COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 7.2.2007
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Recommendation for a

COUNCIL OPINION

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

On the updated stability programme of Ireland, 2006-2009

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL 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. The 2005 reform of the Pact acknowledged its 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 Stability and Growth 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.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the stability programme of Ireland, submitted on 6 December 2006, and has adopted a recommendation for a Council opinion on it (see box for the main points covered by the assessment).

In order to set the scene against which the budgetary strategy in the updated stability programme is assessed, the following paragraphs summarise:

(1) the economic and budgetary performance over the last ten years

(2) the most recent assessment of the Ireland's position under the preventive arm of the Stability and Growth Pact (summary of the Council opinion on the previous update of the stability programme); and

(3) the Commission's assessment of the October 2006 national reform programme.

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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

2.1. Recent economic and budgetary performance

Ireland's economic performance over the past ten years covers an initial period of extremely rapid "Celtic Tiger" rates of growth, extending the extraordinary catch-up achievement that began in the late 1980s. Resilience to the economic turbulence following the turn of the decade has been succeeded by more moderate rates of growth, still far ahead of the West European norm but, in contrast to the earlier period, led more by domestic demand and less broadly based than before, with an unsustainable level of residential construction. The economy's openness is particularly evident in flexible factor markets, with substantial inward foreign investment and labour migration. A fast-growing younger workforce, a business-adaptive policy environment and strong social partnership built up since the 1980s have been strengths. Ireland, being a small open economy, has circumscribed macroeconomic policy discretion. Euro area interest rates have been far lower than would have appeared optimal for Ireland and have contributed in particular to a very high rate of asset price inflation. HICP inflation in general has been relatively high as real incomes have increased, added to by domestic demand pressures and some deficiencies in product markets and network services; external competitiveness seems to have deteriorated up to recently and the external deficit has widened. Public finances have remained well within SGP bounds.

2.2. The assessment in the Council opinion on the previous programme

On 14 March 2006, the Council adopted its opinion on the previous update of the stability programme, covering the period 2005-2008. The Council was 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 invited Ireland to “continue to implement measures to address the long-term budgetary implications of an ageing population”.

2.3. The Commission assessment of the October 2006 national reform programme

The implementation report of the national reform programme of Ireland, provided in the context of the renewed Lisbon strategy for growth and jobs, was submitted on 18 October 2006. Ireland’s national reform programme identifies as key challenges/priorities sustaining and improving its recent good economic performance, based on taking advantage of the opportunities presented by globalisation and the internal market.

The Commission’s assessment of this programme (adopted as part of its December 2006 Annual Progress Report[2]) showed that Ireland is making very good progress in the implementation of its national reform programme. Furthermore, governance of the Growth and Jobs Strategy has gained political visibility, notably due to the recently concluded social partnership agreement, “Towards 2016”.

Against the background of progress made, Ireland was encouraged to focus also on the areas of: reform of pension arrangements; emission reduction measures; labour market participation; inward migration; and older and low-skilled workers.

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[2] Communication from the Commission to the Spring European Council, “Implementing the renewed Lisbon strategy for growth and jobs - A year of delivery” - COM(2006) 816, 12.12.2006.

Box: Main points covered by the assessment

As required by Article 5(1) (for stability programmes) and Article 9(1) (for convergence programmes) of Council Regulation (EC) No 1466/97, the assessment covers the following points:

- whether the economic assumptions on which the programme is based are plausible;

[3] Communication from the Commission to the Council and the European Parliament, "The long-term sustainability of public finances in the EU" - COM(2006) 574, 12.10.2006 - and European Commission, Directorate-General for Economic and Financial Affairs (2006), "The long-term sustainability of public finances in the European Union", European Economy No 4/2006.

- the medium-term budgetary objective (MTO) presented by the Member State and whether the adjustment path towards it is appropriate;
- whether measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the MTO over the cycle;
- when assessing the adjustment path towards the MTO, whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad times, and, for euro-area and ERM II Member States, whether the Member State pursues an annual improvement of the cyclically-adjusted balance, net of one-off and other temporary measures, of 0.5% of GDP as a benchmark to meet its MTO;
- when defining the adjustment path to the MTO (for Member States that have not yet reached it) or allowing a temporary deviation from the MTO (for Member States that have), the implementation of major structural reforms which have direct long-term cost-saving effects (including by raising potential growth) and therefore a verifiable impact on the long-term sustainability of public finances (subject to the condition that an appropriate safety margin with respect to the 3% of GDP reference value is preserved and that the budgetary position is expected to return to the MTO within the programme period), with special attention for pension reforms introducing a multi-pillar system that includes a mandatory, fully-funded pillar;
- whether the economic policies of the Member State are consistent with the broad economic policy guidelines.

The plausibility of the programme's macroeconomic assumptions is assessed by reference to the Commission services' autumn 2006 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. The assessment of consistency with the broad economic policy guidelines is made against the broad economic policy guidelines in the area of public finances as included in the integrated guidelines for the period 2005-2008.

The assessment also examines:

- the evolution of the debt ratio and the outlook for the long-term sustainability of the public finances, which should be given "sufficient attention in the surveillance of budgetary positions" according to the Council report of 20 March 2005 on "Improving the implementation of the Stability and Growth Pact". A Commission Communication of 12 October 2006 sets out the approach to the assessment of long-term sustainability[3];
- the degree of integration with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs. In its cover note of 7 June 2005 to the European Council on the broad economic policy guidelines for the period 2005-2008, the ECOFIN Council stated that the national reform programmes should be consistent with the stability and convergence programmes;
- compliance with the code of conduct[4], which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

[4] "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.

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

On the updated stability programme of Ireland, 2006-2009

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 [27 February 2007] the Council examined the updated stability programme of Ireland, which covers the period 2006 to 2009.

(2) The macroeconomic scenario underlying the programme envisages that real GDP growth will edge lower from 5.4% in 2006 to an average of a little above 4½% over the rest of the programme period. Assessed against currently available information, this scenario appears to be based on plausible growth assumptions, though a sharp downturn in high levels of residential construction and property prices are important risks. The programme's projections for inflation appear realistic.

(3) For 2006 the general government balance is estimated in the programme as a surplus of 2.3% of GDP, against a budgeted deficit of 0.6% of GDP in the previous update; more recent cash data for central government points towards an even stronger surplus, of around 2½% of GDP. The stronger than expected result compared with a year earlier is entirely attributable to the revenue side, reflecting in particular the continuing buoyancy of the property market boosting housing-related taxes, and to a more limited extent higher output growth having a similar effect on mainstream taxes. The estimated outturn for nominal expenditure is close to budget.

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5 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) Ireland's medium-term budgetary strategy is based on maintaining budgetary sustainability, anchored in respect of the Stability and Growth Pact. Surpluses are projected to be maintained throughout the programme period, moderating from an estimated headline surplus of 2.3% of GDP in 2006 to 1.2% in 2007 and progressively declining to 0.6% in 2009; the primary surplus declines similarly from an estimated 3.3% of GDP in 2006 to 1.6% of GDP in 2009. The halving of the budgeted headline surplus in 2007 is due to a higher planned expenditure ratio, the increase representing mainly higher social transfers; in 2008 and 2009 both revenue and expenditure ratios are projected to decline, but expenditure only slightly. Compared with the projections in the previous update (to 2008), the strong increase in the estimated 2006 balance, achieved through higher than expected revenues, is carried forward in terms of the revenue and headline and primary surplus ratios in the following two years, at a declining rate, with virtually no change in the profile of the projected expenditure ratio.

(5) 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 decline from a surplus of just under 3% of GDP in 2006 to just over 1½% in 2009. As in the previous update of the stability programme, the medium-term objective (MTO) for the budgetary position presented in the programme is a balanced position in structural terms, which the programme plans to maintain by a large margin throughout the programme period. As the MTO is itself more demanding than the minimum benchmark (estimated at a deficit of around 1¼% of GDP), achieving the programme's structural balance should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The 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.

(6) The risks to the budgetary projections in the programme appear broadly balanced. On the one hand, the macroeconomic situation, after a probably stronger than assumed starting position, could evolve less favourably than projected, and, associated with this, specific revenue sources, particularly those most closely linked to the housing market, could also be significantly weaker. On the other hand, other revenues taken together appear to have been projected cautiously, and in recent years expenditures have been contained within or close to planned levels.

(7) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the 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 throughout the same period. For 2008 and 2009 the fiscal policy stance is in line with the Stability and Growth Pact. In 2007, however, the structural balance declines strongly, carrying the risk that the fiscal policy stance implied by the programme may be pro-cyclical in this year should the economy turn out to be experiencing good times, a situation to be avoided under the Stability and Growth Pact.

(8) Government gross debt is estimated to have declined to around 25% of GDP in 2006, well below the 60% of GDP Treaty reference value. The programme projects the debt ratio to decline by a further three percentage points over the programme period.

(9) The long-term budgetary impact of ageing in Ireland is well above the EU average, mainly as a result of a relatively younger population and consequently a higher increase in pension expenditure as a share of GDP over the coming decades, influenced in part by the maturing of the pension system. The initial budgetary position, improved compared with 2005, contributes significantly to easing the projected long-term budgetary impact of ageing populations, but is not sufficient to fully cover the substantial increase in expenditure due to the ageing of the population. Maintaining high primary surpluses over the medium term and implementing measures aimed at curbing the significant increase in age-related expenditures would, as recognised in the programme, contribute to reducing risks to the sustainability of public finances. Overall, Ireland appears to be at medium risk with regard to the sustainability of public finances.

