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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Assessment of the action taken by Ireland in response to the Council Recommendation of 7 December 2010 with a view to bringing an end to the situation of excessive government deficit

1. IRELAND

1.1. Excessive deficit procedure and most recent recommendations

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 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.

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.

On 13 July 2010, the Council concluded that the Irish authorities had taken effective action in compliance with the Council recommendations.

On 7 December 2010, the Council recognised a sharp deterioration of Ireland's budgetary position resulting from the impact of the crisis on government revenue and the financial sector, requiring the implementation of very large financial sector support measures. The Council therefore adopted a revised Recommendation under Article 126(7) of the Treaty, extending the deadline for the correction of the excessive deficit to 2015. At the same time, following the request by the Irish authorities for financial assistance from the European Union, the Member States whose currency is the euro and the International Monetary Fund (IMF), the Council granted Union financial assistance to Ireland[1]. The Memorandum of Understanding on Specific Economic Policy Conditionality (the "Memorandum of Understanding") between the Commission and the Irish authorities was signed on 16 December 2010.

The Council recommended to the Irish authorities to 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, and 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 (MEFP) and specified in the Memorandum of Understanding 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 should achieve an improvement in the structural balance of at least 9½% of GDP over the period 2011-2015[2].

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1 OJ L 30, 4.2.2011, p. 34.

2 The deficit path should also be consistent with the preliminary view of Eurostat on the ESA95 accounting treatment at the of time of recording of interest payments on promissory notes payable to Anglo Irish Bank, such that a revision of that view would result in a revision of the deficit path. See

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

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. 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 established the 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.

1.2. Assessment of effective action taken

The Council recommendations of 7 December 2010 were based on projections underlying the financial assistance programme for Ireland. These projections updated the Commission Staff Working Document "European Economic Forecast Autumn 2010" of 29 November 2010 with detailed measures in the 2011 budget announced on 7 December 2010.

According to the most recent Commission services' forecast prepared in the context of the summer 2011 review of the financial assistance programme for Ireland, the outlook for real activity in Ireland is broadly similar to that expected at the time the Council issued its recommendations in December 2010. Real GDP declined by 0.4% in 2010, but is projected to return to a positive growth of 0.6% of GDP in 2011 and 1.9% in 2012. The projected composition of growth has however been adjusted reflecting more pronounced weakness in domestic demand compensated by stronger external demand.

The general government deficit ratio to GDP stood at 32% in 2010, the level also projected on 7 December 2010. Subsequent general government data revisions reduced both revenues and expenditures of the general government by some 0.8% of GDP in 2009, while also changing its composition in 2009 and 2010, but had a limited effect on the overall balance. This was largely due to revisions in detailed accounts of the local authorities for 2009 included in the March 2011 EDP notification, showing capital receipts and capital expenditure lower than estimated before, which broadly cancel out.

The budget for 2011 introduced fiscal consolidation measures of 3.8% of GDP including structural revenue measures of 0.9% of GDP, structural expenditure measures of 2.5% of GDP and one-off measures amounting to 0.4% of GDP. The government deficit is projected at 10.2% of GDP – below the target set by the Council of 10.6% of GDP[3]. A positive tax revenue surprise at the end of 2010 fed into 2011 and the performance in the first six months

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http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/methodology/advice_member_states.

[3] The fiscal forecasts mentioned in this document do not incorporate any savings which would arise from the improvements in the terms of EU financial assistance for Ireland announced following the meeting of the Heads of State and Government of the euro area and EU institutions on 21 July 2011 (see http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/123978.pdf).

of 2011 suggests some 0.4% of GDP higher revenue than projected by Commission services at the time the Council recommendations were issued. This reflects somewhat stronger income and indirect tax elasticities despite weaker-than-projected labour market conditions and private consumption . A small negative denominator effect of 0.1% of GDP compared to December 2010 projections is offset by a positive effect of the measures included in the package of measures that the new government announced on 10 May 2011, the 'Jobs Initiative'. The Jobs Initiative is designed to be budgetary neutral over the period 2011-2014, but it has a deficit-reducing effect of 0.1% of GDP in 2011, mostly on account of the levy on the stock of pension funds on 30 June in each year of 2011-14, which more than offsets the cost of temporary reductions in some tourism-related VAT rates and in the social sectury contributions on low wages. One-off capital injections into the financial sector may have a deficit-increasing effect of up to 12% of GDP in 2011, and this would be excluded from the deficit target in line with the Council recommendation. Classification of the injections will be established on case-by-case basis by the Irish Central Statistics Office, consulting Eurostat, if necessary.

For 2012, the government deficit is projected to reach 8.6% of GDP – the target outlined in the EDP decision. This assumes a fiscal consolidation effort of 2.6% of GDP comprising the full-year effect of the 2011 budget measures of 0.7% of GDP and new measures of 1.9% of GDP committed under the financial assistance programme and presented in the April 2011 update of the stability programme. As compared to the December 2010 forecast underlying the Council Recommendation, the stronger-than-expected tax revenue performance in 2011 will continue in 2012. After a positive contribution in 2011, the Jobs Initiative will have a net negative revenue effect in 2012, with a deficit-increasing effect of 0.3% of GDP as compared to the previous year. Higher interest expenditure on the assistance programme financing amounts to 0.1% of GDP, based on the assumption of the continuation of average programme interest rates so far.

