



EUROPEAN COMMISSION  
DIRECTORATE GENERAL  
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 31 March 2010  
ECFIN/Ares(2010)174407/10-EN

**IRELAND: MACRO FISCAL ASSESSMENT**  
**AN ANALYSIS OF THE DECEMBER 2009 UPDATE OF THE STABILITY**  
**PROGRAMME**

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called 'stability programme' for countries that have adopted the euro as their currency and 'convergence programme' for those that have not. The most recent update of Ireland's stability programme was submitted on 9 December 2009.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 17 March 2010. Comments should be sent to Bettina Kromen ([bettina-maria.kromen@ec.europa.eu](mailto:bettina-maria.kromen@ec.europa.eu)) and Janis Malzubris ([janis.malzubris@ec.europa.eu](mailto:janis.malzubris@ec.europa.eu)). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' autumn 2009 forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 17 March 2010. The ECOFIN Council expected to discuss the opinion on the programme on 16 April 2010.

\* \* \*

All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

[http://ec.europa.eu/economy\\_finance/sgp/index\\_en.htm](http://ec.europa.eu/economy_finance/sgp/index_en.htm)

## TABLE OF CONTENTS

1. INTRODUCTION.....	4
2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE.....	5
3. MACROECONOMIC OUTLOOK .....	7
4. GENERAL GOVERNMENT BALANCE .....	9
4.1. Budgetary implementation in 2009.....	9
4.2. The programme's budgetary strategy for 2010 .....	13
4.3. The programme's medium-term budgetary strategy .....	16
4.4. Risk assessment .....	18
5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY .....	20
5.1. Recent debt developments and medium-term prospects .....	20
5.1.1. Debt projections in the programme .....	20
5.1.2. Assessment .....	22
5.2. Long-term debt projections and the sustainability of public finances .....	23
5.2.1. Sustainability indicators and long-term debt projections.....	23
5.2.2. Additional factors .....	25
5.2.3. Assessment .....	26
6. INSTITUTIONAL FEATURES OF PUBLIC FINANCES.....	27
6.1. Fiscal framework .....	27
6.2. Quality of public finances.....	28
7. OVERALL ASSESSMENT .....	29
ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES.....	31

## **1. INTRODUCTION**

This document assesses the December 2009 update of Ireland's stability programme, which was submitted on 9 December 2009 and covers the period 2009-2014. The programme fully incorporates the 2010 budget, which was presented on the same day. It was approved by the government and presented to the parliament for a debate without a vote together with the budget for 2010.

This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Ireland. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the stability programme against the background of the Commission services' economic forecasts<sup>1</sup>. Section 4 analyses budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses institutional features of public finances. Finally, Section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

---

<sup>1</sup> This assessment uses the Commission services' autumn 2009 forecast, published on 3 November 2009, as a benchmark. However, more recent information that has become available since then has also been taken into account to assess the risks to the programme scenario.

**Table 1. Comparison of key macroeconomic and budgetary projections<sup>1,2</sup>**

		2008	2009	2010	2011	2012	2013	2014
Real GDP (% change)	<b>SP Dec 2009</b>	<b>n.a.</b>	<b>-7.5</b>	<b>-1.3</b>	<b>3.3</b>	<b>4.5</b>	<b>4.3</b>	<b>4.0</b>
	COM Nov 2009	-3.0	-7.5	-1.4	2.6	n.a.	n.a.	n.a.
	SP Oct 2008	-1.4	-4.0	-0.9	2.3	3.4	3.0	n.a.
HICP inflation (%)	<b>SP Dec 2009</b>	<b>n.a.</b>	<b>-1.7</b>	<b>-1.2</b>	<b>1.0</b>	<b>1.7</b>	<b>1.8</b>	<b>1.8</b>
	COM Nov 2009	3.1	-1.5	-0.6	1.0	n.a.	n.a.	n.a.
	SP Oct 2008	3.1	0.5	1.5	1.8	1.8	1.8	n.a.
Output gap <sup>3</sup> (% of potential GDP)	<b>SP Dec 2009</b>	<b>0.0</b>	<b>-7.0</b>	<b>-7.6</b>	<b>-4.6</b>	<b>-2.2</b>	<b>-0.6</b>	<b>0.1</b>
	COM Nov 2009 <sup>4</sup>	-0.1	-7.2	-7.8	-5.4	n.a.	n.a.	n.a.
	SP Oct 2008	0.5	-3.5	-4.1	-3.4	-1.6	-0.5	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	<b>SP Dec 2009</b>	<b>n.a.</b>	<b>-2.0</b>	<b>0.6</b>	<b>1.2</b>	<b>1.6</b>	<b>1.6</b>	<b>1.3</b>
	COM Nov 2009	-5.1	-3.1	-1.8	-1.4	n.a.	n.a.	n.a.
	SP Oct 2008	-6.3	-4.2	-3.5	-3.4	-3.0	-2.8	n.a.
General government revenue (% of GDP)	<b>SP Dec 2009</b>	<b>34.8</b>	<b>34.2</b>	<b>35.2</b>	<b>35.5</b>	<b>36.3</b>	<b>36.7</b>	<b>37.1</b>
	COM Nov 2009	34.9	34.4	34.4	33.8	n.a.	n.a.	n.a.
	SP Oct 2008	33.6	33.7	34.4	34.6	33.9	34.4	n.a.
General government expenditure (% of GDP)	<b>SP Dec 2009</b>	<b>42.0</b>	<b>45.9</b>	<b>46.8</b>	<b>45.5</b>	<b>43.5</b>	<b>41.5</b>	<b>40.0</b>
	COM Nov 2009	42.0	46.9	49.1	48.4	n.a.	n.a.	n.a.
	SP Oct 2008	39.9	43.3	43.4	41.0	38.7	37.0	n.a.
General government balance (% of GDP)	<b>SP Dec 2009</b>	<b>-7.2</b>	<b>-11.7</b>	<b>-11.6</b>	<b>-10.0</b>	<b>-7.2</b>	<b>-4.9</b>	<b>-2.9</b>
	COM Nov 2009	-7.2	-12.5	-14.7	-14.7	n.a.	n.a.	n.a.
	SP Oct 2008	-6.3	-9.5	-9.0	-6.4	-4.8	-2.6	n.a.
Primary balance (% of GDP)	<b>SP Dec 2009</b>	<b>-6.1</b>	<b>-9.6</b>	<b>-8.8</b>	<b>-6.6</b>	<b>-3.4</b>	<b>-1</b>	<b>1</b>
	COM Nov 2009	-6.1	-10.2	-11.3	-10.6	n.a.	n.a.	n.a.
	SP Oct 2008	-5.2	-7.3	-6.4	-3.5	-1.7	0.7	n.a.
Cyclically-adjusted balance <sup>3</sup> (% of GDP)	<b>SP Dec 2009</b>	<b>-7.2</b>	<b>-8.9</b>	<b>-8.6</b>	<b>-8.2</b>	<b>-6.3</b>	<b>-4.7</b>	<b>-2.9</b>
	COM Nov 2009	-7.1	-9.6	-11.5	-12.5	n.a.	n.a.	n.a.
	SP Oct 2008	-6.5	-8.1	-7.4	-5.0	-4.1	-2.4	n.a.
Structural balance <sup>5</sup> (% of GDP)	<b>SP Dec 2009</b>	<b>-6.4</b>	<b>-9.3</b>	<b>-9.2</b>	<b>-8.2</b>	<b>-6.3</b>	<b>-4.7</b>	<b>-2.9</b>
	COM Nov 2009	-7.1	-10.1	-11.5	-12.5	n.a.	n.a.	n.a.
	SP Oct 2008	-6.2	-8.1	-7.4	-5.0	-4.1	-2.4	n.a.
Government gross debt (% of GDP)	<b>SP Dec 2009</b>	<b>n.a.</b>	<b>64.5</b>	<b>77.9</b>	<b>82.9</b>	<b>83.9</b>	<b>83.3</b>	<b>80.8</b>
	COM Nov 2009	44.1	65.8	82.9	96.2	n.a.	n.a.	n.a.
	SP Oct 2008	40.6	52.7	62.3	65.7	66.2	64.5	n.a.

**Notes:**<sup>1</sup>The Commission services' autumn 2009 forecast was prepared on a pre-budget basis.<sup>2</sup>The figures reported as having been taken from the October 2008 stability programme actually refer to its January 2009 addendum.<sup>3</sup>Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.<sup>4</sup>Based on estimated potential growth of 1.8%, -0.5%, -0.7% and 0.0% respectively in the period 2008-2011.<sup>5</sup>Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.8% of GDP in 2008 (deficit-increasing), 0.4% of GDP in 2009 and 0.6% in 2010 (both deficit-reducing) according to the most recent programme and 0.5% of GDP in 2009 (deficit-reducing) according to the Commission services' November 2009 forecast.**Source:***Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations.***2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE**

This section describes recent economic and budgetary developments for Ireland, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

After the high-growth period of the second half of the 1990s, Ireland's economy settled down to a more steady growth phase in 2001-2007. Whereas Ireland's competitive position weakened somewhat during this period, due to price and wage inflation together with declining productivity growth, domestic demand became the main engine of the economy, with a particularly buoyant construction sector. A sharp adjustment from the 2006 peak in the Irish housing market has since spread to the wider economy. This development has been amplified by the decline in global demand and especially by the recession in the main trading partners (euro area, US and UK) of the very open Irish economy. Similarly, while the starting point of the financial sector's weakness was its high exposure to the domestic construction sector, the international financial crisis has

contributed to the deepening of the crisis, given the large weight of the financial services sector in the Irish economy and Irish banks' high dependence on foreign wholesale funding. The economy entered into recession in 2008, and, following a fall in real GDP by 7½% in 2009, a further decline by 1½% is projected in the Commission services' autumn 2009 forecast for 2010.

The downturn has also produced a dramatic deterioration in the Irish public finances. While over the period from 1997 to 2007, the general government balance posted surpluses in all but one year, a deficit of 7.2% of GDP emerged in 2008 and a double-digit deficit ratio is estimated to have been recorded in 2009. The fiscal deterioration mainly reflects the loss of windfall revenue from the property boom, a shift away from tax-rich domestic demand driven growth and the rigidity of the expenditure plans given the sharp decline in revenue as well as an increase in unemployment-related expenditure. This has also fed into a steep increase in the debt ratio from its low level before the crisis, to above the 60% of GDP reference value in 2009. Given these developments, the Council issued a decision under Article 104(6) that an excessive deficit exists in Ireland on 27 April 2009. A revised recommendation under Article 126(7) to end the excessive deficit situation by 2014 was issued on 2 December 2009 (see Box 1 for further details).

Against this background, Ireland's policy response to the crisis has focused on containing the fiscal imbalance, with five substantial consolidation packages having been adopted since July 2008. At the same time, the authorities have also provided support to the weakened financial sector, *inter alia* through guarantees, capital injections and plans for setting up a bad bank to deal with banks' property related impaired assets. In line with the European Economic Recovery Plan, and within the constraints of the medium-run consolidation strategy, Ireland also adopted a modest package of measures to support economic activity.

Going forward, the Irish economy faces manifold challenges related to the further consolidation of public and private balance sheets and the rebalancing of growth, including the need to regain competitiveness and deal with the steep increase in unemployment.

Building on the significant efforts already made, further developing and implementing a broad-based medium-term fiscal consolidation strategy will be key for restoring investor and consumer confidence and returning to sustainable economic growth. At the same time, while the establishment of a bad bank should facilitate an orderly restructuring process in the financial sector as a precondition for restoring credit supply to normal, further capital injections might be warranted, with a possible further impact on public finances, should negative feedback loops materialise.

Rebalancing growth involves redirecting resources from construction to more productive sectors. In this possibly drawn-out process, supporting the re- and up-skilling of the newly-unemployed will be important to prevent them from turning into long-term unemployed, especially since young and low-skilled workers are among the hardest hit. At the same time, repeating the success of Ireland's earlier FDI-based export-led growth strategy will be demanding, given that the economy's competitive position was gradually eroded in recent years, as reflected in a widening external deficit. Competitiveness will have to be regained through measures enhancing productivity growth and adequate wage policies, which would also support employment. While nominal wage adjustment appears to have started in 2009, adequate pay developments will need to be sustained in the medium term. Indeed, with higher exposure than the rest of the euro area to the downturn in the US and UK and to the recent depreciation of sterling, Ireland might need a stronger adjustment than other euro area countries to regain competitiveness. Against this background, the return to trend growth might be delayed. The rate of trend growth

itself might also be reduced by temporarily lower investment due to the cyclical downturn and by the possibly permanent increase in the cost of investment financing after the current reassessment of risks. The return to net outward migration recorded in 2009 after over a decade of strong inflows will, if continued, further contribute to the weakening of trend growth. Finally, given the expected significant impact of population ageing, reforming the pension system with a view to improving its long-term sustainability is another important challenge.

