Ireland - Stability Programme Update

April 2012

Incorporating the Department of Finance's

Spring Forecasts

FOREWORD

This document updates Ireland's Stability Programme. The previous Update and related Council Opinion were presented to and discussed by the Dáil Select Committee on Finance, Public Expenditure and Reform in July 2011.

This Update of Ireland's Stability Programme takes account of Budget 2012 and other Government initiatives, along with the EU/IMF Programme of Financial Support. It includes an update of the economic and fiscal outlook over the short and medium term. It was laid before Dáil Éireann on 27 April 2012.

This document is being submitted to the European Commission in April 2012, in accordance with the requirements under the European Semester. It reflects the horizontal guidance issued by the European Council to Member States in November 2011, and the December 2010 ECOFIN Council recommendations to Ireland under the Excessive Deficit Procedure. It has been prepared in line with the January 2012 guidelines on the format and content of Stability and Convergence Programmes.

This Stability Programme should be read in conjunction with the 2012 Update of Ireland's National Reform Programme (NRP), which outlines progress to date in achieving Ireland's National Targets within the context of the Europe 2020 Strategy. The 2012 Update of the NRP was laid before Dáil Éireann on 27 April 2012 and was submitted to the European Commission in April 2012.

CONTENTS

		Page
Foreword		**2**
List of Tables and Figures		**4**
1.	**Introduction and Overview – General Policy Framework**	**5**
1.1.	Policy strategy	5
1.2.	Economic and budgetary outlook	5
2.	**Economic Outlook**	**8**
2.1.	Summary	8
2.2.	Recent developments	8
2.3.	Macroeconomic projections 2012-13	9
2.4.	Medium-term growth prospects	12
2.5.	The labour market	13
2.6.	Price developments	14
2.7.	Risks to the forecasts	15
2.8.	Range of forecasts	17
2.9.	Sensitivity analysis	18
3.	**The Public Finances**	**19**
3.1.	Summary	19
3.2.	Budgetary outturn 2011	19
3.3.	Budgetary outlook 2012	20
3.4.	Budgetary outlook / Budget 2013	23
3.5.	Public finances 2014-15	24
3.6.	Report of the Irish Fiscal Advisory Council	25
3.7.	Debt level and developments	26
3.8.	Debt sustainability	28
3.9.	Structural budget balance	30
4.	**Quality of Public Finances**	**32**
4.1.	Policy strategy	32
4.2.	Developments on the expenditure side	32
4.3.	Developments on the revenue side	33
4.4.	EU/IMF Programme of support commitments	36
5.	**Institutional Features of Public Finances**	**37**
5.1.	Policy implementation and developments	37
5.2.	European developments	38
5.3.	Fiscal Responsibility Bill	38
5.4.	Further policy developments	39
6.	**Long-Term Sustainability of Public Finances**	**40**
6.1.	Summary	40
6.2.	Long-term budgetary prospects including the implications of ageing	40
6.3.	Policy response	42
7.	**The Excessive Deficit Procedure**	**44**
7.1.	Background	44
7.2.	Steps in Ireland's excessive deficit procedure	44
7.3.	Progress in correcting the excessive deficit	45

Annex 1	Ireland's National Reform Programme under the Europe 2020 Strategy – Summary of progress in respect of Ireland's National Targets	47
Annex 2	Supplementary data	49

LIST OF TABLES AND FIGURES

		Page
Tables		
Table 1	Economic growth, general government balance and debt ratio	6
Table 2	2013-15 general government balance projections and amount of consolidation required to achieve targets	6
Table 3	Macroeconomic prospects	9
Table 4	External assumptions	10
Table 5	External balance	11
Table 6	Divergence from Budget 2012	12
Table 7	Labour market developments	14
Table 8	Price developments	15
Table 9	Effect on the level of real GDP of changing assumptions	16
Table 10	Comparison of macroeconomic projections for Ireland	17
Table 11	Impact on the budget balance of a 1% change in real GDP	18
Table 12	Exchequer based public finance projections	23
Table 13	General government debt developments	27
Table 14	Long-term spending projections	41
Table 15	Requirements and path for the general government balance	45
Table A1	General government balance – technical estimates	49
Table A2	Explanation of the difference between the EBR and the GGB	51
Table A3	Breakdown of revenue	52
Table A4	Expenditure developments	52
Table A5	Cyclical developments – technical results on the basis of the EU's common methodology	53
Table A6	Cyclical developments – technical results on the basis of the IMF's methodology	53
Table A7	Contingent liabilities	53
Figures		
Figure 1	Contributions to GDP growth	13
Figure 2	Breakdown of general government debt 2011	26

CHAPTER 1

INTRODUCTION AND OVERVIEW – GENERAL POLICY FRAMEWORK

1.1. Policy strategy

This Update of Ireland's Stability Programme elaborates on the Government's medium-term economic and budgetary strategy.

The primary aim of this strategy is to return the public finances to a sound position - a key condition for the attainment of strong sustainable employment growth. Considerable progress has already been made in this respect, though it is clear that significant challenges remain. The process of repairing the banking system, so as to ensure that it is in a position to support the real economy as it recovers, is also advancing. In addition, the Government is working to create the conditions in which the internationally traded goods and services sector can grow and prosper and, at the same time, is pursuing an ambitious programme of structural reforms and targeted measures to support domestic activity and job creation.

With the economy returning to growth last year and the underlying General Government Balance well below the ceiling set by the ECOFIN Council in December 2010 (as part of its recommendations to Ireland under the Excessive Deficit Procedure), the above strategy is on track. The Irish Government is committed to ensuring that it remains so in the years to come.

1.2. Economic and budgetary outlook

This document provides an update of the economic and fiscal outlook over the short and medium term. As the degree of uncertainty and margins of error surrounding projections for Ireland and the global economy are particularly high at this time, a number of downside and upside risks to this outlook are also identified.

Last year saw a rebound in economic activity, with GDP recording its first full year of growth since 2007. The short-term outlook for the Irish economy is for a second successive year of positive growth, though recent data suggest that prospects for domestic demand have weakened in the past few months, while external headwinds remain significant. In these circumstances, GDP growth for this year and next has been revised down compared with the *Budget 2012* forecasts. GDP is now projected to grow by 0.7% in 2012, with growth of 2.2% foreseen for 2013. Supported by policy measures, a gradual firming and broadening out of activity is expected over the medium term, with growth of 3% per annum on average projected for the period 2014-15.

The unemployment rate is projected to fall over the forecast horizon, reflecting the assumed pick-up in the pace of economic activity and taking account of policies designed to address the challenges in the labour market.

Table 1: Economic growth, general government balance and debt ratio

	2011	2012	2013	2014	2015
Real GDP (% change)	0.7	0.7	2.2	3.0	3.0
General government balance (% of GDP)	-13.1	-8.3	-7.5	-4.8	-2.8
Underlying GGB	*-9.4*				
Debt ratio (year end)	108.2	117.5	120.3	119.5	117.4

Source: Department of Finance.

Turning to the budgetary position, a General Government Balance (GGB) of –8.3% of GDP is now estimated for 2012. Importantly, this is within the limits set under the terms of the ECOFIN Council decision of December 2010. This figure is an early, point-in-time estimate - it largely reflects the view that non-tax revenues and NPRF investment income are likely to be higher, and debt servicing expenditure lower, than estimated at Budget time. The Government remains committed to adhering to the GGB target of -8.6% of GDP for this year and is satisfied, on the basis of Exchequer Returns data for the first three months of the year, that its budgetary plans are on track and that the fiscal targets will be achieved.

For 2013, based on the agreed additional budgetary consolidation, a GGB of –7.5% of GDP is currently projected. This is in line with the *Budget 2012* forecast and with the limit set by the ECOFIN Council.

The Irish Government is fully committed to bringing the GGB below the –3% of GDP limit by 2015. The forecasts contained in this Update are consistent with the achievement of this target. The consolidation required to do so, as outlined in last November's *Medium-Term Fiscal Statement,* is set out in table 2 below.

Table 2: 2013-15 general government balance projections and amount of consolidation required to achieve targets

	2013	2014	2015
		% of GDP	
General government balance limit – *as set by the ECOFIN Council in December 2010*	-7.5	-5.1	-2.9
Projected general government balance – *as per the 2012 SPU*	-7.5	-4.8	-2.8
		€ billions	
Total Consolidation Amount	3.5	3.1	2.0
Expenditure	2.25	2.0	1.3
➢ *Current*	*1.70*	*1.9*	*1.3*
➢ *Capital*	*0.55*	*0.1*	*0.0*
Tax	1.25	1.1	0.7
➢ *New measures*	*0.95*	*0.9*	*0.4*
➢ *Carry forward*	*0.30*	*0.2*	*0.3*

Source: Department of Finance and Department of Public Expenditure and Reform.
Consolidation amounts in the table are those from the *Medium-Term Fiscal Statement*. It should be noted however that in *Budget 2012*, the carry forward effect into 2013 from revenue measures introduced in 2012 was estimated to be slightly lower than the figure given above.
Rounding may affect totals.

As for General Government Debt (GGD), this is currently forecast at around 117% of GDP for end-2012, up from 108% of GDP at end-2011. Taking account of the agreed funding schedule and the holding of appropriate cash balances by the NTMA, the ratio is projected to peak at 120% next year, before declining in subsequent years to an estimated 117% by the end of 2015. Notwithstanding the estimated fall in the debt-to-GDP ratio further out the forecast horizon, it is projected to remain at an elevated level. Reducing it to a lower, more acceptable level over time will require a sustained prudent budgetary position, along with growth-friendly economic policies.

CHAPTER 2

ECONOMIC OUTLOOK

2.1. Summary

Following three successive years in which output fell, positive growth returned to the Irish economy last year. The nascent recovery is expected to continue this year, and to both broaden and gain ground in 2013. However, with external headwinds adding to those on the domestic front, momentum is set to be softer than previously expected, though the narrative of a gradual, export-led recovery remains the same. GDP is now forecast to grow by 0.7% this year, with growth of 2.2% projected for next year.

Over the medium term, a return to robust and more sustainable growth is foreseen. While exports are expected to continue supporting economic activity, a gradual pick-up in domestic demand is also projected as the recovery broadens further and spills over to the labour market in a more substantive manner. For the period 2014-15, GDP is forecast to expand by 3% per annum on average.

Amid continued high uncertainty, this growth outlook is subject to a number of risks, though these appear broadly balanced at this time.

2.2. Recent developments

Last year saw a rebound in economic activity, with GDP recording its first full year of growth since 2007. As is typical in small open economies such as Ireland's, the traded sector is leading the recovery. Exports of goods and services rose by 4.1% on an annual basis in 2011, although heightened uncertainty and weak external demand meant that momentum softened over the course of the year. Even so, the level of exports in the fourth quarter was well above that of the pre-crisis period, which owes much to the significant price and cost adjustments that have taken place in recent years.

Domestic demand, on the other hand, remains weak and contracted again in 2011. While there was some stock-building, investment fell by 10.6% year-on-year, with personal consumption and government spending down by 2.7% and 3.7% respectively. The overall drag from domestic demand was somewhat less than in previous years though, with tentative signs that export growth is starting to feed through to investment, while employment recovered slightly towards the end of the year. That said, the spill-over from the external side to domestic activity was relatively muted, not least because households, firms and the Government sector are still working through the imbalances built up during the boom.

Imports also contracted last year, declining by 0.7% in annual terms. As a result, net exports made a strong contribution to economic activity and the trade balance increased further. Allowing for cross-border income flows and current international transfers, the current account of the balance of payments showed a surplus – albeit small - for the second year running.

Reflecting these developments, preliminary estimates show that GDP grew by 0.7% in 2011, whereas GNP fell by 2.5%.[1]

Turning to this year, the available high-frequency indicators point to a continuation of the above trends. For instance, recent readings of the new export orders component of the Purchasing Managers' Indices (particularly for the services sector) have been reasonably positive, whereas retail sales remain depressed. As such, the dichotomy – a strong exporting sector and weak domestic demand - that has characterised the Irish economy for some time looks set to continue in the near term.

2.3. Macroeconomic projections 2012-13

The recovery of the Irish economy is expected to continue this year at the same pace as last, before gaining ground in 2013. GDP is forecast to grow by 0.7% in 2012, with growth of 2.2% foreseen for next year. This represents a downgrading of the short-term outlook from that presented in *Budget 2012*, reflecting a weaker external backdrop and the persistence of some domestic headwinds.

Table 3: Macroeconomic prospects

	2011	**2011**	**2012**	**2013**	**2014**	**2015**
	(€ millions)			% change		
Real GNP	129,232	-2.5	-0.2	1.4	2.3	2.3
Real GDP	161,034	0.7	0.7	2.2	3.0	3.0
Nominal GDP	156,438	0.3	1.6	3.3	4.3	4.5
Components of real GDP						
Private consumption	82,245	-2.7	-1.7	0.0	1.0	1.2
Government consumption	26,397	-3.7	-2.2	-2.2	-2.3	-2.1
Investment	16,973	-10.6	-2.5	1.5	3.8	4.5
Changes in inventories (% of GDP)	498	0.3	0.3	0.2	0.2	0.2
Exports	161,472	4.1	3.3	4.3	4.8	4.8
Imports	-123,445	-0.7	1.4	2.6	3.4	3.5
Contributions to real GDP growth						
Domestic demand (excl. inventories)			-1.5	-0.2	0.5	0.7
Changes in inventories			-0.1	0.0	0.0	0.0
Net exports			2.3	2.4	2.4	2.3
				€ millions		
Nominal GDP (rounded to the nearest €25m)		156,450	158,925	164,175	171,150	178,850

Source: 2011 - CSO; 2012 to 2015 - Department of Finance calculations. Note that rounding can affect totals.

The external environment and export prospects

Global activity slowed in the second half of 2011 as the euro area sovereign debt crisis intensified. While policy measures taken by the ECB and European governments in recent months, together with the better than expected data-flow from the US, have helped stabilise the situation, short-term growth prospects remain

[1] As is the norm, more comprehensive figures will be published by the Central Statistics Office during the summer. In addition, there is likely to be some further revisions in 2013 to the GDP/GNP figures for recent years (and later this year, to the labour market data), on foot of the 2011 Census results.

uneven across countries and subject to considerable uncertainty. This reflects a number of factors, including geopolitical tensions in oil-rich countries, the ongoing repair of public and private sector balance sheets in advanced economies and the possibility of resurgent pressure in the euro area.