The authorities' stability programme targets a gradual reduction of the deficit to below 3% of GDP by 2015, the correction deadline set by the Council. To reach the targets, broad consolidation measures were originally specified by the previous government in the National Recovery Plan of November 2010 and committed to in the Memorandum of Understanding on Specific Economic Policy Conditionality. The current government has indicated that the detailed composition of the adjustment will be modified following the results of the ongoing Comprehensive Review of Expenditure. Under the conditionality of the financial assistance programme, a medium term fiscal plan for 2012-2015, outlining aggregate revenue and expenditure measures for each year and respecting the targets outlined by the Council, will be announced to parliament by end-October 2011 in the government's Pre-Budget Outlook. Further details will be provided in the 2012 budget in early December 2011.

The gross debt-to-GDP ratio is forecast to peak at just below 120% in 2013, and decline thereafter, somewhat lower than in the projections underlying the Council recommendations, due to lower-than-expected costs of bank recapitalisation following stress tests of March 2011. Debt dynamics are affected by several below-the-line operations, including the capital injection into banks in 2011 with net debt-increasing effect of around 6 percentage points of GDP, assumptions about the maintenance of higher cash reserves, and differences between accrued and cash interest payments[4].

[4] Total one-off bank recapitalisation cost of up to 12% of GDP in 2011 is partly financed from the Irish existing resources, therefore an increase in the gross government debt is lower.

Regarding the Council's recommendation to limit risks to the adjustment, the Irish authorities have established a five-member Fiscal Advisory Council and a Fiscal Responsibility Bill will be submitted by the end of 2011. This will give the Fiscal Advisory Council a clear statutory mandate and independence and introduce fiscal rules aiming at safeguarding fiscal discipline over the cycle, and provide a basis for assessing the appropriateness of official targets and performance.

Regarding the Council's recommendation to reduce the risks to the long-term sustainability of public finances, legislation was passed in June 2011 increasing the age at which one qualifies for a state pension to 66 years in 2014, 67 in 2021 and 68 in 2028. Moreover, a package of public service pension reforms for new entrants is expected to be submitted for parliamentary approval by end-September 2011. This will include a review of accelerated retirement for certain categories of public servants and an indexation of pensions to consumer prices. Pensions will be based on career average earnings. New entrants' retirement age will also be linked to the state pension retirement age.

1.3. Conclusions

On current information it appears that Ireland has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the government deficit is projected to be below the target of 10.6% of GDP in 2011, in line with the Council's recommendation. For the period beyond 2011, the authorities will outline a medium term fiscal plan for 2012-2015 following the results of the current Comprehensive Review of Expenditure. The plan will present the overall expenditure and revenue measures for each year, underpinning a path for the fiscal deficit in line with the Council recommendations. In order to enhance credibility of the medium term fiscal targets, it will be important to spell out the specific measures. Implementation of the measures and correction of the excessive deficit should ensure that the debt ratio will embark on a downward path towards the 60%-of-GDP reference value.

In view of the above assessment, the Commission considers that no further steps in the excessive deficit procedure of Ireland are needed at present. The Commission will continue to closely monitor budgetary developments in Ireland on quarterly basis in accordance with the Treaty and the SGP, and conditionality set out in the financial assistance programme for Ireland.

Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012	2013	2014	2015
Real GDP (% change)	COM	-3.0	-7.0	-0.4	0.6	1.9	2.4	3.0	3.0
	SP	n.a.	n.a.	-1.0	0.8	2.5	3.0	3.0	3.0
Output gap[1] (% of potential GDP)	COM	0.2	-5.7	-5.2	-3.3	-0.8	n.a.	n.a.	n.a.
	SP	n.a.	n.a.	-6.1	-4.2	-1.2	1.2	3.1	4.5
General government balance (% of GDP)	COM	-7.3	-14.2	-32.0	-10.2	-8.6	-7.5	-4.6	-2.9
	SP	n.a.	n.a.	-32.4	-10.0	-8.6	-7.2	-4.7	-2.8
Primary balance (% of GDP)	COM	-6.0	-12.1	-28.8	-6.3	-3.9	-1.3	1.7	3.3
	SP	n.a.	n.a.	-29.2	-6.2	-3.9	-1.1	1.7	3.4
Cyclically-adjusted balance[1] (% of GDP)	COM	-7.4	-11.9	-29.9	-8.9	-8.3	-7.5	-4.6	-2.9
	SP	n.a.	n.a.	-30.1	-8.3	-7.7	-7.1	-5.1	-3.6
Structural balance[2] (% of GDP)	COM	-7.4	-11.9	-10.1	-9.2	-8.3	-7.5	-4.6	-2.9
	SP	n.a.	n.a.	-10.1	-8.3	-7.7	-7.1	-5.1	-3.6

Government gross debt (% of GDP)	COM	44.4	65.2	94.9	109.9	116.2	119.4	117.6	113.9
	SP	n.a.	n.a.	96.0	111.0	116.0	118.0	116.0	111.0

Note:

[1] Output gaps and cyclically-adjusted balances according to the programme as recalculated by Commission services on the basis of the information in the programme.

[2] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 20% of GDP in 2010 (deficit-increasing) according to the programme; and 0.6% of GDP (deficit-reducing) and 2.6% (deficit-increasing) in 2009; 0.7% of GDP (deficit-reducing) and 20.2% (deficit-increasing) in 2010, and 0.3% of GDP (deficit-reducing) in 2011 according to the Commission services' spring 2011 forecast.

Source: *Summer 2011 review of the assistance programme (COM) and April 2011 stability programme update (SP)*