2003 to eliminate the deficit estimated for 2002. Especially in the light of the phased transfer underway of important tax and spending powers to regional authorities, the Council welcomes the fiscal discipline framework set by the General Law of Budgetary Stability. This needs to be implemented effectively while preserving adequate margins of manoeuvre for the working of the automatic stabilisers in either direction.

The Council welcomes the fact that the updated programme gives greater weight compared with the previous update to the issue of the long-term sustainability of the public finances. It notes the commitment to achieve balanced budget positions leading to a continuous debt reduction as well as that some measures to increase employment rates and the incentives for active ageing and private pension schemes were taken. It nevertheless considers that these are just steps towards the adequate reorientation of policy in line with its previous opinions. Although the revised demographic projections presented would imply a somewhat more moderate budgetary impact than earlier projections, the Council considers that on the basis of current policies the risk of unsustainable public finances in terms of emerging budgetary imbalances in the long run cannot be excluded: such a risk essentially stems from the large projected increase in age-related spending on public pensions. Strengthening long-term sustainability should therefore remain of primary concern in the framework of an ambitious three-pronged strategy. In this respect, the Council notes that no major review of the public pension system has yet been undertaken, in contrast with the recommendations in both the previous opinion and the 2002 Broad Economic Policy Guidelines. The Council urges the Spanish authorities to agree a timetable for reaching policy conclusions and implementation of the envisaged reform of the pension system to align more closely contributions and benefits. Assets of the public pensions reserve fund created in 2000 to finance future liabilities will stand in 2003 slightly above 1 % of GDP, which compares to a target of 1 % in 2004. New targets which will substantially reinforce the fund now need to be set if this fund is to make a substantial contribution to meeting the costs of ageing populations.

Finally, the Council welcomes recent initiatives for structural reform in the labour, capital and product markets. It recommends further progress in these areas to support employment-oriented and non-inflationary growth with lower inflation than recorded hitherto. Particularly, although improvement in the labour market in recent years has been notable, persistence of relatively low total and female employment and wide regional unemployment disparities call for sustained efforts. Such efforts would be consistent with the 2002 Broad Economic Policy Guidelines.

COUNCIL OPINION

of 18 February 2003

on the 2002 update of Ireland's Stability Programme, 2003 to 2005

(2003/C 51/04)

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 ([1]), 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:

On 18 February 2003 the Council examined the 2002 update of Ireland's stability programme, which covers the period 2003 to 2005. The update broadly complies with the data requirements of the revised ‘code of conduct’ on the content and format of stability and convergence programmes. However, compliance would be strengthened by explaining the nature and significance of the large ‘contingency provisions’ included in the public finance projections for the final two years of the programme. The economic policies as reflected in the planned measures in the programme update broadly comply with the Broad Economic Policy Guidelines for 2002.

([1]) OJ L 209, 2.8.1997.

The Council welcomes the commitment of the Irish government to let the Stability and Growth Pact provide the framework for its budgetary policy. However, it notes that, following the very large deterioration in the budget balance in 2001, and in spite of an upward revision of GDP growth and inflation for 2002, the projected budgetary outcome is a deficit of 0,1 % of GDP, half a percent of GDP worse than planned in last year's programme. In cyclically-adjusted terms, the deficit in 2002 becomes significantly worse, not in line with the 'close-to-balance' requirement of the Stability and Growth Pact, although the estimate of the output gap presents unusual margins of uncertainty due to the special features of the Irish economy. Due to revenue reasons, the budgetary stance turned out to be expansionary in 2002 rather than broadly neutral as recommended for that year in the Broad Economic Policy Guidelines.

The programme's macroeconomic scenario assumes a gradual recovery towards growth around that generally accepted to be sustainable in the medium term, of around 5 %. The potential growth rate derived by the Commission based on the data in the programme initially exceeds, but, by the end of the programme, converges to this rate. The projected downward path of inflation ought to be attained, otherwise there would be a significant risk to competitiveness and price stability if wage expectations fail to adapt to the changed economic environment.

The Council observes that the new programme further deepens and extends the downward shift in the projected path for the general government balance that was outlined in the previous programme. The actual balance is projected to continue to deteriorate in 2003 and 2004 (with the deficit rising to 0,7 % and 1,2 % of GDP respectively and the primary surplus falling to 0,9 % and 0,3 % of GDP). The deficit stabilises at 1,2 % of GDP in the last year of the programme. The Council notes with concern that this coincides with a return to Ireland's sustainable growth in the medium term. The reason for the deterioration over the programme period is that the trend decline in the revenue ratio outweighs the modest drop in the expenditure ratio achieved through expenditure restraint. Excluding the build-up of assets in the National Pension Reserve Fund, the debt ratio would continue to fall throughout the period, rather than record a marginal rise to 35 % towards the end of the programme period.

The Council notes however that important considerations bear on the examination of the budgetary position in the programme. Firstly, subject to the abovementioned uncertainties about the measurement of the output gap, the underlying deficit is estimated to have peaked in 2002 and to move closer to balance towards the end of the programme period, in spite of the ongoing deterioration in the actual balances. Specifically, a tightening of fiscal policy of about 0,5 percentage point of GDP is foreseen in 2003, when the budget implements a cut in capital expenditure, a marked reduction in the growth rate of current expenditure and an overall stabilisation of the tax burden. According to Commission calculations, the underlying deficit is 0,6 % of GDP in 2003 and in 2004, and declines to 0,4 % in 2005. However, the targets in the programme respect the safety margin against breaching the 3 % of GDP threshold for the deficit ratio. The Council urges the Irish authorities to ensure that the budgetary stance is implemented as planned in the programme. Secondly, as in all previous stability programmes, the budgetary targets for the final two years incorporate 'contingency provisions' against unforeseen developments. Should these contingency provisions (0,4 % and 0,8 % of GDP in 2004 and 2005 respectively) not be used, this would result in a significant improvement in the budgetary position projected for the medium term.

The low level of the primary surpluses projected in the programme reflects the impact of multi-annual measures, particularly the investment programme expected to peak with the National Development Plan 2000 to 2006. The programme targets imply an underlying deficit of around 0,5 % of GDP in each year (including contingency provisions), reaching a level of close-to-balance or in surplus by the end of the period, which would be in line with the requirement of the Stability and Growth Pact. The Council notes that, should Ireland make only limited use of the contingency provision, the close-to-balance position would be reached already in 2004.

The update reviews the government's structural reform programme, which focuses on lowering the tax burden, broadening the tax base, improving public services and addressing infrastructural needs through the further implementation of the National Development Plan. The Council welcomes the range of measures, outlined in the programme, to improve the management and control of public expenditure and urges the Irish authorities to supplement this with the development of a comprehensive norm-based framework to guide public spending in the medium term.

With its low debt level and gradual build-up of assets in the National Pensions Reserve Fund, Ireland seems to be in a relatively strong position to cope with the budgetary impact of ageing populations. Nonetheless, the Council notes the risk of budget imbalances in the long run on the basis of current policies. A financing gap may emerge over time if age-related spending as a share of GDP approaches the average level for the EU and if the tax ratio is left unchanged. To ensure that public finances are on a sustainable footing, it is thus important to develop sustainable financing arrangements for social welfare expenditure and to maintain a close-to-balance or in surplus position over the long run.