EXECUTIVE SUMMARY

This document presents an ex post evaluation of the three year EU/IMF financial assistance programme that Ireland completed in December 2013. The Irish programme was the second euro area (EA) assistance programme, and the first financed by two new financial assistance instruments established in 2010, the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM). It was designed to address the effects of the severe banking and fiscal crisis that had caused Ireland to lose market access, and cover Ireland's financing gap until market access was restored. The Irish programme was novel, complex, and economically and financially important for both Ireland and the EA as a whole. An ex post evaluation of the design, implementation and outcome of the programme is required by European Commission rules and in line with best practice. ([1]) The aim is to draw lessons for the future from the programme as a whole.

In a global context of decreasing yields and risk premia, Irish economic growth from 2002 onwards was increasingly driven by a property bubble; the Irish banking sector overextended itself with the financial supervision and resolution frameworks proving to be inadequate. The property market crashed in 2007, exposing the vulnerability of the financial sector. The fiscal deficit exploded as cyclical revenues disappeared, and crisis-related spending pressures grew. These included significant financial support to Irish banks.

The Irish programme was put together in a climate of deep uncertainty in Ireland and the EA. The Irish authorities' initial response to the emerging financial and fiscal problems did not succeed in getting the situation under control. Developments elsewhere in the euro area also negatively impacted on the Irish situation. Continued uncertainty over the magnitude of the financial crisis, and the ability of the Irish sovereign to absorb its costs, drove sovereign bond spreads to record highs. At the same time, the EA crisis spread further across countries and sectors. On 21 November 2010, the Irish government requested external financial assistance.

Overall, the programme was relevant, appropriate and effective. Ireland regained market access and made significant progress on financial sector repair, fiscal consolidation and a return to sustainable growth. The financing provided under the programme enabled a smooth and sustained return to full market access for the Irish sovereign. The programme was effective in restoring creditors' confidence in the financial system, as confirmed by access to debt markets by the two pillar banks. Banking supervision improved significantly. The fiscal targets were realistic, and meeting them with a margin added to the credibility of the programme, including with respect to its effectiveness in breaking the vicious financial-sovereign loop that had proven so damaging to the Irish economy. Public debt is now on a downward path and fiscal governance has been strengthened. The Irish economy grew strongly in 2014 and is forecast to continue to expand. The current account balance has shifted into surplus, unemployment is falling, and cost-competitiveness has improved considerably. Nevertheless, challenges remain in fully addressing the legacy of the crisis. Long-term unemployment and youth joblessness remain at high levels and the risk remains that some cyclical unemployment becomes structural. The banking sector has been relatively slow to return to profitability. A high stock of public and private debt, including non-performing loans, continues to weigh on domestic demand. Structural reforms designed to make future growth more sustainable and inclusive are work in progress.

The €85 billion envelope agreed in December 2010 was appropriate: it proved sufficient to meet Ireland's financing needs until it regained market access at sustainable rates. **At that time, it was right to include sizeable contingency reserves in the funding envelope in a context of high financial market volatility and uncertainty.** The envelope, corresponding to approximately 50% of the Irish GDP, came from several sources. Nearly half were provided by the EFSM and EFSF. The remainder came from the IMF, bilateral loans, and Irish national funds. The funding envelope was consistent with the pace of fiscal adjustment envisaged, and was intended to ensure that Ireland would be able to roll-over

([1]) Communication to the Commission (COM), 'Responding to Strategic Needs: Reinforcing the use of evaluation' (SEC(2007)213), http://ec.europa.eu/smart-regulation/evaluation/docs/eval_comm_sec_2007_213_en.pdf

maturing debt and provide support to its banking sector, even under adverse scenarios. Its size was also acceptable to the creditors. In 2011 and early 2012 Irish spreads remained high and volatile, but later in the programme Ireland was able to issue debt at sustainable interest rates.

