COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 2.2.2005
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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, 2004-2007

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1] stipulates that participating Member States, that is, those which have adopted the single currency, had to submit stability programmes to the Council and the Commission by 1 March 1999. In accordance with Article 5 of this Regulation, the Council had to examine each stability programme based on assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). On the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme. According to the Regulation, Member States need to submit annual updates of their stability programmes, which may also be examined by the Council in accordance with these same procedures.

The first stability programme of Ireland, covering the period 1999-2001, was submitted on 2 December 1998 and assessed by the Council on 18 January 1999. Updates were presented every following year. Ireland submitted the most recent update of its stability programme on 1 December 2004. The Commission services have carried out a technical evaluation of this update, taking into account the results of the Commission services Autumn 2004 economic forecasts, and having regard to the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances, the recommendations in the broad economic policy guidelines for the period 2003-2005 and the principles laid down in the Communication from the Commission to the Council and the European Parliament of 27 November 2002 on strengthening the coordination of budgetary policies[3], endorsed by the Council. This evaluation is as follows:

– The new update of the Irish stability programme, covering the period to 2007, was released and presented to the Commission on 1 December 2004, the date coinciding with the government's presentation of the budget for 2005. The update complies with the data requirements of the "code of conduct[4] on the content and format of stability and convergence programmes".

– The prospects for the Irish economy set out in the programme have been upgraded compared with those foreseen in the 2003 update. Real GDP growth is estimated to have rebounded to 5.3% in 2004, compared with 3.3% expected in the previous programme, reflecting both a higher domestic and external contribution. For the period 2005 to 2007, the update envisages real growth to remain around 5.2% p.a. on average in GDP terms. The potential growth rate derived by applying the agreed methodology to the programme data initially exceeds but for later years gradually approaches the rates of growth projected in the programme. HICP inflation is assumed to fall, compared with a higher and flatter profile in the Commission services autumn 2004 forecast (which pre-dates the Irish budget), and to decline below 2% by the end of the programme period. Overall, on the

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1 OJ L209, 2.8.1997. 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 Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

3 COM(2002) 668 final, 27.11.2002.

4 Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

basis of currently available information, the macroeconomic scenario underlying the programme appears plausible, broadly in line with the Commission services evaluation including the autumn 2004 forecast, though the projection for HICP inflation seems on the low side.

– The update estimates a general government surplus of 0.9% of GDP in 2004, significantly better than previous official forecasts (and 2.0 percentage points stronger than the deficit target set in the 2003 update). This outturn is due to higher than expected tax receipts, including the impact of one-off factors and notably receipts arising from the special investigations by the Revenue Commissioners (estimated in the update to have yielded 0.5% of GDP), and to lower than budgeted expenditures, especially on public investment. Over the period 2005 to 2007, the budgetary strategy envisages a general government deficit of 0.8% in 2005 and 0.6% of GDP in the final two years of the programme. As compared to the previous programme, the projected general government deficit ratios in 2005 and 2006 are closer to balance by 0.6 and 0.5 percentage points of GDP respectively against a more favourable macroeconomic scenario. Apart from an initial increase in the expenditure ratio in 2005 as a result of recent budgetary measures, both expenditure and revenue ratios are on a declining trend. Adjusting for the estimated impact of the cycle using the common methodology, the cyclically-adjusted balance is in surplus throughout the projection period, with the exception of a small deficit of 0.2% of GDP in 2005. 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. The projected budget deficits in Ireland need to be further qualified, as a significant programme of public investment is being implemented, which results in an average general government investment ratio over the programme period well above the EU average of recent years.

– The risks attached to the budgetary projections appear broadly balanced. On the one hand, the forecast of receipts appears to be plausible and the existence of the contingency provisions might point to a better than projected outturn. As regards expenditures, Ireland has also recently shown encouraging progress in adhering to expenditure targets, suggesting that various measures taken to strengthen control are proving effective. On the other hand, there are also some risks that the general government balance might turn out weaker than projected in the update. In particular, the growth rate of spending appears somewhat restrained in the later years of the programme. In the light of the risk assessment, the budgetary stance in the programme seems sufficient to maintain the close-to-balance-or-surplus requirement of the Stability and Growth Pact throughout the programme period. Furthermore, there is a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations.

– General government gross debt is estimated to have fallen to 30.5% of GDP in 2004, well below the 60% of GDP Treaty reference value. The debt ratio is projected to broadly stabilise at close to 30% of GDP over the period 2005 to 2007. As in the previous programme, 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 reflect mainly the impact of the acquisition of non-general government assets by the *National Pensions Reserve Fund (NPRF)*, established in 2001 to pre-fund future pension liabilities and which receives an equivalent of 1% of GNP annually from general government resources. Without the accumulation of non-general government assets in this fund, the gross debt ratio would be falling throughout the programme period.

- The update provides an overview of the government's structural reform programme that is oriented towards enhancing the quality of public services, increasing the efficiency of public spending and addressing the infrastructural needs of the Irish economy. The update also reviews, as one of the elements in the drive for value for money, the ongoing reform in the health services. Overall, the economic policies outlined in the update are broadly consistent with the country-specific *2003-2005 Broad Economic Policy Guidelines* in the area of public finances, which recommended the Irish authorities to enhance the efficiency of public spending, improve the medium-term budgetary framework and prioritise the infrastructural elements of the National Development Plan.