### 3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

According to the macroeconomic outlook presented in the programme<sup>2</sup>, the recession is set to continue in 2009-2010, while a strong recovery (with average annual real GDP growth of 4%) is expected in the four following years (see Table 2). Only partially offset by a positive growth contribution from the external sector - reflecting declining imports rather than a strong performance of exports - domestic demand would continue to drive the recession in 2010. Thereafter, domestic demand would be the most significant driver of growth (with positive contributions of all components but government consumption) while, on the back of revived export growth, external trade would contribute about one third to the projected GDP dynamics. After increasing somewhat further in 2010, the sizeable negative output gap as recalculated by the Commission services based on the information in the programme following the commonly agreed methodology is set to diminish over 2011-2013 before closing in 2014.

The real GDP forecast for 2009-2010 is broadly in line with the Commission services' autumn 2009 forecast. Taking into account more recent information, two comments appear warranted. First, while Irish quarterly GDP is rather volatile and prone to later revisions, the data for the third quarter, published after the cut-off date for the autumn forecast, indicate a small upside risk for 2009 (including the third quarter, the carryover for 2009 stands at -6.8%). This would also imply a small upside risk for both sets of forecasts for 2010. Second, and more important, the autumn forecast is based on a no-policy-change scenario for 2010, i.e. does not take into account the potential dampening knock-on effect on disposable income and domestic demand of those consolidation measures adopted in the budget for 2010 that had not yet been specified in the April 2009 supplementary budget, which amount to a sizeable 2% of GDP<sup>3</sup>. On the other hand, signals coming from short-term indicators since the publication of the autumn forecast and after the presentation of the budget have been broadly positive, notably regarding unemployment and consumer sentiment, which has improved markedly. This might indicate a moderate decline in the previously very elevated savings rate (while staying at a high level during the ongoing balance sheet adjustment) and therefore a possibly less severe contraction in private consumption than projected in the autumn forecast. All in all, the Irish authorities' GDP forecast for 2010 does not appear implausible. Regarding the composition of growth, taking into account all available information, the projections for final domestic demand appear broadly plausible, and the slightly cautious projected

---

<sup>2</sup> The external assumptions behind the programme's macroeconomic scenario correspond to those underlying the Commission services' autumn 2009 forecast.

<sup>3</sup> In particular, of the €4bn (2.5% of GDP) package for 2010 announced in April, only the capital spending cuts (0.5% of GDP) could be taken into account into the autumn forecast, with the remainder of the package unspecified until the actual budget for 2010 was presented on 9 December.

growth rate for exports<sup>4</sup> seems warranted given the need to regain competitiveness. Indeed, the projected return to an external surplus averaging 1.3% of GDP over 2010-2014 would appear to be contingent on a continued recuperation of competitiveness.

For 2011, the autumn forecast projected real GDP growth of 2.6% on a no-policy-change basis. This is well below the forecast of 3.3% in the programme, which envisages another €3bn (1.8% of GDP) consolidation package to be introduced that year. The growth contributions of external trade and private consumption are higher than in the Commission services' autumn forecast. The real GDP growth rates projected for the years 2012-2014 (average: 4.3%), which are not covered by the autumn forecast, appear optimistic given in particular the reduction in trend growth to be expected as a consequence of the current crisis (especially on the back of the change in migration patterns and the lower investment profile) and the possible impact of the ongoing fiscal consolidation. Regarding the composition of growth, assuming that households continue to consolidate their balance sheets and given that unemployment is projected to decline only slowly, the projected consumption growth rates might be somewhat optimistic, especially in 2012-14 (annual average: 3.3%). The return to an average annual growth rate of 3.8% for exports over the same period will require that competitiveness is regained through adequate wage developments.

The implications of the programme's macroeconomic outlook for some tax bases might also be somewhat optimistic. A case in point is again private consumption, for which the programme's macroeconomic outlook implies an average nominal growth rate of close to 5% in 2011-2014. Assuming that wage developments do not outpace productivity in a slowly recovering labour market, projected average wage bill growth would fall short of this, while possible tax increases in the context of the ongoing consolidation efforts would act as a drag on disposable income and households should continue to adjust their balance sheets. This indicates a risk that nominal consumption growth might be lower than projected, with unfavourable implications for the revenue side of the budgetary plans.

Overall, the macroeconomic assumptions underlying the programme appear plausible in 2010 and favourable thereafter.

Regarding labour market developments, the programme projects a further decline in employment in 2010 followed by a gradual increase in the outer years. The decrease in the unemployment rate after its peak in 2010 would be slow, with a single-digit rate only reached in 2014. Given the need for substantial sectoral reallocation, the projection of a drawn-out adjustment process in the labour market appears plausible.

In line with the Commission services' autumn forecast, HICP inflation is forecast to remain in negative territory in 2010<sup>5</sup> and subdued in 2011. According to the programme, inflation would stay below 2% thereafter. Given the current under-utilisation of resources and the drawn-out adjustment process in the labour market as the reallocation of resources continues, this seems broadly plausible even if projected growth exceeds potential growth according to the programme in the outer years.

Risks to the economic outlook remain tilted to the downside and are in particular also related to the challenges set out in Section 2 above. Specifically, risks include the fragility of the financial sector, a steeper or more prolonged global downturn, rising interest rates or further exchange rate appreciation, specifically against sterling, as well as the uncertainty surrounding the domestic adjustment in the aftermath of the housing

---

<sup>4</sup> This is broadly offset by a projected significant positive growth contribution of stocks in the programme.

<sup>5</sup> The difference between the two forecasts is largely explained by the estimated effect of the budget on inflation.



market bubble and the capacity of the Irish economy to benefit from the global upturn given competitiveness losses in recent years. The stability programme update acknowledges that these factors are among the risks to the economic outlook. On the upside, the dampening effect of the ongoing consolidation effort could be counteracted by the effects on domestic demand of stabilising unemployment expectations and renewed consumer confidence, as well as a rebound in FDI inflows.

**Table 2: Comparison of macroeconomic developments and forecasts**

	2009		2010		2011		2012	2013	2014
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	-7.5	-7.5	-1.4	-1.3	2.6	3.3	4.5	4.3	4.0
Private consumption (% change)	-7.7	-7.2	-2.4	-3.0	1.8	2.6	3.4	3.3	3.2
Gross fixed capital formation (% change)	-30.4	-33.9	-15.0	-19.2	5.1	4.5	7.8	8.5	7.8
Exports of goods and services (% change)	-3.4	-2.7	1.2	0.4	3.7	3.4	4.0	3.8	3.5
Imports of goods and services (% change)	-8.5	-9.0	-1.0	-2.8	3.7	2.6	2.9	3.0	2.8
<i>Contributions to real GDP growth:</i>									
- Final domestic demand	-10.9	-11.1	-3.2	-4.8	1.9	1.8	2.7	2.7	2.6
- Change in inventories	-0.1	-0.7	0.0	0.8	0.0	0.2	0.0	0.0	0.0
- Net exports	3.4	4.3	1.9	2.4	0.7	1.3	1.7	1.5	1.3
Output gap <sup>1</sup>	-7.2	-7.0	-7.8	-7.6	-5.4	-4.6	-2.2	-0.6	0.1
Employment (% change)	-7.8	-7.8	-3.9	-3.4	0.7	1.0	2.3	2.5	2.3
Unemployment rate (%)	11.7	11.8	14.0	13.2	13.2	12.6	11.8	10.8	9.5
Labour productivity (% change)	0.3	0.4	2.6	2.3	2.0	2.3	2.1	1.7	1.7
HICP inflation (%)	-1.5	-1.7	-0.6	-1.2	1.0	1.0	1.7	1.8	1.8
GDP deflator (% change)	-2.3	-2.2	-0.9	-1.0	1.1	2.2	2.1	2.1	2.0
Comp. of employees (per head, % change)	-1.6	n.a.	-1.8	n.a.	1.1	n.a.	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-3.1	-2.0	-1.8	0.6	-1.4	1.2	1.6	1.6	1.3
<b>Note:</b> <sup>1</sup> In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services. <b>Source:</b> <i>Commission services' autumn 2009 forecasts (COM); Stability programme (SP).</i>									

#### 4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

##### 4.1. Budgetary implementation in 2009

According to the stability programme, the general government deficit is estimated to have reached 11.7% of GDP in 2009, as compared to a deficit of 7.2% of GDP in 2008. This deterioration reflects the substantial knock-on effect that the broad-based recession has had on the public finances, including a considerable tax shortfall and a surge in unemployment-related expenditure. At the same time, the fiscal consolidation packages adopted after the January 2009 addendum to the October 2008 stability programme have helped limit the fiscal deterioration. The combined net deficit-reducing effect of the February 2009 package and the April 2009 supplementary budget is estimated by the Commission services at 3¼% of GDP for 2009 (including a one-off measures of 0.4% of GDP; see below). While the overall thrust of the budgetary strategy is deficit-reducing,

Ireland also adopted a modest package of stimulus measures to support economic activity in line with the EERP (0.7% of GDP).<sup>6</sup>

**Table 3: Budgetary implementation in 2009**

	2008		2009	
	Planned	Outcome	Planned	Outcome
	SP Oct 2008 <sup>1</sup>	SP Dec 2009	SP Oct 2008 <sup>1</sup>	SP Dec 2009
Government balance (% of GDP)	-6.3	-7.2	-9.5	-11.7
Difference compared to target <sup>2</sup>	-0.9		-2.2	
<b>Difference excluding denominator effect <sup>2,3</sup></b>			<b>-1.7</b>	
<i>Of which:</i> due to a different starting position end 2008			-1.1	
due to different revenue / expenditure growth in 2009			-0.4	
p.m. Residual <sup>4</sup>			-0.2	
<i>p.m. Nominal GDP growth (planned and outcome)</i>			-4.1	-9.5
Revenue (% of GDP)	33.6	34.8	33.7	34.2
Revenue surprise compared to target <sup>2</sup>	1.2		0.5	
<b>Revenue surprise excluding denominator effect <sup>2,3</sup></b>			<b>-1.7</b>	
<i>Of which:</i> due to a different starting position end 2008			1.2	
due to different revenue growth in 2009			-2.9	
p.m. Residual <sup>4</sup>			0.0	
<i>p.m. Revenue growth rate (planned and outcome)</i>			-3.8	-11.1
Expenditure (% of GDP)	39.9	42.0	43.3	45.9
Expenditure surprise compared to target <sup>2</sup>	-2.1		-2.6	
<b>Expenditure surprise excluding denominator effect <sup>2,3</sup></b>			<b>0.0</b>	
<i>Of which:</i> due to different starting position end 2008			-2.3	
due to different expenditure growth rate in 2009			2.5	
p.m. Residual <sup>4</sup>			-0.2	
<i>p.m. Expenditure growth rate (planned and outcome)</i>			4.1	-1.1
<b>Notes:</b>				
<sup>1</sup> Based on the January 2009 addendum to the October 2008 stability programme update				
<sup>2</sup> A positive number implies that the outcome was better (in terms of government balance) than planned.				
<sup>3</sup> The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they usually largely cancel against each other.				
<sup>4</sup> The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.				
Source : Commission services				

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new stability programme with the targets from the previous update of the programme. Differences between outcome and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the ‘denominator effect’) are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme update) and the impact of differences in the revenue / expenditure growth rate from the planned growth rates<sup>7</sup>.

<sup>6</sup> This package includes measures announced in the October 2008 budget – a social welfare package (0.3% of GDP); the widening of the standard rate tax band (0.1%) and the reduction of the stamp duty top rate (0.1%) – and other smaller measures (0.2%) announced at different stages and sometimes provided from within existing resources. It should be noted that the social welfare package was basically reversed by measures of a similar size in the April 2009 supplementary budget, while the widening of the standard rate tax band was counteracted by the introduction of a new income levy in 2009.

<sup>7</sup> Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^o - \rho^p = \underbrace{\frac{1+r^p}{1+g^p} \Delta \rho_{-1}}_{\text{Base effect}} + \underbrace{\left( \frac{\rho_{-1}^o}{(1+g^o)(1+g^p)} \right) \Delta r}_{\text{Revenue growth effect}} - \underbrace{\left( \frac{\rho_{-1}^o}{(1+g^o)(1+g^p)} \right) \Delta g}_{\text{Denominator effect}} + \underbrace{\frac{\rho_{-1}^o (r^o g^p - r^p g^o)}{(1+g^o)(1+g^p)}}_{\text{Residual}}$$

The estimated deficit in 2009 (11.7% of GDP) is much worse than targeted in the January 2009 addendum to the October 2008 stability programme (9.5% of GDP), in spite of the above-mentioned significant consolidation measures taken in the course of the year. The April 2009 supplementary budget, after which no further measures were taken (until the budget for 2010), contained a comprehensive re-assessment of revenue and expenditure projections and set an updated deficit target for 2009 of 10¾% of GDP. Judged against this, the estimated outcome is still worse than expected, but less significantly so. In line with the usual practice, the remainder of this section compares the expected outcome with the target set in the previous programme assessed by the Council (i.e. the January 2009 addendum), even if the measures taken subsequently make the comparison difficult.

The 2.2 pps of GDP difference between the estimated 2009 outcome and the target set in January 2009 reflects a denominator effect due to lower GDP (0.5 pp. of GDP), a weaker starting position at the end of 2008 than expected (1.1 pps of GDP) and an adverse revenue growth surprise only partly compensated by the consolidation measures (0.4 pp. of GDP). The decomposition shown in Table 3 is however biased in view of the deficit revision for 2008, including because of unforeseen non-recurrent factors. In addition the size and composition of the government sector has changed as a result of the reclassification made in 2009 of certain non-financial corporations and voluntary hospitals into the government sector, which makes a comparison with the previous stability programme difficult.

The 2008 deficit outcome (7.2% of GDP) was worse than expected in the addendum (6.3%) by 0.9 pp. of GDP. The downward revision of nominal GDP in 2008 accounts for 0.2 pp. of the difference. An additional shortfall of 0.7 pp. of GDP reflects the updated deficit outcome estimate as compared to the estimate of the addendum. This upward revision is largely explained by a negative balance of non-market public companies (0.2%), an accrual adjustment for the Farm Waste Management scheme<sup>8</sup> in 2008 (0.3%) and other worse-than-expected accrual adjustments (0.2% of GDP). Part of the negative balance of non-market public companies is formed by the exceptional purchase of strategic oil stock by the National Oil Reserves Agency (NORA) (0.1% of GDP) in 2008, as the agency was included in general government in 2009. The purchase of oil stock by NORA and the Farm Waste Management scheme together account for 0.5% of GDP<sup>9</sup>, and as these items do not recur in 2009 they do not constitute a base effect for the deficit in 2009. This suggests that the underlying contribution of a worse starting position at the end of 2008 to budgetary implementation in 2009 was some 0.4 pp. of GDP.

The revenue and expenditure growth surprises in 2009 account for most of the difference between the planned and actual deficit for 2009 (some 1 pp. of GDP) once the base effect from 2008 is adjusted as described above. Revenue fell by 11.1% in 2009 as compared to a planned decrease of 3.8%. The much higher-than-planned decline in tax revenue (18% versus 7%), due to a further loss of housing boom related revenue and lower-than-expected economic activity more generally, was partly offset by a stronger-than-foreseen increase in “other revenue”. However, it should be noted that several revenue-increasing measures taken in the course of 2009 moderated the decline in total revenue, without which the fall would have reached some 15%. The April 2009 supplementary budget

---

where  $r$  is the growth rate of revenue and  $g$  is the growth rate of GDP. The subscript -1 refers to the previous year's value. Superscripts  $o$  and  $p$  refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

<sup>8</sup> Under the Farm Waste Management scheme the full amount payable to farmers was accrued back to 2008, while the grants are expected to be paid out over the period 2009-2011.

<sup>9</sup> These two items, together with the purchase of the Westlink toll bridge (0.3% of GDP), are considered as one-off expenditure-increasing items in the programme (together 0.8% of GDP). However they are not treated as one-offs by the Commission services.

notably doubled the rates and lowered entry thresholds of both the income levy and the health levy and increased the maximum income on which pay-related social insurance payments are due. These measures are estimated to have yielded less than 0.5% of GDP in direct taxes and around the same amount in social contributions in 2009. Other small measures yielded 0.1% of GDP mainly affecting indirect tax revenue. In addition, it was decided to transfer the assets and liabilities of pension funds of universities and non-commercial state agencies (estimated one-off yield of 0.4% of GDP in 2009)<sup>10</sup>, thus improving “other revenue”. Overall, the main reason for the revenue shortfall is lower GDP growth than foreseen in the addendum as well as a lower tax-intensity of economic activity in view of the shift away from tax-rich domestic demand, which also reduced the effectiveness of the revenue-raising measures taken in the original budget for 2009 and subsequent consolidation packages.

Expenditure is estimated to have remained flat, rather than rising by just above 4% as planned.<sup>11</sup> This is largely explained by expenditure-reducing measures introduced by the February 2009 package and the April 2009 supplementary budget, adding up to 1.9% of GDP in 2009. In February, expenditure-saving measures of 1% of GDP for 2009 were announced. Half of this was accounted for by the introduction of the “pension levy” on public sector wages (taking into account the tax deductibility of the levy, which implies that its net yield is estimated to be lower than the gross yield by one-third). The postponement of a public sector pay increase previously agreed for 2009 is estimated to have yielded 0.1% of GDP. Other savings were made on capital expenditure (below 0.2% of GDP) and other departmental savings of the central government (above 0.2% of GDP). The April 2009 supplementary budget introduced expenditure-reducing measures in an amount of 0.8% of GDP in 2009, including savings on social payments (0.3% of GDP) and capital expenditure (0.4%).

More detailed data on budgetary implementation for central government on a cash basis allow for a comparison between the provisional outturns for 2009, released in early 2010 (after the submission of the programme)<sup>12</sup>, and the updated targets set in the April 2009 supplementary budget; this comparison is not biased as no major discretionary measures have been taken since.<sup>13</sup> These data show that overall expenditure was in line with the updated target although some minor slippages occurred on the current side. In particular, the public sector pay bill is estimated to have been higher by some 0.1% of GDP than planned, but this is partly offset by savings on social payments as the rise in unemployment had been overestimated. Tax revenue was weaker than foreseen in the updated targets by some 0.8% of GDP as tax elasticities proved to be weaker than expected.

The same data on provisional outturns for 2009 suggest a better deficit outturn in 2009 than estimated in the programme. In particular, cash tax revenue at end-year was higher by some 0.3% of GDP than the estimated outturn in the programme and the provisional outturn of central government expenditure was lower by 0.1% of GDP. However, negative risks to the 2009 deficit outcome cannot be excluded as the full accounts of

---

<sup>10</sup> The Commission services estimate one-off measures in 2009 at 0.5% of GDP. In addition to the transfer of the pension fund assets (+0.4% of GDP), this includes the impact of some smaller one-offs related to advancing corporation and capital gains tax payment dates (+0.2%) and the one-off change in the contribution to the EU budget (-0.1%).

<sup>11</sup> An expenditure growth rate of 0.1% in 2009 results (instead of a decline by 1.1% in Table 3), when the non-recurring additional expenditure in 2008 compared to what was foreseen in the addendum (the purchase of stock by NORA and the Farm Waste Management scheme) is excluded from the base.

<sup>12</sup> Namely, the Exchequer statement for the year 2009 and the Revised Estimates for Public Services for 2010.

<sup>13</sup> Additional expenditure of 0.2% of GDP was passed by the parliament but was broadly compensated by savings of similar size.

general government are produced, in particular the deficit of local government might turn out to be higher.

#### **Box 1: The excessive deficit procedure (EDP) for Ireland**

On 27 April 2009 the Council adopted a decision stating that Ireland had an excessive deficit in accordance with Article 104(6) of the Treaty establishing the European Community (TEC). At the same time, the Council addressed a recommendation under Article 104(7) TEC specifying that the excessive deficit had to be corrected by 2013. On 2 December 2009 the Council, following a recommendation by the Commission, considered under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU) that action had been taken in accordance with the recommendations, but unexpected adverse economic events with major unfavourable consequences for government finances had occurred after the adoption of the recommendation, and issued new recommendations to correct the deficit by 2014.

In particular, Ireland was recommended to, with a view to reducing the deficit in a credible and sustainable manner by taking action in a medium-term framework, specify consolidation measures in the budget for 2010 in line with the package announced in the April 2009 supplementary budget; 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 towards 60 % of GDP; and 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. 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. Further, 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. Moreover, 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. Finally, the Council established 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 Irish authorities were also recommended to 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.

#### **4.2. The programme's budgetary strategy for 2010**

The general government deficit is targeted at 11.6% of GDP in 2010 according to the stability programme, which was presented together with the budget for 2010 to the Parliament on 9 December 2009<sup>14</sup>. The budget contains significant savings amounting to some €4bn (2.5% of GDP). In spite of this effort, the deficit ratio in 2010 is set to “only” stabilise as compared to 2009 given the ongoing underlying deterioration of the fiscal position on a no-policy change basis. The planned stabilisation of the deficit ratio is at a higher level than the 10¾% of GDP projected in the April supplementary budget, due to the worse-than-expected deficit outcome in 2009. Given the steep rise in the interest burden, this implies a significant improvement in primary terms, with the primary deficit targeted to narrow from 9.6% of GDP in 2009 to 8.8% in 2010.

---

<sup>14</sup> Part of the measures were adopted by the Parliament on 9 December 2009 (Financial Resolutions), while other measures are in the process of being adopted (Social Welfare and Pensions Bill, Finance Bill, the Estimates and the Appropriation Bill).

The size of the savings package corresponds to that announced in the April 2009 supplementary budget and recommended in the revised EDP recommendation under Article 126(7) issued by the Council on 2 December 2009. It is noted that the total package includes an amount of €0.24bn (0.15% of GDP) saved not due to discretionary measures but due to a revision of the macroeconomic forecast underlying the budget (especially lower unemployment) relative to earlier estimates. The gross consolidation measures in the budget therefore only yield savings of 2.4% of GDP. At the same time, the consolidation is estimated to produce savings (again compared to earlier estimates) on debt-servicing costs (0.1% of GDP) given the reduced borrowing requirement. Overall, taken at face value, the budgetary strategy for 2010 can be considered to be broadly in line with the Council's EDP recommendations.

**Table 4. Main budgetary measures for 2010**

Revenue measures <sup>1</sup>	Expenditure measures <sup>2</sup>
<ul style="list-style-type: none"> <li>• Introduction of carbon tax on fossil fuels (0.16% of GDP)</li> <li>• ½ pp. reduction of standard VAT rate and lower excise duties on alcohol (-0.14% of GDP)</li> <li>• Transfer of pension fund assets (0.2% of GDP; one-off)<sup>3</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Progressive cuts in public sector wages (-0.6% of GDP)</li> <li>• Reduction in social benefits, including all payments for working age persons, unemployment benefits and child benefits (-0.5% of GDP)</li> <li>• Other reductions in current spending across departments (nearly -0.7% of GDP, including -0.25% of GDP from health spending)</li> <li>• Reduction in public investment (-0.6% of GDP)</li> </ul>
<p><u>Notes:</u></p> <p><sup>1</sup> Estimated impact on general government revenue</p> <p><sup>2</sup> Estimated impact on general government expenditure</p> <p><sup>3</sup> Net effect of the second part of the transfer of pension fund assets to the general government amounting to 0.6% of GDP in 2010 following the first part of the transfer of 0.4% of GDP in 2009</p> <p><i>Source: Commission services and the budget for 2010</i></p>	

According to the stability programme, the revenue-to-GDP ratio is expected to increase to 35.2% in 2010 from 34.2% in 2009. A further drop in the current tax-to-GDP ratio (20.8% in 2010 after 21.2% in 2009) would be more than offset by rising ratios of social contributions and other revenue relative to GDP. The increase in social contributions by 0.5 pp. of GDP reflects a positive carry-over effect of the measures introduced in the April 2009 supplementary budget. The “other revenue” category will increase by 0.9 pp. of GDP due inter alia to the higher surplus of the Central Bank paid to the government in 2010 as compared to 2009 (extra 0.2% of GDP), the higher amount of pension fund assets transferred to the general government than in the previous year (0.2%) and the increased receipts from the bank guarantee schemes in 2010 (0.2%). At the same time, the expenditure-to-GDP ratio would rise by a similar amount, from 45.9% of GDP in 2009 to 46.8% of GDP in 2010, most of which reflects the rise in the interest burden. Within primary expenditure, there is a strong pickup in social payments as a share of GDP (largely on the back of rising unemployment) and, to a lesser extent, other expenditure, which would be almost fully offset by a marked decrease in compensation of employees and intermediate consumption and a smaller cut in the public investment

ratio. It should be noted that a marked fall in nominal GDP (-2.2%) contributes to the increase in the revenue and expenditure ratios.

The measures announced in the budget for 2010, summarised in Table 4, show that nearly all of the adjustment effort is on the expenditure side. Public sector wage cuts averaging 6% are planned to produce savings of 0.6% of GDP in 2010. Significant cuts of around 0.5% of GDP are made in the social welfare budget. About half of this is made up by a cut of 4.1% in all benefits to people of working age. The rest should come from other smaller measures including a reduction in unemployment benefits for new applicants under 24 years of age and for recipients refusing a post offered to them, as well as a cut in child benefits. Other current savings across central government departments amount to some 0.7% of GDP. A large part of this (0.25% of GDP) comes from savings related to healthcare, including reductions in payments to pharmaceutical suppliers and general cost reductions. Public investment is reduced by 0.6% of GDP, but at 4.5% of GDP continues to compare favourably to most EU peers. This follows "a comprehensive review" of capital expenditure by the authorities, who also announce in the budget that they will shortly be publishing their medium-term revised investment priorities.

On the revenue side of the budget, the main measure is the introduction of a carbon tax, which should raise 0.16% of GDP in 2010. This is broadly offset by the decision to reverse the ½ pp. increase in the standard VAT rate that had been introduced in 2009 and to lower excise duties on alcohol (combined cost in 2010 and in a full year: around 0.14% of GDP).