Ireland received the full amount of external assistance, i.e. €67.5 billion, despite its financing needs proving lower than initially envisaged. Once market access had been sustainably restored and EFSF/EFSM terms were improved, explicit reassessment of whether the full financial envelope needed to be disbursed would have been warranted. Ireland's total gross financing needs proved to be €25 billion less than the programme envelope provided for, due mainly to lower bank rescue costs but also to lower cash deficits. The financial sector support was not ring-fenced in the programme envelope, thereby providing more funding to cover other financing needs and replenish the Treasury cash buffer. Ireland also benefited from the removal of the interest rate margins on the EFSF and EFSM loans and from substantial extensions of their maturities. This aided the sustainability of Ireland's debt and helped it to regain full market access, but did not trigger a discussion on adjusting the fiscal targets or the disbursements. With the removal of these margins, IMF loans became relatively expensive, which motivated Ireland's 2014 decision to repay IMF loans early.

The programme contained an appropriate and relevant set of measures to address Ireland's economic and fiscal challenges. The programme Memorandum of Understanding (MoU) built on the Irish authorities' own National Recovery Plan (NRP), which was itself finalised when discussions with the European Commission, ECB and IMF on economic adjustment were already underway. The fiscal and structural reform content of the two documents was largely in line, and built on actions already taken in the years since the crisis first hit. The top priority was rightly given to financial sector restructuring. Fiscal measures were necessary given the large fiscal deficit and growing debt. The structural reforms in the programme were appropriately limited, as Ireland is a relatively competitive and flexible economy. The programme was specified and monitored on the basis that the Irish authorities were willing and able to implement it effectively. Overall, this approach worked well and the programme was a success. Nevertheless, where programme implementation was less smooth, such as on reforms to increase competition in legal services, the capacity of the European Commission, ECB and IMF (hereinafter referred to as the three institutions) to step in and drive progress appears to have been mixed. In a context of strong overall ownership by the Irish authorities, a number of conditions were phrased in terms of "introducing" (in the sense of "submitting") rather than "adopting" legislation, but this did affect the capability of the programme process to drive the completion of structural reforms. Flexibility in programme conditions was appropriate when it reflected evolving circumstances and knowledge.

The financial sector measures were rightly focused on bank recapitalisation and restructuring, while being constrained by policies introduced since 2008, which had largely misinterpreted the crisis as being one of liquidity and confidence. When the programme started, the credit institutions Eligible Liabilities Guarantee (ELG) Scheme was covering more than half of the unsecured senior debt of the domestic banks. The National Asset Management Agency (NAMA) had recently been established and was buying up non-performing assets from domestic banks. NAMA's existing structure was maintained through the programme. The government had already injected €46 billion (including €31 billion of promissory notes) into domestic institutions. This included €34.7 billion into two of the five systemic banks, Anglo Irish Bank (Anglo) and Irish Nationwide Building Society (INBS), alone. This ever increasing support to banks had undermined the credibility in the capacity of the Irish authorities to solve the banking problems, including for financial markets. The remaining challenges included reducing the banks' reliance on emergency central bank funding, downsizing the financial sector, addressing the poor and unclear quality of banks' assets, and ultimately breaking the vicious bond between the health of the financial institutions and the sovereign.

In the specific context of Ireland in 2010, not bailing-in unguaranteed and unsecured senior creditors of domestic banks was appropriate and reflecting complex considerations. In theory, a bail-in is preferable insofar as it limits the costs for the State and encourages proper risk pricing. Bail-in

provisions are now enshrined in the new EU regime. However, a careful assessment concluded that the conditions for such a bail-in were not present in Ireland nor in the EU at the time. With no legal framework in place to manage such an exercise, the legal and economic risks were considered too great in light of the potential benefits. The risks of spill-overs to the Irish and EU financial systems were highly uncertain and perceived to be very high, especially given the absence of a proper EU bank resolution framework. The alternative of a burden sharing that only applied to the senior creditors of the institutions that were to be resolved, Anglo and INBS, would have had fewer benefits to the Irish Exchequer but would still have entailed considerable risks.

The large upfront recapitalisation of banks was appropriate and effective: it helped to restore confidence in the solvency of the Irish banks and sovereign in a context of high uncertainty. In 2011, aggregate recapitalisation needs were finally agreed at €24 billion, of which the State provided the majority (€16.6 billion). This was lower than the €35 billion (including contingency reserves) envisaged in the programme envelope, but higher than the 2011 Prudential Capital Assessment Review (PCAR) assessment of €18.7 billion. The spreads on the senior bonds of the two pillar banks, Allied Irish Banks (AIB) and Bank of Ireland (BOI), started reducing after summer 2011. The two banks regained unguaranteed market access in late 2012. Given that large up-front recapitalisation could have impaired banks' incentives to clean-up their balance-sheet, an earlier introduction of mortgage restructuring targets could have been envisaged.

Bank restructuring was overall appropriately designed: Anglo and INBS were resolved. Competition and fiscal concerns justified the decision not to resolve Permanent TSB (PTSB), despite doubts over its viability. Decisions on whether to resolve or restructure institutions were timely and consistent, which lent the programme credibility. The resolution of Anglo and INBS was envisaged from the start of the programme, and by the end of it the two banks had been successfully put into liquidation. Taken in isolation, there could have been a case for also resolving PTSB (the banking operations of Irish Life and Permanent) given concerns over its viability. However, this option was not pursued because it risked harming competition. Moreover, the immediate fiscal cost of resolution was higher than for restructuring. The restructuring plan for PTSB was approved in April 2015 by the European Commission under State aid rules; the bank is making progress, including raising additional private capital in 2015, although it is yet to reach profitability.

Banks have downsized their balance sheets and stabilised their funding structure, but deleveraging targets did not translate into a reduction in non-performing loans (NPLs). In line with the deleveraging targets, the banks reduced their balance sheet by around €70 billion (45% of GDP). Significant progress was also made in reducing the banks' reliance on the Eurosystem and improving their loan-to-deposit ratio. The deleveraging process was managed flexibly in order to minimise unintended consequences such as high deposit rates or an excessive squeeze on new lending. Disposals – which were in line with EU State aid rules, requiring burden sharing by the beneficiary of aid – may have been too focused on foreign assets as they left Irish banks with less profitable businesses, although this helped to avoid domestic fire sales. Reforms to financial sector governance were much needed but required preparation before they could be implemented. The new personal insolvency framework was put in place only in November 2013 and gained consensus support, but has subsequently suffered from low take-up. At the end of the programme, the envisaged introduction of a credit registry had not yet happened. Also, a decline in NPLs was yet to be seen.

Ireland's fiscal targets proved to be appropriate: they were realistic and were met with a margin, aided by the easing of EFSF/EFSM loan terms, although measurement issues could have been more clearly addressed. At the start of the programme Ireland's structural deficit was assessed to be in double-digits and public debt had increased sharply. The size of the deficit, and worsened economic outlook, justified the decision in December 2010 to move Ireland's deadline for correction of the excessive deficit back by one year to 2015. Ireland implemented sufficient reforms to meet the fiscal targets set out in the programme, whether defined bottom up (consolidation measures) or top down (fiscal deficit reduction),

and is on track to meet the Excessive Deficit Procedure deadline on current forecasts. Overachievement in meeting realistic fiscal plans helped to generate a virtuous circle of good news and credibility. The focus on expenditure reduction reflected the Irish government's preferences. Measuring the size of the fiscal adjustment has proven to be quite difficult. Bottom-up measurement points to a front-loaded consolidation within the programme period, following on from strong consolidation packages in the two years prior to the programme. In contrast, the change in the structural balance points to a back-loaded consolidation – although the structural balance presents substantial shortcomings as a measure of the policy response during times of strong economic change. Ireland's return to GDP growth and market access suggest the scale and profile of consolidation were broadly appropriate. The 2011 lowering of EFSF/EFSM interest rates represented a sizeable fiscal windfall. More consideration could have been given to adjusting the fiscal targets in response, thereby maintaining the originally planned consolidation efforts. Changes to broaden the tax base and control spending have made the public finances more stable and sustainable.

The reforms made to fiscal governance, which were appropriately included in the programme, should in principle support durable debt reduction and temper the risk of pro-cyclical fiscal policy choices. The fiscal governance reforms aimed to prevent a repeat of the overspending during the pre-crisis boom. The fiscal rules and medium-term budgetary framework, adopted under the Fiscal Responsibility Act in 2012 and its amendment in 2013, give Ireland one of the strongest fiscal governance frameworks in the EA in principle. The independent Irish Fiscal Advisory Council (IFAC) became operational on an interim basis in 2011 and was made permanent in 2012. Ireland's debt sustainability risks have eased, but public debt remains high. The fiscal framework will need to prove its worth if a strengthening economy generates growing pressure for a premature relaxation of fiscal policy.

The targeted structural reforms included in the programme were broadly appropriate but their implementation faced some political and technical challenges. The Irish authorities recognised that structural reforms were not the primary focus – particularly for the IMF and ECB. The labour market measures in the MoU were needed to address the risk of the long-term unemployment and skills mismatches generated by the boom-bust cycle becoming permanent. Product market and sectoral reforms aimed to tackle more long-standing economic inefficiencies. In one sense, the addition of skills and health sector measures during the programme was a positive sign of flexibility. But ideally these reforms would have been included and progressed as soon as possible given the challenges that implementing structural reforms present. In a few cases, Ireland's technical or political capacity to draft, pass or implement legislation proved to be a constraint. This could potentially have been anticipated and mitigated, for example by carving out priority aspects of complex "omnibus" bills for early implementation. Ireland showed good overall administrative capacity and did not need extensive technical assistance, but greater use of targeted support could have been beneficial, particularly for labour market and skills policies.

Broad based reforms to tackle both demand and supply side impediments to hiring have been relevant and appropriate but will take time to make an impact. The cost of employing workers at the minimum wage and in specific sectors was reduced, although the measures in the MoU were partly overtaken by political and legal developments. The new active labour market and skills systems that have been put in place, including Intreo, Education and Training Boards (ETBs) and SOLAS (the new Further Education and Training Authority), should help to raise the employment rate of young and lower-skilled workers over the medium term. Given that the need for these reforms was clear by 2010, slow progress in making the new institutions fully operational has raised the risk of hysteresis.

Progress on implementing regulatory reforms that affect vested interests has been mixed. Persistent spending overruns led to the inclusion of health sector reforms towards the end of the programme. It was only in late 2013 that the Irish authorities presented a Finance Operative Model and an eHealth strategy, with key milestones left for the post-programme period. Progress has been made in containing the cost of pharmaceuticals but potential further savings remain dependent on post-programme actions. In 2010, domestic water supplies were free at the point of use. The water network was fragmented and suffered

from under-investment, high leakage, variable water quality and occasional service disruptions. The introduction of a national water utility, Irish Water, and household water charges proved practically and politically challenging. Good progress was made in improving the economy-wide competition framework, although Ireland still lacks civil means of enforcing competition law. Reforms to increase competition in the legal services continue to experience excessive legislative delays. The programme may have missed an opportunity to deliver more fundamental reform to protected sectors.

The burden of adjustment was quite widely shared across Irish society and Ireland's social safety net continued to function effectively, though deprivation has risen. The programme avoided sharp across-the-board reductions in social support. As a result, the comprehensive social safety net that Ireland had in place prior to the programme remained intact. Though distributional considerations were an intrinsic part of programme discussions, the distributional impact of austerity measures was only periodically addressed in the programme reviews.

The programme was consistent with updated EU rules and initiatives and benefitted from them. Ireland's experience also informed the creation of the new EU/EA regulatory framework. Having lost market access, Ireland needed a financial assistance programme. European financial resources (EFSM/EFSF) had to be part of the programme to deliver a big enough funding envelope to re-assure the markets, prevent a full collapse of the Irish banking system and allow a staged fiscal adjustment. At the same time, ECB and European Council statements and actions at the EA level were also important in reassuring the markets of Ireland's solvency. The decision to reduce the interest rate on EFSM/EFSF loans to well below the cost of IMF funds aided Ireland's debt sustainability but makes the ESM (as the successor to the EFSF) a much more attractive lender than the IMF for any future programme. The MoU was consistent with broader EU policies, including the Stability and Growth Pact, rules on fiscal governance, and state aid requirements. The development of the EU surveillance framework over the programme period, including the so-called Six Pack and Two Pack, partly reflected failures in the pre-crisis system. In December 2013, Ireland entered into Post-Programme Surveillance (PPS), which will continue until 75% of the financial assistance has been paid back.