- Ireland appears to be in a relatively favourable position with regard to the long-term sustainability of its public finances, despite significant projected budgetary costs of an ageing population. The relatively low debt ratio in Ireland, the pension reform measures already enacted and the accumulation of resources in the NPRF all contribute to budgetary sustainability and help cope with the impact of ageing. The strategy outlined in the programme is mainly based on conformity to the Stability and Growth Pact framework and further asset accumulation in the NPRF. Ireland's relatively low tax ratio should ease the accommodation of any sustainability gap that arises in the longer term.

Based on this assessment, the Commission has adopted the attached recommendation for a Council Opinion on the updated stability programme of Ireland and is forwarding it to the Council.

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, 2004-2007

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[5], 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 [17 February 2005] the Council examined the updated stability programme of Ireland, which covers the period 2004 to 2007. The programme complies with the data requirements of the "code of conduct on the content and format of stability and convergence programmes".

(2) The macro-economic scenario underlying the programme envisages real GDP growth of 5.3% in 2004 and to stabilise around 5.2% on average over the rest of the programme period. On the basis of currently available information, this scenario seems to reflect plausible growth assumptions. The programme's projections for HICP inflation nevertheless seem on the low side.

(3) After an initially unplanned surplus in 2004, reflecting stronger than expected receipts, including from one-off factors, and some shortfall in budgeted expenditure, the strategy in the update envisages a modest and broadly stable deficit from 2005 onwards. Both expenditure and revenue ratios are on a declining trend over the programme period, although the former increases in 2005 as a result of recent budgetary measures. At the same time, a significant programme of public investment is being implemented, which results in an average general government investment ratio over the programme period of just below 4% of GDP. Adjusting for the estimated

[5] OJ L 209, 2.8.1997, 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.

impact of the cycle using the common methodology, the cyclically-adjusted balance is in surplus throughout the projection period, with the exception of a small deficit in 2005. It should nevertheless be noted that the estimation of the output gap and hence of the cyclically-adjusted balances presents unusually high margins of uncertainty due to the special features of the Irish economy. Compared with the previous programme, the current update envisages stronger general government balances against a more favourable macroeconomic scenario.

(4) The risks attached to the budgetary projections appear broadly balanced. On the one hand, the forecast of receipts appears to be plausible and the inclusion of contingency provisions in the projections for 2006 and 2007 might point to the possibility of a better than projected outturn. As regards expenditures, Ireland has also recently shown encouraging progress in adhering to expenditure targets, suggesting that recent measures taken to strengthen spending controls are proving effective. On the other hand, there are also some risks of higher headline deficits. In particular, the growth rate of spending appears somewhat restrained in the later years of the programme.

(5) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the Stability and Growth Pact's medium-term objective of a position of close to balance or surplus over the period to 2007. It also provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme period.

(6) General government debt is estimated to have fallen to 30.5% of GDP in 2004, well below the 60% of GDP Treaty reference value. The programme projects the debt ratio to stabilise close to 30% of GDP over the period 2005 to 2007. 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.

(7) Ireland appears to be in a relatively favourable position with regard to the long-term sustainability of its public finances. The relatively low debt ratio in Ireland, the pension reform measures already enacted and the accumulation of reserves in the NPRF will contribute to budgetary sustainability and help cope with the impact of ageing. The strategy outlined in the programme is mainly based on conformity to the Stability and Growth Pact framework and further asset accumulation in the NPRF. Overall, Ireland's relatively low tax ratio should ease the accommodation of any sustainability gap that arises in the longer term.

(8) The update provides an overview of the government's structural reform programme that is oriented towards enhancing the quality of public services, increasing the efficiency of public spending and addressing the infrastructural needs of the Irish economy. Overall, the economic policies outlined in the update are broadly consistent with the country-specific *2003-2005 Broad Economic Policy Guidelines* in the area of public finances, which recommended the Irish authorities to enhance the efficiency of public spending, improve the medium-term budgetary framework and prioritise the infrastructural elements of the National Development Plan.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007
Real GDP (% change)	**SP December 2004**	**5.3**	**5.1**	**5.2**	**5.4**
	COM[2]	5.2	4.8	5.0	n.a.
	SP December 2003	*3.3*	*4.7*	*5.2*	*n.a.*
HICP inflation (%)	**SP December 2004**	**2.3**	**2.1**	**2.0**	**1.9**
	COM Oct 2004[2]	2.3	2.4	2.4	n.a.
	SP December 2003	*2.3*	*2.0*	*2.0*	*n.a.*
General government balance (% of GDP)	**SP December 2004**	**0.9**	**-0.8**	**-0.6**	**-0.6**
	COM Oct 2004[2]	-0.2	-0.6	-0.5	n.a.
	SP December 2003	*-1.1*	*-1.4*	*-1.1*	*n.a.*
Primary balance (% of GDP)	**SP December 2004**	**2.1**	**0.6**	**0.6**	**0.7**
	COM Oct 2004[2]	1.2	0.7	0.8	n.a.
	SP December 2003	*0.3*	*0.1*	*0.3*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**SP December 2004[1]**	**1.2**	**-0.2**	**0.1**	**0.0**
	COM Oct 2004[2]	0.1	0.0	0.3	n.a.
	SP December 2003[1]	*-0.7*	*-0.8*	*-0.5*	*n.a.*
Government gross debt (% of GDP)	**SP December 2004**	**30.5**	**30.1**	**30.1**	**30.0**
	COM Oct 2004[2]	30.7	30.7	30.6	n.a.
	SP December 2003	*33.3*	*33.5*	*33.3*	*n.a.*

Notes:
[1] Commission services calculations on the basis of the information in the programme
[2] Commission services autumn 2004 forecast
Sources:
Updated Irish Stability Programme, December 2003 and December 2004 (SP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations