COUNCIL OF THE EUROPEAN UNION

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

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

COUNCIL RECOMMENDATION

of

to Ireland

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

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) and Article 136 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 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 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) On 27 April 2009 the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community, that an excessive deficit exists in Ireland and issued recommendations to correct the excessive deficit by 2013 at the latest, in accordance with Article 104(7) of the Treaty establishing the European Community and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[1]. This would have implied an average annual fiscal effort of at least 1½ % of GDP over the period 2010-2013. The Council also established a deadline of 27 October 2009 for effective action to be taken.

(5) The Council agreed on 20 October 2009 that, provided that the Commission forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, fiscal consolidation in all EU Member States should start in 2011 at the latest, that specificities of country situations should be taken into account, and that a number of countries need to consolidate before then.

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[1] OJ L 209, 2.8.1997, p. 6.

(6) Regulation (EC) No 1467/97 (which is part of the Stability and Growth Pact) establishes provisions for the implementation of Article 104 of the Treaty establishing the European Community, which has become Article 126 of the Treaty on the Functioning of the European Union. According to Article 3(5) of Regulation (EC) No 1467/97, if effective action has been taken 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 and before taking into account the relevant factors mentioned in Article 2(3) of Regulation (EC) No 1467/97, to adopt a revised recommendation under Article 126(7) of the Treaty on the Functioning of the European Union.

(7) Irish real GDP was expected to decline by 5,0 % in 2009 after -2 % in 2008 according to the Commission services' January 2009 interim forecast underlying the initial Council recommendation. However, in retrospect the drop in activity in 2008 was steeper than projected (-3 %) and the situation deteriorated further after the publication of the forecast. A fall in real GDP of around 7½ % is now expected for 2009 according to the Commission services' autumn 2009 forecast, driven by a stronger decline in domestic demand than expected in January. The economic deterioration has also been reflected in a worsening of the budgetary situtaion. The autumn forecast contains an upward revision of the general government deficit in 2009 by 1,5 percentage points to 12,5 % of GDP vis-à-vis the January interim forecast, in spite of considerable consolidation measures taken in February 2009 and in the supplementary budget in April, of about 3,2 % of GDP. The deterioration of the government deficit is largely due to a more pronounced decline of spending on tax rich items e.g. housing and other durables than foreseen in the January interim forecast.

On the back of the downward revisions of the 2009 deficit projection and of the outlook for real GDP growth next year (-1,4 %), the deficit is now expected to reach 14,7 % of GDP in 2010 on a no-policy-change basis, compared to 13,0 % of GDP in the January 2009 interim forecast. The projections are made on a pre-budget basis, while incorporating the full effect of the deficit-reducing measures taken in the course of 2009 following the supplementary budget and the reduction of capital investment announced in the supplementary budget for 2010. Therefore, the projected widening of the deficit in 2010 reflects cyclical and elasticity-related factors rather than expansionary discretionary measures. In view of the above, unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred after adoption of the Recommendation under Article 104(7) of the Treaty establishing the European Community.

(8) The Council established a deadline of 27 October 2009 for the Irish government to adopt measures to achieve the 2009 deficit target and to specify the necessary measures to progress towards the correction of the excessive deficit. In line with this recommendation and in response to the rapid deterioration of the fiscal situation, the Irish authorities introduced a consolidation package with a permanent deficit-reducing effect of 1,9 % of GDP in 2009 in a supplementary budget on 7 April 2009. On the revenue side, the budget contains tax-increasing measures for 2009 in an amount of 1,1 % of GDP, including changes to the health and income levies and pay-related social insurance. On the expenditure side, the announced savings amount to 0,8 % of GDP in 2009, including savings on social transfers and capital expenditure. According to the Commission services' autumn 2009 forecast, the general government deficit is expected to reach 12,5 % of GDP in 2009, thereby exceeding the Irish authorities' target (9½ % in the January addendum to the stability programme revised to 10¾ % target in the April supplementary budget). Although unemployment benefits and debt-servicing costs are higher than foreseen in January, total general government expenditure is now expected to grow by only 0,8 % in 2009 (after 11,1 % in 2008 and compared to 6,1 % in the Commission services' January 2009 interim forecast) on account of the supplementary budget's expenditure-reducing measures.

