An Roinn Airgeadais
Department of Finance

Oifig an Aire
Office of the Minister

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Ms. Sharon Bowles
Chairwoman
Committee on Economic and Monetary Affairs
European Parliament

20 December 2013

Dear Ms. Bowles

I refer to your letter dated 21 November 2013 and the accompanying questionnaire concerning the European Parliament's own initiative report on Troika (European Commission, ECB and IMF) actions in euro area programme countries. In relation to part B of this questionnaire, directed to Member States under a financial programme, I attach a reply on behalf of the Government of Ireland.

Yours sincerely

Michael Noonan T.D.,
Minister for Finance

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B. Questionnaire sent to the Member States under a financial assistance programme

Response from Mr Michael Noonan, Minister for Finance, Ireland.

1. **If applicable, why did your country decide to request a financial assistance programme?**

The world financial crisis, which emerged in 2008 triggered risks in the Irish economy which had been developing in the previous years of the decade. Domestically, the sharp liquidity constraint which was a consequence of global developments was followed by a solvency crisis due to falling asset prices in the property sector and the knock on impact of these changes.

Prior to the crisis, Ireland's tax base had become too reliant on transaction taxes related to the property and construction sectors, which led to a dramatic fall in tax revenue once construction activity slowed. Additionally, through a long series of public policy initiatives Government expenditure had increased steadily throughout the 2000s and combined with the subsequent rapid fall in economic activity, this meant that the Public Finances had to be financed through the issuance of Government debt. The policy response to the deterioration in the State's public finances was to implement a front-loaded programme of fiscal correction that would gradually reduce the deficit and return the State's finances to a sustainable position.

As bank lending was also highly concentrated in the property and construction sectors, the slowdown significantly affected bank balance sheets which led to the need for State support. It should be noted that 30% of the existing debt ratio (as of September 2013) relates to the bail-out by the Irish Government of the Irish banks. At the time of our banking crisis the option now being seen at a European level - bailing-in the senior bondholders - was not available to the Irish Authorities and meant that the burden had to be borne by the equity holders, the junior bondholders, and particularly by the Sovereign which latter ultimately meant the Irish taxpayer. I understand that the previous Government sought to include senior bondholders in resolving banks in wind down, in our case Irish Bank Resolution Corporation (IBRC), but this was prevented by the troika. The approach adopted by the previous Government reflected the views at the time, that sovereign support for banks was necessary to avoid contagion.

By the autumn of 2010 the loss of investor confidence in Ireland triggered a vicious cycle. The assistance of our EU partners and the IMF was therefore sought because of the high yields on Irish bonds, which curtailed the State's ability to borrow. Without this external support, the State would not have been able to raise the funds required to pay for key public services for our citizens and to provide a functioning banking system to support economic activity. The programme provided funding at reasonable rates, and provided the space for Ireland to implement its adjustment in a gradual manner. This support was needed to safeguard financial stability in the euro area and the EU as a whole.

2. **What was your role and function in the negotiation and set-up of the financial assistance programme for your country?**

The Programme was negotiated by senior officials from the Department of Finance and the National Treasury Management Agency (NTMA) our Debt Management Office, on the basis *of a mandate from the then Government, and the Central Bank of Ireland, which is independent. The Government at the time had, shortly before the application was made, published its National Recovery Plan, setting out macroeconomic, structural reform and fiscal policies to address the crisis. The design of the programme was reflective of the National Recovery Plan. The programme agreed by the Troika and Irish negotiators was submitted to the then Government for its approval, and, following that approval, the programme was discussed at a specially convened Eurogroup and ECOFIN meeting on 28th November 2010.*

Following a general election in early February 2011, there was a change of Government. The newly elected Government sought and achieved a number of important changes to the programme conditions. The new Government nevertheless committed to implementing the programme as amended, in order to ensure that funding would continue to be available, and also that Ireland could be put on the road to recovery.

The programme was subject to quarterly reviews of progress and implementation. This process provided for review and revision of the commitments in light of domestic and international developments. In that context the Government used the process to have their policy priorities reflected in the programme – notably in relation to reversal of the minimum wage reduction, use of some privatisation receipts in employment enhancing projects of a commercial nature , changes to bank deleveraging targets, ending transfers of lower value loans to NAMA and the introduction of the jobs initiative. It should also be noted that an integral part of the review mission process was the engagement of Troika Mission principals with the political system, and in particular with the responsible Ministers – i.e. the Minister for Finance and the Minister for Public Expenditure and Reform.