One-off measures account for an estimated net improvement in the deficit by some 0.2% of GDP as total one-offs planned for 2010 are even larger than they were in 2009. This is because 2010 should see the second part of the transfer of pension fund assets to the general government, amounting to 0.6% of GDP in 2010 (0.4% in 2009).<sup>15</sup> In view of its one-off nature and the fact that the assets are transferred to the National Pensions Reserve Fund, this item is not regarded by the authorities as part of the savings package of 2.5% of GDP.

The planned fiscal stance appears to be neutral in 2010, as the structural deficit recalculated by the Commission services is estimated to stay broadly unchanged as compared to 2009. However, in primary terms, the improvement is close to 1pp of GDP. This is much less than suggested by a bottom-up approach (the savings package in the budget for 2010 amounts to 2.5% of GDP), which can be explained by the ongoing underlying deterioration of the fiscal position on a no-policy change basis<sup>16</sup> and, to a lesser extent, negative tax buoyancy<sup>17</sup>. The overall thrust of the permanent deficit-reducing measures in 2010 is actually estimated at 4¼% of GDP if one sums up the measures in the budget for 2010 and the carry-over effect from the measures taken in the course of 2009<sup>18</sup>.

---

<sup>15</sup> The second part of the transfer of pension fund assets was not included in the Commission services' autumn forecast due to uncertainty regarding the transaction.

<sup>16</sup> The budget for 2010 targets a deficit of 11.6% of GDP as compared to the pre-budget estimate of 13½% of GDP.

<sup>17</sup> The authorities estimate that a consolidation package of this substantial size would have a dampening effect on economic activity, which would in turn lead to significant negative tax buoyancy (0.6% of GDP), thus reducing the net contribution of the measures to deficit reduction to around 2% of GDP.

<sup>18</sup> Given the timing of the April 2009 supplementary budget (the main tax measures have been effective from 1 May 2009), the savings of 1.9% of GDP in 2009 from the permanent measures should be equivalent in full year terms to a package of 3.2% of GDP. This implies a positive carry-over effect into 2010 of 1.3 pps. of GDP. A smaller carry-over effect is expected from the measures announced in

### 4.3. The programme's medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with the one in the previous update - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

According to the stability programme, the main objective of the medium-term budgetary strategy is to pursue further consolidations efforts so as to reduce the general government deficit to below 3% of GDP by the end of the programme period (2014). After a stabilisation of the nominal deficit ratio in 2010 at the 2009 level, the consolidation path envisages a nominal annual improvement by 1¾ pps. of GDP in 2011, 2¾ pps. in 2012, 2¼ pps. in 2013 and 2 pps. in 2014. In structural terms, this would, according to the Commission services' calculations, provide for an improvement by 1 pp. of GDP in 2011 and 1¾ pps. annually in the period 2012-2014. While the headline deficit would remain in negative territory, the primary balance is projected to turn into surplus in 2014 (at 1% of GDP), with the gap reflecting high debt-servicing costs in the outer years of the programme.

As compared to the medium-term budgetary strategy in the previous stability programme, the correction period has been extended by one year in line with the Council recommendation of 2 December 2009. As in the previous programme, the correction appears back-loaded towards the outer years of the programme and coincides with the expected strong economic recovery after 2011, which is on average by more than 1 pp. higher than projected in the previous stability programme.

The authorities acknowledge the existence of a large structural gap between expenditure and revenues, which will not be corrected automatically as the cyclical position of the Irish economy improves. The April 2009 supplementary budget was the first budget to include nominal consolidation targets for the years after the budget. In particular, an annual adjustment of €4bn (2½% of GDP) split between the current and capital side of the budget was indicated for 2010 and 2011. The annual consolidation plans for 2012 and 2013 indicated only an annual adjustment effort on the current side of the budget, of €4bn (2¼% of GDP) and €3bn (1½% of GDP) respectively, while capital spending would be frozen at €6bn (3¼% of GDP), up from the level reached in 2011. While the budget for 2010 indeed contains a savings package in line with the target for 2010 (see previous section), the stability programme revises the targets for the consolidation packages in 2011 and 2012 down to €3bn (1¾% of GDP) split between the current and capital side of the budget. For 2013 and 2014, consolidation packages are indicated only for the current side of the budget, of €1.5 (¾% of GDP) and €1bn (½% of GDP) respectively, and a new, lower level of capital expenditure is set of €5.5bn (2¾% of GDP). While the reasons for the downward revision of the size of the future consolidation packages are not discussed explicitly, it appears that it is due to a combination of the extension of the deadline for the correction by one year and the more optimistic macroeconomic scenario.

Even if the budget for 2010 was in line with the previously announced consolidation target, the targets for the consolidation efforts in subsequent years appear to be only indicative as *"[t]he scale and nature of these future measures will be reviewed in the context of future Budgets and will very much depend on the strength of the economic cycle at the time"*. Also, the envisaged efforts are not underpinned by broad consolidation measures so that also the planned contribution of revenue versus expenditure measures to these efforts is not clear although some qualitative indications are given regarding future

---

the February package (0.6% of GDP), including the postponement of the agreed wage increase from September 2009 (0.5% of GDP).



reform plans, "including reforming the income tax and social security system, further public sector pension reform, property taxation etc" (see also sections 5.2.2 and 6.2).

**Table 5: Composition of the budgetary adjustment**

(% of GDP)	2008	2009		2010		2011		2012	2013	2014	Change: 2009-2014
	COM	COM	SP	COM <sup>1</sup>	SP	COM <sup>1</sup>	SP	SP	SP	SP	SP
<b>Revenue</b>	<b>34.9</b>	<b>34.4</b>	<b>34.2</b>	<b>34.4</b>	<b>35.2</b>	<b>33.8</b>	<b>35.5</b>	<b>36.3</b>	<b>36.7</b>	<b>37.1</b>	<b>2.9</b>
<i>of which:</i>											
- Taxes on production and imports	12.2	10.6	11.0	10.3	11.0	10.3	11.5	11.8	12.0	12.3	1.3
- Current taxes on income, wealth, etc.	11.3	10.2	10.2	10.4	9.8	10.3	10.4	11.0	11.5	11.8	1.6
- Social contributions	6.9	7.6	7.7	7.9	8.2	7.7	8.1	8.0	7.9	7.8	0.1
- Other (residual)	4.5	6.0	5.3	5.8	6.2	5.4	5.5	5.5	5.3	5.2	-0.1
<b>Expenditure</b>	<b>42.0</b>	<b>46.9</b>	<b>45.9</b>	<b>49.1</b>	<b>46.8</b>	<b>48.4</b>	<b>45.5</b>	<b>43.5</b>	<b>41.5</b>	<b>40.0</b>	<b>-5.9</b>
<i>of which:</i>											
- Primary expenditure	41.0	44.6	43.8	45.7	43.9	44.4	42.1	39.7	37.6	36.1	-7.7
<i>of which:</i>											
Compensation of employees and intermediate consumption	16.9	17.8	18.7	18.1	16.7	17.7	15.8	15.0	14.4	14.0	-4.7
Social payments	13.8	17.3	16.3	18.5	17.8	18.1	17.3	16.6	16.1	15.6	-0.7
Subsidies	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.5	0.4	0.5	0.0
Gross fixed capital formation	5.3	4.4	4.8	4.1	4.5	3.7	3.8	3.8	3.7	3.6	-1.2
Other (residual)	4.5	4.6	3.5	4.5	4.3	4.3	4.6	3.8	3.0	2.4	-1.1
- Interest expenditure	1.0	2.2	2.1	3.3	2.9	4.0	3.4	3.8	3.9	3.9	1.8
<b>General government balance (GGB)</b>	<b>-7.2</b>	<b>-12.5</b>	<b>-11.7</b>	<b>-14.7</b>	<b>-11.6</b>	<b>-14.7</b>	<b>-10.0</b>	<b>-7.2</b>	<b>-4.9</b>	<b>-2.9</b>	<b>8.8</b>
<b>Primary balance</b>	<b>-6.1</b>	<b>-10.2</b>	<b>-9.6</b>	<b>-11.3</b>	<b>-8.8</b>	<b>-10.6</b>	<b>-6.6</b>	<b>-3.4</b>	<b>-1.0</b>	<b>1.0</b>	<b>10.6</b>
One-off and other temporary measures	0.0	0.5	0.4	0.0	0.6	0.0	0.0	0.0	0.0	0.0	-0.4
<b>GGB excl. one-offs</b>	<b>-7.2</b>	<b>-13.0</b>	<b>-12.1</b>	<b>-14.7</b>	<b>-12.2</b>	<b>-14.7</b>	<b>-10.0</b>	<b>-7.2</b>	<b>-4.9</b>	<b>-2.9</b>	<b>9.2</b>
Output gap <sup>2</sup>	-0.1	-7.2	-7.0	-7.8	-7.6	-5.4	-4.6	-2.2	-0.6	0.1	7.1
Cyclically-adjusted balance <sup>2</sup>	-7.1	-9.6	-8.9	-11.5	-8.6	-12.5	-8.2	-6.3	-4.7	-2.9	5.9
<b>Structural balance<sup>3</sup></b>	<b>-7.1</b>	<b>-10.1</b>	<b>-9.3</b>	<b>-11.5</b>	<b>-9.2</b>	<b>-12.5</b>	<b>-8.2</b>	<b>-6.3</b>	<b>-4.7</b>	<b>-2.9</b>	<b>6.3</b>
<i>Change in structural balance</i>		-3.0	-2.2	-1.4	0.1	-1.0	1.0	1.8	1.7	1.7	
Structural primary balance <sup>3</sup>	-6.1	-7.9	-7.2	-8.2	-6.3	-8.5	-4.8	-2.5	-0.8	1.0	8.1
<i>Change in structural primary balance</i>		-1.8	-1.1	-0.3	0.9	-0.3	1.5	2.2	1.8	1.7	
<b>Notes:</b> <sup>1</sup> On a no-policy-change basis. <sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme. <sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures. <b>Source:</b> Stability programme (SP); Commission services' November 2009 forecasts (COM); Commission services' calculations											

The future consolidation packages have been "*technically distributed*" in Table 5, which provides a detailed breakdown of expenditure and revenue developments over the programme period. Taken as such, the projections in the programme point to a mainly expenditure-based consolidation, as the expenditure ratio would be reduced by 6.8 percentage points of GDP over the period 2010-2014 (and almost 8pp in primary terms), whereas the revenue ratio would rise by 1.9 percentage points. In the absence of measures, all that can be said is that some recovery of tax revenue elasticities might be expected in the cyclical upturn, as well as a decline in social payments from the projected decline in unemployment.

Taken at face value, the medium-term budgetary strategy seems to be in line with the revised EDP recommendation under Article 126(7) issued by the Council on 2 December 2009. In particular, the consolidation path aims at a deficit just below 3% of GDP by 2014. However, the envisaged consolidation efforts are not underpinned by broad measures and the marked cyclical contribution to the consolidation in the outer years foreseen in the programme, consistent with its favourable macroeconomic scenario, implies that the average annual structural effort needed according to the programme to correct the excessive deficit by 2014 falls short of the 2pp of GDP recommended by the Council.

The Irish authorities set the medium-term objective (MTO) for the budgetary position at  $-\frac{1}{2}\%$  of GDP (see Box 2). The programme does not mention a target year for achieving the MTO.

**Box 2: The medium-term objective (MTO) for Ireland**

As noted in the Code of Conduct<sup>19</sup>, the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically-adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

Specifically, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

As communicated by the authorities, the MTO of Ireland is  $-0.5\%$  of GDP. In view of the new methodology and given the most recent projections and debt level, the MTO reflects the objectives of the Pact.

#### **4.4. Risk assessment**

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2011, Table 5 compares the detailed revenue and expenditure projections in the Commission services' autumn 2009 forecast, which are derived under a no-policy change scenario, with those in the updated programme. Concerning 2010, it should be borne in mind that the Commission services' autumn 2009 forecast was elaborated on a pre-budget basis and therefore cannot be compared with the programme projections. The assessment takes explicitly into account all available information about more recent developments.

The budgetary outcomes could be worse than targeted in 2010 and considerably worse than targeted thereafter.

First, the significant consolidation efforts from 2011 onwards are not underpinned by measures so that also the planned contribution of revenue versus expenditure measures to these efforts is not clear. The indicative nature of the revenue and expenditure projections in the stability programme makes it impossible to evaluate the plausibility of the tax projections in relation to the macroeconomic scenario and of the projections for individual expenditure components. The risk from the lack of information on the consolidation measures is compounded by the fact that even the targeted size of the consolidation packages for the different years set out in the programme appears to be indicative (because it is stated to be subject to review in future budgets), notwithstanding

---

<sup>19</sup> "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council on 10 November 2009, available at: [http://ec.europa.eu/economy\\_finance/sgp/legal\\_texts/index\\_en.htm](http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm)

the fact that for 2010 a savings package of the previously announced size was implemented.

Second, an important downside risk is related to the economic outlook, which appears to be favourable in the outer years of the programme, given in particular the reduction in trend growth to be expected as a consequence of the current crisis. Also in view of the expected change in the composition of economic growth away from domestic demand in the medium term, the previous level of revenue relative to GDP might not be achieved automatically, and projections for some tax bases, including private consumption, appear somewhat optimistic.