(10) The stability programme does not contain a qualitative assessment of the overall impact of the October 2006 implementation report of the national reform programme within the medium-term fiscal strategy. In addition, it provides no systematic information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme and its budgetary projections do not explicitly take into account the public finance implications of the actions outlined in the national reform programme. The measures in the area of public finances envisaged in the stability programme nevertheless seem consistent with those foreseen in the national reform programme. In particular, both programmes envisage ongoing implementation of ambitious plans to upgrade infrastructure, notably in the context of the National Development Plan published in January 2007, while the stability programme complements the actions envisaged in the national reform programme with detailed description of measures to improve the institutional features of the public finances, notably measures to increase the efficiency of tax collection and achieve greater value for money in expenditure management.

(11) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.

(12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and most optional data[6].

The overall conclusion is that the medium-term budgetary position is sound and, provided the fiscal stance in 2007 does not prove pro-cyclical, the budgetary strategy provides a good example of fiscal policies conducted in compliance with the Stability and Growth Pact. In any case, it would be prudent to maintain room for manoeuvre against any reversal of the current growth pattern which has been led by strong housing sector developments.

In view of the above assessment, in particular the projected increase in age-related expenditure, Ireland is invited to continue to implement measures to improve the long-term sustainability of its public finances.

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6 In particular, data are not provided for deflators for private consumption, public consumption and investment, net lending/borrowing of the private sector, government expenditure by function and decomposition of the general government debt stock-flow adjustment.

Comparison of key macroeconomic and budgetary projections

		2005	2006	2007	2008	2009
Real GDP (% change)	**SP Dec 2006**	**5.5**	**5.4**	**5.3**	**4.6**	**4.1**
	COM Nov 2006	5.5	5.3	5.3	4.3	n.a.
	SP Dec 2005	*4.6*	*4.8*	*5.0*	*4.8*	*n.a.*
HICP inflation (%)	**SP Dec 2006**	**2.2**	**2.7**	**2.6**	**2.0**	**1.7**
	COM Nov 2006	2.2	2.9	2.7	2.2	n.a.
	SP Dec 2005	*2.2*	*2.0*	*2.0*	*1.8*	*n.a.*
Output gap (% of potential GDP)	**SP Dec 2006**[1]	**-0.4**	**-1.2**	**-1.6**	**-2.2**	**-2.5**
	COM Nov 2006[5]	-0.5	-1.4	-1.9	-2.7	n.a.
	SP Dec 2005[1]	*-1.3*	*-1.9*	*-2.2*	*-2.1*	*n.a.*
General government balance (% of GDP)	**SP Dec 2006**	**1.1**	**2.3**	**1.2**	**0.9**	**0.6**
	COM Nov 2006	1.1	1.2	0.9	0.4	n.a.
	SP Dec 2005	*0.3*	*-0.6*	*-0.8*	*-0.8*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2006**	**2.1**	**3.3**	**2.3**	**1.8**	**1.6**
	COM Nov 2006	2.1	2.2	1.9	1.4	n.a.
	SP Dec 2005	*1.5*	*0.6*	*0.4*	*0.5*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**SP Dec 2006**[1]	**1.3**	**2.8**	**1.8**	**1.8**	**1.6**
	COM Nov 2006	1.3	1.7	1.6	1.5	n.a.
	SP Dec 2005[1]	*0.8*	*0.2*	*0.1*	*0.1*	*n.a.*
Structural balance[2] (% of GDP)	**SP Dec 2006**[3]	**1.6**	**2.7**	**1.8**	**1.8**	**1.6**
	COM Nov 2006[4]	1.6	1.7	1.6	1.5	n.a.
	SP Dec 2005	*0.8*	*0.2*	*0.1*	*0.1*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2006**	**27.4**	**25.1**	**23.0**	**22.4**	**21.9**
	COM Nov 2006	27.4	25.8	24.4	23.6	n.a.
	SP Dec 2005	*28.0*	*28.0*	*28.2*	*28.3*	*n.a.*

Notes:
[1] Commission services calculations on the basis of the information in the programme.
[2] Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.
[3] One-off and other temporary measures of -0.3% of GDP in 2005 (assumed: cf note 4) and 0.1% of GDP in 2006 (indicated in the programme); no information is given in the programme for 2007-09.
[4] One-off and other temporary measures taken from the Commission services' autumn 2006 forecast (-0.3% of GDP in 2005, i.e. surplus-reducing).
[5] Based on estimated potential growth of 6.1%, 6.3%, 5.8% and 5.2% respectively in the period 2005-2008.
Source:
Stability programme (SP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations