COUNCIL OPINION

of 10 March 2009

on the updated stability programme of Ireland, 2008-2013

(2009/C 68/02)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 10 March 2009, the Council examined the updated stability programme of Ireland ([2]), which covers the period 2008 to 2013.

(2) After more than a decade of strong economic growth which had become increasingly driven by domestic demand, Ireland is now going through a severe recession. The downturn was caused by the sharp correction in the housing market and has since spread to the wider economy, aggravated by the global financial crisis and the recession in Ireland's main trading partners.

These developments have also led to a very sharp deterioration of the public finances (with the general government balance going from a small surplus in 2007 to a deficit of 6,3 % of GDP in 2008). Against this background, the authorities have adopted consolidation measures in different steps starting in mid-2008. In this context, measures have also been taken to strengthen purchasing power and support an orderly adjustment in the property market while refocusing public investment on key projects. The key challenge for the years ahead is the implementation of a credible and sustainable fiscal consolidation strategy with a view to restoring market confidence, while at the same time redirecting resources from construction to more productive sectors and regaining competitiveness through measures enhancing productivity growth and adequate wage policies. The continued fragility of the financial sector might hamper the adjustment process in the short run and put further strain on the public finances. With a view to improving their long-term sustainability, reforming the pension system is another important challenge.

(3) The macro-economic scenario underlying the programme envisages that the contraction of real GDP by 1,4 % in 2008 will be followed by further declines by 4,0 % in 2009 and 0,9 % in 2010 before growth recovers to an average rate of 2,9 % over the rest of the programme period. When assessed against currently available information ([3]), these growth assumptions appear broadly plausible up to 2010. From 2011 onwards, the projected economic growth appears rather optimistic. The programme's projections for inflation appear realistic. The same applies to the outlook for the external deficit and competitiveness.

([1]) OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

([2]) Including the addendum submitted on 9 January 2009.

([3]) The assessment notably takes into account the Commission services' January 2009 forecast, but also other information that has become available since then.

(4) For 2008, the general government deficit is estimated at 6,3 % of GDP in the Commission services' January 2009 interim forecast, against a target of 0,9 % of GDP set in the previous update of the stability programme ([1]). This significantly worse-than-expected outturn reflects both a considerable tax shortfall and some expenditure overruns ([2]). Tax revenue targets were not met due to the permanent loss of housing boom-related revenue and lower-than-expected economic activity more generally. While in July 2008 some measures were taken to limit the increase in expenditure, spending growth was higher than planned, especially in social transfers, interest expenditure and public investment. Social transfers are fulfilling their role as automatic stabilisers, as reflected in higher unemployment-related spending.

(5) The general government deficit is targeted to widen to 9,5 % of GDP in 2009, mainly reflecting the economic slump. The government has carried out a discretionary tightening amounting to close to 3 % of GDP. At the same time, some measures have been adopted providing support to the economy in reaction to the downturn, in the order of 0,5 % of GDP. Taken together, this implies an overall tightening of around 2,5 % of GDP. This tightening includes a package announced in the addendum without providing details and therefore not incorporated in the Commission services' interim forecast. It is assessed by the Commission to generate net savings in 2009 amounting to 0,8 % of GDP; slightly below the 1 % of GDP announced by the government ([3]). Despite the tightening, the structural deficit (as recalculated by the Commission services on the basis of information in the programme) is estimated to widen by 2 percentage points of GDP, due to the loss of tax revenue linked to the ongoing adjustment in the housing market, difficulties in bringing down spending growth sufficiently quickly as well as a sharp downward revision in potential growth.

(6) The government's medium-term budgetary strategy is to bring the headline deficit below the 3 % of GDP reference value by 2013. The decline in the deficit would start in 2010 and would accelerate from 2011. The programme provides no indications as to when the medium-term objective (MTO) should be met ([4]). While an annual consolidation objective amounting to a cumulated effort of around 7 % of GDP in nominal terms is announced from 2010 onwards, no specific measures are set out. The indicative projections of the addendum envisage a mainly expenditure-based consolidation strategy. Over the programme period, the revenue ratio is expected to increase slightly (by 0,75 percentage point of GDP), while the primary expenditure ratio is projected to decline markedly (by around 5,25 percentage points), especially in social transfers and government consumption. Interest expenditure as a share of GDP is expected to treble over the programme period, to 3,5 % of GDP. The fast rise in the deficit, falling nominal GDP and sizeable stock-flow adjustment in 2008 linked to a deliberate build-up of liquidity contribute to a doubling of the debt ratio between 2007 and 2009 and a breach of the 60 % of GDP reference value from 2010.

(7) The budgetary outcomes are subject to downside risks throughout the programme period. First, significant risks stem from the lack of information on the planned consolidation strategy after 2009, in particular as regards the trajectory for expenditure and revenue, especially in view of the importance given to expenditure restraint. ([5]) Second, growth projections in the economic scenario might be favourable, especially in the outer years of the programme. In view of the negative risks to the deficit targets, the evolution of the debt ratio is also likely to be less favourable than projected in the programme. In addition, specific risks relate to contingent liabilities arising from the financial crisis, in particular from possible further capital injections into banks (debt) and the government's bank guarantees (deficit and debt, if called).

([1]) The addendum estimates the deficit outcome for 2008 at 6,3 % of GDP. In view of the reported breach of the Treaty reference value, the Commission prepared on 18 February 2009 a report under Article 104(3) of the Treaty.

([2]) The higher-than-expected expenditure is explained by (i) higher-than-planned social transfers; (ii) increased interest expenditure; and (iii) unbudgeted capital investment, including the purchase of the Westlink toll bridge at a cost of 0,3 % of GDP.

([3]) In early February, the government specified the package, which consists of a pension levy on public sector wages (tentatively estimated at 0,5 % of GDP on a full-year basis, taking into account the levy's tax deductibility), further cuts in public investment (0,2 % of GDP) and other smaller expenditure-saving measures (adding up to 0,2 % of GDP on a full-year basis).

([4]) The programme contains for the first time a quantification of the MTO, which should be a structural balance (i.e. a cyclically-adjusted balance net of one-off and other temporary measures) in the range of – 0,5 % to 0 % of GDP, compared to the previous indication of a position of 'close to balance'.

([5]) The national authorities have announced that policy decisions in relation to the allocation between expenditure and revenue measures of the planned consolidation will be announced in subsequent budgets.

(8) The long-term budgetary impact of ageing in Ireland is well above the EU average, mainly as a result of a relatively high projected increase in pension expenditure over the coming decades. The budgetary position in 2008 as estimated in the programme, which is markedly worse than the starting position of the previous programme, compounds the budgetary impact of population ageing on the sustainability gap. If the 2009 budgetary position as projected by the Commission services' interim forecast was taken as the starting point, the sustainability gap would widen substantially. While assets have been accumulated in the National Pension Reserve Fund (NPRF) in order to pre-fund part of future pension expenditure, gross debt is projected to exceed the Treaty reference value within the programme period. Reducing the high primary deficit over the medium term, as foreseen in the programme, and implementing reform measures that curb the substantial increase in age-related expenditure would contribute to reducing the high risks to the sustainability of public finances. The above-mentioned risks from financial sector stabilisation schemes put in place by Ireland could have a potential negative impact on the long-term sustainability of public finances, primarily via their impact on government debt, if the costs of the government support are not fully recouped in the future.

(9) Ireland's medium-term budgetary framework has some weaknesses. In particular, budgetary targets for the years beyond that covered by the budget, especially expenditure envelopes, can be changed in subsequent budgets. 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. At the same time, it might limit their ability to commit credibly to a consolidation strategy in difficult times. While these issues are not directly addressed in the programme, the government has established a Commission on Taxation and a 'Special Review Group on Public Service Expenditure and Numbers' to make recommendations for the improvement of the taxation system and of public expenditure programmes respectively. The reports of these groups are expected in the course of 2009 and the national authorities have indicated that the recommendations will feed into the decision-making process for the 2010 budget and subsequent budgets.

(10) Ireland adopted several measures to safeguard the stability of the financial sector. The statutory limit for the deposit guarantee scheme was increased to EUR 100 000 per depositor. Guarantees to covered banks were put in place in an estimated amount of EUR 400 billion. A recapitalisation programme of EUR 10 billion (5 % of GDP) for three major banks, intended to be financed at least partly from the NPRF, was announced in December. However, one of the concerned banks was instead later taken into public ownership. The capital injections (EUR 7 billion announced on February 11 for the remaining two banks) are to be funded from the NPRF and future contributions to it.

(11) Fiscal policy in 2009 is overall consolidating the budget, which is adequate and in line with the European Economic Recovery Plan agreed in December 2008 by the European Council, in view of the high deficit and sharply increasing debt position. Moreover, in line with the EERP, Ireland adopted a number of measures to support economic activity and to enhance structural reforms. This package is an adequate response to the macro-fiscal situation. The measures taken by the Irish authorities focus on support to households' purchasing power and investment and are timely and targeted. Specific measures were taken to support the adjustment process in the housing market, where the current economic downturn started, while other measures were targeted specifically at the most vulnerable groups likely to be most affected by the crisis, including a social welfare package. The measures are of a permanent rather than temporary nature but this has to be seen in the light of the fact that the overall budgetary strategy is deficit-reducing. Furthermore, support to the recovery would come from structural measures such as continued high public investment in the framework of Ireland's multi-annual National Development Plan (around 4,5 % of GDP annually over the programme period) and tax advantages for R & D activities and small start-up companies. These measures are related to the medium-term reform agenda and the country-specific recommendations proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs.

(12) After the further deterioration in 2009, the deficit is projected to narrow progressively. However, a reduction of the headline deficit below 3 % of GDP by 2013, as envisaged in the programme, will require addressing the above-mentioned significant risks to the budgetary targets and standing ready to adopt additional measures if necessary. The fiscal consolidation plans should be backed up with measures.

(13) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data ([1]).

The overall conclusion is that, following a very sharp deterioration in 2008, the general government deficit will widen further in 2009, to 9,5 % of GDP. The fiscal consolidation measures and the measures to support the economy can be regarded as welcome and adequate given the high deficit and sharply increasing debt position and are in line with the European Economic Recovery Plan. After the budgetary deterioration in 2009, the programme envisages a reduction of the deficit below the 3 % of GDP reference value by 2013, while debt would breach the 60 % of GDP reference value from 2010. This would take place against the background of a rapid recovery of economic activity after 2010. The budgetary outcomes are subject to downside risks throughout the programme period, mainly due to (i) the lack of information on the envisaged consolidation measures after 2009; and (ii) the favourable macro-economic outlook especially in the outer years of the programme. Further risks stem from the measures in place to support the financial sector. There is a need to regain competitiveness through measures enhancing productivity growth and adequate wage policies. A reduction of the headline deficit below 3 % of GDP by 2013, as envisaged in the programme, will require addressing the significant risks to the budgetary targets and standing ready to adopt additional measures if necessary. Also with a view to improving the long-term sustainability of public finances, the fiscal consolidation plans should be backed up with measures.

In view of the above assessment Ireland is invited to:

(i) limit the widening of the deficit in 2009 and specify and rigorously implement substantial annual efforts within a broad-based fiscal consolidation programme for 2010 and beyond;

(ii) in order to limit risks to the adjustment, strengthen the binding nature of the medium-term budgetary framework as well as closely monitor adherence to the budgetary targets throughout the year;

(iii) in view of the significant projected increase in age-related expenditure, and also of the increase in debt, albeit from a low level, expected over the programme period, improve the long-term sustainability of public finances by implementing further pension reform measures in addition to pursuing fiscal consolidation.

Comparison of key macro-economic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	**SP Jan 2009**	**6,0**	**– 1,4**	**– 4,0**	**– 0,9**	**2,3**	**3,4**	**3,0**
	COM Jan 2009	6,0	– 2,0	– 5,0	0,0	n.a.	n.a.	n.a.
	SP Nov 2007	*4,8*	*3,0*	*3,5*	*4,1*	*n.a.*	*n.a.*	*n.a.*
HICP inflation (%)	**SP Jan 2009**	**2,8**	**3,1**	**0,5**	**1,5**	**1,8**	**1,8**	**1,8**
	COM Jan 2009	2,9	3,1	0,7	1,8	n.a.	n.a.	n.a.
	SP Nov 2007	*2,8*	*2,4*	*2,0*	*1,8*	*n.a.*	*n.a.*	*n.a.*

([1]) In particular, where required data are concerned, only nominal effective exchange rate, EU GDP growth and growth of relevant foreign markets were not provided. On the optional data side, gaps include sectoral balances and government expenditure by function.