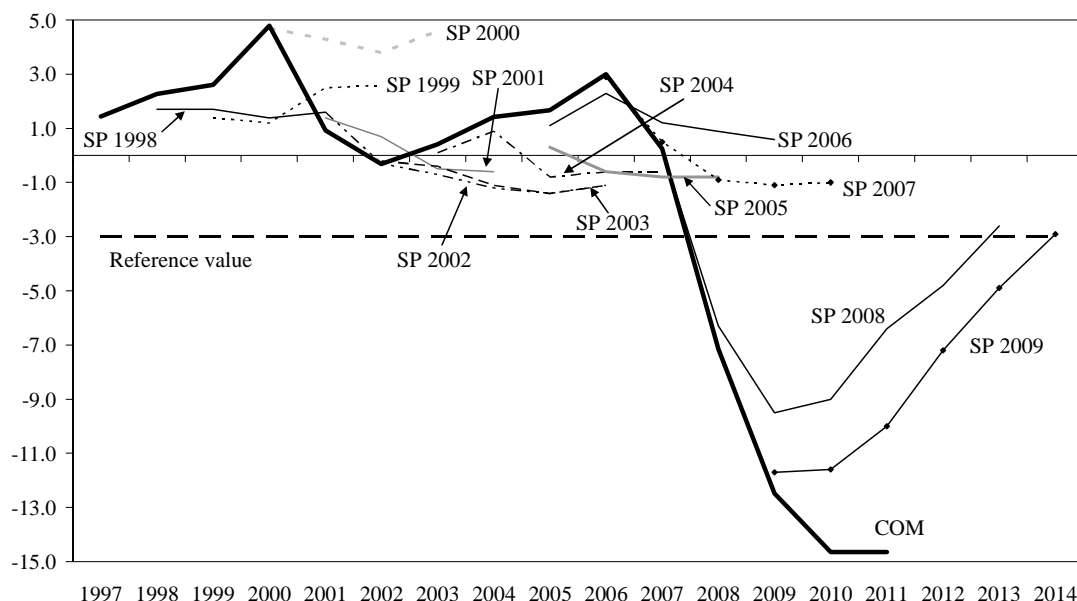
Third, also in view of the size of the planned consolidation, there is a risk of expenditure overruns in 2010 and also beyond, to the extent that the still to be spelled out strategy should rely on expenditure restraint. In particular, the risk might be especially relevant for the category "compensation of employees and intermediate consumption", where significant savings have already been implemented in recent consolidation packages and a further reduction would be implied by the programme projections. Figure 1 shows that, in the last few years, outturns for the government balance have been worse than projected in successive stability programmes. Therefore, the plausibility of the programme's budgetary projections might be questioned. However, it is noted that, despite additional consolidation measures during 2008 and 2009, very strong revenue shortfalls linked to the severe recession were the main reason why the budgetary targets were missed. At the same time, however, the track record points to the risk of expenditure overruns in the sense that expenditure growth rates for general government have turned out to be higher than planned in successive stability programmes, especially in 2007 and 2008. For the year 2009, the comparison between the spending growth rate in the previous programme with the estimated outcome in the most recent programme is invalidated by the fact that very significant further savings were implemented after the adoption of the previous programme (see section 4.1). However, such a comparison is possible for the central government based on cash data (provisional outturn for 2009 versus plans in the April 2009 supplementary budget). These data show that, while overall expenditure was in line with plans, some minor slippages occurred on the current side. In particular, one crucial area in the government's recent consolidation efforts – the public sector wage bill – had a higher-than-planned outturn by 0.1% of GDP.

Additional risks are related to support for the financial sector. Specifically, the Irish authorities have issued guarantees to covered banks which, in the event they were called, would lead to an increase in gross government deficit and debt<sup>20</sup>. However, some of the cost of government support to the financial sector might be recouped in the future.

---

<sup>20</sup> The original comprehensive guarantee amounting to around 170% of GDP - for deposits at and debt securities issued by seven Irish banks and building societies - issued by the Government in September 2008 will expire on 29 September 2010. However, the authorities have since introduced the "Eligible Liabilities Guarantee Scheme 2009". This scheme provides for a State guarantee for certain eligible liabilities (including deposits and forms of senior unsecured debt) of up to five years in maturity incurred by participating institutions during the period from the commencement date of the ELG Scheme (9 December 2009) to 29 September 2010 on certain terms and conditions.

**Figure 1: Government balance projections in successive programmes (% of GDP)**



*Source: Commission services' autumn 2009 forecast (COM) and successive stability programmes*

## 5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

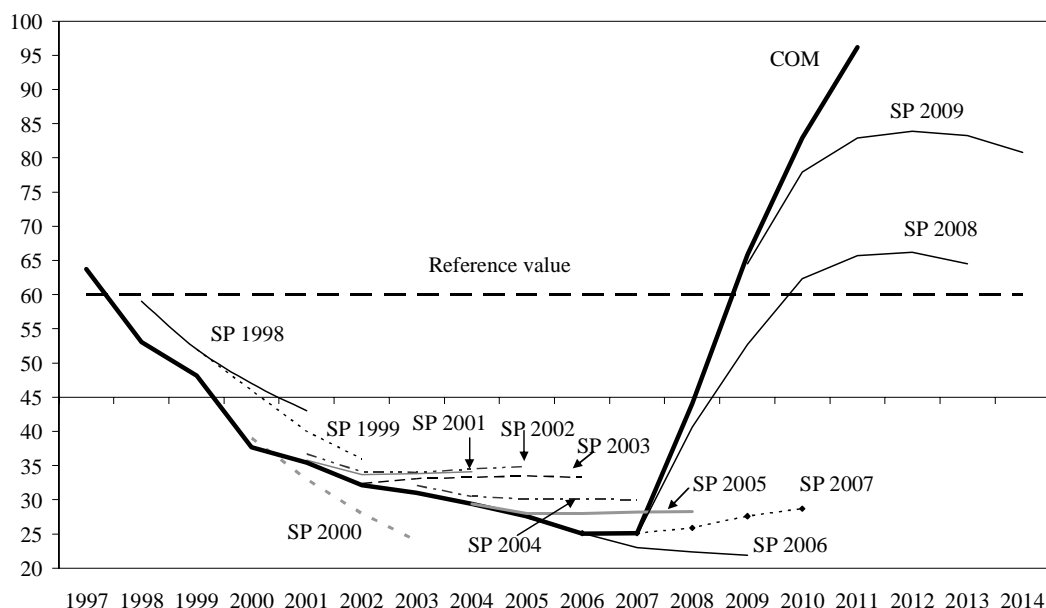
### 5.1. Recent debt developments and medium-term prospects

#### 5.1.1. Debt projections in the programme

Having jumped to 44% of GDP in 2008 after 25% of GDP in 2007, the gross debt-to-GDP ratio is according to the programme estimated to have reached nearly 66% of GDP in 2009, broadly in line with the Commission services' autumn 2009 forecast and above the 60% of GDP reference value. As illustrated by Figure 2 and Table 6, the programme projects a further steep rise in the debt ratio between 2009 and 2012 (by over 13 pps. in 2010 and 5 pps. in 2011) to a peak at nearly 84% of GDP in 2012, and a gradual decline thereafter to below 81% of GDP by the end of the programme period (2014).

The 20 percentage points increase in the debt ratio in 2009 was according to the programme mainly driven by the primary deficit. However, the snowball effect (on the back of rising interest expenditure in conjunction with negative economic growth and inflation rates) also made a sizeable (nearly 7 pps.) contribution to the rise in the debt ratio. The same holds, albeit to a lesser extent, for the stock-flow adjustment (4 pps.), mainly related to the funding of capital injections into banks. Together with the larger-than-expected deficit, this stock-flow adjustment also explains the 8 pps difference between the estimated 2009 outcome and the target for the debt ratio set in the previous stability programme.

**Figure 2: Debt projections in successive programmes (% of GDP)**



*Source: Commission services' autumn 2009 forecast (COM) and successive stability programmes*

With the recession still ongoing in 2010, the primary deficit and the "snow-ball" effect are expected to continue to contribute most to the rise in the debt ratio. From 2011 onwards, the return to positive real GDP growth and annual inflation rates would lead to a negative snowball effect according to the programme. Also, the stock-flow-adjustment would turn negative. The latter reflects two factors. First, a gradual unwinding of the exchequer deposits (liquidity) currently held for precautionary purposes against the background of the uncertainty in financial markets is planned. These cash reserves are estimated in the programme to have stood at 12% of GDP at the end of 2009. In the outer years, the unwinding of the cash balances should more than offset the second factor, which is the debt-increasing impact of the authorities' annual contributions to the National Pension Reserve Fund (NPRF) to pre-fund ageing related expenditure<sup>21</sup>. These developments, together with an improving primary balance ultimately turning positive in 2014 would lead to a reduction in the debt ratio in the last two years of the programme period.

It should be noted that in the case of Ireland net debt is significantly lower than gross debt on account of the above-mentioned cash balances and the assets held in the NPRF<sup>22</sup>. Taking these factors into account, net debt stood at 39.5% of GDP at end 2009 according to the programme.

<sup>21</sup> The 2010 contribution to the NPRF was frontloaded to 2009 in order to fund (together with the contribution for 2009) the above-mentioned capital injections into banks. According to the programme, "payments in subsequent years are offset by the transfer in 2009 and 2010 to the NPRF of the assets of the pension funds of third level universities and certain non-commercial semi-state bodies". In 2012, a partial contribution (0.5% of projected GNP) will be made and from 2013, the previous practice of a contribution of 1% of GNP per year will be resumed.

<sup>22</sup> The fund was worth 13.6% of GDP at end-2009.

**Table 6: Debt dynamics**

(% of GDP)	average 2003-07	2008	2009		2010		2011		2012	2013	2014
			COM	SP	COM	SP	COM	SP	SP	SP	SP
<b>Gross debt ratio</b> <sup>1</sup>	<b>27.6</b>	<b>44.1</b>	<b>65.8</b>	<b>64.5</b>	<b>82.9</b>	<b>77.9</b>	<b>96.2</b>	<b>82.9</b>	<b>83.9</b>	<b>83.3</b>	<b>80.8</b>
Change in the ratio	-1.4	18.9	21.7	20.4	17.1	13.4	13.3	5.0	1.0	-0.6	-2.5
<i>Contributions</i> <sup>2</sup> :											
<b>1. Primary balance</b>	<b>-2.4</b>	<b>6.1</b>	<b>10.2</b>	<b>9.6</b>	<b>11.3</b>	<b>8.8</b>	<b>10.6</b>	<b>6.6</b>	<b>3.4</b>	<b>1.0</b>	<b>-1.0</b>
<b>2. "Snow-ball" effect</b>	<b>-1.0</b>	<b>2.1</b>	<b>7.0</b>	<b>6.8</b>	<b>4.9</b>	<b>4.3</b>	<b>1.0</b>	<b>-0.7</b>	<b>-1.3</b>	<b>-1.1</b>	<b>-0.8</b>
<i>Of which:</i>											
Interest expenditure	1.0	1.0	2.2	2.1	3.3	2.8	4.0	3.4	3.8	3.9	3.9
Growth effect	-1.4	0.8	3.7	3.7	0.9	0.9	-2.1	-2.4	-3.5	-3.4	-3.1
Inflation effect	-0.6	0.3	1.1	1.1	0.6	0.6	-0.9	-1.6	-1.6	-1.7	-1.6
<b>3. Stock-flow adjustment</b>	<b>2.0</b>	<b>10.7</b>	<b>4.5</b>	<b>4.1</b>	<b>0.9</b>	<b>0.3</b>	<b>1.7</b>	<b>-0.9</b>	<b>-1.0</b>	<b>-0.4</b>	<b>-0.6</b>
<i>Of which:</i>											
Cash/accruals diff.	0.1	-0.4		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.
Acc. financial assets	1.6	11.1		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.
Privatisation	0.0	0.0		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.
Val. effect & residual	0.2	0.0		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.
<b>Notes:</b>											
<sup>1</sup> End of period.											
<sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.											
<b>Source:</b>											
Stability programme (SP); Commission services' November 2009 forecasts (COM); Commission services' calculations.											

### 5.1.2. Assessment

Compared to the programme, the Commission services' autumn 2009 forecast projects a steeper debt path for 2009-11, with increases to nearly 83% of GDP in 2010 and over 96% of GDP in 2011. This is mainly due to higher projected primary deficits than in the programme, also given the underlying no-policy-change assumption for 2010-11 of the autumn forecast. Further, the Commission services' forecast projects more unfavourable snowball effects, mainly due to more prudent assumptions on interest expenditure. Finally, projected stock-flow adjustments are also different as the autumn forecast embodied the technical assumption of no change in the accumulated cash balances in 2010-11.

