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Commission puts forward recommendations on budgetary policy for Ireland

The European Commission adopted today a recommendation to the Council of Ministers on the 2000 update of Ireland's Stability Programme (2001-2003). The Commission concludes that the 2000 update is in line with the requirements of the Stability and Growth Pact but that Irish budgetary plans for 2001 are inconsistent with the 2000 Broad Economic Policy Guidelines (BEPG) adopted last June by the European Council in Feira. The 2000 update of Ireland's Stability Programme estimates a general government surplus of 4.7% of GDP in 2000 and projects an average surplus ratio of 4.2% over the remaining period covered. The Commission welcomes such surpluses, that would clearly be sufficient to provide a safety margin against breaching the deficit threshold of 3% of GDP in the event of normal cyclical fluctuations. However, given the evidence and further risks of overheating of the Irish economy, the Commission and the Council have in the 2000 BEPG urged the Irish authorities to use budgetary policy to ensure economic stability. In the course of 2000, the extent of overheating has increased even if the headline inflation in December 2000 ended slightly below the November peak. CPI inflation averaged 5.6% in 2000 against a prediction of 3.1% in the last stability programme update. In spite of this, budgetary plans for 2001 are expansionary and pro-cyclical and are therefore considered inconsistent with those guidelines. The Commission has therefore recommended to the ECOFIN Council to adopt, on [12 February 2001], a recommendation under Article 99.4 addressed to the Irish government with a view to ending the inconsistency of the expansionary aspects of budgetary plans with the BEPG.

The Commission's assessment of the member states' stability programmes is an important element in the multilateral surveillance process. Given the continuous strengthening of economic policy co-ordination in the Union and the important spill-over effects that economic policies in one member state can have for the euro-zone as a whole, the Commission is putting increasing emphasis in its analysis on the degree of ambition with which member states plan to conduct their economic policies over the short and medium term. Pedro Solbes, EU Commissioner for economic and monetary affairs, commenting on the decision said: *"Consistent with our views on the role of public finances in economic policy, our judgement on the appropriateness of the policy-mix given the current economic cycle and the apparent contradiction between 2001 budget and the Council Broad Economic Policy Guidelines for 2000, the Commission has decided to recommend for the first time the use of a recommendation as provided in Article 99.4 of the Treaty."*

The recommendation for a Council recommendation with a view to ending the inconsistency with the broad guidelines of the economic policies is a procedure in the Treaty (Article 99) concerning the co-ordination of economic policies at the level of the European Union. The Treaty provides for the adoption, by the Council, of a recommendation on the broad guidelines of the economic policies of the Member States and of the Community. On the basis of reports submitted by the Commission, the Council regularly monitor economic developments and consistency with the guidelines. In the case of inconsistency, the Council may make recommendations to the Member State concerned, based on a recommendation from the Commission. The Commission has today recommended to the Council to make such a recommendation to Ireland.

The Commission's other main conclusions on the 2000 update of Ireland's Stability programme are:

- The Irish economy has shown a bright performance and continued to grow very rapidly in 2000, with real GDP growth of just over 10% expected for 2000. As a result, the budgetary projections in the 1999 update of the Stability Programme have been exceeded by a large margin. The debt ratio is projected to decline to 24% of GDP by 2003.
- The Commission welcomes structural reform to promote a stronger, more balanced supply side of the Irish economy. On the public finances side, progress has been made to ensure the long-term sustainability of the public finances in the light of population ageing with the creation of the National Pensions Reserve Fund. In addition, ongoing reform of the tax/benefit system and increased capital expenditure commitments enhance the quality of public finances. Structural reform aimed at increasing micro-economic efficiency such as competition-enhancing measures are desirable and should help contain inflationary pressures in the medium run.
- However in the course of 2000 inflationary pressures have intensified and CPI inflation has been 5.6% on average in 2000 (and 5.3% in HICP terms). Although the deterioration in inflation performance is partly due to external or temporary factors, there is also evidence of increasing domestically-generated inflation. The 2000 update expects that, over the period covered in the update, both real GDP growth and headline inflation will show a gentle decline.
- In this context, the expansionary nature of the budget for 2001 constitutes a major risk to this benign outlook. The budgetary plans for 2001 consist of indirect and direct tax cuts and very large increases in current and capital expenditure. As these measures will fuel demand but are likely to generate smaller supply effects in the short term, the overheating problem will worsen. The 2000 update itself projects that the positive output gap will rise further to peak in 2001 at over 5% of trend GDP. The fiscal loosening planned for 2001 is inappropriate in an economy operating well above potential.
- The budget for 2001 includes measures aimed at containing inflation: indirect tax cuts and direct tax relief. However, in the current context, these measures will further fuel demand and therefore likely to be counterproductive.

The Stability and Growth Pact, adopted by the Amsterdam European Council in June 1997, requires countries participating in the euro-zone to present stability programmes to the Council and the Commission. These programmes provide information on how countries intend to meet the objectives of the Pact and in particular the medium term goal of a budget close to balance or in surplus.

Key figures from the 2000 update of Ireland's Stability Programme

	2000	**2001**	**2002**	**2003**
Real GDP[1]	10.7	8.8	6.3	5.7
General government budget surplus[2]	4.7	4.3	3.8	4.6
General government debt[2]	39	33	28	24
Consumer price index[1]	5.5	4.5	3.5	2.5
Employment[1]	4.5	3.5	2.1	1.8

[1] annual percentage change
[2] percentage of GDP