Table 4: External assumptions

	2011	2012	2013
External GDP growth		% change	
World (excluding EU)	4.2	4.2	4.3
United States	1.7	2.3	2.0
Euro Area	1.4	-0.3	0.9
United Kingdom	0.7	0.8	2.0
Technical Assumptions			
Euro-sterling exchange rate	0.87	0.83	0.83
Euro-dollar exchange rate	1.39	1.32	1.32
Brent crude (dollars per barrel)	111.5	119.9	113.5

Source: European Commission mid-April 2012 (with the exception of the Euro Area and the United Kingdom which are taken from the IMF's April 2012 WEO).

Looking to Ireland's main export markets, the outlook for the US in particular appears brighter at the current juncture. Indeed, the European Commission has revised up its growth forecasts for the US economy for the period 2012-13 since the autumn, while the IMF is projecting marginally stronger growth in the UK this year. Less positively, some of the risks to the euro area growth outlook previously identified have materialised. As a result, prospects for the region – especially near-term ones - have weakened since Budget time.

Weighted by their share in Irish exports, GDP in Ireland's key trading partners is now projected to increase by a modest ½% or so this year and by around 1½% next year - roughly a ¼ of a percentage point lower in both years than at the time of *Budget 2012*.

As such, export growth is projected to slow to 3.3% in 2012. While ongoing competitiveness gains should provide some support and the traded sector will remain the driver of the recovery, the more challenging international environment implies some moderation in trade this year. On the other hand, a pick-up in external demand is expected to translate into stronger export growth next year (in the region of 4.3%).

Outlook for domestic demand

Near-term domestic demand prospects also remain muted, with a further contraction envisaged for this year. The pace of the decline is set to ease relative to 2011 though and should come close to stabilising next year. Policy measures, such as lending targets for the pillar banks and initiatives to support the domestic economy and job creation, are expected to help in this respect.

Nonetheless, weak private consumption (-1.7% in 2012 and 0% in 2013) is expected for the period ahead. The factors that held back consumer spending last year -

declining real disposable incomes and an elevated savings rate (reflecting, inter alia, balance-sheet repair, uncertainty and high unemployment) – are set to do so again this year. Moreover, retail sales data for January and February, along with higher oil prices and a marginally weaker outlook for wage growth and employment compared to Budget time, suggest that the contraction in private consumption this year is likely to be around ½ a percentage point greater than previously expected. Looking to next year, on the back of some improvement in labour-market conditions and a pick-up in earnings, consumer spending is projected to be broadly flat, thus bringing to an end the decline evident since 2008.

As for public consumption, ongoing fiscal consolidation means that government spending is expected to fall by some 2.2% both this year and next.

Turning to investment, a fall of 2.5% is forecast for this year, followed by modest growth of 1.5% in 2013. Although corporate deleveraging is likely to continue weighing on machinery and equipment investment for some time to come, the spate of foreign direct investment announcements in recent months bodes well, while the impetus from the external side is expected to strengthen over the course of the year and into next. On this basis, a rebound in machinery and equipment investment is projected in 2012. The outlook for new house building remains muted however, with output expected to fall again this year.

Lastly, imports are forecast to increase broadly in line with final demand. Taking into account cross-border income flows and current international transfers, the current account surplus of the balance of payments is projected to widen further, to 1.1% of GDP this year and 2.2% next year.

Table 5: External balance

	2011	2012	2013	2014	2015
Current account (% of GNP)	0.1	1.4	2.9	4.2	4.9
Current account (% of GDP)	0.1	1.1	2.2	3.2	3.7
Of which: (% of GDP)					
- Balance on goods and services	21.2	23.1	25.1	26.8	28.3
- Balance of primary incomes and transfers	-21.1	-22.0	-22.9	-23.6	-24.5
Capital account	-0.3	-0.3	-0.3	-0.3	-0.2
Statistical discrepancy (€ millions)	184				

Source: 2011 - CSO; 2012 to 2015 - Department of Finance calculations. Note that rounding can affect totals.

Drawing these elements together, GDP is forecast to grow by 0.7% in 2012 and by 2.2% in 2013. Given the composition of this growth, and the important role of the largely foreign-owned exporting sector, a modest decline (-0.2%) in GNP is expected this year, followed by growth of 1.4% next year.

As already mentioned, the short-term outlook presented here is a bit more subdued than that set out in *Budget 2012*. The latest data to hand suggest that prospects for consumer spending and housing activity have weakened in recent months, while external headwinds have gained some traction. In these circumstances, GDP growth for this year and next has been revised down, by around a ½ and a ¼ of a percentage

point respectively. The narrative of a gradual, export-led recovery remains the same however, with the growth outlook for 2014-15 also little changed.

Table 6: Divergence from Budget 2012

	2011	2012	2013	2014	2015
Real GDP growth (%)					
- Previous forecast	1.0	1.3	2.4	3.0	3.0
- Current update	0.7	0.7	2.2	3.0	3.0
- Difference	-0.3	-0.6	-0.2	0.0	0.0
General government balance (% of GDP)					
- Previous forecast	-10.1	-8.6	-7.5	-5.0	-2.9
- Current update	-13.1	-8.3	-7.5	-4.8	-2.8
- Difference	-3.0	0.3	0.0	0.2	0.1
- Current update (underlying GGB)	*-9.4*				
- Difference	*0.7*				
General government gross debt (% of GDP)					
- Previous forecast	107	115	119	118	115
- Current update^	108.2	117.5	120.3	119.5	117.4
- Difference	1.2	2.5	1.3	1.5	2.4

Source: Department of Finance calculations. Note that rounding can affect totals.

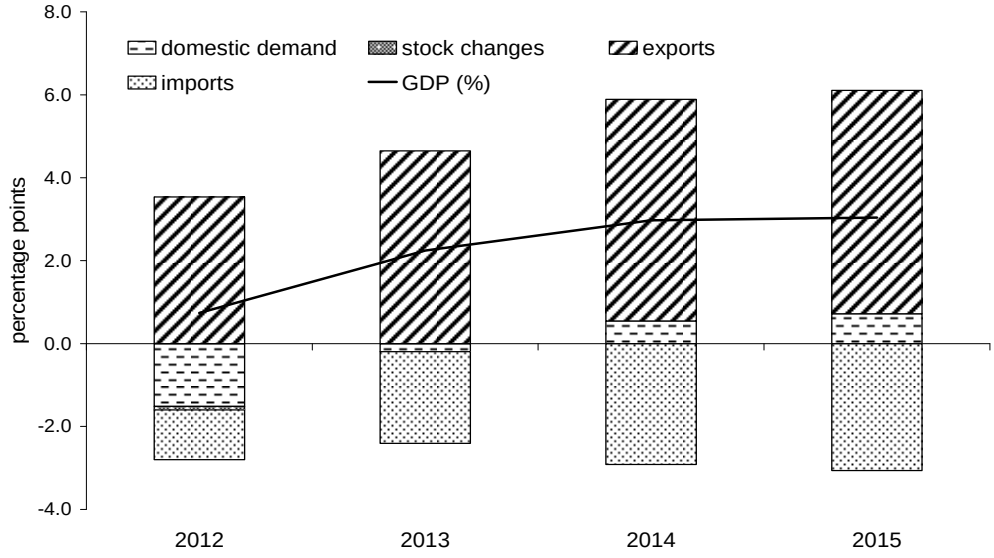
^ At 117.5%, the current estimate of the General Government debt-to-GDP ratio for 2012 has increased by around 2½ percentage points since Budget time, primarily because of the decision to settle the 2012 IBRC Promissory Note payment with a Government bond and, as a consequence, to maintain a higher level of cash balances at year-end than previously assumed.

2.4. Medium-term growth prospects

In keeping with the typical recovery path of a small open economy, a gradual firming and broadening out of economic activity is expected over the medium term. On a GDP basis, average growth of 3% per annum is forecast for the period 2014-15 (the corresponding GNP figure is 2.3%). These projections take account, in so far as is possible for an economy such as Ireland's, of the trend growth rate and the amount of slack in the economy.

On the demand side, a number of forces are set to shape developments further out the forecast horizon. The assumed strengthening of external demand as global activity regains momentum will support the traded sector and export growth, which is expected to remain the driving force behind the recovery of the Irish economy. While fiscal consolidation and ongoing private sector deleveraging will continue to weigh on domestic demand, precautionary savings should unwind somewhat as the labour market and confidence improves. Consequently, an uptick in private consumption and investment is foreseen. Reflecting excess supply, housing activity is set to remain rather muted though. Overall, domestic demand is projected to make a positive, though fairly modest, contribution to growth from 2014 onwards. Stock-building, on the other hand, is (on a technical basis) not expected to add to, or subtract from, growth over the medium term.

Figure 1: Contributions to GDP growth



Source: Department of Finance calculations.

On the supply side, a positive growth dividend is assumed from the structural reforms set out in the EU/IMF Programme and those being pursued through various Government initiatives and within the context of the Europe 2020 Strategy. A summary of progress in respect of Ireland's National Targets under the latter – the detail of which is discussed in the 2012 Update of the National Reform Programme – is provided in annex 1.

2.5. The labour market

While labour-market conditions remain weak, with employment down by 2.1% for 2011 as a whole, a degree of stabilisation was evident towards the end of last year. Indeed, employment rose by 0.6% in the fourth quarter (quarter-on-quarter, seasonally adjusted), the first such increase since late 2007.

A further year-on-year contraction is likely this year, though the fall is expected to be more modest (0.4%). This represents a downward revision of around a ¼ of a percentage point from the Budget forecast, reflecting in part greater clarity about restructuring across the economy, especially in the banking sector, but also weaker than anticipated economic activity. Supported by the Government's *Action Plan for Jobs 2012* (in the absence of which the downward revision for this year would be have been more marked), the economy is, however, expected to be creating jobs on a net basis by the end of 2012. A return to employment growth on a full-year basis is anticipated for next year, as economic activity picks up and the measures implemented as part of the 2012 Action Plan take effect. Thereafter, the pace of hiring is projected to strengthen.

Table 7: Labour market developments

	2011 ('000s)	2011	2012	2013	2014	2015
		% change				
Employment	1,810	-2.1	-0.4	0.8	1.3	1.6
Unemployment rate (QNHS basis)	304	14.4	14.3	13.6	12.8	11.7
Labour productivity (GDP per person employed)		2.9	1.1	1.4	1.6	1.5
Compensation of employees		-3.3	-0.6	1.7	2.9	3.6
Compensation per employee		-1.0	0.4	1.0	1.4	1.9

Source: 2011 - CSO and Department of Finance calculations; 2012-15 - Department of Finance calculations.

Notwithstanding net job creation in the order of 60,000 over the period 2012-15, the number of people out of work is set to remain at a relatively high level. As the labour force is projected to decline at a marginally faster rate than employment this year – on the back of continuing net outward migration and subdued labour force participation - the unemployment rate is projected to fall slightly, to 14.3%. Further declines are projected over the medium term, though the unemployment rate is still forecast to be in double digits by 2015.

It is stressed that these labour market forecasts take account only of policies which are known; they should in no way be seen as Government targets. The impact of measures yet to be announced - including those that will be published as part of the 2013, 2014 and 2015 action plans – will be factored into the Department of Finance's macroeconomic forecasts as and when the announcements are made and information about the specifics becomes available. On this basis, it can be expected that over time, the labour market outlook will become more favourable, and that the Government's policy aim of increasing the numbers at work by 100,000 by 2016 will be realised. Later forecasts will continue to reflect progress in this respect.

There is also considerable upside risk to the near-term employment outlook. Income tax data, for example, were ahead of target for the first quarter of the year which augurs well, as do recent foreign direct investment announcements. Moreover, the measures being taken as part of the *Action Plan for Jobs 2012* - including improved access to finance for small businesses, a reduction in costs and red tape and supports for exports, management and innovation – may translate into jobs more rapidly than assumed. As such, the labour market aspect of the macroeconomic projections presented here will need to be monitored carefully.

2.6. Price developments

Last year saw a pick-up in consumer prices, in both HICP and CPI terms. Price increases are expected again this year, with energy and administrative charges likely to be the key drivers, as was the case in 2011. Geopolitical instability and demand side pressures have contributed to raising the cost of a barrel of oil, from around $112 on average last year to an average of $119 in 2012 to date. At the same time, exchange rate movements over the past few months, while benefitting exports, have exacerbated the rise in wholesale energy prices and other imported goods. In

addition, there will be some impact from the indirect tax and other policy measures introduced towards the end of 2011. Weak domestic demand and considerable spare capacity in the economy means that underlying or 'core' inflation should remain muted however.

Annual HICP inflation of 1.8% is now forecast for this year. As consumer prices elsewhere are projected to increase at a somewhat faster pace, a continued improvement in Ireland's competitiveness position is on the cards. On a CPI basis, inflation is expected to average 1.6% in 2012 - the interest rate trajectory is flat at the moment, while base effects will fall out over the course of the year.

More modest consumer-price inflation is forecast for next year, though as domestic demand recovers, prices should start to trend up again further out the forecast horizon.

Table 8: Price developments

	2011	2012	2013	2014	2015
			% change		
GDP deflator	-0.4	0.9	1.0	1.3	1.4
Private consumption deflator	0.9	1.6	1.2	1.4	1.7
Harmonised index of consumer prices (HICP)	1.1	1.8	1.3	1.5	1.8
Consumer price index (CPI)	2.6	1.6	1.3	1.4	1.8
Export price deflator (goods and services)	0.7	1.1	1.3	1.4	1.4
Import price deflator (goods and services)	3.7	1.5	1.3	1.4	1.5

Source: 2011 - CSO and Department of Finance calculations; 2012-15 - Department of Finance calculations.

More broadly, the GDP deflator – which takes account of price changes in all components of demand and so is the widest measure of price developments in the economy – is projected at 0.9% this year. This turnaround follows, in part, from the fact that the terms-of-trade effect is expected to be less negative than was the case last year (while import prices are still rising faster than export prices, the gap is set to narrow). A favourable euro-dollar exchange rate is helping in this respect, whereas oil price developments and the near-term expiry of a number of pharmaceutical patents are likely to have the opposite effect.

Over the medium term, a gradual firming of the GDP deflator is expected which, in turn, will support a strengthening of nominal GDP growth.

2.7. Risks to the forecasts

Given the high degree of uncertainty at present, the growth outlook presented here is subject to an unusually large number of risks.

As always, 'perennial' risks - those to which macroeconomic projections for open economies are generally subject – apply. These include growth in Ireland's main trading partners and movements in commodity prices, exchange rates and interest

rates. By way of illustrating the potential impact on the Irish economy of benign / adverse developments on these fronts, model simulations using the Economic and Social Research Institute's macroeconomic model (HERMES) are presented in table 9. These estimates should be seen as indicative; the estimated impacts may not hold in every circumstance (i.e. specific factors or policy stances within a given year could alter them). Moreover, the structural change that Ireland has gone, and is still going, through means that normal, long-held economic relationships are now proving less reliable as indicators of future prospects.

Table 9: Effect on the level of real GDP of changing assumptions

	Year 1	Year 2	Year 3	Year 4
		% change from baseline		
1 pp. change in interest rates	+/-0.4	+/-1.7	+/-2.2	+/-2.2
1% change in world growth	+/-0.9	+/-1.5	+/-1.7	+/-1.5
€10 change in oil prices	+/-0.3	+/-0.8	+/-1.2	+/-1.2
1% change in the €/$ and €/£ exchange rates	+/-0.0	+/-0.1	+/-0.1	+/-0.1
1 pp. change in the savings rate	+/-0.3	+/-0.3	+/-0.3	+/-0.3

Source: ESRI.

At the current juncture, there are also risks stemming from the unusual circumstances prevailing domestically and globally.

The most important risks of a domestic origin relate to the scale and speed of balance sheet repair on the part of households and the corporate sector, ongoing fiscal adjustment and its effect on economic activity, and the availability of credit. While there is obvious downside potential in relation to these, there is also scope for some upside potential on the back of, inter alia, policy measures. As table 9 shows, if, as a result of such measures, confidence improved and uncertainty dissipated more rapidly than assumed, the household savings rate could fall at a faster pace, boosting economic activity.

In terms of externally sourced risks, the possibility of renewed sovereign stress in the euro area and the potential for spill-over effects to the financial system and the real economy is a key concern, as is the possibility of oil supply disruptions and the impact this would have on global growth. Notwithstanding recent policy actions, the balance in respect of these two risks remains largely to the downside.

It should, however, be noted that the outlook for Irish exports is affected by more than expectations about global growth. It is also subject to risks related to the composition of the products that Ireland exports and overall competitiveness. As the composition of Irish exports is relatively concentrated, changes in demand or supply conditions for specific products can potentially have a large impact (both positive and negative). On the other hand, the structural reform measures that Ireland is pursuing as part of the EU/IMF Programme and through various Government initiatives pose a clear upside risk - they may well boost competitiveness, and thus exports, by more than expected.

Likewise, there is considerable upside potential to the labour market outlook on foot of the *Action Plan for Jobs 2012*. As already mentioned, the measures set out in this may translate into stronger and more rapid job creation than assumed, which would boost households' income and support consumer spending.

In sum, the margins of error surrounding macroeconomic projections for Ireland are considerably higher at present than would normally be the case. In light of this, section 2.9 discusses the sensitivity of the public finances to economic conditions.

2.8. Range of forecasts

Table 10 compares the Department of Finance's forecasts for the main macroeconomic variables with those of other agencies. Against a background of heightened uncertainty, notably about the outlook for the euro area, some divergence of views is to be expected. Indeed, when comparing the different projections, it should be borne in mind that the assumptions underpinning them may vary.

Table 10: Comparison of macroeconomic projections for Ireland

		Annual % change			
2012		GDP	GNP	HICP	Employment
Department of Finance	*April '12*	0.7	-0.2	1.8	-0.4
Central Bank of Ireland	*April '12*	0.5	-0.7	1.5	-0.8
IMF	*April '12*	0.5	n.a	1.7	-1.0
Consensus	*End-March '12*	0.5	-0.4	1.5	n.a
ESRI	*February '12*	0.9	0.1	1.4	-1.5
European Commission	*February '12*	0.5	n.a	1.6	n.a.
OECD	*November'11*	1.0	n.a	0.8	n.a

		Annual % change			
2013		GDP	GNP	HICP	Employment
Department of Finance	*April '12*	2.2	1.4	1.3	0.8
Central Bank of Ireland	*April '12*	2.1	1.0	0.9	0.4
IMF	*April '12*	2.0	n.a	1.2	0.7
Consensus	*End-March '12*	1.8	1.2	1.4	n.a
ESRI	*February '12*	2.3	1.0	1.3	-0.8
European Commission	*February'12*	n.a	n.a	n.a.	n.a.
OECD	*November'11*	2.4	n.a	0.9	n.a

Source: Institutions cited.

The range of GDP growth forecasts for this year extends from 0.5% to 1.0%, with the Department's projection in the middle. The Central Bank, the IMF and the European Commission are at the lower end of this scale, as is the private-sector consensus. The ESRI and the OECD, on the other hand, are marginally more optimistic than the Department, although the forecasts by the OECD are not as recent as others.

The picture for next year is very similar to the above, with the Department's GDP growth projection again roughly mid-way.

2.9. Sensitivity analysis

To test the sensitivity of the public finances to economic conditions, the HERMES model has been used to simulate a situation in which real GDP differs from the baseline by 1%. Four alternative causes of the change in economic growth are modelled – a change in world growth, a change in interest rates, a change in oil prices and a change in the savings rate.

Table 11: Impact on the budget balance of a 1% change in real GDP

	2012	2013	2014	2015
Baseline GDP growth (%)	0.7	2.2	3.0	3.0
Baseline GGB (% of GDP)	-8.3	-7.5	-4.8	-2.8
1% change in GDP due to a change in interest rates				
Cumulative impact on GGB (% of GDP)	Up to 0.5	Up to 0.5	Up to 0.6	Up to 0.6
GGB range (% of GDP)	-8.8 to -7.8	-8.0 to -7.0	-5.4 to -4.2	-3.4 to -2.2
1% change in GDP due to a change in world growth				
Cumulative impact on GGB (% of GDP)	Up to 0.3	Up to 0.4	Up to 0.4	Up to 0.4
GGB range (% of GDP)	-8.6 to -8.0	-7.9 to -7.1	-5.2 to -4.4	-3.2 to -2.4
1% change in GDP due to a change in oil prices				
Cumulative impact on GGB (% of GDP)	Up to 0.1	Up to 0.1	Up to 0.2	Up to 0.2
GGB range (% of GDP)	-8.4 to -8.2	-7.6 to -7.4	-5.0 to -4.6	-3.0 to -2.6
1% change in GDP due to a change in the savings rate				
Cumulative impact on GGB (% of GDP)	Up to 0.7	Up to 0.7	Up to 0.7	Up to 0.7
GGB range (% of GDP)	-9.0 to -7.6	-8.2 to -6.8	-5.5 to -4.1	-3.5 to -2.1

Source: Department of Finance calculations on the basis of the ESRI's macroeconomic model.

These estimates suggest that a 1% fall in real GDP resulting from higher interest rates or lower world growth would lead to a deterioration in the General Government Balance (relative to the baseline) of about ½ a percentage point of GDP in the short to medium run. This finding is broadly symmetrical in that higher growth as a result of lower interest rates, or stronger global activity, would improve the GGB by a similar amount.

While a 1% increase in real GDP on foot of a decline in the savings rate would also improve the GGB, by around ¾ of a percentage point of GDP (relative to the baseline), higher oil prices would worsen it by around a ¼ of a percentage point. Again, the effects are broadly symmetrical.

As with the simulation results presented in table 9, the estimates above are subject to considerable uncertainty and should be seen as indicative - the estimated impacts may not hold in every circumstance. Moreover, it is assumed that there is no fiscal policy response to the changed budgetary position over the period. In reality such a response would occur if desirable in the interests of economic or budgetary sustainability, and in light of the commitments entered into in order to achieve the targets set out in the December 2010 ECOFIN Council decision.

CHAPTER 3

THE PUBLIC FINANCES

3.1. Summary

Excluding the impact of financial support for the banking sector, the underlying General Government Balance (GGB) is estimated at –9.4% of GDP last year. This represents an improvement from the previous year's outturn and was well within the –10.6% of GDP limit set by the ECOFIN Council in December 2010.

Budget 2012 implemented a substantial budgetary adjustment package aimed at further improving the public finances with a GGB of –8.6% of GDP targeted for this year, consistent with the limit set in December 2010. With just three months Exchequer (cash) data to hand, and while acknowledging some potential risks, the current outlook is for a GGB of –8.3% of GDP this year, an improvement on the Budget day estimate.

The Irish Government remains firmly committed to restoring sustainability to the public finances through the implementation of further budgetary consolidation and growth-enhancing policy measures aimed at reducing the GGB below the –3% of GDP threshold by end-2015.

In relation to *Budget 2013*, the Government is also fully committed to the targets set, and in this regard will implement a consolidation package consistent with adhering to the –7.5% of GDP limit for the GGB for next year. The split between expenditure and revenue measures for 2013 was outlined in last November's *Medium-Term Fiscal Statement*, though the precise make-up of the adjustment package will be decided by Government later this year in advance of *Budget 2013*, in light of more up-to-date economic and fiscal data which will become available.

The ratio of General Government Debt (GGD) to GDP is forecast to be around 117% at the end of this year and is projected to peak at 120% at end-2013, before moving onto a declining path thereafter.

3.2. Budgetary outturn 2011

Exchequer tax revenue amounted to €34,027 million in 2011, an increase of 7.2% compared with a year earlier. This strong year-on-year growth rate was largely due to the introduction of the Universal Social Charge (USC) and receipts from the temporary levy on personal pension funds introduced to fund the Government's May 2011 *Jobs Initiative*. On the other hand, delayed corporation tax receipts of some €¼ billion which were only received into the Exchequer account in January 2012, but which were appropriate to 2011, dampened the growth rate somewhat. When all of these factors are taken into account, it is estimated that tax revenues grew only marginally in 2011. Nevertheless, after a three-year period in which aggregate tax revenue fell by one-third, such an outcome is a positive development.

The Exchequer deficit (also know as the Exchequer Borrowing Requirement – EBR) in 2011 was €24.9 billion, compared with €18.7 billion in 2010. The large increase was primarily related to banking related payments including the first €3.1 billion

payment in respect of the Promissory Notes and a further net €6.5 billion in once-off payments relating to the recapitalisation of the banking sector in July 2011. Excluding Exchequer banking related payments and, for completeness, the proceeds from the sale of part of the National Pensions Reserve Fund (NPRF) Commission shareholding in Bank of Ireland, the EBR actually declined by some €2¾ billion year-on-year in 2011.

The outturn for the underlying GGB for 2011 was –€14.7 billion or –9.4% of GDP, well within the –10.6% of GDP limit set by the ECOFIN Council in December 2010, and an improvement on the 2010 underlying position. However, the headline GGB is estimated at –13.1% of GDP last year; the higher figure is due to the inclusion of some €5.8 billion (3.7% of GDP) in GGB worsening capital transfers to AIB and ILP arising from the July 2011 recapitalisation of the banking sector.

3.3. Budgetary outlook 2012

Budget 2012 forecast a GGB of –8.6% of GDP for 2012 and an EBR of €18.9 billion. Tax revenues were projected to be €35.8 billion in 2012, an increase of some 4½% on the 2011 yield (when account is taken of the delayed corporation tax receipts which were received into the Exchequer account in January 2012, but which were appropriate to 2011).

In terms of the performance in the period to end-March, Exchequer data show that €8.7 billion in tax revenue was collected in the first quarter of the year. On a headline basis, this represents a very significant increase of €1.2 billion or 16.2% on the first quarter of 2011. Compared with the monthly profile published in early February, taxes were just over €0.8 billion or 10.2% ahead of expectations at end-March. However there are two very specific factors that were largely responsible for this over-performance compared to profile.

Firstly, €251 million in corporation tax receipts which were expected in December 2011 were not received into the Exchequer account until January 2012. As such, they did not form part of the original *Budget 2012* estimate of corporation tax and, therefore, did not form part of the published profile. In general government terms, these receipts are accounted for as 2011 revenues. Nevertheless, corporation tax still performed better than expected in the first quarter of 2012, due to a lower than expected level of repayments to companies. However, the expectation is that some of these repayments will be made in the coming months with a consequential negative impact on collection in those months.

Secondly, income tax was up €739 million or 25.8% year-on-year and €321 million or 9.8% ahead of target at end-March. A substantial part of the surplus arises from a technical reclassification of receipts from employers which they had previously returned as PRSI. While this benefits income tax, it also means that PRSI income was lower, resulting in higher net voted current expenditure of the Department of Social Protection. As this is purely a reclassification between the revenue and expenditure sides of the balance sheet, the EBR and GGB impacts are neutral.

Notwithstanding this, income tax performed well in the first quarter of 2012, recording an underlying 18½% increase on the corresponding period in 2011. A

large year-on-year increase in income tax was expected and is largely attributable to the full year impact of the measures introduced in *Budget 2011*, most notably the USC, but also to the reductions in credits and bands.

The main revenue raising measure introduced in *Budget 2012* was a 2% increase in the standard rate of VAT, and March was the first month in which the full impact of the rate change was evident. On a cumulative basis, VAT was €101 million or 3.2% ahead of target at the end of the first quarter, and €182 million or 5.8% up on the same period in 2011.

Excise duties – the fourth of the 'big-four' tax-heads – disappointed a little in the first quarter of the year, recording a €42 million or 4.1% shortfall to end-March and a marginal year-on-year fall. Each of the four smaller tax-heads – stamp duties, capital gains tax (CGT), capital acquisitions tax (CAT) and customs duties – generally performed close to profile in the first quarter.

Adjusting for the delayed corporation tax receipts and the income tax reclassification issue, it is estimated that aggregate tax revenues were up just over 10% year-on-year and some 4.4% ahead of profile at end-March.

In terms of the outlook for the year as a whole, tax revenue in 2012 was projected to increase by 4½%, and trends in the first quarter mean that this target remains achievable. However, there are risks which will require ongoing monitoring. An updated position will be provided in the context of the mid-year Exchequer figures due for publication in early July.

Turning to the spending side, overall net voted expenditure at end-March, at €11.6 billion, was €586 million or 5.3% up year-on-year and €501 million or 4.5% ahead of profile. Adjusting for the PRSI reclassification issue (outlined above), net voted expenditure was 2.6% ahead of target at end-March.

Net voted current expenditure, at €11.1 billion at end-March, was up €649 million or 6.2% year-on-year and €533 million or 5% ahead of profile, due largely to overspending in the Health Vote Group and in the Department of Social Protection. The latter was caused in part by the PRSI reclassification issue. Adjusting for this, net voted current expenditure was 3.1% ahead of target at end-March.

The net voted current expenditure of the majority of the other Vote Groups was below profile at end-March.

Net voted capital expenditure at end-March, at €531 million, was €32 million or 5.6% below expectations and €63 million or 10.6% lower year-on-year.

Expenditure for the year as a whole remains in line with the *Revised Estimates for Public Services 2012* as published in February, save for the shortfall in PRSI arising from the technical reclassification of receipts to income tax, and pressures arising in relation to the Live Register (i.e. claimant count) area. These Live Register pressures also present challenges for later years. It will be important to adhere to spending targets in 2012, as was done in 2011, if budgetary targets are to again be achieved.

While taxation receipts in 2012 are projected to be just above 2004 levels, the gross voted expenditure of Government Departments and Offices in 2012, at an estimated €56 billon, is projected to be 37% above the level it was in 2004, despite the very significant adjustments to both revenues and expenditure since mid-2008. While the gap between the State's revenues and expenditure is clearly on a downward trajectory, it remains at an elevated level and it will need to continue to be addressed by economic and fiscal policy over the coming years.

The current estimate of the Exchequer deficit or EBR for 2012 is €18.7 billion[2], almost exactly in line with the *Budget 2012* estimate, notwithstanding some compositional changes (see table 12).

On the plus side, national debt servicing costs are now projected to be some €0.4 billion lower than envisaged at the time of the Budget, with the savings arising mainly as a result of the timing of transactions to date this year.

Higher than expected fees in respect of the Bank Guarantee, and the delayed corporation tax receipts from December 2011, are also benefitting the Exchequer position in 2012 compared to the original *Budget 2012* forecast.

Offsetting these improvements somewhat are changes to the European Stability Mechanism (ESM). Firstly, its entry into force has been brought forward to mid-2012[3] and, secondly, paid-in capital is to be accelerated, with two tranches to be paid both this year and next with the final tranche paid in 2014. Ireland's contribution will be 1.592% of the total €80 billion paid-in capital, amounting to a total of €1.27 billion. Importantly, as the ESM is treated as an International Financial Institution, Member States' contributions will be treated as a financial transaction, with no impact on the GGB. However, the decision to bring forward the entry into force of the ESM and to accelerate the payment schedule does increase the State's funding requirements in 2012 and 2013.

Taking all of these factors into account, as well as some GGB-specific effects (such as higher NPRF investment income), the GGB for 2012 is now estimated at –8.3% of GDP. This figure is an early, point-in-time estimate. The Government remains committed to adhering to the GGB target of -8.6% of GDP for this year and is satisfied - on the basis of Exchequer Returns data for the first three months of the year - that its budgetary plans are on track and that the fiscal targets will be achieved.

[2] The EBR estimate for 2012 includes €3.06 billion in respect of the Promissory Note payment to IBRC, although settlement of this payment was through a Government bond. Due to the unique nature of this transaction, the precise Exchequer accounting treatment will be reflected in the end-April Exchequer Statement which will be published on 2 May 2012.

[3] Originally, it was planned that the ESM would enter into force in mid-2013, and that paid-in capital would be made in five equal instalments beginning next year (in an Irish context, this would have amounted to c. €254 million per annum).

Table 12: Exchequer based public finance projections

	2012	2013	2014	2015
		€ millions		
Current budget				
Expenditure				
Gross Voted Current Expenditure	51,895	50,590	48,715	47,355
Non-Voted Current Expenditure	8,630	9,420	10,150	10,670
Gross Current Expenditure	60,525	60,010	58,865	58,025
less Expenditure Receipts and Balances	*11,085*	*10,970*	*11,235*	*11,535*
Net Current Expenditure	49,435	49,040	47,630	46,485
Receipts				
Tax Revenue	36,375*	38,460	41,025	43,280
Non-Tax Revenue	2,730	2,025	1,655	1,620
Net Current Revenue	39,105	40,485	42,680	44,900
Current budget balance	**-10,330**	**-8,555**	**-4,950**	**-1,585**
Capital budget				
Expenditure				
Gross Voted Capital	3,960	3,375	3,255	3,255
Non-Voted Expenditure	6,435**	4,590	4,160	3,920
Gross Capital Expenditure	10,395	7,965	7,415	7,175
less Capital Receipts	*325*	*335*	*320*	*320*
Net Capital Expenditure	10,070	7,630	7,095	6,855
Capital Resources	1,745	1,650	1,645	1,640
Capital budget balance	**-8,325**	**-5,980**	**-5,450**	**-5,215**
Exchequer balance	**-18,655**	**-14,530**	**-10,400**	**-6,800**
General government balance	**-13,115**	**-12,355**	**-8,140**	**-4,950**
% of GDP	***-8.3%***	***-7.5%***	***-4.8%***	***-2.8%***

Sources: Department of Finance and Department of Public Expenditure and Reform.
Figures rounded to the nearest €5 million.
Rounding may affect totals.
*Tax revenue for 2012 includes €251 million from delayed December 2011 corporation tax receipts, and an estimated €300 million from the reclassification to income tax of receipts previously returned as PRSI income. Excluding these impacts, tax revenues are expected to be in line with the *Budget 2012* forecast of €35,825 million. The impact of the reclassification is budgetary neutral as lower PRSI receipts result in higher net voted current expenditure. For the purposes of the General Government Balance measure, these corporation tax receipts are accounted for as part of 2011 revenues.
**Non-voted capital expenditure includes €3.06 billion in respect of the Promissory Note payment to IBRC although settlement of this payment was through a Government bond. Due to the unique nature of this transaction, the precise Exchequer accounting treatment will be reflected in the end-April Exchequer Statement which will be published on 2 May 2012.
The non-voted capital expenditure projections do not include any 1% of GNP contributions to the NPRF.

3.4. Budgetary outlook / Budget 2013

The Government is fully committed to implementing a budgetary adjustment package consistent with the aim of further reducing the GGB to –7.5% of GDP next year, in line with the limit set by the ECOFIN Council in December 2010, and consistent with correcting the excessive deficit by 2015.

While recognising that the Government will, over the coming months and on the basis of updated economic and fiscal data, finalise the precise details of the measures that will be implemented as part of *Budget 2013*, there is a substantial amount of information available on the magnitude and design of the adjustment planned for 2013. See, for instance, the *Medium-Term Fiscal Statement*, the *Comprehensive Expenditure Report 2012-2014 (CER), Budget 2012* and the March 2012 EU/IMF Programme Memorandum of Understanding.

The 2013 GGB is currently forecast at –7.5% of GDP, in line with the ceiling set by the ECOFIN Council. For the purposes of producing public finance forecasts, table 12 sets out the position based on the implementation of measures consistent with the overall commitments in policy documents such as those referred to above.

It is important to note that the current budgetary forecasts for the years 2013-15 assume the payments in respect of the Promissory Notes to IBRC are settled as they were in 2011; that is with a €3.06 billion cash payment from the Exchequer. It is the case that the Government is eager to have the Promissory Notes examined to see if they can be re-engineered in a way that is less burdensome on the State. In that regard, the Irish Government is involved in technical discussions with the European Commission, ECB and IMF in relation to the IBRC Promissory Notes. Any changes that might arise from these technical discussions would be factored into the budgetary projections at a later stage.

In this respect, it is important to also bear in mind that the GGB estimate for 2013 makes allowance for some €1.9 billion, or over 1% of GDP, in interest on the Promissory Notes. In light of the interest holiday secured on the Promissory Notes for 2011 and 2012, there was no impact on the GGB in those years arising from this interest. However for 2013, this represents a significant additional General Government expenditure item that must be allowed for in the forecasts and is part of the reason why the GGB is expected to decline to just –7.5% of GDP next year.

3.5. Public finances 2014-15

The Irish Government remains firmly committed to reducing the GGB to below –3% of GDP by end-2015. Consistent with the plans outlined above, further budgetary adjustments will be required in 2014 and 2015 in order to achieve this objective. While the scale and the speed of the adjustment will depend on the economic situation prevailing at the time, the public finance forecasts underpinning this Update are consistent with the level of adjustment outlined in the *Medium-Term Fiscal Statement*. Based on current forecasts, these levels of adjustment are sufficient to ensure that the GGB is below 3% of GDP by 2015. As with 2013, the exact nature of the measures to be implemented will be decided by Government at a later stage, in light of the emerging economic and fiscal outlook and in light of policy priorities.

Spending adjustments will be informed by the CER, and it is proposed to undertake a periodic review of expenditure approximately every three years so that the multi-year Ministerial expenditure ceilings can be re-set to reflect developing Government priorities. These reviews will examine every area of spending, to enable the Government to meet its overall budgetary objectives, to maximise the scope for

reform and restructuring across the public service, and to realign the allocations with the Government's new priorities.

The approach to revenue policy in the years 2014-15 will, conditions permitting, follow that implemented in 2012 and proposed for 2013. This means a continued emphasis on all forms of broadening the tax base generally.

3.6. Report of the Irish Fiscal Advisory Council

As part of the agenda of reforming Ireland's budgetary architecture, the Government established the Irish Fiscal Advisory Council last summer. The role of the Council is to independently assess, and comment publicly on, whether the Government is meeting its own stated budgetary targets and objectives. The Council has also been tasked with assessing the appropriateness and soundness of the Government's macroeconomic and budgetary projections and its fiscal stance. In April 2012, the Council published its second *Fiscal Assessment Report*.

The Report concludes that the *Budget 2012* macroeconomic forecasts were broadly appropriate at the time of their publication last December. The Council notes, however, that data available since then, together with more recent external growth projections, suggest that the 2012 GDP growth forecast is somewhat on the high side (note that the macroeconomic forecasts contained in this document have been revised downwards on foot of this slightly disappointing data-flow).

In terms of the budgetary assessment, the Council is of the view that in light of the deterioration in the growth outlook, there is a risk that the 8.6% of GDP General Government deficit target for this year may not be achieved. The Council suggests therefore that additional fiscal consolidation measures of some €400 million may be necessary, although it does note that it is too early to say if this will be required.

The Government has noted the second *Fiscal Assessment Report*. Based on the first quarter Exchequer data, the Government is confident that this year's deficit target can be achieved without the need for additional measures. Furthermore, and as outlined in section 3.3, the GGB in 2012 is improved by additional revenues from Bank Guarantee fees and from the income of the NPRF, as well as lower debt servicing costs. These mean the 2012 GGB is currently estimated at –8.3% of GDP.

In the context of bringing the GGB below –3% of GDP by 2015, the Council remains of the opinion that the fiscal consolidation process should be accelerated, and recommends additional budgetary adjustments of the order of €2.8 billion over the period to 2015. This would, in the view of the Council, reduce the deficit to 1.7% of GDP in 2015.

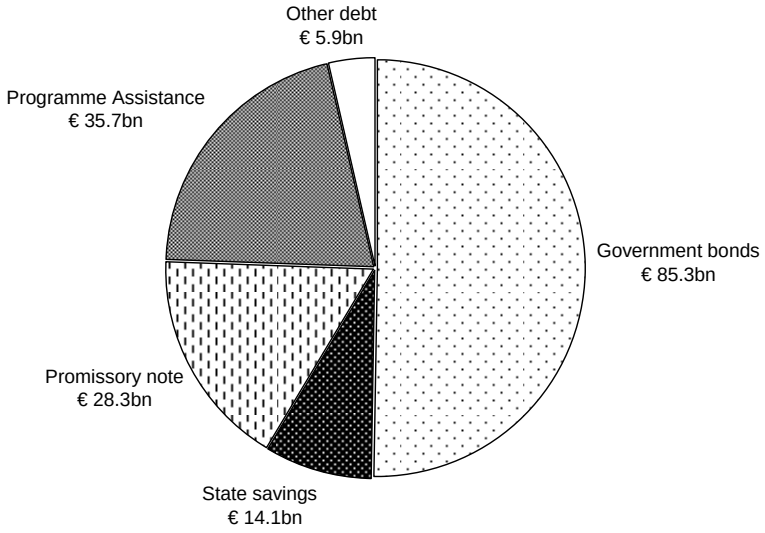
The Government is cognisant of the views of the Council and fully aware of the importance of continuing to adhere to the deficit targets. Indeed, having a lower deficit by 2015 would, all other things being equal, lower the debt level and reduce debt servicing costs. That said, the Government is also conscious of the impact that additional consolidation could have on domestic economic activity and, in particular, on the labour market. The Government's view is that correcting the excessive deficit by 2015 strikes the appropriate balance between the necessary

consolidation on the one hand, and supporting the emerging economic recovery on the other hand.

3.7. Debt level and developments

At the end of 2011 General Government Debt stood at €169 billion, or 108% of GDP[4]. The composition is set out in figure 2 below. It consisted of €85.3 billion of Government bonds; €35.7 billion of Programme assistance debt; €28.3 billion in Promissory Notes; €14.1 billion State Savings or retail debt; and €5.9 billion other Government debt.

Figure 2: Breakdown of general government debt 2011



Source: Department of Finance and NTMA.
Programme assistance includes loans from the EFSF, EFSM, IMF and UK, the prepaid margin to the EFSF and reflects currency fluctuations.
State Savings are savings products offered by the state to personal savers which include Post Office Deposit savings.
The remaining €5.9 billion of General Government Debt includes Local Authority and Housing Finance Agency debt (€1.5 billion), short-term debt (€2.9 billion), as well as other medium/long-term loans, swaps and related collateral, coinage, the debt of the non-commercial semi-state sector and state savings accruals.

The debt-to-GDP ratio is projected to increase further next year, although at a slower pace as the deficit in the public finances shrinks further and as nominal GDP growth strengthens.

[4] General Government Debt is a gross measure that does not allow the netting-off of liquid assets. The concept of net government debt is not specifically defined or generally used in international comparisons. However, netting-off the €13.8 billion in cash, deposits and other liquid assets held by the Exchequer, as well the €5.4 billion discretionary portfolio of the NPRF, against the General Government Debt would give a net government debt position of 96% of GDP at end-2011.

At present, the ratio is expected to end 2012 at around 117% of GDP. This is a little in excess of the *Budget 2012* forecast, largely reflecting a higher projected cash balance position at end-year and the issuance of Government bonds to settle the 2012 Promissory Note payment to IBRC. As GGD is a gross measure, this stronger cash balance position actually worsens the ratio although it can be argued that it is necessary, for reasons of prudence and investor confidence, that the Exchequer, at the end of 2012, has adequate funding to meet its estimated liabilities in the early part of 2013, which include a €6 billion bond redemption. The stronger cash position provides more flexibility around funding.

The debt-to-GDP ratio is forecast to peak at 120% of GDP in 2013, before declining to 117% by 2015 (see table 13). Such a peak ratio is clearly an elevated one, and it will require a sustained prudent budgetary position, along with growth-friendly economic policies, if it is to be brought down to lower, more acceptable levels over time.

Table 13: General government debt developments

% of GDP	**2011**	**2012**	**2013**	**2014**	**2015**
Gross debt	108.2	117.5	120.3	119.5	117.4
Change in gross debt (=1+2+3)	15.7	9.3	2.9	-0.8	-2.1
Contributions to change in gross debt ratio					
1. General government deficit	13.1	8.3	7.5	4.8	2.8
2. Stock-flow adjustment	2.9	2.7	-0.9	-0.6	0.3
3. Nominal GDP contribution to change in the debt ratio	-0.3	-1.7	-3.7	-4.9	-5.1
Composition of GGB					
4. General government balance	-13.1	-8.3	-7.5	-4.8	-2.8
5. Interest expenditure	-3.4	-4.1	-5.6	-5.5	-5.6
6. Primary balance (= 4 - 5)	-9.7	-4.2	-1.9	0.8	2.8
Composition of stock-flow adjustment					
7. Change in Exchequer deposits	1.0	0.8	-0.8	-1.3	-0.1
8. Interest adjustments	-0.4	-0.2	-1.0	0.1	0.0
9. Equity transactions	3.7	1.4	0.4	0.1	0.0
10. Accrual adjustments	0.4	0.0	0.1	0.1	0.1
11. Impact of NPRF	-2.8	0.3	0.4	0.3	0.3
12. EFSF prepaid margin	0.3	0.0	0.0	0.0	0.0
12. Other	0.6	0.3	0.0	0.0	0.0
Memorandum item					
Average interest rate (%)	3.7	3.8	4.9	4.8	4.9

Source: Department of Finance.
The average interest rate is calculated by dividing the General Government interest expenditure for the year in question by the stock of General Government Debt outstanding at the end of the previous year. The increase in the rate in 2013 primarily reflects the impact of the ending of the Promissory Note interest holiday which applied in 2011 and 2012.

During 2011, Ireland drew down €34½ billion[5] in funding from the EU/IMF Programme at an average interest rate of 3.7% and an average maturity of 7.5 years. The sources of that funding were as follows:

- €7.6 billion from the EFSF;
- €13.9 billion from the EFSM;
- €12.6 billion from the IMF EFF; and
- €0.5 billion in bilateral loans from the UK.

This borrowing was applied to fund an Exchequer deficit of €24.9 billion (of which a net €6.5 billion was for bank recapitalisation payments) and to refinance €9.1 billion of maturing debt, both short and long-term. The NTMA maintained healthy Exchequer cash balances of €13.1 billion at the Central Bank at year end.

Given the rapidly increasing volume of debt that has emerged in recent years, the cost of servicing the debt has also increased significantly and will, for the forecast period, absorb an increasing amount of revenues. In 2011, General Government interest expenditure as a percentage of General Government revenues amounted to 9.6%. In 2007, the equivalent figure was just 2.9%. By 2015, based on current assumptions regarding the evolution of revenues, debt levels and interest rates on Government borrowing, the equivalent of some 15.5% of General Government revenues, will be required to service GGD.

3.8. Debt sustainability

The current debt-to-GDP ratio is very high relative to historic experience, to the threshold that is generally considered safe, and to the 60% Stability and Growth Pact limit. In these circumstances, it is vital that the debt ratio is stabilised and returned to lower, more acceptable levels as quickly as possible, bearing in mind the requirement to protect the emerging economic recovery.

As part of the reforms to the Stability and Growth Pact, contained in the so-called '6-pack' of legislative reforms, Member States with a debt-to-GDP ratio in excess of 60% will have to reduce the part of their debt ratio above the 60% threshold by 1/20th annually. The first step for Ireland will be to stabilise the debt ratio but once that is achieved and the '1/20th' rule is activated (note that a transition period applies for Member States currently subject to the excessive deficit procedure), there will be a requirement to run primary surpluses for a prolonged period in order to reduce the debt ratio towards 60% of GDP. Fostering economic growth will be a key part in this, as will running sustainable budgets.

Stabilising and subsequently reducing the debt ratio is one of Government's key policy objectives. Under the forecasts presented in this Update, the ratio is projected to peak in 2013 and to decline thereafter. The narrowing of the gap that currently exists between revenues and expenditure through additional fiscal consolidation will assist in this regard, as will the achievement of a primary surplus – an excess of revenues over expenditure excluding interest expenditure – by 2014.

[5] As per the end-December 2011 Exchequer Statement.

In addition, economic growth will also be an important factor in reducing the debt ratio. While it is not envisaged that nominal growth will return to the rates seen in the mid to late 1990s and earlier part of the last decade, the Government is implementing policies designed to put the economy on a faster growth path, with positive implications for the debt ratio. Higher growth means that the primary balance required to stabilise and reduce the debt ratio is lower than it would otherwise be. It makes it easier to generate the debt-stabilising primary balance, because higher growth should lead to higher tax revenues, and it also means a bigger denominator and therefore a lower ratio.

It is important to bear in mind that asset disposals could play a role in reducing the debt level, as highlighted by the *Review Group on State Assets and Liabilities*. It should be noted though that the GGD forecasts in this Update make no allowance for any asset disposals.

Ireland's debt dynamics and sustainability are also improved by the interest rate reduction on EU/IMF Programme funding secured last July, following the euro area Heads of State/Government meeting, as well as the lengthening of maturities on Programme loans. This will be of particular assistance as it means there is less pressure on the State to borrow to refinance maturing debt in the short-to-medium term, giving the State valuable breathing space to continue with the process of returning the economy to health and the public finances to a sustainable position.

Market Return

Ireland is using the access to secure funding it has under the EU/IMF Programme to make significant progress in addressing its fiscal and banking difficulties and this is reflected in improved investor sentiment.

Ireland has maintained its credit rating amidst downgrades for a number of other euro area countries in recent months, in recognition of its strong performance in meeting EU/IMF Programme targets. Ireland's sovereign credit rating has remained unchanged since July 2011 and bond spreads have declined significantly and are, as of mid-April, now below the level evident when the EU/IMF Programme was negotiated in late 2010.

In January, the National Treasury Management Agency (NTMA) conducted a bond swap exercise which extended the maturity by a year of some €3½ billion of debt which was due for repayment in early 2014. This is a significant first step in terms of managing our post-Programme funding requirements and reduces somewhat the funding 'cliff' in January 2014.

The NTMA has also begun the process of re-engaging with the changing investor base and building contacts in advance of full bond market re-entry. Notwithstanding the access to funding under the EU/IMF Programme, the State is anxious to resume normal market funding as soon as possible and to bring to an end its reliance on official funding sources. That is the ultimate aim of the EU/IMF Programme. The NTMA remains in regular contact with a broad range of market participants, and conditions permitting, is seeking to gradually extend its presence in the short-term debt market before seeking to raise longer-term debt later this year.

The NTMA has also reached agreement with the pensions industry – the pension funds and the insurance companies who sell annuities to them – on the structure of a new type of bond which will facilitate the creation of long term annuities based on the Irish Government bond yield curve. The new structure is for amortising bonds with maturities potentially ranging from 15 to 40 years, which pay the investor an equal amount each year over the life of the bond rather than the usual annual interest (or coupon) payment followed by the repayment of principal at maturity. The NTMA stands ready to provide these bonds to the pensions industry as soon as the industry is in a position to invest in them and the products that the pensions industry propose to offer are certified by the Pensions Board.

3.9. Structural budget balance

As stated at the outset, the primary aim of the Government's medium-term strategy is to return the public finances to a sound position. The forecasts set out in this Stability Programme Update are consistent with a General Government Balance of just under –3% of GDP in 2015. The exact size of the structural component of the 3% of GDP deficit is, of course, uncertain[6]. Technical estimates differ depending on the approach used (see annex 2). It is also the case that estimates of the structural balance further out the forecast horizon are not fixed - policies being implemented at present, together with future measures, can be expected to impact positively on the figures.

Indeed, by definition, reducing the structural element of the deficit will require policy action, though not necessarily taxation and expenditure adjustments. Other options are available and it is the Government's intention to pursue these. Such measures include labour market reforms - some of which are already in train - together with investment in technology and infrastructure to boost the productive capacity of the economy. To this end, the Government has established NewERA and the Strategic Investment Fund, and at the same time is working to improve financing conditions.

This ambitious programme of microeconomic reforms, by boosting the productive capacity of the economy, is expected to help reduce the structural element of the deficit by the middle part of the decade. For example, reforms along the lines of those set out in the *Action Plan for Jobs 2012* and the *Pathways to Work* initiative, aimed at addressing some of the skills mis-match in the labour market, should help lower the unemployment rate. This would have a structurally beneficial impact on the public finances, on both the revenue and expenditure sides. In other words, the structural fiscal position is set to improve with these microeconomic reforms.

[6] The structural balance is the budgetary position that would prevail if transitory elements in the headline (GGB) balance - owing to economic fluctuations and temporary / one-off factors - were removed. Removing these elements provides greater clarity about the underlying fiscal position. For instance, when an economy is performing strongly tax receipts are higher than normal and unemployment spending is lower than normal, thus flattering the headline budgetary position. In a similar vein, the deterioration in the headline budgetary position is exaggerated in a downturn by taxes being weaker than normal and unemployment payments being above normal. The objective of running a balanced budget in structural terms is to save in 'good' times so as to be able to spend in 'bad' times.

As discussed in last year's SPU, Ireland's 'medium-term budgetary objective' (MTO) currently stands at -0.5% of GDP. This objective was set well in advance of the Inter-Governmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the 'Stability Treaty'). Ireland is making progress towards the achievement of its MTO, with further progress to be made in the post-2015 period on a phased basis, in accordance with a timeline to be agreed.

CHAPTER 4

QUALITY OF PUBLIC FINANCES

4.1. Policy strategy

Against the background of budget restructuring initiatives at European level, a number of significant changes to the existing budgetary system have been taken in Ireland. These changes will have the effect of creating a more transparent, accountable and sustainable fiscal architecture for Ireland.

4.2. Developments on the expenditure side

Under its Programme, *Government for National Recovery 2011-2016,* the Government is committed to bringing about a major transformation of Ireland's budget system. The key elements of the public expenditure reform measures were set out in the *Comprehensive Expenditure Report 2012-2014 (CER),* published in December 2011.

Multi-annual expenditure framework

In the past, the expenditure *Estimates* process was an annual event focussed on the forthcoming year. Last December's CER set fixed current expenditure ceilings for all Departments for the coming three years. This approach builds upon the success of Ireland's long-standing multi-annual capital expenditure framework, and applies it to the current spending area. Since the total quantum of spending available to each Department is now known for 2013 and 2014, this allows for constructive, creative input from the public and politicians on how these resources should be prioritised for the period ahead in each area. Special arrangements will apply to certain demand-driven blocks of expenditure, notably the Live Register, which are related to the economic cycle and are not so amenable to multi-annual planning and control.

Another aspect of the new arrangements is the addition of a mechanism to foster responsible expenditure management by Departments, including:

- the carryover of unspent current funding from one year to the next,
- the retention of a proportion of the funding arising from certain categories of asset disposal; and
- the application of an offsetting adjustment in the envelope for the following year for Departments which fail to manage within their expenditure ceiling.

All of these mechanisms will be subject to detailed safeguards.

This new multi-annual framework will also encompass existing multi-annual expenditure management mechanisms – namely the *Employment Control Frameworks (ECFs)* for controlling staff numbers and the *Administrative Budget Agreements (ABAs)* which apply to the civil service. As a result, public service managers will have one coherent set of budgetary rules and objectives, with unnecessary paper-filling, overlapping procedures and other administrative overheads eliminated.

This framework will also encompass a periodic review of expenditure - approximately every 3 years - so that the multi-year Ministerial expenditure ceilings can be re-set to reflect developing Government priorities. These reviews will examine every area of spending so as to enable the Government to meet its overall budgetary objectives, as well as maximising the scope for reform and restructuring across the Irish public service, and also facilitating a realignment of the allocations in accordance with new priorities.

A new Value for Money code

The *CER* introduced a new, consolidated *Value-for-Money (VFM) Code*, bringing together and updating a range of VFM, appraisal and evaluation processes that have had only limited impact in the past, in terms of influencing the policy debate on resource allocation issues. In particular, the procedures for conducting *VFM & Policy Reviews* (VFMPRs i.e. in-depth evaluations of existing expenditure programmes) have now been streamlined, and have been complemented with *Focused Policy Assessments (FPAs)* – short, intensive evaluations of particular policy topics. These reforms are intended to generate a flow of high-quality, robust analytical information, to assist all stakeholders in the policy-making process in assessing priorities vis-à-vis the allocation of resources.

Performance-based budgeting

The extension of the system of 'performance budgeting' to the majority of Government Departments in the *2012 Estimates* brings a sharper focus to the actual outputs and outcomes delivered with scarce public resources. This approach presents Departmental Estimates on a Strategic Programme basis, consistent with the presentation of the respective *Annual Output Statements* and *Statements of Strategy*. These Estimates are also supplemented with certain performance information regarding the outputs and impacts of Programme expenditure.

This initiative facilitates Dáil Éireann in holding Ministers and Departments to account for the effective and efficient use of resources, and sharpens the focus upon performance at the organisational level. This approach also links effectively with other performance-related initiatives under the reform agenda, including improved value-for-money arrangements and clearer target-setting for State agencies.

4.3. Developments on the revenue side

Significant adjustments have also taken place on the revenue side of the account since the consolidation process began in July 2008.

The first such adjustments were implemented as part of *Budget 2009* in October 2008. Since then, income, capital, inheritance, indirect, carbon, pensions and property related taxes have all been increased.

In terms of the total tax on income, it is worth noting that marginal tax rates have increased across the board, and that the number of people paying tax has risen considerably as part of a policy of base broadening. This is a policy that will be of great benefit as employment picks up. By way of illustration:

- the top marginal tax rate has increased from 43.5% for employees in 2008 to 52% in 2012;
- for the self-employed it has increased from 46.5% to 55%;
- under *Budget 2011*, due to a reduction in credits and bands, it is estimated that 132,000 previously exempt income earners were brought into the income tax net;
- the estimated number of income earners paying the Universal Social Charge (USC) in 2011 was almost 2 million, the broadest tax base in the income tax system. The previous broadest base – the Income Levy – was charged on just under 1.5 million income earners in 2010. Although the base of the USC was narrowed in *Budget 2012* as a result of the increase in the lower exemption threshold, it is estimated that 1.65 million income earners are still liable to pay the USC.

Examples in other areas of taxation include:

- tax on capital gains/inheritance and on interest on savings has increased by a half from 20% to 30%;
- an annual property charge on second homes has been introduced;
- a €100 Household Charge has been introduced as an intermediate step on the road to the introduction of a full property tax in the coming years;
- the standard rate of VAT has been increased by two percentage points from 21% to 23%;
- a comprehensive Carbon Tax has been introduced and is now €20 per tonne;
- excise duties on tobacco and oil have been increased, as have motor tax rates:
- a programme of termination of tax expenditures has been implemented, and
- tax relief associated with private pension provision has been considerably reduced.

As part of the EU/IMF Programme, Ireland is implementing a comprehensive structural reform package, including measures to broaden the tax base. While the increased tax burden has been spread widely across areas such as tax on income, capital, inheritance, indirect, carbon, pensions and property, the Government is keen to avoid the implementation of policy measures that could hinder the recovery. The primary function of a tax system is to provide the resources to finance public expenditure, ideally in a manner that incentivises growth, promotes income and wealth redistribution and addresses social and environmental concerns. It should not unduly hinder economic development, rather it should maximise growth potential. An efficient tax system must also seek to minimise compliance and collection costs, while targeting tax avoidance and evasion.

In this respect, the Government has previously outlined its steadfast commitment to the maintenance of Ireland’s 12½% corporate tax regime, as it is critical to supporting the economy’s recovery and employment growth. Certainty is a key element desired by investors and to abandon the present corporation tax policy would substantially damage Ireland's ability to attract foreign direct investment and, hence, Ireland’s ability to 'grow our way' to sustained economic recovery.

The Programme for Government states that, as part of the Government's fiscal strategy, the Government will maintain the current rates of income tax together with bands and credits. This is consistent with the view that the overriding aim of the Government's medium-term economic and budgetary strategy is to return the economy to sustainable employment growth. Given this focus on job creation, taxes on employment should, insofar as is possible, be kept to a minimum.

Given the very substantial increases in income tax implemented in *Budget 2011*, through changes in the tax credits and bands as well as the introduction of the Universal Social Charge, the Government decided not to make any further substantial changes to income tax in *Budget 2012*.

However, in light of the requirement to increase revenues as part of the process of reducing the deficit in the public finances, it is necessary that other areas of taxation deliver the revenue increase consistent with overall budgetary commitments. Accordingly, in delivering *Budget 2012*, the Government did not increase income tax but instead placed the burden on indirect taxes such as VAT, excise duties, carbon tax and local taxes.

The approach in 2013-15 will be informed by the same principles. Conditions permitting, there will be no changes to the main income tax bands, rates or personal credits. As income tax (including the USC) is estimated to account for over 40% of total Exchequer tax revenues this year, maintaining the current bands, credits and rates in subsequent years will be dependent on making progress on expenditure reductions and tax changes in other areas.

Over the period 2013-15, the emphasis will be on all forms of indirect taxation and a substantial broadening of the tax base generally. The strategic objective is to ensure that the burden of taxation is spread in a manner that is both fair and sustainable in the longer term, through the taxation of, for example, immobile assets rather than employment. In addition, carbon taxes and excise duties on energy products are being examined with a view to protecting revenues, while encouraging behavioural change and reducing Ireland's greenhouse gas emissions.

This approach will not preclude base broadening in the area of income tax. This could include curtailment, reduction or abolition of a variety of income tax reliefs, a substantial broadening of the PRSI base and a further reduction in the tax related costs of private pension provision.

Stability of the revenue base is key and in this regard base broadening is an important policy objective. It is clear now that a significant proportion of the tax revenues generated in the middle part of the last decade was of a temporary nature, and will not return even as the economy recovers. Tax revenues in the future must not be as susceptible to economic downturns as the capital taxes generated in the mid-part of the last decade were.

Revenue is generated by economic activity, not by increased tax rates. High tax rates and a narrow base of economic activity may raise far less revenue than lower rates on a much wider base. Accordingly, recognition must be given to not just the 'quantity' of revenue to be raised but also to the 'quality' of the measures adopted.

4.4. EU/IMF Programme of support commitments

In addition to the introduction of a medium-term expenditure framework, under the terms of the EU/IMF Programme, Ireland is also committed to establishing an independent Fiscal Advisory Council and to implementing a Fiscal Responsibility Law. The former - the Irish Fiscal Advisory Council - has been in place on a non-statutory basis since the summer of 2011. The Council is an independent body, whose status as such will be underpinned on a statutory basis by the *Fiscal Responsibility Bill* (which will be legislated for later this year, subject to the outcome of the upcoming referendum on the Stability Treaty).

The most recent review visit of the External Partners under the EU/IMF Programme was completed at end-April 2012. Ireland's Programme remains on track.

CHAPTER 5

INSTITUTIONAL FEATURES OF PUBLIC FINANCES

5.1. Policy implementation and developments

Over the course of 2011, in line with the Programme for Government's ambitious agenda of budgetary reform and the requirements of the EU/IMF Programme, a number of significant budgetary reforms were introduced. Work to introduce further reforms in the context of the *Fiscal Responsibility Bill*, was also advanced. For instance, a discussion document setting out proposed fiscal rules was published in April 2011, with an open seminar on the same topic held in May of last year.

Key reforms that have been introduced include:

- the establishment of a separate Department of Public Expenditure and Reform in order to focus attention on identifying and addressing the key priorities in these areas, which are fundamental to the achievement of broader budgetary and reform-related objectives;
- the undertaking of a *Comprehensive Review of Expenditure*, which involved a rigorous examination and re-appraisal of every area of public expenditure to set a basis for the achievement of significant savings and efficiencies;
- the introduction of a new, modern *Medium Term Expenditure Framework* (MTEF) including the setting of multi-year Departmental ceilings for current expenditure to complement the multi-year capital envelopes introduced in 2004;
- the MTEF also allows for the introduction of a new 'whole-of-year' budgetary system, with earlier engagement by the Oireachtas and by Government on the prioritisation of expenditure allocations, and the identification of medium-term structural reform measures that will be necessary to ensure that the expenditure ceilings are complied with;
- the extension of 'performance budgeting', re-designing the annual expenditure *Estimates* to integrate information on performance, outputs and outcomes, and thereby improve the quality and rigour of the annual processes for parliamentary scrutiny, accountability and resource allocation;
- the establishment of the Irish Fiscal Advisory Council on a non-statutory basis with the function of assessing and commenting on the performance of the Government in relation to its budgetary targets and objectives.

In successfully achieving each of these objectives, the Government has been able to inject a dynamic of reform into the system of public administration, to complement and, indeed, support the ongoing process of fiscal correction. Some of the above reform measures, including the MTEF, will also reinforce other reform initiatives already underway, such as the *Employment Control Frameworks* that have been put in place to set targets for, and to manage, the multi-year process of reducing staff numbers in each area of the public service.

The Government intends to maintain the momentum of reform over the coming year, including by reference to the issues set out below.

5.2. European developments

Work on the preparation of the *Fiscal Responsibility Bill* – which allows for greater certainty and clarity regarding the conduct of national fiscal policy over the medium term - was advanced in 2011. However, developments at European level over the period superseded the planned provisions of the Bill and the EU/IMF Troika agreed to reschedule the deadline for the publication of the Bill from the end of 2011 to the end of June 2012. The main European developments were:

- the '6-pack' of five regulations and one directive that was adopted in November 2011;
- the '2-pack' of additional proposed regulations that is still under consideration; and
- the Inter-Governmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the 'Stability Treaty') agreed in March 2012.

The provisions of the '6-pack', which are already in effect in Ireland, are reinforcing the need for a major restructuring of the budgetary system. Its emphasis on the general government aspects of budgeting underscores the need for continuing reforms in domestic budgetary procedures, particularly in relation to expenditure policy and formulation.

The proposals included in the '2-pack' will also have major implications for the budgetary system, not least in relation to the common budgetary timeline, if the draft regulations are adopted with most of the current proposals intact. As a general principle, however, the impetus for reform arising from the EU developments is very much in keeping with the momentum and the direction of reform that has already been well advanced in Ireland over the course of 2011.

5.3. Fiscal Responsibility Bill

The Government has decided that ratification of the Stability Treaty requires a referendum, which is scheduled to be held on 31 May 2012. In the context of this, the Government has prepared and published the draft legislation that it will bring before the Houses of the Oireachtas to implement the provisions of Articles 3 and 4 of the Stability Treaty, if the referendum result permits its ratification. This draft legislation was published on 26 April 2012 as an information document in the context of the referendum. The draft legislation provides that the Government must endeavour to satisfy the budgetary rule and the debt rule. The former is that the budgetary position must be either at the medium-term budgetary objective (MTO) or on the adjustment path towards it, unless there are exceptional circumstances. The debt rule states that if the ratio of General Government Debt to GDP is above 60%, then it must be reduced by $1/20^{th}$ of the difference between the current rate and 60% per annum.

The *Fiscal Responsibility Bill* also provides for the other requirements set out in the Stability Treaty, namely (i) limits on the MTO, (ii) the introduction of a correction mechanism in the event that there is a significant deviation from the MTO or the adjustment path towards it, and (iii) the putting of the Irish Fiscal Advisory Council

on a statutory basis (as it has been allocated the function of monitoring the Government's compliance with the budgetary rule).

5.4. Further policy developments

The draft legislation implementing the provisions of the Stability Treaty only deals with its requirements, meaning that the EU/IMF Programme commitment to put the Ministerial expenditure ceilings on a statutory footing will be provided for in separate legislation, to be published by the end of September 2012. These ceilings were introduced as part of the MTEF and are already being applied on an administrative basis. However, providing a statutory grounding for them will reinforce the durability of this important structural reform measure into the future.

CHAPTER 6

LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES

6.1. Summary

In addition to the budgetary challenges arising from the recent fiscal and banking crises, Ireland's public finances – along with those of many other Member States – will face increasing pressure in the decades ahead as the composition of the population becomes older. The extra spending pressure associated with an ageing society will have major implications for the long-term sustainability of the public finances, manifesting itself in two ways. First, spending on pensions, health and long-term care as a percentage of GDP will rise. Second, the share of the population tasked with financing it will shrink. Taken together, these trends imply that it will become increasingly difficult to finance public expenditure from available public funds. Ireland's ability to meet these longer-term challenges will require the implementation of appropriate and timely policy responses, a process which has already started.

6.2. Long-term budgetary prospects including the implications of ageing

The latest demographic projections from EUROSTAT[7] indicate that the size and composition of Ireland's population will undergo considerable change in the coming decades. While the overall size of the population is expected to increase, of greater importance from the viewpoint of the public finances is the projected change in its composition, particularly its increasing age.

The number of older people will rise considerably in both absolute and relative terms. The population aged 65 and over - which currently stands at about 12% - is expected to almost double by 2060. In contrast, the share of the working age population is projected to gradually fall from around 67% to 60%. There are currently about six people of working age for every older person in Ireland. This ratio will change to about three to one by 2060.

It should be noted that the latest EUROSTAT demographic assumptions are more favourable than the previous set. The fertility rate increased from 1.90 in 2008 to 2.07 in 2010, meaning that Ireland now has the highest fertility rate of any EU Member State. Similarly, the proportion of those of working age as a percentage of the total population has also improved.

From a public finance perspective, a 'greying' population will pose significant challenges. Projections carried out at EU level by the Economic Policy Committee and the European Commission (2009) provide an estimate of the magnitude for Ireland. These projections indicate that public spending on pensions, health and long-term care will increase from 12% of GDP in 2007 to 15% by 2030 and to 21% by 2060. Potential savings from education expenditure will contribute only a small offsetting amount.

[7] EUROSTAT (2010), *EUROPOP 2010*

Pension projections undertaken at national level as part of the *National Pensions Framework*[8] *(NPF)* presents a similar picture of rising expenditure. Over the period to 2050, the NPF projects that spending on social welfare and public service pensions will increase from around 5½% of GDP to 15%.

The technical long-run projections set out below, while subject to considerable uncertainty, are a useful tool in demonstrating the scale and timing of fiscal challenges. They are, however, quite dated given the impacts of the crisis, particularly for Ireland. Updated projections, which should better reflect recent developments, will be published by the Economic Policy Committee and the European Commission this summer.

Table 14: Long-term spending projections

% of GDP unless otherwise stated	**2007**	**2020**	**2030**	**2040**	**2050**	**2060**
Total age-related expenditures	17.1	18.7	20.4	21.7	24.5	26.1
Total pension expenditure	5.2	6.4	7.5	8.6	10.5	11.3
Social security pensions	4.0	4.6	5.4	6.4	8.0	8.6
Old-age and early pensions	*2.6*	*3.2*	*4.0*	*5.0*	*6.6*	*7.2*
Other pensions	*1.4*	*1.4*	*1.4*	*1.5*	*1.4*	*1.4*
Occupational pensions (Public Service)	1.2	1.8	2.1	2.2	2.5	2.7
Health care	5.8	6.1	6.5	6.9	7.3	7.6
Long-term care	0.8	0.9	1.1	1.4	1.8	2.2
Education expenditure	4.5	4.4	4.4	4.0	4.1	4.2
Other age-related expenditures (Unemployment benefit)	0.8	0.9	0.9	0.8	0.8	0.8

Underlying Assumptions	**2020**	**2030**	**2040**	**2050**	**2060**
Labour productivity growth	1.8	1.7	1.7	1.7	1.7
Real GDP growth	1.7	1.7	1.3	1.1	1.7
Participation rate males aged 20-64	81.8	80.6	80.5	81.2	81.1
Participation rate females aged 20-64	69.4	70.7	71.2	71.3	71.3
Total participation rates aged 20-64	75.7	75.7	76.0	76.3	76.3
Unemployment rate	5.1	5.1	5.1	5.1	5.1
Population aged 65+ over total population	13.3	16.0	19.4	23.7	25.2

Source: Economic Policy Committee and European Commission, *2009 Ageing Report, Economic and Budgetary Projections for the EU-27 Member States (2008-2060)*

The projections contained in table 14 indicate that age-related spending will rise significantly between 2007 and 2060. The main features of the results are:

- Spending on pensions is expected to increase to 11.3% of GDP in 2060, more than twice the corresponding 2007 figure of 5.2%.
- The majority of the projected increase in pension spending is accounted for by the Social Security component of the pension system. Most notably,

[8] National Pensions Framework (Chapter 2) - www.nationalpensionsframework.ie.

spending on 'Old-Age and Early Pensions' which covers pensioners who are aged 65/66 and over, is set to rise from 2.6% of GDP in 2007 to 7.2% of GDP in 2060.

- Expenditure on health and long-term care trends upwards over the projection timeframe and is expected to account for 9.8% of GDP in 2060.

6.3. Policy response

In October 2009, the European Commission assessed the sustainability of Ireland's public finances as being of 'high risk' due to the large age-related spending pressures that lie ahead, as well as the budgetary position. In response to this and the Excessive Deficit Procedure recommendation of December 2010, a number of steps have been taken to address the long-term sustainability of the public finances, while also seeking to safeguard the welfare needs of older members of society. As pensions are expected to account for the majority of the projected increase in age-related spending, a particular focus has been placed on initiatives in this area. Recent measures in this respect are set out below.

State pension

Beginning with the social security State pension, there have been a series of significant reforms introduced in recent years. Many of these followed on from the recommendations contained in the *National Pensions Framework* and include:

- the enactment of legislation which will increase the State pension age to 66 in 2014, 67 in 2021 and 68 in 2028;
- the minimum number of years required for a State pension was increased in April 2012 from 5 to 10 years;
- a 'total contributions approach' will be introduced for those reaching the State pension age from 2020, replacing the current averaging system.

Public Service pay

Public service pay has been cut by a cumulative average of 6.5% per cent (with reductions of a minimum of 5% applying to those at the lower end of the earnings spectrum up to a maximum reduction of 30% for certain political officeholders). This cut, allied with an effective pay freeze for all public servants since the end of 2008 which is projected to last until the middle of this decade at the earliest, will contribute substantially to lowering the projected cost of the future pensions bill.

Pension-related deduction

In March 2009 a 'Pension-Related Deduction (PRD)' was introduced as part of the *Financial Emergency Measures in the Public Interest Act 2009*. This expenditure measure produces savings of some €900 million annually by way of a progressive levy on the gross pay of pensionable public servants.

Public Service pension reduction

A pension reduction (the 'Public Service Pension Reduction') was introduced by the *Financial Emergency Measures in the Public Interest Act 2010*. With effect from the first of January 2011, all public service pensions in payment have been reduced. This progressive measure is estimated to save around €100 million annually.

Public Service pensions: single scheme
A new single pension scheme for all new entrants to the public service is progressing through parliament at present. It is estimated that the scheme, which is a commitment under the EU/IMF Programme, will lower the cost of public service pension provision over the long term by about a third.

The primary mechanisms through which these savings will be made include:

- the calculation of pensions on the basis of 'career average' earnings – this is a change from the current position where the pension is based on 'final salary';
- the modification of the earnings-linking of pensions – the new scheme provides for post-retirement pension increases to be linked to consumer prices (CPI) and not pay; and
- a phased increase in the minimum pension age from the current age of 65 to 66 in 2014, 67 in 2021 and 68 in 2028 (this is linked to the minimum State pension age).

The new scheme is a far-reaching transformation of the public service pension system and will apply to the civil service, education sector, health sector, local authorities, Gardai, defence forces, regulatory sector and non-commercial semi-state bodies. It also includes the President, Oireachtas members and the judiciary.

Long-term care
With respect to long-term care, the main development has been the introduction of the *Nursing Homes Support Scheme*. This puts the financing of individuals' long-term care needs on a fair and equitable basis - people are asked to contribute towards their long-term nursing home care according to their means and can enter any nursing home (public, private or voluntary) subject to it having an available bed and being able to cater for their particular needs. The scheme will be three years in operation in October 2012 and will be reviewed at that time.

Notwithstanding the above steps, the scale of the task is such that it will be necessary to put in place additional policy measures in order to safeguard the long-term sustainability of the public finances. There is a need to take advantage of the current demographic 'window of opportunity' - as confirmed by the 2011 Census results - to better equip the economy to meet the challenges ahead. Such measures could include increasing the population at work, cutting age-related spending and improving the country's productive capacity. In making these choices, it will be important to recognise the trade-offs that exist so as to put in place an appropriate policy mix. Given the present budgetary situation, due regard will need to be given to the impact on the wider economy of the various options and their timing.

CHAPTER 7

THE EXCESSIVE DEFICIT PROCEDURE

7.1. Background

The purpose of this chapter is to update the position with regard to the excessive deficit procedure to which Ireland is currently subject.

Article 126(1) of the Treaty on the Functioning of the EU (hereafter the 'Treaty') requires Member States to avoid excessive deficits. The Treaty – article 126(2) – also imposes a requirement on the European Commission to monitor compliance with budgetary discipline by assessing whether Member States annual deficits and debt (actual or planned) exceed reference values.

Protocol 12 annexed to the Treaty lays down a reference value of 3% of GDP in respect of annual deficits and a reference value of 60% of GDP in respect of public debt. Budgetary developments in excess of these reference values can trigger the opening of the excessive deficit procedure. At present, the majority of Member States, including Ireland, are subject to the procedure.

7.2. Steps in Ireland's excessive deficit procedure

27 April 2009 – opening of the excessive deficit procedure

In April 2009, the Council adopted a decision under 126(6) that, for the first time, an excessive deficit existed in Ireland, and adopted recommendations under 126(7) that, inter alia, Ireland correct its excessive deficit by 2013. The Council also established a deadline of end-October[9] for Ireland to take effective action to ensure that the deficit would be corrected in a timely fashion.

2 December 2009 – new Council recommendations

In early-December 2009, the Council concluded that Ireland had taken effective action in accordance with its April recommendation, but that unexpected adverse economic events with major unfavourable consequences for the public finances had occurred subsequent to the April Council decision.[10]

In light of these adverse economic developments, the Council adopted revised recommendations to Ireland and extended the deadline for correction of the excessive deficit by one year to 2014. Among the recommendations was a requirement for an annual fiscal effort of 2% of GDP per annum over the period 2010-14. The Council also established a deadline of early-June for Ireland to take effective action in response to the Council's revised recommendations.

[9] Article 3(4) of Council Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure establishes a deadline of six months at most for effective action to be taken by the Member State concerned.

[10] Article 3(5) of Council Regulation 1467/97 provides for the possibility of revised Council recommendations in circumstances where effective action has been taken in response to Council recommendations but unexpected adverse economic events arise, subsequent to the Council recommendations, which have major consequences for the public finances of the Member State concerned.

13 July 2010 – Council concludes effective action taken by Ireland
In July, the Council concluded that Ireland had taken effective action to correct the excessive deficit within the required timeframe and that no further steps in the excessive deficit procedure were required.

7 December 2010 – new Council recommendations as part of external assistance
Ireland formally requested external financial assistance from the EU and IMF in November 2010. As part of this, and in recognition of the deterioration in public finances resulting from the impact of the financial crisis, the Council once again adopted revised recommendations to Ireland and extended the deadline for correcting the excessive deficit to 2015.

The recommendations included the requirement for fiscal consolidation measures to ensure that the annual underlying (i.e. excluding direct support for the banking sector) fiscal deficit is below a pre-determined ceiling over the 2011-15 period (see table 15 below). The Council also recommended institutional reforms to the public finances, including the establishment of a budgetary advisory council and the adoption of legislation aimed at introducing binding multi-annual expenditure ceilings. The Council established a deadline of early-June for Ireland to take effective action in response to its revised recommendations.

August 2011 – concludes effective action taken by Ireland
In August 2011, the Commission communicated to the Council its assessment that Ireland had taken effective action in response to the Council's recommendations of 7 December and that in the Commission's opinion, no further steps in the excessive deficit procedure were needed.

7.3. Progress in correcting the excessive deficit

Table 15 sets out the maximum underlying General Government deficit permitted under the Council's recommendations as per 7 December 2010. The Irish Government's projections for the General Government Balance for the period 2012-15 are also outlined, as is the underlying outturn for last year.

Table 15: Requirements and path for the general government balance

% of GDP	**2011**	**2012**	**2013**	**2014**	**2015**
EDP ceiling for general government balance	-10.6	-8.6	-7.5	-5.1	-2.9
Projection for general government balance	-9.4	-8.3	-7.5	-4.8	-2.8

Source: Department of Finance.

The outturn for last year was well below the ceiling imposed by the Council. For this year, the current projection is for a deficit of 8.3% of GDP, which again is within the requirements established by the Council. On the basis of the Government's consolidation strategy set out in this document, the deficit requirements over the period remain on track to be achieved.

In relation to the fiscal effort recommended by the Council, the total fiscal consolidation implemented for 2011 and 2012, together with the additional consolidation over the period 2013-15 (outlined in the Government's *Medium Term Fiscal Statement* of November 2011 and in table 2) amounts to around 11% of GDP.

Finally, in relation to institutional reforms, the Irish Fiscal Advisory Council was established last year and will be put on a statutory basis as part of the *Fiscal Responsibility Bill* (which, as already mentioned, will be legislated for later this year, subject to the outcome of the upcoming referendum on the Stability Treaty). A medium-term expenditure framework has also been established.

In summary, therefore, Ireland is implementing the Council's recommendations and remains on track to correct its excessive deficit within the timeline established by the Council.

ANNEX 1

IRELAND'S NATIONAL REFORM PROGRAMME UNDER THE EUROPE 2020 STRATEGY – SUMMARY OF PROGRESS IN RESPECT OF IRELAND'S NATIONAL TARGETS

Overcoming obstacles to growth is a key factor in tackling the current economic challenges facing Ireland and Europe as a whole. Ireland remains committed to close engagement with the European Commission and other Member States in order to achieve enhanced economic coordination across the European Union. The 2012 NRP Update provides a review of progress made this year in achieving Ireland's National Targets within the framework of the Europe 2020 strategy. Below are Ireland's five national Headline Targets, with a brief outline of some of the pertinent policy measures implemented since the 2011 NRP.

Employment

Headline target: to raise to 69-71% the employment rate for women and men aged 20-64, including through the greater participation of young people, older and low-skilled workers, and the better integration of legal migrants, and to review the target level of ambition in 2014, in the context of a proposed mid-term review of the Europe 2020 Strategy.

Policies introduced this year include the *Action Plan for Jobs 2012* and the *Pathways to Work* initiative, aimed at labour market activation and the support and creation of jobs. Last year's NRP highlighted five bottlenecks in the Irish labour market. The NRP Update 2012 outlines measures introduced to alleviate these bottlenecks and youth unemployment.

R&D

Headline target: to improve the conditions for research and development, in particular with the aim of raising combined public and private investment levels in this sector to 2.5% of GNP.

The 2012 NRP Update outlines recent developments including Project maths and the development of a National Intellectual Property Protocol. It also details the future alignment of public investment by research funders consistent with the 14 areas of priority identified in the report of the Research Prioiritisation Steering Group.

Climate Change

Headline target: to reduce greenhouse gas emissions in the non-traded sector by 20% compared to 2005 levels; increase the share of renewables in final energy consumption to 16% by 2020; and to move towards a 20% increase in energy efficiency.

The 2012 NRP Update provides information on the advancement of policy strategies such as the *National Climate Change Strategy 2007-12*, the *Renewable Energy Directive* and the *National Energy Efficiency Action Plan*. It also refers to the current *Review of National Climate Policy* which is a precursor to the introduction of primary legislation on climate change.

Education

Headline target: to reduce the percentage of 18-24 year olds with at most lower secondary education and not in further education and training to 8%; and to increase the share of 30-34 year olds who have completed tertiary or equivalent education to at least 60%.

The 2012 NRP Update provides progress on various strategies, including the '*Delivering Equality of Opportunity in Schools*' national action plan and the national strategy to improve literacy and numeracy among children and young people.

Poverty

Following a comprehensive review of Ireland's national poverty target, the Government agreed to adopt a revised national poverty target.

Revised headline target: to reduce consistent poverty to 4% by 2016 (interim target) and to 2% or less by 2020, from the 2010 baseline rate of 6.2%; and to lift up a minimum of 200,000 people out of the risk of poverty or exclusion between 2012 and 2020.

A number of other changes also agreed will have a positive impact, notably the adoption of sub-targets for children and jobless /low-work intensity households, and new supporting indicators.

Key policy measures include income supports, financial inclusion, affordable energy and labour market activation, along with important links to education and training and access to quality services through the implementation of the *National Action Plan for Social Inclusion.*

ANNEX 2

SUPPLEMENTARY DATA

Table A1: General government balance – technical estimates

	ESA	2011	2011	2012	2013	2014	2015
		€m	% of GDP				
Net lending (EDP B.9) by sub-sector							
1. General government (=6-7)	S.13	-20,515	-13.1	-8.3	-7.5	-4.8	-2.8
2. Central government	S.1311	-20,518	-13.1	-8.1	-7.4	-4.6	-2.7
3. State government	S.1312	n/a	n/a	n/a	n/a	n/a	n/a
4. Local government	S.1313	10	0.0	-0.1	-0.1	-0.1	-0.1
5. Social security funds	S.1314	-8	0.0	0.0	0.0	0.0	0.0
General government (S.13)							
6. Total revenue	TR	55,839	35.7	35.8	35.9	36.1	36.0
7. Total expenditure	TE	76,354	48.8	44.1	43.5	40.8	38.8
8. Net lending/borrowing (=6-7)	B.9	-20,515	-13.1	-8.3	-7.5	-4.8	-2.8
9. Interest expenditure	D.41	5,386	3.4	4.1	5.6	5.5	5.6
10. Primary balance (= 1 + 9)		-15,129	-9.7	-4.2	-1.9	0.8	2.8
11. One-off and other temporary measures		-5,744	-3.7	0.3	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		37,096	23.7	24.5	25.3	25.8	26.0
12a. Taxes on production and imports	D.2	18,045	11.5	11.6	11.7	11.5	11.2
12b. Current taxes on income, wealth etc.	D.5	18,344	11.7	12.5	13.1	13.8	14.4
12c. Capital taxes	D.91	707	0.5	0.5	0.5	0.5	0.5
13. Social contributions	D.61	10,342	6.6	6.2	6.1	6.0	5.8
14. Property income	D.4	2,061	1.3	1.5	1.5	1.4	1.3
15. Other		6,340	4.1	3.6	3.1	2.9	2.8
16. (=6) Total revenue (=12+13+14+15)	TR	55,839	35.7	35.8	35.9	36.1	36.0
p m.: Tax burden		47,854	30.6	31.0	31.6	32.1	32.2
Selected components of expenditure							
17a. Compensation of employees	D.1	17,879	11.4	11.5	10.9	10.3	9.7
17.b Intermediate consumption	P.2	8,603	5.5	5.2	4.9	4.5	4.2
18. Social payments (18 = 18a+18b)		28,109	18.0	17.3	16.5	15.3	14.5
18a. Social transfers in kind supplied via market producers	D.63	3,397	2.2	2.3	2.2	2.0	1.9
18b. Social transfers other than in kind	D.62	24,712	15.8	15.1	14.3	13.3	12.6
19=9 Interest expenditure	D.41	5,386	3.4	4.1	5.6	5.5	5.6
20. Subsidies	D.3	579	0.4	0.4	0.4	0.3	0.3
21. Gross fixed capital formation	P.51	5,187	3.3	2.5	2.3	2.1	2.0
22. Other		10,611	6.8	3.1	2.9	2.7	2.6
23=7 Total expenditure (= 17+18+19+20+21+22)	TE	76,354	48.8	44.1	43.5	40.8	38.8
p m. : Government consumption (nominal)	P.3	27,876	17.8	18.0	17.3	16.3	15.3

Source: Department of Finance, Department of Public Expenditure and Reform and NTMA estimates. Rounding may affect totals.

Table A1 sets out the General Government Balance (GGB) for the years 2011 to 2015 in terms of selected components of general government receipts and expenditures. Ireland's headline GGB in 2011 was -13.1% of GDP (see item 1). A significant amount of this deficit (3.7 percentage points of GDP, see item 11) arises from

capital injections into financial institutions that took place in July last year. Ireland's underlying deficit (which excludes banking recapitalisation) was 9.4% of GDP in 2011, well below the ECOFIN Council limit of 10.6%.

Methodological Changes in the table since Budget 2012 publication
The figures in table A1 reflect some methodological changes that introduce a level shift when comparing the current table with the equivalent table published at Budget time. This level shift comes about through realigning the Department of Finance data with the outturn ESA95 tables sent to Eurostat by the CSO (in particular ESA Table 0200). The biggest impact comes from the inclusion of imputed output of local authority house rentals. In 2011, the CSO introduced a change to the accounting treatment of local authority house rentals. The new method introduces an increase of close to €1 billion to both receipts and expenditures. Other smaller adjustments and imputations captured in the ESA Table 0200 are also included in this table. It is important to note that the methodological changes mentioned here have no effect on the balance. This is because each adjustment or imputation is matched by an opposite adjustment or imputation.

Explanatory notes to the components of table A1
Item 1: Net lending by general government is identical with the general government balance.
Item 9 & 20 Interest expenditure by general government is calculated on an accruals basis. In Ireland's case this includes interest payable on the promissory note paid to financial institutions in 2010. There is an interest holiday where no general government interest is due on the promissory notes in 2011 and 2012.
Item 12a Taxes on production and imports include VAT, customs, excise and stamp duty, local authority rates and the non-household part of motor tax.
Item 12b Current taxes on income and wealth comprise income tax, capital gains tax and corporation tax, the household part of motor tax and the household charge.
Item 12c Capital taxes comprise capital acquisitions tax and the pension funds levy.
Item 13 Social Contributions consist mainly of contributions to the Social Insurance Fund. Imputed social contributions are also included.
Item 14 Property income is made up of investment or dividend income.
Item 15 Other receipts include miscellaneous receipts such as Departmental receipts (appropriations in aid), rents and receipts from abroad, receipts by non- commercial State sponsored bodies and miscellaneous capital receipts.
Item 17b Intermediate consumption is current spending on goods and services by government units.
Item 19 Social transfer payments include pensions, child benefit, payments for medical goods, transfers to the rest of the world and other unrequited payments to households. Social transfers in kind include such items as free travel on public transport and fuel allowances.
Item 22 Gross fixed capital formation is expenditure by government on capital formation such as construction and machinery. The value in this table is net of the sale of non-financial assets.
Item 23 In 2011 other expenditure includes €5.8 billion deficit increasing capital transfer into Irish banks. This item includes also transfer payments to non-government bodies such as secondary and higher education and capital grants.

Table A2: Explanation of the difference between the EBR and the GGB

	2012	2013	2014	2015
		€ millions		
(a) Exchequer balance	-18,655	-14,530	-10,400	-6,800
(b) Interest adjustments	-265	-2,125	-1,755	-1,790
(c) Exclude equity and loan transactions	2,290	675	220	-35
(d) Accrual adjustments	10	155	170	145
(e) Promissory Notes	3,085	3,085	3,085	3,085
(f) Net borrowing/lending of non-commercial State sponsored bodies	-50	140	130	30
(g) Transactions between the Exchequer, Government Departments and Extra-Budgetary Funds	115	-145	20	20
(h) Impact of NPRF	555	590	595	590
(i) Net (borrowing)/surplus of Central Government	-12,915	-12,155	-7,940	-4,750
(j) Net Surplus of the Social Insurance Fund	0	0	0	0
(k) Net (borrowing)/surplus of Local Government	-200	-200	-200	-200
(l) General government balance (=i + j + k)	-13,115	-12,355	-8,140	-4,950
(m) General government balance	-13,115	-12,355	-8,140	-4,950
(n) GGB as a % of GDP	-8.3%	-7.5%	-4.8%	-2.8%
(o) Nominal GDP (rounded to the nearest €25m)	158,925	164,175	171,150	178,850

Source: Department of Finance, Department of Public Expenditure and Reform and NTMA estimates. Rounding may affect totals.
Figures rounded to the nearest €5 million.

1. Interest expenditure reflects the accrued interest payable on Promissory Notes issued to financial institutions and a Eurostat ruling that there would be no interest payable on these Promissory Notes for the years 2011 and 2012.
2. The Exchequer Balance is the traditional domestic budgetary aggregate which measures the net surplus or deficit position of the Exchequer account. It is the difference between total receipts into and total expenditure out of the Exchequer account of the Central Fund.
3. The EBR estimate for 2012 includes €3.06 billion in respect of the Promissory Note payment to IBRC, although settlement of this payment was through a Government bond. Due to the unique nature of this transaction, the precise Exchequer accounting treatment will be reflected in the end-April Exchequer Statement which will be published on 2 May 2012.
4. The General Government Balance (GGB) measures the fiscal performance of all arms of Government, i.e. Central Government, Local Authorities, Vocational Education Committees and non-commercial State sponsored bodies, as well as funds such as the Social Insurance Fund and the National Pensions Reserve Fund which are managed by Government agents. It thus provides an accurate assessment of the fiscal performance of a more complete 'Government' sector.
5. The GGB does not reflect the position of commercial State sponsored bodies as these agencies are classified as being outside the General Government sector. The GGB is calculated in accordance with ESA95, a consistent standard developed by the EU to facilitate budgetary comparisons between EU Member States in accordance with their obligations under the Maastricht Treaty.

b) This adjustment reflects the requirement, under ESA95 rules, that changes in the assets of the Capital Services Redemption Account and capital gains or losses on foreign exchange contracts, swaps, etc., should be excluded from the interest recorded for the purposes of calculating the GGB. An adjustment for interest accrued but not paid on small savings is also included, as is an adjustment for FISIM. Accrued interest payable on the Promissory Notes issued to financial institutions is also included.
c) Equity and loan transactions are excluded from the GGB on the basis that they affect the composition but not the level of assets and liabilities.
d) This adjustment is required in respect of certain transactions recorded on an accruals basis in calculating the GGB. These include tax accruals, Departmental balances, EU transfers, and the impact of the capital envelopes facility, which allows a carryover of up to 10% of Departmental capital spending into the following year in accordance with Section 91 of the Finance Act 2004.
e) This reflects the amounts committed in Promissory Notes to certain financial institutions in 2010. These amounts are paid in equal instalments of 10% of the principal sum. The full GGB effect of the Promissory Notes principal sum was shown in 2010 and, as such, the effect of this is removed from the GGB in subsequent years. On 2nd April 2012 the annual Promissory Note payment of €3.06 billion to IBRC was made with a Government bond. This has no direct effect on the GGB.

g) Transfers between units within the General Government sector do not affect the GGB.
h) The National Pensions Reserve Fund (established in 2001) is within the General Government sector and transactions within the sector do not have an impact on the GGB. These figures include income earned on the investments made by the NPRF. There is no provision for a 1% of GNP payment from the Exchequer into the NPRF for the years 2012 to 2015.

Table A3: Breakdown of revenue

	2011 (€ billions)	**2011**	**2012**	**2013**	**2014**	**2015**
		% of GDP				
Total revenue at unchanged policies*	55.8	35.7	35.8	35.9	36.1	36.0
Discretionary revenue	1.5	1.0	1.1	0.7	0.6	0.4

Source: Department of Finance.
* Total General Government revenue on the basis of policies already implemented up to and including *Budget 2012*. For 2013-15, the figures are consistent with the implementation of further discretionary revenue measures as set out in *Budget 2012* and the *Medium-Term Fiscal Statement* (MTFS).
** Discretionary revenue measures include PRSI adjustments and are inclusive of carryover from the previous year. The figures reflect the yield as estimated on a static basis. The 2012 figure is as per *Budget 2012*. It should be noted also that the Universal Social Charge, introduced *in Budget 2011* to replace the income and health levies, was estimated to deliver an additional 0.3% of GDP in revenues in 2012. 2013-15 figures are as per *Budget 2012* and the MTFS. The precise make-up of the discretionary revenue measures to be introduced by the Government over the period 2013-15 will be decided at a later stage.

Table A4: Expenditure developments

	2011 (€ millions)	**2011**	**2012**	**2013**	**2014**	**2015**
		% of GDP				
Expenditure on EU Programmes fully matched by revenue from EU funds	390	0.2	0.2	0.2	0.2	0.2
Expenditure fully matched by mandated revenue increases*	-	-	-	-	-	-
Non-discretionary changes in unemployment benefit expenditure**	40	0.0	-0.1	-0.1	-0.1	-0.1

Source: Department of Public Expenditure and Reform.
* Revenue increases are currently going towards deficit reduction.
** Estimated impact of Live Register forecasts on Jobseeker payment expenditure.

Table A5: Cyclical developments – technical results on the basis of the EU's common methodology

	2011	2012	2013	2014	2015
Economy					
1) Real GDP growth (%)	0.7	0.7	2.2	3.0	3.0
2) Potential GDP growth (%)	-0.7	-0.4	0.8	1.0	1.6
Contributions:					
- *labour*	*-1.7*	*-1.4*	*-0.4*	*-0.3*	*0.1*
- *capital*	*-0.1*	*-0.1*	*-0.1*	*0.0*	*0.0*
- *total factor productivity*	*1.0*	*1.1*	*1.3*	*1.4*	*1.5*
3) Output gap^	-3.8	-2.8	-1.4	0.5	1.8
Public Finances (% of GDP)					
4) Net lending of general government	-13.1	-8.3	-7.5	-4.8	-2.8
5) Interest expenditure	3.4	4.1	5.6	5.5	5.6
6) One-off measures	-3.7	0.3	0.0	0.0	0.0
Structural Fiscal Developments (% of GDP)					
7) Cyclical budgetary component (=0.4*3)	-1.5	-1.1	-0.6	0.2	0.7
8) Structural budget balance (=4-6-7)	-7.9	-7.5	-6.9	-5.0	-3.5
9) Structural primary balance (=8+5)	-4.5	-3.4	-1.3	0.5	2.1

Source: Department of Finance technical calculations using the EU's common methodology. Rounding can affect totals.

^ For illustrative purposes and for simplicity, the 2012 output gap can be approximated from the output gap in 2011 (-3.8%) and the difference between the actual growth rate in 2012 and the potential growth rate (i.e. 1.1 pp). A similar approximation can be done for later years.

Table A6: Cyclical developments – technical results on the basis of the IMF's methodology

	2011	2012	2013	2014	2015
Potential GDP growth (%)	-0.1	0.4	1.0	1.5	2.1
Structural budget balance (% of GDP)	-8.3	-6.4	-5.5	-3.8	-2.5
Structural primary balance (% of GDP)	-4.9	-2.2	0.1	2.0	3.3

Source: IMF technical calculations.

Table A7: Contingent liabilities

	2011
	% of GDP
Public guarantees	110.4
Of which linked to the financial sector	*110.3*

Source: Department of Finance.