COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 22.2.2006
SEC(2006) 230 final

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of Ireland, 2005-2008

(presented by the Commission)

EXPLANATORY MEMORANDUM

Background

The Stability and Growth Pact, which entered into force on 1 July 1998, is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. In 2005, the Pact was amended for the first time. The reform acknowledged the Pact's usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Pact, stipulates that Member States have to submit, to the Council and the Commission, stability or convergence programmes and annual updates thereof (Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes). The first stability programme of Ireland was submitted in December 1998. In accordance with the Regulation, the Council delivered an opinion on it on 18 January 1999 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. In accordance with the same procedure, updated stability and convergence programmes are assessed by the Commission and examined by the Committee mentioned above, while the Council may examine them.

In these programmes, Member States need to specify their medium-term objective for the budgetary position and set out the policy measures to achieve and maintain it, including the accompanying economic assumptions. Following the reform of the Pact, the medium-term objective should be differentiated for individual Member States in the light of the economic and budgetary heterogeneity in the Union, including as regards the fiscal risk to sustainability. Other elements of the reform are that a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline in economic good times should be achieved, while "major structural reforms" with a verifiable impact on long-term sustainability should be taken into account for a temporary deviation from the medium-term objective or the adjustment path towards it.

Taking into account the Commission services' autumn 2005 forecast, the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances and the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008, the Commission has examined the recently submitted update of the stability programme of Ireland and, based on its assessment below, has adopted a recommendation for a Council opinion on it.

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[1] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

[2] "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 11 October 2005.

Assessment

(1) The 2005 update of the Irish stability programme, covering the period up to 2008, was submitted on 7 December 2005[3]. The programme broadly follows the model structure and data provision requirements for stability and convergence programmes specified in the new code of conduct[4].

(2) Ireland has experienced an impressively rapid increase in real GDP per capita and employment levels over the last decade. In recent years the Irish economy has continued to grow at just below 5% p.a., the highest rates in the euro area, while employment is on the rise and inflation has converged rapidly towards the euro area average. As regards budgetary developments, the fiscal position has been broadly sound, with the general government balance recording surpluses in most years over the last decade and the debt ratio falling significantly (to under 30% of GDP in 2005).

(3) The update projects GDP growth to remain in a narrow range of between 4½% and 5% over the programme period, only slightly less favourable than expected in the previous update. On the basis of currently available information, the macroeconomic scenario appears to be based on plausible growth assumptions and is broadly in line with the Commission services' autumn 2005 forecast for the period until 2007. However, while the current picture suggests a broadly healthy condition of the economy with robust growth to continue, there are some downside risks to the macroeconomic outlook in the medium term. In particular, these are related to global economic prospects, given the openness of the economy; and domestically, to any sharp downturn from the extended residential construction boom. The programme's projections for HICP inflation, which is assumed to decline below 2% by the end of the programme period, seem somewhat on the low side.

(4) In its opinion of 17 February 2005, the Council endorsed the budgetary strategy presented in the previous update of the stability programme, covering the period 2004-2007. As regards budgetary implementation in 2005, the previous update targeted a general government deficit of 0.8% of GDP, while the current update estimates a 0.3% surplus despite a downward revision of growth. The main reason for the far better outcome in 2005 than initially targeted is to be found on the revenue side.

(5) The update confirms the commitment of the Irish government to maintaining sound public finances. Starting from a 0.25% of GDP surplus in 2005, the budgetary strategy envisages a general government deficit of 0.6% in 2006 and 0.8% of GDP in the final two years of the programme. The primary surplus falls from 1½% of GDP in 2005 to 0.5% in the years 2006-2008. The revenue-to-GDP ratio is on a declining trend, while the expenditure ratio initially increases and falls back to the 2005 level only towards the end of the programme period. The investment-to-GDP ratio is projected to increase by 0.5 percentage point of GDP over the period 2005 to 2008, which results in an average general government investment ratio over the programme period well above

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3 According to the code of conduct, Ireland should be regarded as complying with the deadline in case of submission on "budget day", i.e. traditionally the first Wednesday of December.

4 The programme provides all compulsory data, but has gaps in the optional data (in particular on price developments and net financial debt) prescribed by the new code of conduct.

the EU average of recent years. Apart from the better-than-expected 2005 outturn, the new update broadly confirms the budgetary targets of the previous programme.