The following lessons can be drawn from this ex post evaluation of the Irish assistance programme:

Broader financial sector governance measures, including reforms to the insolvency framework, should be given a high priority. They contribute to the effectiveness of bank recapitalisation and restructuring. However, governance reforms tend to lose momentum when the immediate pressure eases. Prompt supervisory actions could help to achieve more upfront loan provisioning and restructuring, with the aim of accelerating balance sheet repair.

Ireland's problems informed the design of the new EU bank resolution framework, under which bail-in should be implemented upfront in future. This should limit the costs of banking sector support to the State in times of crisis and encourage proper risk pricing ex ante. The capital requirements for banks under restructuring should, in any case, reflect credible assumptions on the losses yet to be realised. These losses should, in turn, be promptly recognised.

In financial sectors dependant on wholesale and other unstable sources of financing, deleveraging is an important means to address the inherent risks in the funding structure and to improve its resilience. The deleveraging process is ultimately unavoidable and should take place as soon as possible. Nevertheless, it is important that the deleveraging process does not lead to fire sales, excessive competition for deposits among banks leading to hikes in deposit interest rates, or an undue squeeze on new lending.

Banking sector restructuring entails complex considerations about banks' viability, in a context of high uncertainty and potential spillovers. Nevertheless decisions on either resolution or restructuring should be followed by prompt and consistent actions to ensure a timely liquidation or return to viability.

Consolidation plans which are realistic and in line with a country's priorities can give strong impetus and confidence to the consolidation process. Achievable fiscal targets give the programme stability and credibility.

Achievable fiscal targets can lead to a virtuous circle of good news and credibility for the programme. Frontloaded fiscal consolidation allows the brunt of the impact to be introduced when the importance of adjustment is well understood and helps underpin a strong return of market confidence. Nevertheless, it needs to be done with due consideration of the implications for growth and unemployment. Care should be taken to be explicit in how the consolidation effort will be measured in a programme context. Measuring the effort made according to the impact of the measures may have strong merits, but is not without its own measurement issues. Being explicit about these measurement issues at the start of the programme can help add credibility to it.

Structural reforms needed to rebalance the economy should be included in the programme from the beginning. They then need to be worked up and resourced as soon as possible, given that their design and implementation takes time. Structural reforms can present significant technical and legislative challenges, and affect vested interests. Including necessary reforms in the programme increases the chances of them happening, but the sustained focus of the national authorities and the three institutions is needed to deliver timely and successful implementation. The possible need for technical assistance should be considered as part of the programme design process, or in early reviews. When structural reforms are complex and may be facing delays, the possibility of carving out priority aspects for early implementation should be considered.

In the presence of high financial market volatility and uncertainties about banks' capital needs, the inclusion of sizeable contingent reserves in the financial envelope adds to the credibility and effectiveness of the programme. Nevertheless, a faster-than-expected and apparently sustainable improvement in financial and economic conditions during the programme justifies a reassessment of the financing gap and the size of the associated disbursements. Ring-fencing the financial sector support in the total envelope would also be desirable, at a minimum to trigger an explicit reassessment of whether the full financial envelope needs to be disbursed.

A programme MoU should reflect all aspects of policy dialogue that are important for the success of programme, including the distributional impact of adjustment measures.

The contribution of programme conditions in reaching the programme's objectives should be constantly monitored. Programme requirements should remain flexible, with a view to adapting existing measures and adding new ones when required.

While it is known that economic crises and the subsequent adjustment can have high social costs, the distributional and social implications are generally difficult to estimate accurately at the start of a programme. However, distributional issues should be clearly and systematically addressed as part of the programme process and documentation.

Ownership by the authorities is key to programme success. A programme consistent with national preferences fosters ownership. Nevertheless, with due consideration to the degree of ownership and institutional capability of national authorities, programme commitments concerning complex reforms to address long-term problems should be more detailed, and closely monitored, especially when vested interests are strong.

The creation of a structured process for monitoring and enforcing programme reforms within the national administration is beneficial to a programme's success. It can have positive spillover effects on the efficiency and effectiveness of a national public administration.