Therefore, the worsening of the deficit in 2009 is exclusively due to a worse than anticipated downturn causing revenue to fall by an expected 10,9 %, significantly beyond what could be expected on the basis of standard elasticities, and in spite of significant consolidation measures. Regarding the following years, the supplementary budget outlines a nominal deficit path for bringing the deficit to 3 % of GDP by 2013. In a first step towards strengthening the medium-term fiscal framework, it also quantifies the nominal consolidation packages of nearly 2½ % of GDP each year needed to achieve the deficit targets for 2010 and 2011, without however specifying the underlying measures. On a no-policy change basis, i.e. excluding the supplementary budget's as yet unspecified taxation and current expenditure measures accounting for 2 % and 2¼ % of GDP in 2010 and 2011, the Commission services autumn forecast's projects a deficit of 14,7 % of GDP for both those years, where the projected widening of the deficit in 2010 reflects cyclical and elasticity-related factors rather than expansionary discretionary measures. Overall, taking into account economic developments compared to the outlook in the Commission services' January 2009 interim forecast, it can be concluded that Ireland has taken effective action as required by the Council recommendation of 27 April 2009.

(9) Since the Irish authorities are considered to have taken effective action in compliance with the Council recommendations of 27 April 2009 under Article 104(7) of the Treaty establishing the European Community and unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred in Ireland, revised recommendations under Article 126(7) of the Treaty on the Functioning of the European Union for Ireland are justified.

(10) In spite of the effective action, the above-mentioned events have led to a revision of the deficit target for 2009. Starting from the estimated 12,5 % of GDP deficit outcome in 2009 in the Commission services' autumn 2009 forecast, as from 2010 an average annual fiscal effort of around 2¾ % of GDP would now be necessary to bring the deficit below the 3 % of GDP reference value by 2013. Furthermore, the growth outlook for 2010 appears more unfavourable than underlying the initial recommendations. In view of the above, a new deadline for correction of the excessive deficit in Ireland by 2014 at the latest is appropriate. This correction would represent an average annual fiscal effort of 2 % of GDP between 2010 and 2014[1].

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[1] In line with the initial recommendations under Article 104(7) of the Treaty establishing the European Community issued by the Council on 27 April 2009, where due consideration was given to the special circumstances and the EERP framework, an average annual fiscal effort is recommended. As in the initial recommendations the fiscal effort should take into account all factors relevant for achieving the fiscal policy objectives, starting with the level of the general government deficit and gross debt as well as other indicators, such as the current account position, the level of contingent liabilities of the financial sector, interest payments, risk premia and the expected change in age-related expenditure in the medium term. In particular, in Ireland, due consideration was given to the need to act promptly to address the fiscal situation in Ireland - specifically given the then elevated sovereign bond spreads and risks to the long-term sustainability of the public finances, also in view of the rapid projected increase in debt, albeit from a low level, and the high contingent liabilities resulting from financial rescue operations - while also considering the size of the fiscal effort and especially the very weak economic background. In calculating the average annual fiscal effort, the 2011 deficit in the Commission services' autumn 2009 forecast is taken as the starting point. The total fiscal effort needed to reach the nominal deficit target of 3 % by the deadline is then calculated by assuming a gradual closure of the output gap by 2015.

(11) Bringing the deficit below 3 % of GDP by 2014 will require significant consolidation efforts. A credible and sustainable adjustment path would require the Irish authorities in particular to specify consolidation measures in the budget for 2010 in line with the package announced in the April 2009 supplementary budget and ensure an average annual fiscal effort of 2 % of GDP over the period 2010-2014. The Irish authorities should specify the measures that are necessary to achieve the correction of the excessive deficit by 2014, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

(12) According to the October 2009 EDP notification, the government gross debt ratio is expected to reach around 64 % of GDP in 2009, so that the 60 % of GDP reference value would be breached. In addition to annual contributions to pre-fund future pension payments, the authorities have chosen to build up a precautionary liquidity buffer with debt-increasing effect. Going forward, the debt ratio is expected, on a no-policy change basis, to increase to around 96 % of GDP in 2011 according to the Commission services' autumn 2009 forecast. Further debt increases could result from contingent liabilities arising from the financial crisis, in particular from possible further capital injections into banks and the government's bank guarantees (which would also affect the deficit, if called). Assuming that risks from financial rescue operations do not materialise, implementing the consolidation efforts outlined above would contribute to bringing the debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus.

(13) 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 enforceable nature of its medium-term budgetary framework as well as closely monitoring adherence to the budgetary targets throughout the year. With the specification in the April supplementary budget of the nominal consolidation packages needed to achieve the deficit targets for 2010 and 2011, a first step in the right direction has been made.

(14) The long-term budgetary impact of ageing in Ireland is well above the EU average, mainly as a result of a relatively high projected increase in pension expenditure over the coming decades. The budgetary position in 2009 compounds the budgetary impact of population ageing on the sustainability gap. Improving the primary balance over the medium term and further reforms to the social security system would contribute to reducing the risk to the long-term sustainability of public finances as defined by the Commission Communication[1] on "Long-term sustainability of public finances for a recovering economy" and discussed by the ECOFIN Council[2] on 10 November 2009.

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1 Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf

2 Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf

(15) 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 2009 and 2014 could usefully be devoted to this issue.

(16) In general, 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. In particular, considering the suggested improvements to the expenditure and taxation systems laid down in the summer 2009 reports of the Commission on taxation and the Special Review Group on Public Service Expenditure and Numbers, reforms should be geared towards broadening the narrow Irish tax base and reducing current expenditure over the coming years, while reconsidering public investment priorities in the light of the changed economic environment. In addition, Ireland should foster a swift adjustment to sustainable medium-term growth by productivity-enhancing measures and adequate wage policies which will help restore competitiveness.

(17) In addition, in view of the importance of achieving its medium-term objective (MTO) to provide an adequate safety margin against cyclical downturns and to ensure convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, Ireland should also ensure that budgetary consolidation towards the MTO is sustained after the excessive deficit is corrected,

HEREBY RECOMMENDS:

(1) Recognising that Ireland's budgetary position in 2009 resulted from the interplay of the severe recession and the free play of automatic stabilisers on the one hand and significant consolidation efforts on the other (as part of which some moderate recovery measures were taken), which is an appropriate response to the European Economic Recovery Plan, the Irish authorities should put an end to the present excessive deficit situation by 2014.

(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) specify consolidation measures in the budget for 2010 in line with the package announced in the April 2009 supplementary budget;

(b) ensure an average annual fiscal effort of 2 % of GDP over the period 2010-2014, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the 60 % of GDP reference value at a satisfactory pace by restoring an adequate level of the primary surplus;

(c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2014, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

(3) In addition, the Irish authorities should seize opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the 60 % of GDP reference value.

(4) To limit risks to the adjustment, Ireland should strengthen the enforceable nature of its medium-term budgetary framework as well as closely monitor adherence to the budgetary targets throughout the year.

(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 as soon as possible.

(6) The Council establishes the deadline of 2 June 2010 for the Irish government to take effective action to specify consolidation measures in the budget for 2010 in line with the package announced in the April 2009 supplementary budget and to outline in some detail the consolidation strategy 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 2009 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 2010 and 2014.

Further, the Council invites the Irish authorities to implement reforms with a view to raising potential GDP growth. This includes reforms conducive to enhancing the quality of public finances. In particular, reforms should be geared towards broadening the narrow Irish tax base and reducing current expenditure over the coming years, while reconsidering public investment priorities in the light of the changed economic environment. In addition, Ireland is invited to foster a swift adjustment to sustainable medium-term growth by productivity-enhancing measures and adequate wage policies which will help restore competitiveness.

This Recommendation is addressed to Ireland.

Done at Brussels,

For the Council
The President