EDP, which seems necessary in view also 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 to ensure the correction of the excessive deficit. In this context, a separate chapter in the updates of the Irish stability programme which will be prepared between 2009 and 2013 could usefully be devoted to this issue.
- (12) In general, in the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy.

HEREBY RECOMMENDS:

- (1) On the basis of the macroeconomic outlook of the Commission services' January 2009 interim forecast, the Irish authorities should put an end to the present excessive deficit situation by 2013.
- (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 in accordance with the path for deficit reduction as specified in the January 2009 addendum to the October 2008 stability programme on which the Council gave its opinion on 10 March 2009. Specifically, to this end, the Irish authorities should:
 - (a) do the necessary to ensure that the 2009 deficit target is achieved;
 - (b) stand ready to implement additional annual efforts going beyond those foreseen in the stability programme addendum in the subsequent years of the correction period in order to ensure that the annual targets are respected even if downside

risks to the budgetary targets were to materialize and in so doing ensure that the rise in the debt ratio is halted;

- (c) spell out the detailed measures that are necessary to achieve this consolidation path and implement them rigorously; in particular, implement reforms to reduce current expenditure over the coming years, reconsider public investment priorities in the light of the changed economic environment, broaden the narrow Irish tax base in order to create more sustainable revenue streams and align them to reduced expenditure levels.
- (3) To limit risks to the adjustment, Ireland should strengthen the binding nature of its medium-term budgetary framework as well as closely monitor adherence to the budgetary targets throughout the year.
- (4) The Council establishes the deadline of [24 October 2009] for the Irish government to take effective action regarding the measures to achieve the 2009 deficit target and the specification of the necessary measures 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' January 2009 interim forecast.
- (5) The Irish authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the Irish stability programme which will be prepared between 2009 and 2013.

In addition, the Council invites the Irish authorities to ensure that budgetary consolidation towards the medium-term objective for the budgetary position – a structural balance between -0.5 and 0% of GDP – is sustained after the excessive deficit has been corrected. In view of the significant projected increase in age-related expenditure and also of the increase in debt expected over the programme period (albeit from a low level) the Council also invites the Irish authorities to improve the long-term sustainability of public finances by implementing further pension reform measures in addition to pursuing fiscal consolidation.

This recommendation is addressed to Ireland.

Done at Brussels,

For the Council
The President