The evolution of the debt ratio is likely to be less favourable than projected in the programme for several reasons. Firstly, the downside risks to the primary deficit targets (see section 4.4) could translate into a more rapid increase in debt. Note that if GDP growth in the outer years turned out to be lower than envisaged in the programme, this would affect debt developments unfavourably not only via the possible impact on the deficit but also via a smaller denominator effect than planned. Further risks are related to financial sector support measures, in particular the likely need for significant further capital injections. Steps that have already been taken to facilitate an orderly restructuring process in the financial sector include the establishment of the bad bank National Asset Management Agency (NAMA). Given that banks will transfer impaired loans to this institution at a discount, their capital bases will be reduced. There is a risk that in addition to raising funds in the markets to remedy this, some banks might need further injections of public capital. Unless the entirety of the required funds came from the National Pension Reserve Fund (NPRF), this would increase the gross debt level (while being accompanied by a similar increase in government assets). Similarly, support to the banking sector might prove necessary if the quality of mortgages and non-property related loans (not covered by NAMA) were more strongly affected by the recession than currently anticipated.

## 5.2. Long-term debt projections and the sustainability of public finances

### 5.2.1. Sustainability indicators and long-term debt projections

This section presents sustainability indicators based on long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology.<sup>23</sup>

Table 7 shows that the projected increase in age-related spending amounts to 8.7 percentage points of GDP between 2010 and 2060, which is clearly higher than the EU average (4.6 pp.). Sustainability indicators for two scenarios are presented in Table 8. 'The 2009 scenario' is based on a no-policy-change assumption and the 2009 structural primary balance as a starting position, while 'the programme scenario' takes into account the consolidation planned in the programme up to 2014 and is based on the projected 2014 structural primary balance as a starting position. Including the increase of age-related expenditure and assuming that the structural primary balance remained at its 2009 level, the sustainability gap (S2)<sup>24</sup> would amount to 14.8% of GDP, about 3 pps more than in last year's assessment. This is mainly due to a significantly worse estimated structural primary balance in the starting year, while additionally the rise in age-related expenditure in the 2009 projections is higher than in the previous ones. The starting budgetary position is not sufficient to stabilise the debt ratio over the long term and entails a risk of unsustainable public finances even before considering the long-term budgetary impact of ageing.

In contrast to the "2009 scenario", which reflects the weakening of the budgetary position in response to the current economic crisis, the "programme scenario", which is based on the end-of-programme structural primary balance, shows a considerably smaller gap. If the budgetary consolidation planned in the programme were achieved, risks to long-term sustainability of public finances would be mitigated because the planned structural primary surplus would be sufficient to close the gap stemming from the initial budgetary position. However, the long-term budgetary impact of ageing would remain to be covered.

Based on the assumptions used in the projections of age-related expenditure and the calculation of the sustainability indicators, Figure 3 displays the projected debt ratio over the long term.

---

<sup>23</sup> Economic Policy Committee and the European Commission (2009), '2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (2008-60)', *European Economy* No. 2/2009. European Commission (2009), 'Sustainability Report 2009, *European Economy* No. 9/2009. European Commission (2008), 'Public finances in EMU – 2008', *European Economy* No. 4/2008.

<sup>24</sup> The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

**Table 7: Long-term age-related expenditure: main projections**

(% of GDP)	2007	2010	2020	2030	2040	2060	Change 2010- 60
<b>Total age-related spending</b>	<b>17.2</b>	<b>17.5</b>	<b>18.7</b>	<b>20.3</b>	<b>21.9</b>	<b>26.2</b>	<b>8.7</b>
- Pensions	5.2	5.5	6.4	7.5	8.7	11.3	5.9
- Healthcare	5.8	5.9	6.1	6.5	6.9	7.6	1.7
- Long-term care	0.8	0.9	0.9	1.1	1.4	2.2	1.3
- Education and unemployment benefits	5.3	5.3	5.3	5.2	4.9	5.1	-0.2
<b>Property income received</b>	<b>1.1</b>	<b>1.0</b>	<b>1.0</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>-0.1</b>

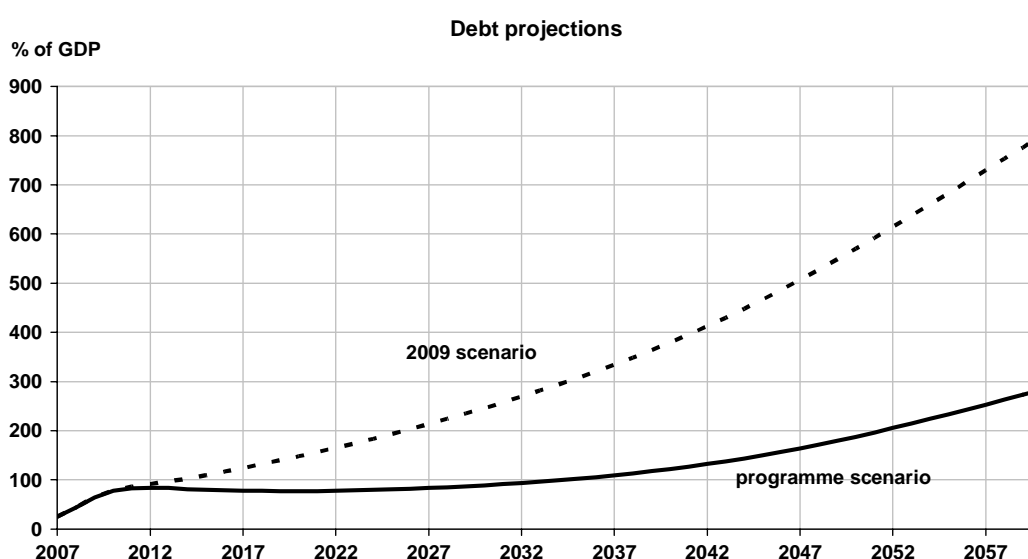
*Source: Economic Policy Committee and Commission services.*

**Table 8: Sustainability indicators and the required primary balance**

	2009 scenario			Programme scenario		
	S1	S2	RPB	S1	S2	RPB
Value	12.4	14.8	7.2	3.8	6.4	7.0
of which:						
Initial budgetary position (IBP)	8.1	8.3	-	-0.2	-0.1	-
Debt requirement in 2060 (DR)	0.7	-	-	0.4	-	-
Long-term change in the primary balance (LTC)	3.6	6.5	-	3.6	6.5	-

*Source: Commission services.*

**Figure 3: Long-term projections for the government debt ratio**



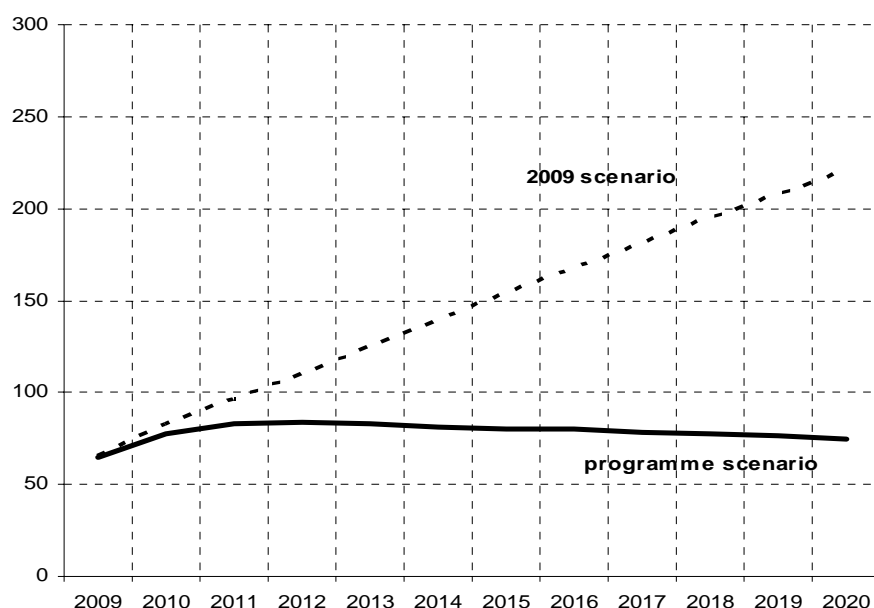
*Note:* Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.

*Source:* Commission services calculations



Based on the alternative assumptions of economic developments presented in the Commission services' autumn 2009 forecast<sup>25</sup> (notably assuming GDP growth rates to only gradually recover to the values projected before the crisis and tax ratios to return to pre-crisis levels), Figure 4 shows the projections for the debt ratio in the medium term. The projected debt trajectories show relatively similar paths until 2020 under the assumptions underlying the long-term projections and those underlying the medium-term projections. However, the debt ratio in the 2009 scenario when account is taken of the alternative assumptions of economic developments just mentioned would increase faster than under the baseline assumptions presented above, while in the programme scenario debt would stabilise at around 80% of GDP in 2012-13 and slightly decrease thereafter<sup>26</sup>.

**Figure 4: Medium-term projections for the government debt ratio**



*Source: Commission services' calculations*

### 5.2.2. Additional factors

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account, as shown in Table 9. While the projected structural primary balance under a no-policy-change scenario would add to the sustainability risk, additional factors do not change the overall assessment.

The stability programme reports that a reform of the public sector pension system for new entrants to the service is to be introduced in 2010. Pension payments would thereafter be based on career average earnings rather than final salary, while the retirement age would be increased by one year to 66. The government "will also consider" indexing payments to both existing and future pensioners to the consumer price index rather than to wage developments, which is expected to result in significant savings.

<sup>25</sup> Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009.

<sup>26</sup> The projected stabilisation/decrease in the debt ratio is due also to the assumption of the tax ratio to return beyond the programme horizon to pre-crisis levels. Without this assumption the debt ratio would continue to rise.

Further, the "National Pensions Framework", which was published on 3 March 2010, around 2½ years after the Green paper on pensions, contains the authorities' plans for more broad-based pension reforms. With the exception of the measures in the area of public sector pensions discussed above, the plans set out in this new policy document were not announced in the stability programme. While the Commission services still have to examine in detail the proposed reform before being able to assess its impact in terms of sustainability and adequacy, from a sustainability perspective, the key measure appears to be a gradual increase of the age at which people qualify for the State pension, from 65 years currently to 68 in 2028<sup>27</sup>. Another key measure is the introduction of a new pension scheme to top up the state pension for employees who are not already covered by a supplementary scheme, aimed at ensuring adequacy of retirement incomes. Those earning above a certain income threshold will be automatically enrolled in this new scheme (but can opt out) and both the State and the employer will provide matching contributions. At the same time, "the government will seek to maintain the value of the State pension at 35 per cent of average (...) earnings", which underlines that, while the introduction of a supplementary pension scheme should increase adequacy, it might have a limited impact on the sustainability of the public finances.

Also, as pointed out in section 5.1 above, it should be noted that net Irish debt is lower than the gross figures due to the assets accumulated in the National Pension Reserve Fund (NPRF) to partly pre-fund future pension expenditure.

**Table 9: Additional factors for the assessment of long-term sustainability risks**

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2011 in COM Autumn 2009 forecast	-
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	na
Difference between S1 and S2	na
<p><i>Note:</i> '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability.  '<i>na</i>': not applicable.</p> <p>Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".</p> <p>An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.</p> <p><i>Source:</i> Commission services.</p>	

### 5.2.3. Assessment

The long-term budgetary impact of ageing is clearly higher than 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 as estimated in the programme compounds the budgetary impact of population ageing on the sustainability gap. It is noted that assets have been accumulated in the NPRF in order to pre-fund part of future pension expenditure. Reducing the high primary deficit over the medium term, as already foreseen in the programme, and implementing structural reform measures including to

<sup>27</sup> According to the press, at present half the workforce is solely reliant on the State pension in retirement.

curb the substantial increase in age-related expenditure would contribute to reducing the high risks to the sustainability of public finances.

Medium-term debt projections that assume GDP growth rates to only gradually recover to the values projected before the crisis and tax ratios to return to pre-crisis levels show that the budgetary strategy envisaged in the programme, taken at face value, would stabilise the debt ratio by 2020.

## **6. INSTITUTIONAL FEATURES OF PUBLIC FINANCES**

### **6.1. Fiscal framework**

Whereas weaknesses in the Irish fiscal framework were masked in the recent past by high economic and tax revenue growth, the current more challenging circumstances reveal that Ireland still has margin to further improve in particular its medium-term budgetary framework. According to recent research by the Commission services among all EU27 countries<sup>28</sup>, the country scores well below the EU average in relation to the efficiency and quality of its domestic budgetary procedures encompassing the preparation, approval and execution of the budget. Low transparency, a low degree of centralisation during budgetary execution and scant use of performance budgeting appear as the main weaknesses.

Ireland has had two elements of multi-annual budgetary planning in place for several years. First, Ireland produces three-year budgetary projections, with the first year corresponding to the budget and the outer two years presenting revenue and expenditure trends, in a first stage on a no-policy change basis and subsequently modified by including an arbitrary envelope for subsequent budgets. These three-year projections are the basis for the stability programmes. Second, the National Development Plan is a 7-year multi-annual framework designed to manage and monitor investment expenditure over the medium term. More recently, the April 2009 supplementary budget introduced multi-annual nominal consolidation targets, i.e. specified the size of consolidation packages for years beyond the budget year. The domestic framework is supplemented by specific rules, such as the 1% of GNP annual contribution to the National Pension Reserve Fund<sup>29</sup> and deficit ceilings for local authorities.