		2007	2008	2009	2010	2011	2012	2013
Output gap [1] (% of potential GDP)	**SP Jan 2009**	**4,4**	**0,5**	**– 3,5**	**– 4,1**	**– 3,4**	**– 1,6**	**– 0,5**
	COM Jan 2009 [3]	4,4	0,1	– 4,5	– 4,2	n.a.	n.a.	n.a.
	SP Nov 2007	*– 0,5*	*– 1,3*	*– 1,5*	*– 0,7*	*n.a.*	*n.a.*	*n.a.*
Net lending/borrowing *vis-à-vis* the rest of the world (% of GDP)	**SP Jan 2009**	**– 5,4**	**– 6,3**	**– 4,2**	**– 3,5**	**– 3,4**	**– 3,0**	**– 2,8**
	COM Jan 2009	– 5,4	– 5,7	– 3,3	– 3,2	n.a.	n.a.	n.a.
	SP Nov 2007	*– 4,4*	*– 3,9*	*– 3,5*	*– 3,1*	*n.a.*	*n.a.*	*n.a.*
General government revenue (% of GDP)	**SP Jan 2009**	**35,7**	**33,6**	**33,7**	**34,4**	**34,6**	**33,9**	**34,4**
	COM Jan 2009	35,7	33,7	33,7	33,9	n.a.	n.a.	n.a.
	SP Nov 2007	*36,6*	*36,1*	*35,8*	*35,4*	*n.a.*	*n.a.*	*n.a.*
General government expenditure (% of GDP)	**SP Jan 2009**	**35,4**	**39,9**	**43,3**	**43,4**	**41,0**	**38,7**	**37,0**
	COM Jan 2009	35,4	40,0	44,7	46,9	n.a.	n.a.	n.a.
	SP Nov 2007	*36,1*	*37,0*	*36,9*	*36,5*	*n.a.*	*n.a.*	*n.a.*
General government balance (% of GDP)	**SP Jan 2009** [2]	**0,2**	**– 6,3**	**– 9,5**	**– 9,0**	**– 6,4**	**– 4,8**	**– 2,6**
	COM Jan 2009	0,2	– 6,3	– 11,0	– 13,0	n.a.	n.a.	n.a.
	SP Nov 2007	*0,5*	*– 0,9*	*– 1,1*	*– 1,0*	*n.a.*	*n.a.*	*n.a.*
Primary balance (% of GDP)	**SP Jan 2009**	**1,2**	**– 5,2**	**– 7,3**	**– 6,4**	**– 3,5**	**– 1,7**	**0,7**
	COM Jan 2009	1,2	– 5,2	– 8,7	– 10,3	n.a.	n.a.	n.a.
	SP Nov 2007	*1,4*	*0,0*	*– 0,1*	*0,0*	*n.a.*	*n.a.*	*n.a.*
Cyclically-adjusted balance [1] (% of GDP)	**SP Jan 2009**	**– 1,5**	**– 6,5**	**– 8,1**	**– 7,4**	**– 5,0**	**– 4,1**	**– 2,4**
	COM Jan 2009	– 1,5	– 6,3	– 9,1	– 11,3	n.a.	n.a.	n.a.
	SP Nov 2007	*0,7*	*– 0,4*	*– 0,5*	*– 0,7*	*n.a.*	*n.a.*	*n.a.*
Structural balance [4] (% of GDP)	**SP Jan 2009**	**– 1,7**	**– 6,2**	**– 8,1**	**– 7,4**	**– 5,0**	**– 4,1**	**– 2,4**
	COM Jan 2009	– 1,5	– 6,3	– 9,4	– 11,3	n.a.	n.a.	n.a.
	SP Nov 2007	*0,5*	*– 0,4*	*– 0,5*	*– 0,7*	*n.a.*	*n.a.*	*n.a.*

		2007	2008	2009	2010	2011	2012	2013
Government gross debt (% of GDP)	**SP Jan 2009**	**24,8**	**40,6**	**52,7**	**62,3**	**65,7**	**66,2**	**64,5**
	COM Jan 2009	24,8	40,8	54,8	68,2	n.a.	n.a.	n.a.
	SP Nov 2007	*25,1*	*25,9*	*27,6*	*28,7*	*n.a.*	*n.a.*	*n.a.*

Notes:

([1]) Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

([2]) The targets for the general government balance include as yet unspecified additional annual consolidation measures of 2,25% of GDP in 2010, 2 % in 2011, 1,75% in 2012, and 1,5% in 2013. The additional consolidation measures for 2009 (1 % of GDP) are in the process of being specified.

([3]) Based on estimated potential growth of 4,0 %, 2,2 %, – 0,4 % and – 0,4 % respectively in the period 2007-2010.

([4]) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0,3 % of GDP in 2008 (deficit-increasing) according to the most recent programme and 0,3 % in 2009 (deficit-reducing) according to the Commission services' January interim forecast.

Source:

Stability programme (SP); Commission services' January 2009 interim forecasts (COM); Commission services' calculations.