3. **What was the role of the national Parliament in the negotiation of the MoU? How did the government present the text to the Parliament? How did the Parliament adopt the final MoU? Did social partners take part in the discussion on MoU?**

The negotiation and approval of the Memorandum of Understanding was carried out in accordance with Ireland's Constitutional and legislatively mandated procedures. The technical negotiation of the programme conditions, as set out in the MoU, was led by senior officials on the basis of a mandate provided by Government, along with the participation of the Central Bank and the NTMA. In addition, the legislative and fiscal measures in the programme required the approval of the Oireachtas (Parliament) in the normal course. The application for financial assistance was the subject of two Dáil debates during December 2010, the second of which resulted in a vote in favour of the programme conditions. In addition, following each review, the updated programme documents were laid before the Houses of the Oireachtas, once finalised. The social partnership process had been an integral part of the policy making framework for over two decades up to 2010. While dialogue continued with the social partners, they had no explicit role in the negotiations process.

4. **How much leeway did you have to decide upon the design of the necessary measures (consolidation or structural reforms)? Please explain.**

As already noted, the design of the initial programme measures reflected the assessment of the national authorities of the measures which would be required to meet the fiscal *adjustment and structural reform required. The change of Government following the election in February 2011 was reflected in a number of important changes to the programme conditions. In relation to financial sector reform, a similar process was in play. However, measures which had been set out in the Financial Sector Restructuring addressed the key issues in that sector. It should be noted however, that at the time of the banking crisis the option now being seen at a European level - bailing-in the senior bondholders - was not available to the Irish Authorities despite the previous Government seeking this option for banks in wind down. This meant that the burden had to be borne by the equity holders, the junior bondholders, and particularly by the Sovereign which latter ultimately meant the Irish taxpayer. The approach adopted reflected the views at the time, that sovereign support for banks was necessary to avoid contagion.*

5. Do you consider that that all consolidation measures/structural reforms were equally spared/divided among citizens? Please explain.

The Programme for Government contains a commitment to require all public bodies to take due note of equality and human rights in carrying out their functions. In practice, this means that when considering how a consolidation measure is formulated, a statement on the likely effects of the decision sought on equality and persons experiencing or at risk of poverty or social exclusion must be included in Memoranda to Government. Consequently, the Government considers the issue of whether the impact of a measure will have undue consequences for a particular portion of the population, both at an individual policy and at programme level.

It is through the above mentioned methods, that the Government seeks to spread the burden of consolidation in as fair and equitable a manner as possible. This is evident in the progressivity rating of the Irish taxation system which, using the standardised OECD methodology, is more progressive than any other EU member of the OECD.

With regard to the distribution among citizens, a distributional analysis of taxation measures is performed in each Budget based on various income levels for the different categories of income earners. These categories include single individuals, married one-earner couples with no children and married one-earner couples with children. In addition, a distributional impact analysis which models the impacts on disposable income by income decile using SWITCH, the ESRI Tax-Benefit model, is also undertaken in evaluating the various policy measures introduced in the Budget. An example of this distributional analysis can be seen in Annex F of the Budget 2013 publication, which modelled recent budgets and progressivity issues and the cumulative impact of budgetary policy over the period since the initial budgetary response to the emerging crisis in October 2008.

This issue has been examined by the independent Economic and Social Research Institute,(the ESRI), in a recently published assessment of the distributional impact of the budgetary adjustments undertaken since the onset of the financial crisis in 2008 (Distributional Impact of Tax, Welfare and Public Service Pay Policies: Budget 2014 and Budgets 2009-2014. http://www.esri.ie/news_events/latest_press_releases/distributional-impact-of-/index.xml). This considered all budgets from October 2008, including budgets before the programme started, and of course those introduced during the years of the programme. Over the full period from 2009 to 2014, the study found that all income groups experienced losses. For most income groups, the income loss was in a narrow range, between

11 and 12 per cent. The greatest losses were for those in the highest 10 per cent of household income (adjusted for family size). This group saw losses of about 15½ per cent, mainly from tax increases and reductions in public service pay. At the other end of the income scale, policy-induced losses were somewhat higher than average (about 12½ per cent) for those with the lowest incomes. These results do not conform with either a progressive pattern (losses increasing with income) or regressive pattern (losses declining with income). Over a substantial range the pattern is broadly proportional – similar percentage losses for each income group. According to the ESRI's analysis, the greatest policy-induced losses have been at the top of the income distribution, and the next greatest losses at the bottom.

6. Please describe the quality of the cooperation between your authorities and the Troika institutions on site.

The discussions between the Troika and the Irish authorities were conducted in a constructive manner focussing on the common aim of achieving Ireland's successful exit from the programme. It is important to note that the programme provided funding at reasonable rates, and provided the space for Ireland to implement its adjustment in a gradual manner. It is also important to recognise the importance of liquidity support provided by the ECB to ensure our banking system could continue to operate smoothly while undergoing significant restructuring.

7. What impact did the entry into force of Regulation (EU) No 472/2013 have on the implementation of the programmes? Did you make use of the provisions of the Regulation, particularly Article 7 (11)? If not, why?

The entry into force of Regulation (EU) No 472/2013 resulted in a new legislative base for Ireland's programme, and required an appropriate amendment of the Council Implementing decision to reflect this fact. It also required the preparation of a report under Article 7(9) of the Regulation which has also been completed. As the programme was well performing, and as the Regulation entered into force shortly before our exit, the impact was somewhat limited. In relation to Article 7 (11), the Troika accepted an invitation from the Joint Oireachtas Committee on Finance, Public Expenditure and Reform to appear before it in July 2012 (before the Regulation entered into force). A repeat invitation could not be accommodated before the end of the Programme due to time constraints. It should also be noted that the Troika regularly met representatives of the three main opposition parties/groupings during their quarterly review missions.

8. How many cases of infringement of national law challenging the legality of the decisions arising out of the MoU are you aware of in your country?

The challenges to the legality of decision arising out of the MoU have related to financial sector measures.

- *Challenges to the making of a subordinated liabilities order which altered the terms and conditions of subordinated bonds issued by a credit institution in the State.*

- *Challenges to direction orders given to a financial institution to accept government investment in a specified manner.*

9. **Are you satisfied with the objectives and the effective outcomes of the programme in your country?**

The response to this question should be seen in the context of the replies provided to the previous 8 questions. The key objectives of our programme were to address financial sector weaknesses, to put Ireland's economy on a path of sustainable growth, to strengthen our public finances, to boost job creation, and to fully regain international capital market access. Now, as we have successfully exited our programme we are beginning to reap the rewards of our sustained efforts. Economic growth has returned, albeit at a slower pace than was anticipated at the start of the programme. The public finances have been put on a sustainable footing and unemployment is declining slowly but steadily. Importantly, we have also successfully returned to financial market funding. The financial sector has undergone significant restructuring since the beginning of the crisis and we will continue to progress this agenda. All of this has been achieved by steadfast implementation and delivery of our commitments under the programme and complemented by European decisions that led to a reduction of the interest rates and an extension of the maturities of the EFSF and EFSM loans.

Our programme can be viewed as being successful in that respect. However, a number of significant challenges remain. Our unemployment, though falling, remains high and this needs to be addressed, particularly in relation to youth unemployment. Our overall level of debt remains high – and is expected to peak this year at slightly over 120% of GDP. As already noted, a substantial portion of this relates to legacy debt in the banking sector, and we continue to explore ways of reducing this burden.

Ireland's exit from the EU/IMF Programme is the result of the commitment and determination of the Irish people to get the job done. The Irish Economy is recovering, the public finances are under control, the banking system is restructured and well capitalized and, most importantly, jobs are being created. Market confidence in Ireland is high and we will be making a full return to normal market funding early in the new year. We have been working to the objective of programme exit for the past three years and we will now return to being a normal Eurozone member state, with normal market funding arrangements. This is an important milestone on Ireland's recovery and will send a further signal that Ireland is recovering, returning to normal market funding and building for a sustainable future.

20 *December 2013*