A key weakness of the domestic framework is that budgetary targets for the outer years, especially expenditure envelopes, can be changed in subsequent budgets. This appears to also apply to the newly introduced multi-annual consolidation "targets" (see sections 4.3 and 4.4). As recent experience has shown, this makes it more difficult for policymakers to maintain a prudent fiscal policy course in the presence of (persistent) windfall revenues, while possibly limiting their ability to implement a medium-term consolidation strategy in difficult times. The domestic framework should thus be strengthened so as to provide a more binding and stability-oriented medium-term planning tool and to improve monitoring and implementation procedures ("enforcement"). The resort to independent fiscal institutions, entrusted with specific fiscal policy-related tasks such as the preparation of prudent macroeconomic forecasts for the budget, may also be positive as has been proven in other EU countries.

The programme acknowledges the importance of a "robust budgetary framework in ensuring that fiscal consolidation is successful and enduring" and recalls reforms

---

<sup>28</sup> See the report Public Finance in EMU 2006 (European Economy Nr 3. 2006, [http://ec.europa.eu/economy\\_finance/publications/publication423\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication423_en.pdf)).

<sup>29</sup> With ad-hoc amendments in recent years, see footnote 21 in section 5.1.1 above.

implemented over the last years, including the introduction of multi-year capital envelopes in 2004 and of multi-annual plans (i.e. consolidation targets) in the April 2009 supplementary budget. For the future, the programme contains rather vague announcements of further reform plans. In particular, "additional measures now being considered" include using possible future windfall tax revenues for deficit reduction purposes, also with a view to containing debt developments. This measure would be in line with Commission services' previous findings about the importance of revenue rules as the most direct tool to keep the spending of windfall revenues in good times in check to help address pro-cyclicality of fiscal policy and the deficit bias<sup>30</sup>. Further, the programme mentions that the introduction of multi-annual binding expenditure envelopes for current expenditure is under consideration, in line with the recommendations of the Commission on expenditure (see next section). As mentioned above, such multi-annual plans are already in place for capital expenditure.

Regarding the more short-term budgetary framework the authorities publish monthly statements on central government revenue and expenditure developments. Also, since mid-2008 they have responded flexibly to the ongoing fiscal deterioration by taking corrective action also outside the usual December budget framework. Going forward, institutionalising a strong mechanism for regularly reviewing budgetary plans at higher than annual frequency would help limit the risk of deviating from the targets in case of unfavourable growth-related revenue surprises or expenditure overruns.

## **6.2. Quality of public finances**

The crisis also revealed more clearly some vulnerabilities of the Irish tax system. In particular, the decline in revenue recorded in the context of the housing market correction and the wider recession was exacerbated by the previous high reliance on taxing transactions in assets<sup>31</sup>. More generally speaking Ireland's tax base appears to have become too narrow in recent years and would need to be broadened in the context of a comprehensive medium-term consolidation strategy.

The recommendation to broaden the tax base also featured prominently in the report of the *Commission on Taxation* set up by the government, which was published in September 2009. According to the programme, in further developing their consolidation strategy, the government intend to take into account this report. Already in the budget for 2010, a carbon tax was introduced and plans for further measures aimed at broadening the tax base in line with the recommendations of the Commission on Taxation have been announced. In particular, the programme mentions that the coalition partners' recent Renewed Programme for Government contains a commitment to introduce a property tax, while stressing that "a great deal of preliminary work is required to underpin this tax". The move from a transaction-based tax to an annual tax should have a positive impact on the quality of the public finances insofar as it should reduce the volatility of revenue flows. At the same time, mortgage interest relief will be phased out by end-2017. Further, the programme reports that preparations are underway for the introduction of water metering to introduce water charges to finance the provision of local services. Finally, in 2011 a new system of income tax and a new universal social contribution should replace the income levies.

On the expenditure side of the budget, future reforms will according to the programme be informed by the report of the *Special Group on Public Service Numbers and Expenditure*

---

<sup>30</sup> See Public Finances in EMU 2009, chapter II.4, available at: [http://ec.europa.eu/economy\\_finance/publications/publication15390\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication15390_en.pdf).

<sup>31</sup> The revenue share from VAT from housing; Stamp duty on property and land; Capital gains tax from property and land in total Irish tax revenue increased from 8.4% in 2002 to 18% in 2006.

*Programmes* published in July 2009. In the context of the expenditure-related consolidation measures in the budget for 2010, a review of investment expenditure was already carried out. According to the programme, the aim of the review was "to ensure that the investment programme focuses on the priorities that are most important to the challenges which we now face and which promote economic recovery", which would be in line with promoting the quality of public expenditure.

Apparently also aimed at improving the efficiency of public service provision and expenditure, a special Efficiency Review in the Local Government sector is being carried out and should according to the programme be finished by mid-2010. The report of the *Special Group on Public Service Numbers and Expenditure Programmes* had studied in some detail the possibilities for merging or eliminating overlapping state agencies. While the budget for 2010 somewhat surprisingly did not contain further measures in this area, the programme of agency rationalisation initiated in the budget for 2009 should according to the stability programme be carried forward.

The above-mentioned reforms relating to the public sector pension system announced in the stability programme update, together with further more broad-based pension reforms, which could usefully build on the March 2010 "National Pensions Framework" (see section 5.2.2), would further improve the quality of Ireland's public finances.

## **7. OVERALL ASSESSMENT**

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the Council recommendations under Article 126(7) of 2 December 2009 with a view to correcting the excessive deficit and the budgetary objectives of the Stability and Growth Pact, against the background of the current economic situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

As mentioned in Sections 4.2 and 4.3 above, the significant savings package implemented in 2010 can be regarded as broadly in line with the Council's EDP recommendations. The budgetary strategy for the period 2011-2014 taken at face value can be considered in line with the EDP recommendations.

However, the budgetary outcomes could be worse than targeted in 2010 and considerably so thereafter. In particular, for 2010 the government has, as recommended, implemented a savings package of the size announced in the April 2009 supplementary budget but there is a risk of expenditure overruns in view of the scale of the envisaged retrenchment. For the outer years 2011-2014, the measures underlying the consolidation targets need to be spelled out so as to confirm the targeted size of the consolidation efforts, which appear to be indicative. To the extent that the still to be spelled out strategy should rely on expenditure restraint, expenditure overruns are an additional risk. Furthermore, the strategy needs to be reinforced in case growth should turn out to be lower than projected in the programme's favourable macroeconomic scenario.

Overall, in 2010 the budgetary strategy set out in the programme is broadly consistent with the Council recommendations under Article 126(7). However, from 2011 on, taking into account the risks to the deficit targets, the budgetary strategy may not be consistent with the Council recommendations. In particular, the deficit targets for 2011-2014 need to be backed up by concrete measures and the plans for the entire period need to be strengthened to address the risks from less favourable GDP growth and slippages on the expenditure side. The marked cyclical contribution to the consolidation in the outer years foreseen in the programme, consistent with its favourable macroeconomic scenario, implies that the average annual structural effort needed according to the programme to

correct the excessive deficit by 2014 falls short of the 2pp of GDP recommended by the Council. This reinforces the conclusion that the authorities should stand ready to take additional measures beyond the planned consolidation packages in case growth turned out to be lower than projected in the programme.

According to the programme, after peaking at nearly 84% of GDP in 2012, the gross government debt to GDP ratio is planned to return to a mildly downward path, mainly due to strong nominal GDP growth and the planned return to a primary surplus in the last year of the programme. Upward risks to the debt targets stem from the risks to the deficit targets spelled out above, while weaker-than-projected economic growth would have an additional unfavourable effect on debt via the denominator effect. Further risks relate to the high contingent liabilities related to existing financial rescue operations and the likely need for further significant public support for the financial sector.

Unless these risks are adequately addressed and the consolidation plans fully implemented, the budgetary strategy may not be sufficient to bring the government debt ratio back on a declining path by the end of the programme period. The 60% of GDP Treaty reference value for debt would at any rate continue to be exceeded including in the final year of the programme, when the deficit-to-GDP ratio would, according to the programme, return to a value below the 3% of GDP threshold. It will therefore be important for the authorities to seize any further opportunities to accelerate the reduction of the gross debt ratio back towards the reference value.

From a broader perspective, backing up the programme's consolidation strategy and rigorously implementing it would also be appropriate given certain underlying factors underpinning the need for substantial fiscal consolidation. In particular, these relate to the high risks to the long-term sustainability of the public finances in view of the expected change in age-related expenditure in the medium term but 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.

It will be important to strengthen the budgetary strategy by addressing the risks to the budgetary targets outlined above. One factor which would help limit risks to the adjustment would be a further reinforcing of the Irish medium-term budgetary framework, which as discussed in Section 6.1 above has some weaknesses. In particular, strengthening the enforceable nature of the medium-term budgetary framework would increase the strategy's credibility. Further, closely monitoring adherence to the budgetary targets throughout the year will limit the risk of deviating from the targets in case of unfavourable growth-related revenue surprises or expenditure overruns.

\* \* \*

## ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned. It also assesses to what extent Country followed up on the Council's recommendation to report on progress made in the correction of the excessive deficit, in a separate chapter of the programme.

### (i) Model structure

The programme update broadly adheres to the code of conduct model structure. The programme uses the broad section outline with subsections corresponding to the model structure. Additional useful information is provided in a supplementary table comparing the main macroeconomic forecasts for Ireland in 2010.

### (ii) Data requirements

As regards the code of conduct data requirements, all compulsory data have been provided with the exception of the nominal effective exchange rate; EU GDP growth, and growth of relevant foreign markets. Gaps in optional data remain as follows: Table 1b (deflators for public consumption and investment); Table 1c (labour productivity, hours worked); Table 1d (components of sectoral balances); Table 2 (general government compensation of employees and intermediate consumption); Table 3 (general government expenditure by function); Table 4 (decomposition stock-flow adjustment; liquid financial assets and net financial debt) and Table 7. More significantly, the revenue and expenditure projections in the programme are of a technical nature rather than being targets.

The tables on the following pages show the data presented in the December 2009 update of the stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

### (iii) Separate chapter on progress made in the correction of the excessive deficit

In its recommendations under Article 126(7) of 2 December 2009 with a view to bringing the excessive deficit situation to an end, the Council also invited Ireland to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the stability programmes. Ireland partly complied with this recommendation. In particular, the revenue and expenditure projections in the outer years are of an indicative nature and the consolidation efforts in these years are not underpinned by broad measures.

### (iv) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

\* \* \*

The SCP...	Yes	No	Comments
<i>a. Involvement of parliament</i>			
... mentions status vis-à-vis national parliament.		X	
... indicates whether Council opinion on previous programme has been presented to national parliament.	X		
<i>b. Economic outlook</i>			
... (for euro area and ERM II Member States) uses "common external assumptions" on main extra-EU variables.	X		
... explains significant divergences with Commission services' forecasts <sup>1</sup> .		X	
... bears out possible upside/downside risks to economic outlook.	X		Provides a table on

The SCP...	Yes	No	Comments
			sensitivity analysis
... analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.		X	
<i>c. Monetary/exchange rate policy</i>			
... (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.			Not applicable
<i>d. Budgetary strategy</i>			
... presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
... (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.			Not applicable
... (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).		X	Reports on measures but no explicit reference to last SPU's very outdated targets
... backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.		X	Only for 2010
... specifies state of implementation of measures.		X	
<i>e. "Major structural reforms"</i>			
... (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.			Not applicable
... includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.			Not applicable
<i>f. Sensitivity analysis</i>			
... includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	X X		Impact on deficit only Change in world growth Not applicable Not applicable
... (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.			Not applicable
<i>g. Broad economic policy guidelines</i>			
... provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.		X	
<i>h. Quality of public finances</i>			
... describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
<i>i. Long-term sustainability</i>			
... outlines strategies to ensure sustainability.	X		
... includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).		X	Table 7 missing
<i>j. Other information (optional)</i>			
... includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		
<p><u>Notes:</u> SCP = stability/convergence programme; CP = convergence programme  <sup>1</sup>To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.</p> <p><u>Source:</u>  Commission services</p>			



## Tables from Annex 2 of the code of conduct

Table 1a. Macroeconomic prospects

	ESA Code	2008	2008	2009	2010	2011	2012	2013	2014
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. Real GDP</b>	B1*g	183991	n.a.	-7.5	-1.3	3.3	4.5	4.3	4.0
<b>2. Nominal GDP</b>	B1*g	181816	n.a.	-9.5	-2.2	5.6	6.7	6.5	6.1
<b>Components of real GDP</b>									
<b>3. Private consumption expenditure</b>	P.3	91055	n.a.	-7.2	-3.0	2.6	3.4	3.3	3.2
<b>4. Government consumption expenditure</b>	P.3	27991	n.a.	-0.6	-3.0	-0.5	-0.5	-0.5	-0.5
<b>5. Gross fixed capital formation</b>	P.51	41766	n.a.	-33.9	-19.2	4.5	7.8	8.5	7.8
<b>6. Changes in inventories and net acquisition of valuables (% of GDP)</b>	P.52 + P.53	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>7. Exports of goods and services</b>	P.6	151875	n.a.	-2.7	0.4	3.4	4.0	3.8	3.5
<b>8. Imports of goods and services</b>	P.7	131266	n.a.	-9.0	-2.8	2.6	2.9	3.0	2.8
<b>Contributions to real GDP growth</b>									
<b>9. Final domestic demand</b>		-	n.a.	-11.1	-4.8	1.8	2.7	2.7	2.6
<b>10. Changes in inventories and net acquisition of valuables</b>	P.52 + P.53	-	n.a.	-0.7	0.8	0.2	0.0	0.0	0.0
<b>11. External balance of goods and services</b>	B.11	-	n.a.	4.3	2.4	1.3	1.7	1.5	1.3

Table 1b. Price developments

	ESA Code	2008	2008	2009	2010	2011	2012	2013	2014
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. GDP deflator</b>		n.a.	n.a.	-2.2	-1.0	2.2	2.1	2.1	2.0
<b>2. Private consumption deflator</b>		n.a.	n.a.	-2.1	-0.8	1.6	1.8	2.0	1.9
<b>3. HICP<sup>1</sup></b>		n.a.	n.a.	-1.7	-1.2	1.0	1.7	1.8	1.8
<b>4. Public consumption deflator</b>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>5. Investment deflator</b>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>6. Export price deflator (goods and services)</b>		n.a.	n.a.	1.9	0.8	2.0	1.7	1.6	1.5
<b>7. Import price deflator (goods and services)</b>		n.a.	n.a.	1.3	0.5	0.7	1.0	1.1	1.1

<sup>1</sup> Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2008	2008	2009	2010	2011	2012	2013	2014
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. Employment, persons<sup>1</sup></b>		2100	n.a.	-7.8	-3.4	1.0	2.3	2.5	2.3
2. Employment, hours worked <sup>2</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>3. Unemployment rate (%)<sup>3</sup></b>		n.a.	6.3	11.8	13.2	12.6	11.8	10.8	9.5
<b>4. Labour productivity, persons<sup>4</sup></b>		n.a.	n.a.	0.4	2.3	2.3	2.1	1.7	1.7
5. Labour productivity, hours worked <sup>5</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>6. Compensation of employees</b>	D.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>7. Compensation per employee</b>		n.a.	n.a.	n.a.	optional	optional	optional	optional	optional

<sup>1</sup>Occupied population, domestic concept national accounts definition.

<sup>2</sup>National accounts definition.

<sup>3</sup>Harmonised definition, Eurostat; levels.

<sup>4</sup>Real GDP per person employed.

<sup>5</sup>Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013	2014
<b>1. Net lending/borrowing vis-à-vis the rest of the world</b>	B.9	n.a.	-2.0	0.6	1.2	1.6	1.6	1.3
<i>of which:</i>								
- Balance on goods and services		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Balance of primary incomes and transfers		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Capital account		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2. Net lending/borrowing of the private sector	B.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Net lending/borrowing of general government	EDP B.9	n.a.	-11.7	-11.6	-10.0	-7.2	-4.9	-2.9
<b>4. Statistical discrepancy</b>		n.a.	optional	optional	optional	optional	optional	optional

Table 2. General government budgetary prospects

	ESA Code	2008	2008	2009	2010	2011	2012	2013	2014
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector									
1. General government	S.13	-13038	-7.2	-11.7	-11.6	-10.0	-7.2	-4.9	-2.9
2. Central government	S.1311	-12451	-6.8	-10.2	-10.8	-9.9	-7.1	-4.8	-2.8
3. State government	S.1312	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	-333	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
5. Social security funds	S.1314	-254	-0.1	-1.3	-0.7	0.0	0.0	0.0	0.0
General government (S13)									
6. Total revenue	TR	63294	34.8	34.2	35.2	35.5	36.3	36.7	37.1
7. Total expenditure	TE <sup>1</sup>	76331	42.0	45.9	46.8	45.5	43.5	41.5	40.0
8. Net lending/borrowing	EDP B.9	-13037	-7.2	-11.7	-11.6	-10.0	-7.2	-4.9	-2.9
9. Interest expenditure	EDP D.41	1879	1.0	2.1	2.9	3.4	3.8	3.9	3.9
10. Primary balance <sup>2</sup>		-11158	-6.1	-9.6	-8.8	-6.6	-3.4	-1.0	1.0
11. One-off and other temporary measures <sup>3</sup>		-1409	-0.8	0.4	0.6	0.0	0.0	0.0	0.0
Selected components of revenue									
12. Total taxes (12=12a+12b+12c)		43040	23.7	21.4	20.9	22.1	23.1	23.6	24.3
12a. Taxes on production and imports	D.2	22149	12.2	11.0	11.0	11.5	11.8	12.0	12.3
12b. Current taxes on income, wealth, etc	D.5	20560	11.3	10.2	9.8	10.4	11.0	11.5	11.8
12c. Capital taxes	D.91	331	0.2	0.2	0.1	0.2	0.2	0.2	0.2
13. Social contributions	D.61	12501	6.9	7.7	8.2	8.1	8.0	7.9	7.8
14. Property income	D.4	2426	1.3	1.5	1.9	1.6	1.6	1.7	1.7
15. Other <sup>4</sup>		5327	2.9	3.6	4.1	3.7	3.7	3.5	3.4
16=6. Total revenue	TR	63294	34.8	34.2	35.2	35.5	36.3	36.7	37.1
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995) <sup>5</sup>			30.8	29.4	29.4	30.4	31.3	31.7	32.1
Selected components of expenditure									
17. Compensation of employees + intermediate consumption	D.1+P.2	30884	17.0	18.7	16.7	15.8	15.0	14.4	14.0
17a. Compensation of employees	D.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
17b. Intermediate consumption	P.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18. Social payments (18=18a+18b)		25181	13.8	16.3	17.8	17.3	16.6	16.1	15.6
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	2853	1.6	1.7	1.7	1.7	1.6	1.5	1.5
18b. Social transfers other than in kind	D.62	22328	12.3	14.6	16.0	15.6	15.0	14.5	14.1
19=9. Interest expenditure	EDP D.41	1879	1.0	2.1	2.9	3.4	3.8	3.9	3.9
20. Subsidies	D.3	1083	0.5	0.5	0.6	0.6	0.5	0.4	0.5
21. Gross fixed capital formation	P.51	9814	5.4	4.8	4.5	3.8	3.8	3.7	3.6
22. Other <sup>6</sup>		7730	4.3	3.5	4.3	4.6	3.8	3.0	2.4
23=7. Total expenditure	TE <sup>1</sup>	76331	42.0	45.9	46.8	45.5	43.5	41.5	40.0
p.m.: Government consumption (nominal)	P.3	32189	17.7	19.1	17.2	16.8	15.9	15.5	14.9

<sup>1</sup>Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.<sup>2</sup>The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).<sup>3</sup>A plus sign means deficit-reducing one-off measures.<sup>4</sup>P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).<sup>5</sup>Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.<sup>6</sup>D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

**Table 3. General government expenditure by function**

% of GDP	COFOG Code	2007	2012
1. General public services	1	n.a.	n.a.
2. Defence	2	n.a.	n.a.
3. Public order and safety	3	n.a.	n.a.
4. Economic affairs	4	n.a.	n.a.
5. Environmental protection	5	n.a.	n.a.
6. Housing and community amenities	6	n.a.	n.a.
7. Health	7	n.a.	n.a.
8. Recreation, culture and religion	8	n.a.	n.a.
9. Education	9	n.a.	n.a.
10. Social protection	10	n.a.	n.a.
11. Total expenditure (=item 7=23 in Table 2)	TE <sup>1</sup>	n.a.	n.a.

<sup>1</sup>Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

**Table 4. General government debt developments**

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013	2014
<b>1. Gross debt<sup>1</sup></b>		n.a.	64.5	77.9	82.9	83.9	83.3	80.8
<b>2. Change in gross debt ratio</b>		n.a.	20.4	13.4	5.0	1.0	-0.6	-2.5
<b>Contributions to changes in gross debt</b>								
<b>3. Primary balance<sup>2</sup></b>		n.a.	-9.6	-8.8	-6.6	-3.4	-1.0	1.0
<b>4. Interest expenditure<sup>3</sup></b>	EDP D.41	n.a.	2.1	2.9	3.4	3.8	3.9	3.9
<b>5. Stock-flow adjustment</b>		n.a.	4.1	0.3	-0.9	-0.9	-0.3	-0.6
<i>of which:</i>								
- Differences between cash and accruals <sup>4</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets <sup>5</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>of which:</i>		-	-	-	-	-	-	-
- privatisation proceeds		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other <sup>6</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>p.m.: Implicit interest rate on debt<sup>7</sup></b>		n.a.	4.2	4.3	4.7	4.8	4.9	5.0
<b>Other relevant variables</b>								
<b>6. Liquid financial assets<sup>8</sup></b>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>7. Net financial debt (7=1-6)</b>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

<sup>1</sup>As defined in Regulation 3605/93 (not an ESA concept).

<sup>2</sup>Cf. item 10 in Table 2.

<sup>3</sup>Cf. item 9 in Table 2.

<sup>4</sup>The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

<sup>5</sup>Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

<sup>6</sup>Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

<sup>7</sup>Proxied by interest expenditure divided by the debt level of the previous year.

<sup>8</sup>AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013	2014
<b>1. Real GDP growth (%)</b>		n.a.	-7.5	-1.3	3.3	4.5	4.3	4.0
<b>2. Net lending of general government</b>	EDP B.9	-7.2	-11.7	-11.6	-10.0	-7.2	-4.9	-2.9
<b>3. Interest expenditure</b>	EDP D.41	n.a.	2.1	2.9	3.4	3.8	3.9	3.9
<b>4. One-off and other temporary measures<sup>1</sup></b>		n.a.	0.4	0.6	0.0	0.0	0.0	0.0
<b>5. Potential GDP growth (%)</b>		n.a.	-0.6	-1.4	-0.2	1.8	2.5	3.1
contributions:								
- labour		n.a.	-1.7	-2.3	-1.4	0.3	0.6	0.8
- capital		n.a.	0.5	0.2	0.2	0.3	0.4	0.5
- total factor productivity		n.a.	0.6	0.8	1.0	1.2	1.5	1.7
<b>6. Output gap</b>		n.a.	-7.0	-6.9	-3.7	-1.1	0.6	1.5
<b>7. Cyclical budgetary component</b>		n.a.	-2.8	-2.8	-1.5	-0.4	0.3	0.6
<b>8. Cyclically-adjusted balance (2 - 7)</b>		n.a.	-8.9	-8.8	-8.5	-6.8	-5.2	-3.5
<b>9. Cyclically-adjusted primary balance (8 + 3)</b>		n.a.	-6.8	-5.9	-5.1	-3.0	-1.3	0.4
<b>10. Structural balance (8 - 4)</b>		n.a.	-9.3	-9.4	-8.5	-6.8	-5.2	-3.5

<sup>1</sup>A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2008	2009	2010	2011	2012	2013	2014
<b>Real GDP growth (%)</b>								
Previous update		n.a.	-4.0	-0.9	2.3	3.4	3.0	n.a.
Current update		n.a.	-7.5	-1.3	3.3	4.5	4.3	4.0
Difference		n.a.	-3.5	-0.4	1.0	1.1	1.3	n.a.
<b>General government net lending (% of GDP)</b>	EDP B.9							
Previous update		n.a.	-9.5	-9.0	-6.4	-4.8	-2.6	n.a.
Current update		n.a.	-11.7	-11.6	-10.0	-7.2	-4.9	-2.9
Difference		n.a.	-2.2	-2.6	-3.6	-2.4	-2.3	n.a.
<b>General government gross debt (% of GDP)</b>								
Previous update		n.a.	52.7	62.3	65.7	66.2	64.5	n.a.
Current update		n.a.	64.5	77.9	82.9	83.9	83.3	80.8
Difference		n.a.	11.8	15.6	17.2	17.7	18.8	n.a.

**Table 7. Long-term sustainability of public finances**

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Old-age and early pensions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other pensions (disability, survivors)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Long-term care ( <i>this was earlier included in the</i>	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Education expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Of which</i> : from pensions contributions (or social contributions if appropriate)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Of which</i> : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Assumptions</b>						
Labour productivity growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Real GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Participation rate males (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Participation rates females (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total participation rates (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Unemployment rate	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Population aged 65+ over total population	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

**Table 8. Basic assumptions**

	2008	2009	2010	2011	2012	2013	2014
Short-term interest rate <sup>1</sup> (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Long-term interest rate (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
USD/€ exchange rate (annual average) (euro area and ERM II countries)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Nominal effective exchange rate	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
EU GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Growth of relevant foreign markets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World import volumes, excluding EU	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Oil prices (Brent, USD/barrel)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

<sup>1</sup>If necessary, purely technical assumptions.