(6) Based on Commission services' calculations on the basis of the programme according to the commonly agreed methodology, the structural position (i.e. in cyclically-adjusted terms and net of one-off and other temporary measures) is planned to deteriorate in 2006 by some 1 percentage point of GDP before stabilising at around balance over the programme period, while the negative output gap is projected to widen from around 1¼% in 2005 to some 2% in the rest of the programme period[5]. The programme sets the medium-term objective (MTO) for the budgetary position as meant in the Stability and Growth Pact as a general government position close to balance in structural terms. As the programme's MTO is more demanding than the minimum benchmark (estimated at a deficit of around 1¼% of GDP), its achievement should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. As regards appropriateness, the programme's MTO lies within the range indicated for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct and is more demanding than implied by the debt ratio and average potential output growth in the long term.

(7) On balance, the risks to the budgetary projections in the update seem to be on the positive side, in particular in 2006. The revenue forecast might suggest cautious assumptions on tax projections in the programme. The degree of current expenditure restraint in the later years of the programme seems demanding, but the existence of the contingency provision against unforeseen developments might point to a better than projected outturn. The capital outlays might also turn out somewhat below planned allocations, in particular as a significant increase in capital spending to tackle the economy's infrastructure needs is projected over the programme period. Risks to the budgetary targets stemming from the macroeconomic projections in the update appear neutral and are broadly in line with the Commission services' evaluation; however, the budgetary projections could be vulnerable if the downside macroeconomic risks in the medium term were to be realised.

(8) In view of this risk assessment, the budgetary strategy outlined in the programme seems sufficient to ensure that the programme's MTO is maintained throughout the programme period. It is also sufficient to provide a safety margin against breaching the 3% of GDP deficit reference value with normal macroeconomic fluctuations in each year.

(9) The debt ratio, which was still just below 100% of GDP in the early 1990s, is estimated to have reached 28% of GDP in 2005, well below the 60% of GDP Treaty reference value. The debt ratio is projected to broadly stabilise at this level over the programme period. Both the primary balance and the interaction between interest payments and nominal GDP growth are projected to contribute to lowering the debt ratio, but this is broadly offset by sizeable stock-flow adjustments. The latter essentially reflect the impact of the acquisition of non-general government assets by the *National Pensions Reserve Fund (NPRF)*, without which the gross debt ratio would be falling throughout the programme period.

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[5] However, the special features of the Irish economy imply that the estimates of the output gap underlying such calculations are subject to an unusually high margin of uncertainty.

(10) With regard to the sustainability of public finances, Ireland appears to be at medium risk on grounds of the projected budgetary costs of an ageing population. The currently sound budgetary position, in conjunction with the low debt level and the accumulation of assets in the National Pension Reserve Fund, helps partly to offset the significant rise in age-related government expenditure, notably on pensions, projected over the long term. Ireland has also recently enacted reforms to the pension system for public servants and the authorities envisage further measures that should contribute to a more sustainable basis for the provision of public service pensions. The commitment to monitoring the adequacy of contribution rates through regular actuarial reviews is helpful. Implementing additional measures aimed at easing the budgetary impact of an ageing population over the long term would be nevertheless an important element in reducing risks to the sustainability of public finances.

(11) The envisaged measures in the area of public finances are broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008. In particular, Ireland respects its MTO and the update provides an overview of the government's structural reform programme that should contribute towards enhancing the quality of public services, increasing the efficiency of public spending and addressing the infrastructural needs of the Irish economy.

(12) The National Reform Programme of Ireland, submitted on 28 October 2005 in the context of the renewed Lisbon strategy for growth and jobs, identifies the following challenges with significant implications for public finances: (i) to continue to prioritise public investment in economic and social infrastructure and other growth-enhancing expenditures; and (ii) to maintain a stable macroeconomic environment, sustainable public finances, and to ensure moderate inflation levels. The budgetary implications of the policy directions outlined in the National Reform Programme appear to be reflected in the budgetary projections of the stability programme. The measures in the area of public finances envisaged in the stability programme are in line with the actions foreseen in the National Reform Programme. The stability programme complements these measures with proposed changes in the institutional features of the public finances, including some innovations in the budgetary and estimates process.

In view of the above assessment, the fiscal position can be considered as sound and the budgetary strategy provides a good example of fiscal policies conducted in compliance with the Pact. It would be appropriate for Ireland to continue to implement measures to address the long-term budgetary implications of an ageing population.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of Ireland, 2005-2008

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[6], 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 [14 March 2006] the Council examined the updated stability programme of Ireland, which covers the period 2005 to 2008.

(2) Ireland has experienced an impressively rapid increase in real GDP per capita and employment levels over the last decade. In recent years the Irish economy has continued to grow at just below 5% p.a., the highest rates in the euro area, while employment is on the rise and inflation has converged rapidly towards the euro area average. As regards budgetary developments, the fiscal position has been broadly sound, with the general government balance recording surpluses in most years over the last decade and the debt ratio falling significantly (to under 30% of GDP in 2005).

(3) In its opinion of 17 February 2005, the Council endorsed the budgetary strategy presented in the previous update of the stability programme, covering the period 2004-2007. As regards budgetary implementation in 2005, the previous update targeted a general government deficit of 0.8% of GDP, while the current update estimates a 0.3% surplus despite a downward revision of growth. The main reason for the far better outcome in 2005 than initially targeted is to be found on the revenue side.

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6 OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

(4) The programme broadly follows the model structure and data provision requirements for stability and convergence programmes specified in the new code of conduct[7].

(5) The macroeconomic scenario underlying the programme envisages that real GDP growth will remain in a narrow range of between 4½% and 5% over the programme period. Assessed against currently available information, this scenario appears to be based on plausible growth assumptions. While the current picture suggests a broadly healthy condition of the economy with robust growth to continue, there are some downside risks to the macroeconomic outlook in the medium term. In particular, these are related to global economic prospects, given the openness of the economy; and domestically, to any sharp downturn from the extended residential construction boom. The programme's projection for HICP inflation appears to be somewhat on the low side.

(6) The update confirms the commitment of the Irish government to maintaining sound public finances. Starting from a 0.25% of GDP surplus in 2005, the budgetary strategy envisages a general government deficit of 0.6% in 2006 and 0.8% of GDP in the final two years of the programme. The primary surplus falls from 1½% of GDP in 2005 to 0.5% in the years 2006-2008. The revenue-to-GDP ratio is on a declining trend, while the expenditure ratio initially increases and falls back to the 2005 level only towards the end of the programme period. The investment-to-GDP ratio is projected to increase by 0.5 percentage point of GDP over the period 2005 to 2008. Apart from the better-than-expected 2005 outturn, the new update broadly confirms the budgetary targets of the previous programme.

(7) Following the fiscal expansion planned for 2006, the structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology is planned to stabilise at around 0.1% of GDP over the rest of the programme period. The programme sets the medium-term objective (MTO) for the budgetary position at a structural position of close to balance and plans to maintain a structural position that satisfies the programme's MTO throughout the programme period. As the programme's MTO is more demanding than the minimum benchmark (estimated at a deficit of around 1¼% of GDP), its achievement should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. As regards appropriateness, the programme's MTO lies within the range indicated for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct and is more demanding than implied by the debt ratio and average potential output growth in the long term.

(8) The budgetary outcome could be better than projected in the programme, in particular in 2006. The revenue forecast might imply cautious assumptions on tax projections in the programme and, on the expenditure side, the capital outlays might turn out somewhat below planned allocations. Risks to the budgetary targets stemming from the macroeconomic projections in the update appear neutral and are broadly in line with the Commission services' evaluation; however, the budgetary projections could be vulnerable if the downside macroeconomic risks in the medium term were to be realised.

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7 The programme provides all compulsory, but has gaps in the optional data prescribed by the new code of conduct.

(9) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the programme's MTO throughout the programme period, as envisaged in the programme. In addition it provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations in each year.

(10) The debt ratio, which was still just below 100% of GDP in the early 1990s, is estimated to have reached 28% of GDP in 2005, well below the 60% of GDP Treaty reference value. The programme projects the debt ratio to stabilise at this level over the programme period. In the absence of acquisition of non-general government assets by the *National Pensions Reserve Fund (NPRF)*, the debt ratio would be falling significantly throughout the programme period.

(11) With regard to the sustainability of public finances, Ireland appears to be at medium risk on grounds of the projected budgetary costs of an ageing population. The currently sound budgetary position, in conjunction with the low debt level and the accumulation of assets in the National Pension Reserve Fund, helps partly to offset the significant rise in age-related government expenditure, notably on pensions, projected over the long term. Ireland has also recently enacted reforms to the pension system for public servants and the authorities envisage further measures that should contribute to a more sustainable basis for the provision of public service pensions. The commitment to monitoring the adequacy of contribution rates through regular actuarial reviews is helpful. Implementing additional measures aimed at easing the budgetary impact of an ageing population over the long term would be nevertheless an important element in reducing risks to the sustainability of public finances.

(12) The envisaged measures in the area of public finances are broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008. In particular, Ireland respects its MTO and the update provides an overview of the government's structural reform programme that should contribute towards enhancing the quality of public services, increasing the efficiency of public spending and addressing the infrastructural needs of the Irish economy.

(13) The National Reform Programme of Ireland, submitted on 28 October 2005 in the context of the renewed Lisbon strategy for growth and jobs identifies, in particular, the following challenges with significant implications for public finances: (i) to continue to prioritise public investment in economic and social infrastructure and other growth-enhancing expenditures; and (ii) to maintain a stable macroeconomic environment, sustainable public finances, and to ensure moderate inflation levels. The budgetary implications of the policy directions outlined in the National Reform Programme appear to be reflected in the budgetary projections of the stability programme. The measures in the area of public finances envisaged in the stability programme are in line with the actions foreseen in the National Reform Programme. The stability programme complements these measures with proposed changes in the institutional features of the public finances, including some innovations in the budgetary and estimates process.

The Council is of the opinion that, overall, the budgetary position is sound and the budgetary strategy provides a good example of fiscal policies in compliance with the Stability and Growth Pact. The Council invites Ireland to continue to implement measures to address the long-term budgetary implications of an ageing population.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007	2008
Real GDP (% change)	**SP Dec 2005**	**4.5**	**4.6**	**4.8**	**5.0**	**4.8**
	COM Nov 2005[2]	4.5	4.4	4.8	5.0	n.a.
	SP Dec 2004	*5.3*	*5.1*	*5.2*	*5.4*	*n.a.*
HICP inflation (%)	**SP Dec 2005**	**2.3**	**2.2**	**2.0**	**2.0**	**1.8**
	COM Nov 2005	2.3	2.2	2.5	2.4	n.a.
	SP Dec 2004	*2.3*	*2.1*	*2.0*	*1.9*	*n.a.*
Output gap (% of potential GDP)	**SP Dec 2005[1]**	**0.1**	**-1.3**	**-1.9**	**-2.2**	**-2.1**
	COM Nov 2005[6]	0.1	-1.6	-2.2	-2.6	n.a.
	SP Dec 2004[1]	*-1.0*	***-1.8***	***-2.3***	***-2.0***	*n.a.*
General government balance (% of GDP)	**SP Dec 2005**	**1.4**	**0.3**	**-0.6**	**-0.8**	**-0.8**
	COM Nov 2005[2]	1.4	-0.4	-0.3	-0.1	n.a.
	SP Dec 2004	*0.9*	*-0.8*	*-0.6*	*-0.6*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2005**	**2.6**	**1.5**	**0.6**	**0.4**	**0.5**
	COM Nov 2005[2]	2.7	0.8	0.8	0.9	n.a.
	SP Dec 2004	*2.1*	*0.6*	*0.6*	*0.7*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**SP Dec 2005[1]**	**1.4**	**0.8**	**0.2**	**0.1**	**0.1**
	COM Nov 2005[2]	1.4	0.2	0.6	0.9	n.a.
	SP Dec 2004[1]	*1.2*	*-0.2*	*0.1*	*0.0*	*. n.a.*
Structural balance[3] (% of GDP)	**SP Dec 2005[4]**	**0.7**	**1.1**	**0.1**	**0.1**	**0.1**
	COM Nov 2005[2,5]	0.7	0.6	0.6	0.9	n.a.
	SP Dec 2004	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2005**	**29.4**	**28.0**	**28.0**	**28.2**	**28.3**
	COM Nov 2005[2]	29.8	29.0	28.7	28.2	n.a.
	SP Dec 2004	*30.5*	*30.1*	*30.1*	*30.0*	*n.a.*

Notes:

[1] Commission services calculations on the basis of the information in the programme.

[2] Commission services' Autumn 2005 forecast pre-dates the December 2005 Budget on which the updated stability programme is based.

[3] Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.

[4] One-off and other temporary measures taken from the programme (0.3% of GDP in 2005; surplus decreasing). An estimate of one-offs for 2004 and 2006 provided by the Irish Department of Finance: 0.7% of GDP in 2004 and 0.1% of GDP in 2006 respectively (both surplus increasing).

[5] One-off and other temporary measures taken from the Commission services' Autumn 2005 forecast (0.4% of GDP in 2005; surplus decreasing).

[6] Based on estimated potential growth of 5.8%, 6.1%, 5.5% and 5.3% respectively in the period 2004-2007.

Source:

Stability programme (SP); Commission services' Autumn 2005 economic forecasts (COM); Commission services' calculations.