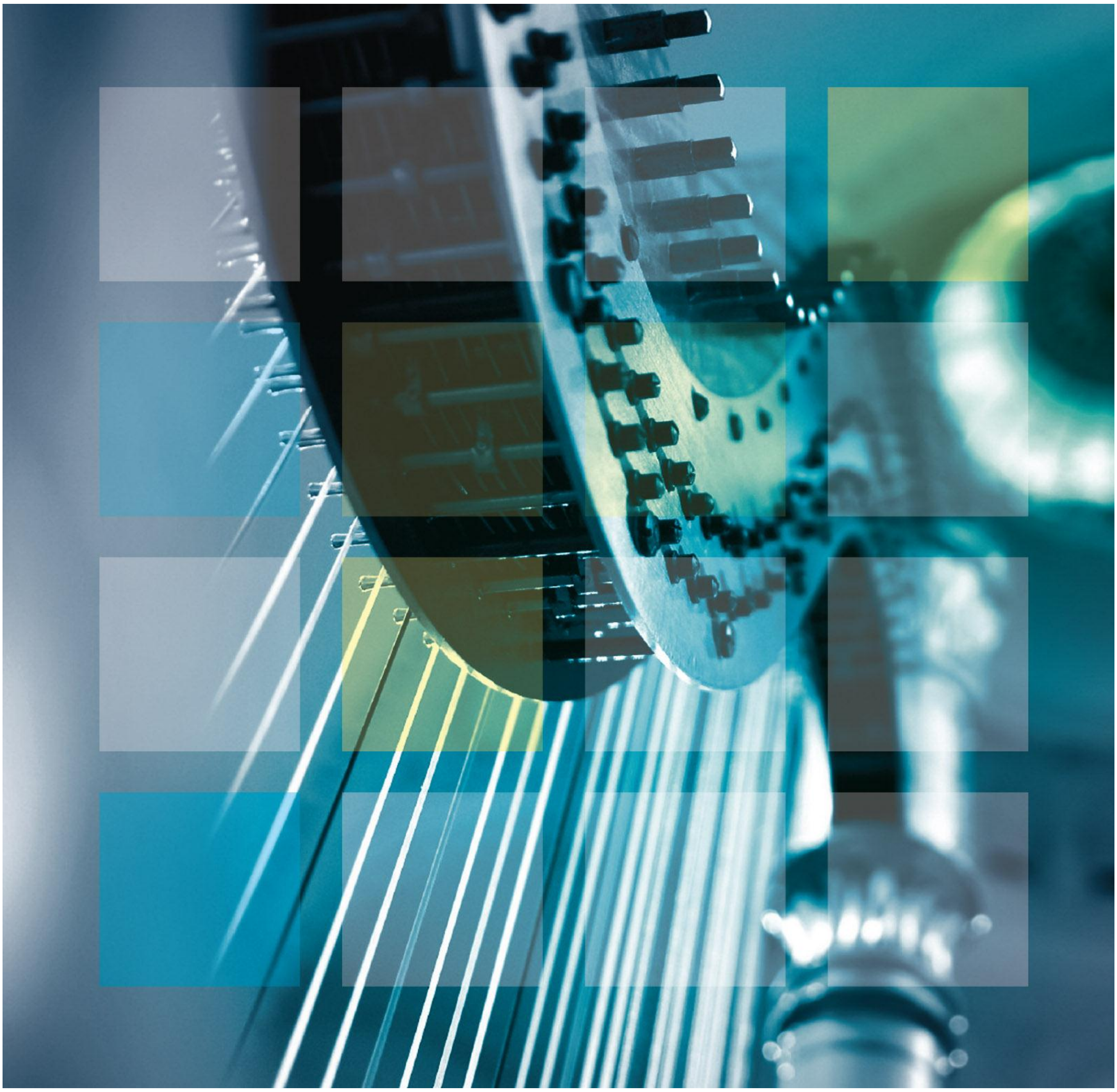

Irish Stability Programme April 2013 Update

Incorporating the Department of Finance's Spring Forecasts

An Roinn Airgeadais
Department of Finance

Irish Stability Programme

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Spring Forecasts

Foreword

This Update of Ireland's Stability Programme takes account of Budget 2013 and other Government initiatives, along with the EU-IMF Programme of Financial Assistance. It includes an update of the economic and fiscal outlook covering the short and medium term. It was laid before the Houses of the Oireachtas on 30 April 2013 and discussed at the Joint Oireachtas Committee on Finance, Public Expenditure and Reform on the same day.

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

This Stability Programme should be read in conjunction with the 2013 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 2013 Update of the NRP was laid before Dáil Éireann on 30 April 2013 and was submitted to the European Commission on the same day.

The analysis and forecasts contained in this document are based on data available to late-April

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Chapter 1

Summary Overview and General Policy Strategy

1.1. Policy strategy

The Government's primary macroeconomic policy objective is to put the economy back on a sustainable growth path so as to move to a point where sustained net employment creation is taking place.

Considerable progress is being made towards achieving this objective. Competitiveness has improved substantially in recent years, underpinning strong inward investment flows and robust export growth. In addition, tangible progress is being made to ensure a banking system healthy enough to support productive investment by *inter alia* the SME sector.

In relation to the public finances, the policy objective remains the correction of the excessive general government deficit by 2015, as recommended by the ECOFIN Council in late-2010. All of the interim annual deficit ceilings set by the Council have been met, and the Government remains committed to bringing the deficit below 3 per cent of GDP within the stated time horizon.

Sustainable public finances are essential for balanced economic growth. Once the excessive deficit is corrected, fiscal policy in Ireland will be framed in line with the requirement to make sufficient progress towards the medium term budgetary objective which, in Ireland's case, is for a balanced budget once allowance is made for the impact of the economic cycle on government revenue and expenditure.

1.2. Economic and budgetary outlook

Provisional figures show that GDP expanded by 0.9 per cent last year, the second year in which positive growth was recorded. Crucially, the data also show a stabilisation of domestic demand in the second half of the year.

In terms of the short-term outlook, GDP is projected to increase by 1.3 per cent this year, a modest downward revision to the projections which underpinned Budget 2013. The figures also incorporate some revisions to the composition of activity. In particular, the data-flow in recent months justifies a modest upward revision to the projection for domestic demand, while the poorer external environment and some sector-specific issues necessitate a downward revision to the forecast for exports.

For 2014 and over the medium term, the pace of economic expansion is projected to strengthen. This is based on the assumption of a continued modest recovery in domestic demand and an improvement in economic activity in our key export markets.

Turning to the budgetary position, a general government deficit of 7.6 per cent of GDP is now estimated for 2012, well within the ceiling set by the ECOFIN Council of 8.6 per cent. In relation to the 2013 position, there have been a number of important developments since the Budget. These include a better-than-expected end-2012 fiscal position, the replacement of the promissory notes with long term government bonds, the sales of interest-bearing stakes in the financial sector and, of course, the first quarter economic and fiscal data. Some of these developments positively impact on the deficit this year, while others have a negative impact; on balance, the impacts offset each other so that in overall terms an underlying general government deficit of 7.4 per cent of GDP is anticipated for this year, broadly unchanged from the projection last December.

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

	2012	2013	2014	2015	2016
Real GDP (% change)	0.9	1.3	2.4	2.8	2.7
Underlying general government deficit (% of GDP)	7.6	7.4	4.3	2.2	1.7
EDP ceiling (% of GDP)	8.6	7.5	5.1	2.9	n.a.
Debt ratio (year-end)	117.6	123.3	119.4	115.5	110.8

Source: Department of Finance

On the basis of the macro-economic forecasts outlined in table 1, the consolidation effort needed to achieve deficits within the recommended ceilings is set out in table 2. These figures are consistent with those previously outlined in Budget 2013. Savings of approximately €1 billion (0.6 per cent of GDP) will accrue from the replacement of the promissory notes by long term government bonds in each of the years from 2014 to 2016. The *purely technical* assumption has been made that these are used for deficit reduction.

Table 2: Fiscal consolidation - estimates and breakdown 2013-2016

	2013	2014	2015	2016
Total Consolidation Amount - € billion	**3.5**	**3.1**	**2.0**	**0.0**
Expenditure	**1.9**	**2.0**	**1.3**	**0.0**
Current	1.4	1.9	1.3	0.0
Capital	0.5	0.1	0.0	0.0
Revenue	**1.4**	**1.1**	**0.7**	**0.0**
New Measures	1.2	0.5	0.6	0.0
Carry Forward	0.2	0.6*	0.1	0.0
Increased Dividends	**0.1**	-	-	-

*2014 carry forward measures is inclusive of all measures announced in Budget 2013
Source: Department of Finance and Department of Public Expenditure and Reform
Rounding may affect totals

Importantly, the general government debt-to-GDP ratio is projected to peak this year at 123 per cent and begin declining from next year. The debt peak is slightly higher than anticipated at Budget time and is reflective of market pre-funding in the early months of the year rather than any underlying deterioration in the fiscal position. The Government is conscious of the need to continue reducing the debt ratio over the medium term and this will require the continued maintenance of a prudent budgetary strategy as well as measures to boost the potential growth rate of the economy.

Chapter 2

Economic Outlook

Summary

Real GDP grew by 0.9 per cent in 2012, the second successive year of growth in the Irish economy. Growth was once again led by the exporting sectors, with services exports the main engine of growth. Domestic demand stabilised in the second half of the year, with signs of a modest improvement in the labour market visible from mid-year onwards.

Turning to 2013, high-frequency data are consistent with further moderate output growth once again. The forecast for GDP growth this year has been revised down slightly to 1.3 per cent (from 1.5 per cent at the time of the Budget) on the back of a downward revision to overall export growth. On the other hand, available data suggest that domestic demand is now projected to expand slightly.

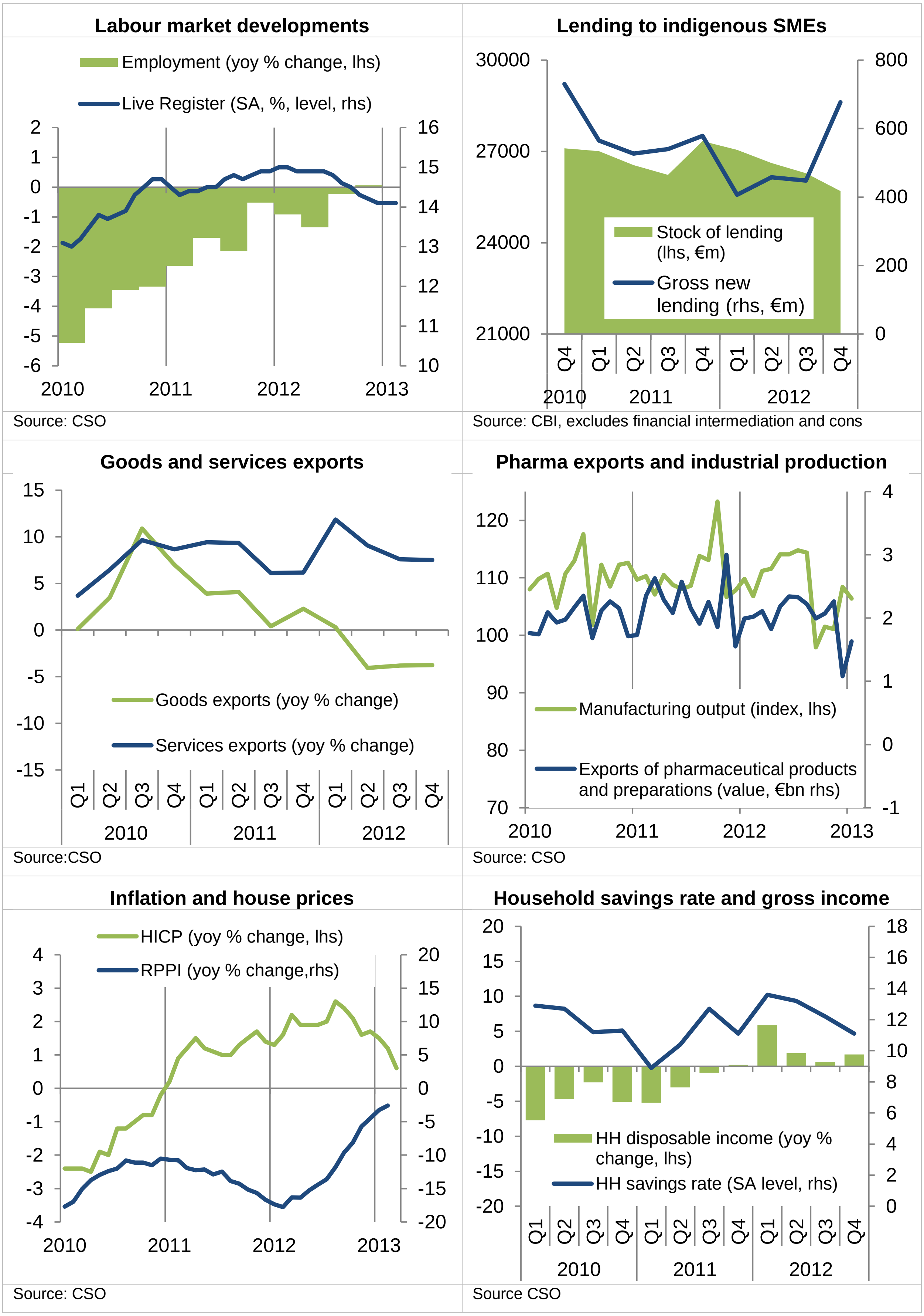
Beyond this year, domestic demand is expected to strengthen gradually. Combined with an assumed recovery in our main export markets, this is expected to result in average GDP growth of about 2½ per cent per annum over the medium term. This should have positive implications for the labour market, with annual employment growth of around 1¼ per cent anticipated over the medium term.

2.1. Macroeconomic outturn 2012

Recently-published data show that the economy recorded a second consecutive year of output growth in 2012, with GDP expanding by 0.9 per cent. Importantly, domestic demand stabilised in the second half of last year, with annual growth in consumer spending for the first time since 2010. Disposable household income rose over the course of the last year, while the household savings rate declined from the second quarter onwards. Core retail sales have remained in positive territory and the year-on-year decline in house prices is slowing. However, public consumption continued to decline, in line with consolidation-related policy objectives.

Investment made a positive contribution to growth in 2012 for the first time in a number of years. While building and construction spending continued to decline, increased spending on machinery and equipment was evident throughout the year, including in the important non-aircraft component. The availability of credit is clearly crucial for continued recovery in investment, especially by the SME sector. At end-December, the stock of lending to indigenous SMEs was down 5.0 per cent year-on-year at just under €26 billion, although gross new lending in the quarter rose year-on-year to €677 million (see figure 1)

Figure 1: High frequency indicators



The external situation provided a mixed picture. Although exports grew by 2.9 per cent in 2012, the pace of growth slowed over the course of the year. In particular, goods exports contracted for the first time since 2009 due to both the general slowdown in Ireland's trading partners as well as product-specific developments, most notably in the pharma-chem sector. By contrast, services exports performed strongly in 2012 – growing by 8.9 per cent – led by increased exports of business and IT services. This gave rise to two interesting developments: firstly, the value of services exports exceeded that for goods exports for the first time and secondly, services exports exceeded services imports, thereby reversing the traditional deficit on services trade. Looking ahead, some of these service sectors appear relatively insulated from global demand conditions, and Ireland continues to attract FDI in these sectors.

Imports of goods and services increased by 0.3 per cent last year. Taking into account the modest deterioration in the terms-of-trade, the overall trade balance expanded once again last year. At the same time, the factor income flow deficit narrowed, mainly due to firm-specific developments (which may unwind over the forecast horizon). All of these developments contributed to an increase in the current account of the balance of payments to 4.9 per cent of GDP, the highest on record.

2.2. Macroeconomic projections 2013

The global economic backdrop remains challenging, particularly in the advanced economies with which Ireland conducts the bulk of its trade. Private sector deleveraging, fiscal consolidation and heightened uncertainty are among the key factors weighing on activity in these regions.

In February, the European Commission revised downwards its projections for GDP growth in the euro area and the US and maintained a relatively weak forecast for the UK. Weighted by their share in Irish exports, GDP in Ireland's key trading partners is now projected to increase by 0.6 per cent this year and by 1.7 per cent next year – this compares with 0.9 per cent and 1.9 per cent respectively assumed at the time of Budget 2013. However, the baseline assumption is one in which a modest international recovery takes hold in the second half of this year, gaining momentum next year

Table 3: External assumptions

	2012	2013	2014
External GDP growth		% change	
World (excluding EU)	3.9	4.0	4.5
United States	2.2	1.9	2.6
Euro area	-0.6	-0.3	1.4
United Kingdom	0.0	0.9	1.9
Technical Assumptions			
Euro-sterling exchange rate	0.81	0.85	0.85
Euro-dollar exchange rate	1.29	1.31	1.31
Brent crude (dollars per barrel)	112	105	99

Source: European Commission Winter Forecasts 2013 except for oil prices (futures prices) and exchange rates which are presented as ten-day moving averages as of late-April unchanged thereafter

Against this background, Ireland's export growth is set to slow in 2013. In addition, sector-specific developments – namely the impact of the patent cliff in the pharmaceutical sector – will likely have a negative impact on merchandise exports this year. The value of goods exports fell just over 10 per cent in the year to February, led by the decline in pharmaceutical output evident since the latter half of 2012, while manufacturing output remains essentially flat. While the relatively strong performance of services exports is expected to continue, a downward revision to the export forecast, to around 2.3 per cent, appears warranted.

Table 4: Macroeconomic prospects

	2012	2012	2013	2014	2015	2016
	€ m	year-on-year change				
Real GNP	131,306	3.4	0.8	1.8	2.0	2.0
Real GDP	160,214	0.9	1.3	2.4	2.8	2.7
Nominal GDP	163,595	2.9	2.6	3.8	4.2	4.2
Components of GDP	current 2012 € m	year-on-year real percentage change				
Private consumption	81,984	-0.9	0.2	1.1	1.2	1.0
Government consumption	24,679	-3.7	-2.1	-2.0	-1.5	0.0
Investment	16,463	1.2	3.7	8.2	4.3	4.5
Stock changes (% of GDP)	-79	0.0	0.2	0.0	0.0	0.0
Exports	177,134	2.9	2.3	3.0	4.3	4.2
Imports	-137,635	0.3	1.8	2.3	3.3	3.5
Contributions to real GDP growth		annual percentage point contribution				
Domestic demand		-0.9	0.2	1.1	0.8	1.0
Stock changes		-0.2	0.2	0.0	0.0	0.0
Net exports		2.9	1.0	1.4	1.9	1.7
		€ millions				
Nominal GDP (rounded to nearest €25m)		163,600	167,900	174,275	181,550	189,125

Source: 2012 - CSO; 2013 to 2016 - Department of Finance.
Note that rounding can affect totals.

Turning to domestic demand, a slight upward revision from Budget day forecasts seems appropriate. Consumer spending held up relatively well at the end of last year, and core retail sales have been reasonably strong in the early part of this year. Slightly better-than-assumed labour market conditions and the likelihood of lower-than-anticipated inflation will also support consumption which is now projected to increase by 0.2 per cent. Government consumption is set to fall by 2.1 per cent; this is slightly less than previously anticipated and reflects a number of technical factors. Investment spending is set to increase by 3.7 per cent, mainly driven by continued investment in machinery and equipment.

The projection for import growth has been revised down to 1.8 per cent, mainly due to revisions to the projection for final demand. The import content of pharma-chem output is relatively high, and is expected to decline in line with production. Taking account of likely terms-of-trade developments and cross-border factor income flows, the current account surplus is projected to remain high (averaging over 5 per cent of GDP over the medium term) in line with multinational-led export growth and the relatively muted recovery in domestic demand that are in prospect.

Table 5: External balance

	2012	2013	2014	2015	2016
Current account (% of GNP)	6.1	6.1	6.3	6.5	6.6
Current account (% of GDP)	4.9	5.0	5.1	5.2	5.3
Of which: (% of GDP)					
- Balance on goods and services	24.1	24.5	25.1	26.3	27.2
- Balance of primary incomes and transfers	-19.1	-19.5	-20.1	-21.0	-21.9
Capital account	-1.2	-1.2	-1.1	-1.1	-1.0
Statistical discrepancy (% of GDP)	0.6	0.6	0.6	0.6	0.6

Source: 2012 – CSO; 2013 to 2016 – Department of Finance.
Note that rounding can affect totals.

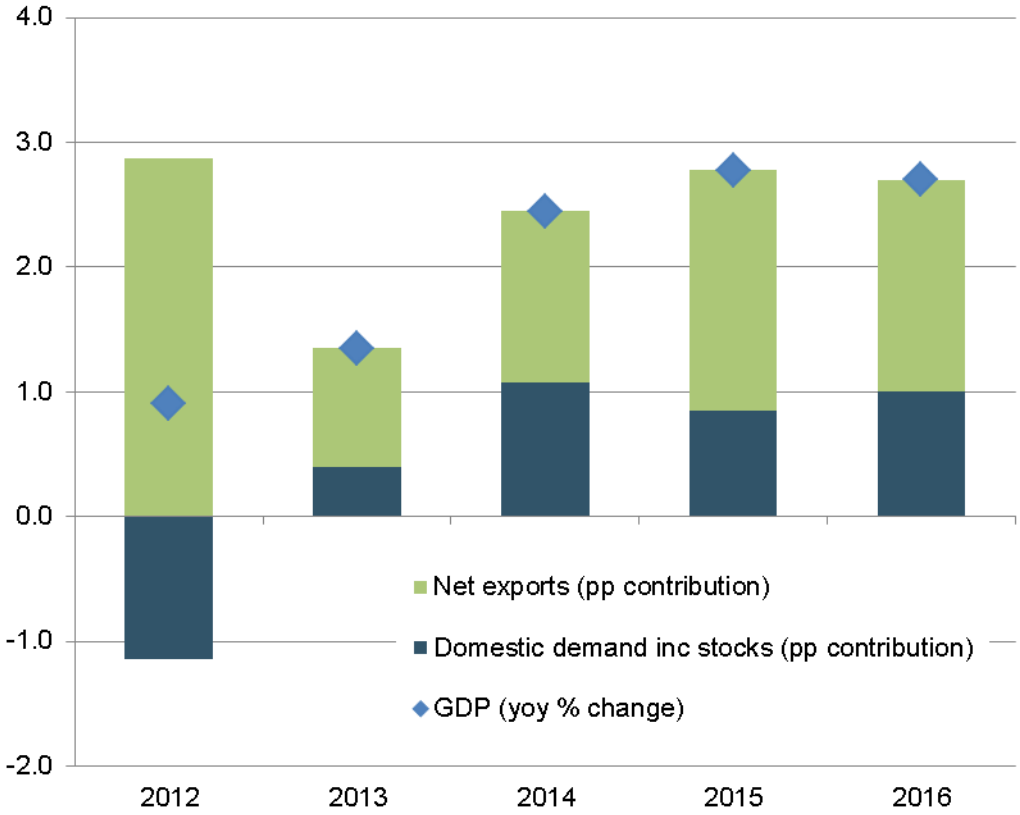
2.3. Medium-term growth prospects 2014-2016

The medium-term forecasts are based on the assumption of an improvement in demand in our main export markets over the second half of this year, and that this recovery gains momentum next year and thereafter. Together with gains in competitiveness in recent years, this should underpin an acceleration in Irish export growth in the coming years.

The baseline assumption is for domestic demand growth to strengthen gradually over the forecast horizon. Continued modest employment growth should support further modest increases in consumer spending, although high levels of household indebtedness mean that the savings rate will decline only gradually over the medium term. Annual average growth in household spending of around 1 per cent is therefore envisaged. Government consumption is set to contract in line with policy objectives. Investment is set to increase modestly in line with the need to return capital formation to a higher level consistent with growth in the capital stock.

Import growth is assumed to accelerate, in line with the outlook for final demand, while the current account of the balance of payments is likely to remain in significant surplus over the forecast horizon.

Figure 2: Contribution to GDP growth



Source: 2012 – CSO; 2013 to 2016 – Department of Finance.
Note: 2012 contributions not additive due to chain linking

2.4. The labour market

While the labour market situation remains challenging, signs of stabilisation have become evident since the mid-part of last year. After adjusting for seasonal factors, data from the quarterly national household survey (QNHS) show that employment increased in both the third and fourth quarters of last year, with the result that at end-year annual employment growth was recorded for the first time since 2008. On a sectoral basis, continued net job reductions were evident in the public service; however, the data show that modest employment gains are now a feature in large parts of the private sector.

In terms of the outlook, employment growth of around 0.4 per cent is now projected for this year as a whole. This is based on a number of factors, including stronger carry-over from the better-than-anticipated employment growth at the tail-end of last year, as well as the assumption of slightly stronger domestic demand this year. In addition, the IDA recorded the highest level of net job creation in a decade during 2012 and continued foreign direct investment announcements in recent months augur well for the short-term. Recent services PMI data also bode well for employment in this sector, with job creation being suggested in each of the last seven months.

Employment growth is expected to strengthen over the later years of the forecast horizon as the recovery in domestic activity gains momentum. There is also some upside potential stemming from the measures introduced as part of the recent *Action Plan for Jobs 2013* and the *Pathways to Work* initiatives, which may have an impact on employment levels over the short- and medium-term.

Table 6: Labour market developments

	2012	**2012**	**2013**	**2014**	**2015**	**2016**
	('000s)	% change (unless otherwise stated)				
Employment	1,838	-0.6	0.4	1.1	1.3	1.4
Unemployment rate (QNHS basis)	316	14.7	14.0	13.3	12.8	12.3
Labour productivity (GDP per person employed)		1.5	0.9	1.3	1.5	1.3
Compensation of employees		0.0	1.3	2.7	3.0	3.3
Compensation per employee		0.6	1.0	1.6	1.7	2.0

Source: 2012 - CSO and Department of Finance calculations; 2013-16 - Department of Finance estimates

Both survey and administrative (live register) data suggest that the rate of unemployment has peaked. According to the QNHS, the level of unemployment declined over the course of last year, with the unemployment rate also declining. This trend appears to have continued into this year, with the live register pointing to a standardised unemployment rate of 14.0 per cent in March. This compares with a peak of 15.0 per cent in February of last year. However, not all of the reduction in unemployment is due to increases in employment; some of the improvement also reflects falling labour supply, due to outward migration and falling participation.

The average unemployment rate stood at 14.7 per cent in 2012 and an average rate of 14.0 per cent is forecast for 2013. The unemployment rate is forecast to decline gradually over the period 2014-2016, as employment growth strengthens. However, increased labour supply is likely to result from the assumed economic recovery which is likely to curtail, at least to some extent, the decline in unemployment.

2.5. Price developments

Last year saw some uptick in consumer price inflation, with the harmonised index of consumer prices (HICP) increasing by 2.0 per cent. Much of this was due to factors such as higher energy prices. Elsewhere, inflationary pressures were relatively contained. For instance, core inflation (i.e. excluding energy and unprocessed food prices) increased by just 0.9 per cent last year.

Inflationary pressures are expected to remain relatively muted once again this year. The stabilisation of domestic demand is unlikely to result in the emergence of any significant price pressures on the domestic front while exchange rate movements over the first few months of the year should limit external inflationary pressures. In this general environment, annual HICP inflation of 1.2 per cent is forecast for this year. This compares favourably with a projection of 1.8 per cent for the euro area as a whole[1], and is consistent with a further improvement in Ireland's competiveness this year. A gradual acceleration in the rate of inflation is assumed over the medium term as recovery in the domestic economy begins to take effect.

Table 7: Price developments

	2012	**2013**	**2014**	**2015**	**2016**
			% change		
GDP deflator	2.0	1.3	1.3	1.4	1.4
Private consumption deflator	1.7	1.3	1.6	1.7	1.7
Harmonised index of consumer prices (HICP)	2.0	1.2	1.8	2.0	2.0
Export price deflator (goods and services)	3.2	0.9	1.1	1.2	1.4
Import price deflator (goods and services)	4.1	1.0	1.2	1.2	1.5

Source: 2012 - CSO and Department of Finance calculations; 2013-16 - Department of Finance projections

In terms of the GDP deflator – which accounts for price changes in all components of demand and so is the broadest measure of price developments in the economy – an increase of 1.3 per cent is forecast for this year. This reflects the fact that the terms of trade effect is projected to be broadly flat this year, due to recent exchange rate developments and base effects related to oil prices.

[1] European Economic Forecast – Winter 2013 European Commission

Chapter 3

Outlook for the Public Finances

Summary

The general government deficit for 2012 was 7.6 per cent of GDP or €12.5 billion. This represents a significant improvement on the underlying position in 2011 when an underlying deficit of 9.1 per cent of GDP was recorded. The improvement reflects primarily the impact of the Budget 2012 adjustment package, a continuation of modest economic growth and specific once-off factors.

Budget 2013 targeted an underlying deficit of 7.5 per cent in 2013, consistent with the limit set by the ECOFIN Council in December 2010. To achieve this, consolidation measures amounting to €3.5 billion (2.1 per cent of estimated 2013 GDP) were adopted. There have been a number of fiscal developments since Budget day which, in aggregate terms, more or less offset each other. As a result, the revised update for the underlying deficit is reduced slightly from that at the time of the Budget to 7.4 per cent.

The Government remains firmly committed to restoring stability to and improving the sustainability of the public finances through the implementation of further budgetary consolidation and targeted growth-enhancing policy measures aimed at reducing the deficit below the 3 per cent of GDP threshold by 2015. A key underlying technical assumption is that the 2014-2016 promissory note savings are used for deficit reduction and that the consolidation amounts outlined at Budget time remain the same. As is standard budgetary procedure, Government will make decisions in light of the emerging economic and fiscal outlook and in light of policy priorities at Budget time.

The ratio of general government debt to GDP is forecast to peak at 123 per cent this year, before moving onto a downward path. This year's estimate represents a small deterioration relative to Budget and reflects market pre-funding in the early months of this year, rather than any underlying deterioration in the fiscal position.

3.1. Budgetary outturn 2012

Exchequer tax revenue grew by 7.7 per cent on a headline basis in 2012, the second consecutive year of growth since the crisis began. Following a better-than-expected performance in December, taxes ended the year €271 million (0.7 per cent) ahead of target. A significant part of the annual performance was attributable to once off factors such as the delayed receipt of corporation tax in 2012 and the impact of the PRSI/Income Tax reclassification. Adjusting for these factors, tax revenue growth last year was estimated at 5.3 per cent. The four main sources of tax revenue - income tax, VAT, corporation tax and excise duties – all recorded year-on-year growth. Income tax, the largest contributor to overall tax revenue, recorded annual growth of 7.8 per cent on an adjusted basis last year.

On the spending side, the 2012 provisional outturn as published in the Revised Estimates for Public Services 2013 on 17 April shows that gross expenditure fell by 2.8 per cent year-on-year, reflecting the impact of the significant adjustments made to expenditure in Budget 2012. Gross total expenditure was €55.9 billion at the end of 2012, in line with Revised Estimates Volume (REV) 2012 estimates. Live Register pressures resulted in Department of Social Protection spending being just under 1 per cent above the 2012 estimate as published in the REV 2012. Similarly, health spending exceeded the 2012 estimate by just over 1 per cent. However, these over-spends were offset by savings elsewhere. Year-on-year comparisons of net expenditure in 2012 are distorted by the PRSI/Income tax reclassification discussed above[2].

The Exchequer deficit or Exchequer borrowing requirement (EBR) in 2012 was €14.9 billion, compared with an Exchequer deficit of €24.9 billion in 2011. The improvement is primarily due to the fact that the July 2011 bank recapitalisation payments were not repeated during 2012 and the settlement of the 2012 IBRC promissory note payment with a Government bond. That said, even after adjustment is made for certain banking related payments and receipts, the Exchequer deficit was around €1.4 billion lower in 2012 than in 2011.

In general government terms, the underlying deficit is estimated at €12.5 billion (7.6 per cent of GDP), well within the limit target of 8.6 per cent of GDP set by the ECOFIN Council.

3.2. Budgetary outlook 2013

Budget 2013 forecast an EBR of €15.4 billion for this year and an underlying general government deficit of 7.5 per cent of GDP. The current estimate of general government deficit is marginally improved on the Budget day estimate despite an improvement of €4.2 billion to the EBR. The improvement on the EBR is mainly due to large banking transactions which did not impact significantly on the general government accounts.

At Budget time, tax revenues were projected to be €38 billion in 2013, an annual increase of some 5 per cent. However, the aforementioned better-than-expected outturn for 2012 and other developments since Budget 2013 are expected to further increase tax revenue by an estimated €320 million (0.2 per cent of GDP) in 2013.

In terms of the performance in the period to end-March, Exchequer data show that €8.8 billion in tax revenue was collected in the first quarter of the year, slightly ahead (0.5 per cent) of target and up 1.1 per cent year-on-year. An important point to note is that a number of the measures contained in Budget 2013, most notably the property tax are designed to take full effect in the latter half of the year. Taking these factors into account, the performance over the first quarter has been broadly satisfactory.

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[2] In 2012, the Revenue Commissioners completed a technical re-classification of receipts from employers to Income Tax which was previously returned as PRSI. While benefitting Income Tax, PRSI receipts were lowered, resulting in higher net voted current expenditure by the Department of Social Protection. This was purely a re-classification between the revenue and expenditure side of the balance sheet and was budgetary neutral.

Looking at the key tax heads individually, the performance of income tax has been positive with revenue up 1.7 per cent year-on-year in the first quarter (adjusting for the impact of last year's PRSI/income tax reclassification, receipts grew by an estimated 7.9 per cent). VAT and excise duties were behind target at the end of the first quarter although both were up in year-on-year terms. On an underlying basis, corporation tax receipts were ahead of target.

There have been a number of once-off banking-related measures over the first months of 2013 which will impact on the public finances. Most importantly, the replacement of the promissory notes with government bonds in early February was a very significant success from a cash-flow perspective. Additionally, the sale of the Bank of Ireland contingent capital instruments in January boosted Exchequer receipts by €1,057 million, while, all told, the sale of Irish Life to Great Canadian Western will generate receipts of €1,340 million. However, it should be noted that the vast majority of the above is classified as a "financial transaction", and as such does not improve the general government balance on which the EDP deficit targets are based.

Turning to the spending side, the recently-published Revised Estimates for Public Services 2013 (REV) set out the detailed allocations for all Government Departments. The 2013 estimate for total gross expenditure is €54.6 billion. This is 2½ per cent down on the 2012 gross expenditure provisional outturn figure. Detailed monthly gross and net profiles will be published shortly and expenditure will be closely monitored against these profiles for the remainder of the year.

The overall net voted expenditure at end-March 2013, at €10.9 billion, was €689 million or 5.9 per cent down year-on-year. A significant element of this can be attributed to the PRSI/Income tax reclassification in 2012 and adjusting for this, total net spending is down 4.1 per cent as compared with the same period last year.

Net voted current expenditure, at €10.5 billion at end-March, was down €545 million or 4.9 per cent year-on-year, or 3 per cent in underlying terms. Net voted capital expenditure at end-March, at €387 million, was €144 million or 27.1 per cent lower year-on-year, reflecting traditional volatility in the relatively small first quarter capital drawdown.

National debt servicing costs are now also projected to be over €0.3 billion higher than estimated at the time of the Budget last December. The increase reflects the interest on the floating rate bonds issued to replace the IBRC promissory note. Excluding this impact, however, national debt servicing costs are now estimated to be somewhat lower than the Budget 2013 forecast.

The current estimate of the Exchequer deficit or EBR for 2013 is €11.2 billion, which is €4.2 billion lower than the estimate at Budget time. This very significant improvement is explained by the three large banking transactions mentioned above.

The underlying general government deficit for 2013 is forecast at 7.4 per cent of GDP, a small improvement on the Budget day estimate. The improvement is mainly due to the increase in the estimate of tax revenues and of other receipts. There is no benefit to the general government deficit through the sales of the contingent capital notes and Irish Life. Furthermore, the deficit is worse off in 2013 (though benefitting significantly in the coming years) as a result of the promissory note restructuring. The box below outlines the effect of the promissory note on the general government accounts.

Promissory note restructuring

The promissory note restructuring in February marked a very significant step in the Government's strategy of improving the sustainability of Ireland's public debt.

At the time of the announcement, a pro-forma analysis was published which estimated that, on the assumption that the restructuring had taken place on 1 January 2013, the impact on the general government deficit in 2013 would be broadly neutral. Given the time that has passed, the Department now has more definitive estimates of the impact of the promissory note restructuring on the 2013 outturn. The figures outlined here show the assumptions that underpin the SPU calculations.

In 2013, the Exchequer was scheduled to pay €3.1 billion towards the promissory note. This payment was not due to be recognised in the general government deficit as the full impact of the promissory notes was accounted for in the 2010 deficit on an ESA 95 basis. However, accrued interest payable to IBRC of €1,875 million was to be recorded on the deficit.

The replacement of the IBRC promissory note with long-term floating rate bonds and the liquidation of IBRC incur three substantive costs in 2013 which are now in the calculations of general government deficit:

- €700 million - interest costs on the new floating rate bonds
- €200 million - 39 days accrued interest that is recorded under Eurostat rules
- €1,150 million – updated estimate of the pay-out under Ministerial guarantees related to the liquidation of IBRC.

Taking all of the above into account, the impact of the promissory note restructuring on the 2013 general government deficit is now a deficit-increasing €175 million (about 0.1 per cent of GDP), compared to the initial broadly neutral estimate.

It should be emphasised that the benefits from the promissory note restructuring are much more noticeable in the 2014-2016 period when the upfront costs absorbed in 2013 no longer weigh. The overall general government balance will improve by about €1 billion per annum over those years.

The effect of the transaction on the debt in 2013 is to increase the net debt position (i.e. the general government debt less cash and other liquid assets) by about €1.3 billion. This is primarily due to the pay-out under ministerial guarantee and also due to differing interest paying profiles on the two instruments. The promissory note transaction underpins, however, longer term debt sustainability and will significantly reduce the State's funding requirement over the medium to long term.

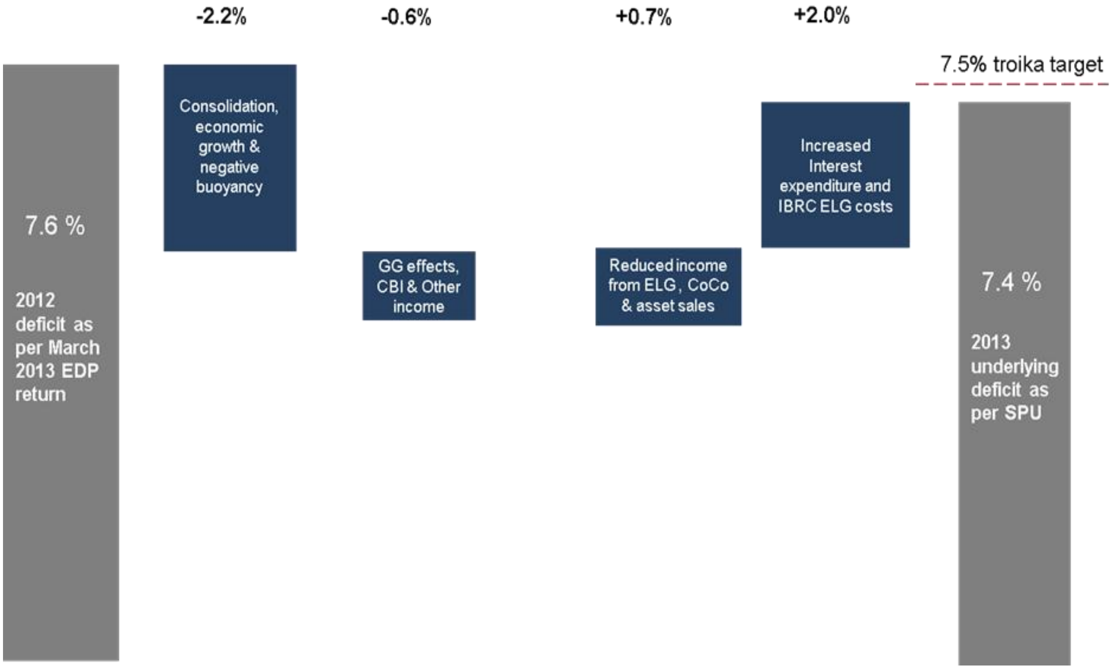
As mentioned in the pro-forma document at the time of the announcement of the promissory note deal, the Minister for Finance will be required to compensate NAMA if the amount generated on the sale of assets by the Special Liquidator is insufficient to cover amounts due to NAMA. It is not possible to determine the quantum of this potential shortfall until the asset sale process is concluded.

3.3. Transition from the deficit for 2012 to the deficit for 2013

The first official estimate of the outturn general government deficit and debt for 2012 was made by the CSO on 22nd April as part of the reporting requirements under the Maastricht Treaty. This report showed a deficit at 7.6 per cent of GDP in 2012. The Department of Finance's current forecast of the underlying deficit for 2013 is 7.4 per cent of GDP.

Figure 3 details the transition from the deficit for 2012 to the deficit for 2013. In particular, although a consolidation package of €3.5 billion is implemented in 2013, there are a number of items in the 2012 accounts whose equivalents are less favourable in 2013.

Figure 3: Transition from 2012 general government deficit to 2013



Notes:
Diagram not drawn to scale.
The diagram starts with the 2012 general government deficit of 7.6 per cent of GDP. All further adjustments show the difference between 2013 and 2012 items to arrive at the 2013 deficit. A negative adjustment lowers and improves the deficit while a positive adjustment causes deterioration to this figure.

- The net effect of €3.5 billion consolidation, economic growth, and negative buoyancy arising from the consolidation improves the deficit by about 2.2 per cent of GDP.
- CBI dividends and other income are roughly €250 million better in 2013 than in 2012. General government accruals are over €200 million better in 2013 over their equivalents in 2012. €250 million of this latter amount arises from a corporation tax accrual made in January 2012.
- With the end of the bank guarantee scheme in 2013 and the reduction of its contingent liabilities on the State, a year-on-year reduction of approximately €700 million income is estimated; the sale of the BOI contingent capital note will lead to a reduction of €100 million in income; the same level of income from sale of state assets in 2012 is not expected in 2013.
- General government interest expenditure is just over €2 billion higher in 2013 than in 2012 which includes interest payable on the new floating rate Government bonds issued to replace the IBRC promissory note and €200 million accrued interest on the promissory note. The overall interest bill for 2013 is about €1 billion better than was predicted at Budget time due to the promissory note deal. However, a further €1.2 billion non-interest costs arise in 2013 from the liquidation of IBRC.

Table 8: Budgetary projections 2012-2016

CURRENT BUDGET	2012	2013	2014	2015	2016
Expenditure	€m	€m	€m	€m	€m
Gross Voted Current Expenditure	52,170	51,145	49,230	47,780	48,260
Non-Voted (Central Fund) Expenditure	8,100	11,2 5	10,930	11,315	11,705
Gross Current Expenditure	**60,270**	**62,360**	**60,160**	**59,095**	**59,965**
less Expenditure Receipts and Balances	10,710	10,850	11,050	11,295	11,410
Net Current Expenditure	**49,560**	**51,510**	**49,110**	**47,800**	**48,555**
Receipts					
Tax Revenue	36,645	38,270	40,975	43,325	44,990
Non-Tax Revenue	2,820	2,465	1,750	1,770	1,790
Net Current Revenue	**39,465**	**40,735**	**42,725**	**45,095**	**46,780**
CURRENT BUDGET BALANCE	**-10,095**	**-10,775**	**-6,385**	**-2,705**	**-1,775**
CAPITAL BUDGET					
Expenditure					
Gross Voted Capital	3,825	3,430	3,230	3,250	3,285
Non-Voted Expenditure	3,570	1,650	1,190	855	840
Gross Capital Expenditure	**7,395**	**5,080**	**4,420**	**4,105**	**4,125**
less Capital Receipts	340	335	310	310	310
Net Capital Expenditure	**7,055**	**4,745**	**4,110**	**3,795**	**3,815**
Capital Resources	**2,270**	**4,295**	**1,555**	**1,600**	**3,585**
CAPITAL BUDGET BALANCE	**-4,785**	**-450**	**-2,555**	**-2,195**	**-230**
EXCHEQUER BALANCE	**-14,890**	**-11,230**	**-8,940**	**-4,900**	**-2,005**
EXCHEQUER PRIMARY BALANCE	**-9,230**	**-3,615**	**-520**	**3,850**	**7,070**
UNDERLYING GENERAL GOVERNMENT BALANCE	**-12,460**	**-12,500**	**-7,545**	**-3,965**	**-3,190**
% of GDP	*-7.6*	*-7.4*	*-4.3*	*-2.2*	*-1.7*
UNDERLYING GENERAL GOVERNMENT PRIMARY BALANCE	*-6,325*	*-4,260*	*945*	*4,950*	*5,990*
% of GDP	*-3.9*	*-2.5*	*0.5*	*2.7*	*3.2*

Notes:
Figures rounded to the nearest €5m. Rounding may affect totals
A technical assumption is made that voted expenditure grows by 1% in 2016
For consistency purposes, expenditure figures for 2012 are as per end-December 2012 Exchequer Statement and do not match the 2012 outturn figures in the recent Revised Estimates Volume.
Definition of underlying general government balance for Programme target purposes excludes capital repayments to the financial sector. The underlying figures above reflect payments to the Credit Unions from the Credit Union Fund.

3.4. Budgetary outlook 2014-2016

Further adjustments will be needed in the coming years to reduce the deficit and to put the debt-to-GDP ratio on a downward path. For the purposes of this document, the key underlying technical assumption underpinning the projections is that the promissory note savings in the 2014 to 2016 period are used for deficit reduction and that the consolidation targets outlined at Budget time remain the same. As is standard budgetary procedure, Government will make decisions in light of the emerging economic and fiscal outlook and in light of policy priorities. The projections for the deficit over the medium term are set out in table 8.

Regarding other banking related developments, the Government continues to negotiate with its European partners on any potential retrospective recapitalisation of the financial sector by the ESM. Any changes that might arise from these technical discussions would be factored into the budgetary projections at the relevant time.

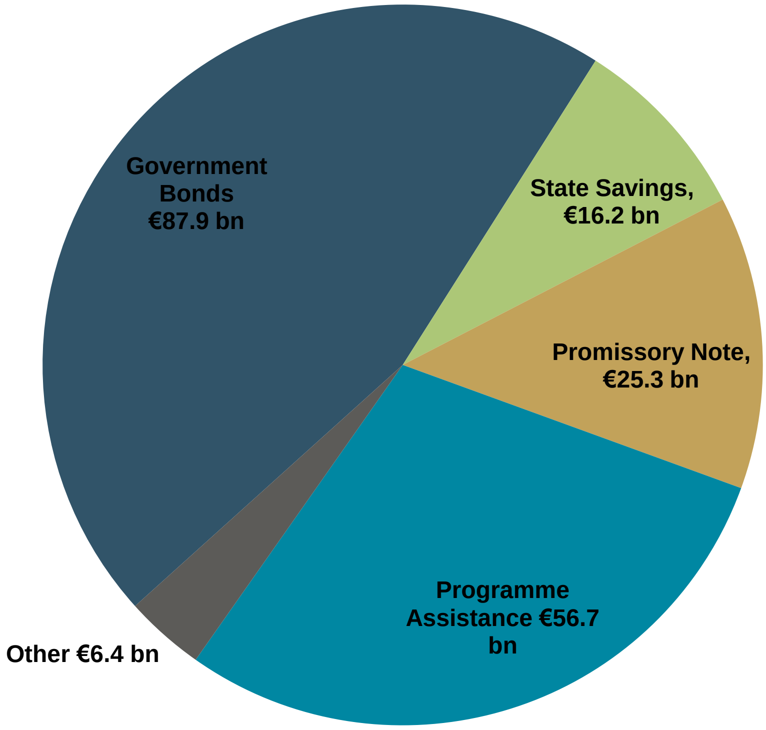
Once the excessive deficit is corrected in 2015, the public finances in Ireland will be subject to the binding requirements of the preventive arm of the Stability and Growth Pact and the Treaty on Stability, Co-ordination and Governance (the 'fiscal compact'). In summary, the requirement will be to make sufficient progress towards our Medium Term Budgetary Objective (MTO), which is for a balanced budget in structural terms (more detail is provided in chapter 8). The key issue from an Irish perspective is that given the reasonably strong potential growth rate of the economy over the medium term, it should be possible to respect the rules while allowing for some small growth in nominal expenditure without discretionary increases in tax revenue. In other words, an improvement in the structural deficit can be achieved by allowing tax revenues to increase in line with potential growth (along with inflation) once expenditure increases are lower than this.

3.5. Debt level and developments

The general government debt-to-GDP ratio has increased significantly in recent years, as a result of a substantial mismatch between government expenditure and revenue, and the large support the State has had to provide to the banking sector.

At end-2012, Ireland's general government debt stood at an estimated €192 billion or 118 per cent of GDP. Figure 4 shows the compositional breakdown of the end-2012 stock of debt.

Figure 4: Composition of general government debt at end-2012



Source: Department of Finance, NTMA and CSO
Note: In February 2013 the promissory note commitment was replaced by a portfolio of government bonds. The effect of this exchange (excluding costs related to the whole transaction) is to replace the promissory note debt with government bond debt, with no immediate effect on the general government debt.

The debt ratio is expected to peak this year at 123 per cent of GDP. It is set to decline over the forecast horizon, to an estimated 111 per cent by 2016. It is important that Ireland reaches its debt stabilising primary budget balance. The projections take into account forecasts for nominal GDP growth and the average interest rate on the stock of government debt. Ireland is likely to reach its debt-stabilising primary balance target next year, and government debt will begin to decline as a percentage of GDP aided by a reduction in previously-accumulated cash balances.

The current estimate of the gross government debt-to-GDP ratio for end-2013, at 123 per cent, is two percentage points higher than the Budget 2013 estimate. This is largely because of somewhat higher pre-funding for 2014 and 2015 in the early part of this year.

It is important to note that the increase in the ratio does not reflect any deterioration in the fiscal position. General government debt is a gross measure which does not allow for the off-set of cash and other assets.

It is necessary, for reasons of prudence and to assure investors that they will be repaid upon redemption, that the Exchequer maintains a sufficiently strong cash position at year end, as the EU-IMF Programme comes to a conclusion. In that context, it is also worth noting that there is a €7.6 billion bond maturity in mid-January

2014 which must be provided for. The NTMA's borrowing so far this year amounts to pre-funding future needs. In other words, funding has been brought forward resulting in a correspondingly reduced need to go to the market in the future. Gross debt is higher in the short-term, but will decline at a faster pace than was previously profiled as cash is used up.

Ireland's projected end-2013 cash balances have increased since the Budget estimate because of the successful pre-funding in the first quarter, and the lower Exchequer Borrowing Requirement (EBR) which is resulting from the sale of the Bank of Ireland contingent capital notes, the sale of Irish Life and the non-payment of the IBRC promissory note. The end-year cash balance projection is reduced somewhat by the up-front costs associated with the IBRC liquidation.

Given the significant increase in the volume of debt in recent years, debt service costs have also risen considerably. In 2012, general government interest expenditure as a percentage of general government revenues amounted to 10.8 per cent. In 2007, the equivalent figure was just 2.8 per cent. By 2016, based on current assumptions regarding the evolution of revenues, debt levels and interest rates on government borrowing, the equivalent of some 13.9 per cent of general government revenues will be required for debt servicing. However, as was described in the November 2012 Medium Term Fiscal Statement, this ratio remains considerably lower than in the 1980s.

Gross debt and net debt

General government debt, as defined under the Excessive Deficit Procedure (EDP) regulation, is a gross measure and consists of certain liabilities that require payment by the debtor to the creditor at a date or dates in the future. The classes of liabilities include currency and deposits, debt securities (for example, bonds) excluding financial derivatives, and loans. Debt liabilities do not include equity or investment fund shares, financial derivatives or accounts payable. A standardised definition of net general government debt is now used by the CSO in its new quarterly release, 'Government Finance Statistics'. Under this definition, net general government debt is calculated as general government debt minus government's financial assets in the form of these same classes of instruments.[3]

In Ireland's case, the EDP debt instrument assets which are allowed to be netted off, to arrive at net general government debt, include cash and other deposits held by the Exchequer and other general government bodies; preference share warrants held by the NPRF and other assets of the NPRF, the Housing Finance Agency loan assets; and contingent capital notes held by the Minister of Finance. Table 9 shows estimates of ratios of the general government debt and the net general government debt, based on the figures available for the Budget 2013 publication and in the current document.[4] The estimate of general government debt for end-2013 has increased over the previous estimate. However, the estimate of the net debt position for end-2013 is 98 per cent of GDP, marginally improved since Budget time.

[3] http://www.cso.ie/en/media/csoie/releasespublications/documents/economy/2012/gfsa_0912.pdf

[4] This is the first time this particular definition has been used in a publication by the Department.

Table 9: General government debt and net general government debt 2012 and 2013, per cent of GDP - comparison with last publication

Document	Budget 2013		SPU 2013	
Publication date	**Dec-12**		**Apr-13**	
End-year	**2012**	**2013**	**2012***	**2013**
% of GDP				
General government debt	117.6	121.3	117.6	123.3
EDP debt instrument assets	24.4	22.9	24.5	25.4
Net debt position	93.2	98.4	93.1	97.9

Source: Department of Finance, NTMA, CSO
*CSO estimate

Market Return

Ireland re-engaged with the international debt markets in 2012 for the first time since its entry into the EU-IMF Programme in November 2010. These engagements included bond switches of some €4.5 billion, the issuance of conventional bonds (€4.2 billion) as well as the issuance of a completely new debt instrument – Irish Amortising Bonds – which are tailored to meet the needs of the domestic pensions industry. Some €1 billion was raised from this source in 2012. Improving market sentiment and Ireland's outperformance of fiscal targets were reflected by the bond market with the yield on Ireland's 2020 maturity dropping from 8.26 per cent at end-2011 to 4.45 per cent at end-2012.

In July 2012, the NTMA also successfully returned to the markets at the short end of the yield curve when three-month Treasury Bills were sold for the first time since September 2010. Regular €500 million Treasury Bill auctions have continued since then and have been met with strong demand and low interest rates. The annualised yield in the April 2013 auction of €500 million three-month maturity Treasury Bills was 0.195 per cent.

The positive bond market momentum generated in 2012 has carried into 2013. In January €2.5 billion was raised, at a yield of 3.32 per cent, by way of a syndicated tap of the October 2017 Treasury bond. This was followed in March with the syndicated issue of a new €5 billion 10 year benchmark bond at a yield of 4.15 per cent. This was the first such long-term issuance since January 2010 and demand was strong with orders of around €13 billion. 82 per cent of this new bond was taken up by overseas investors. Taking account of the remaining Troika disbursements and the funding to date in 2013, Ireland is well positioned to have 12-15 months of advance funding in place when the EU-IMF Programme comes to a conclusion at the end of 2013.

Ireland has maintained its credit ratings amidst downgrades for a number of other European countries in recent months, in recognition of the outperformance of fiscal targets, the continuation of economic growth and strong adherence to the EU-IMF Programme. Both Standard & Poor's and Fitch have recently upgraded Ireland's outlook from negative to stable. Ireland's recent successful return to the international bond market and its large cash balances means that it is well placed to exit from the EU-IMF Programme at the end of 2013.

3.6. Structural budget balance

The structural balance is the budgetary position that would prevail if the economy was operating at its full capacity. For the purposes of the Stability and Growth Pact (the Pact), a production function approach that is harmonised across Member States is used to assess the productive capacity of the economy. Deviations of actual demand from full capacity (the output gap) are an estimate of the economy's cyclical position; the cyclical budgetary component is determined from this output gap together with estimates of the sensitivity of revenue and spending to the economy cycle.

As outlined in previous Updates, this one-size-fits-all methodology can – especially for small, open economies undergoing rapid changes – lead to real-time estimates of the structural balance that are sometimes counter-intuitive. In Ireland's case, this means that the results need to be interpreted with caution. Estimates of the structural balance are presented in table 10.

Table 10: Cyclical developments

	2012	**2013**	**2014**	**2015**	**2016**
1. Real GDP growth (%)	0.9	1.3	2.4	2.8	2.7
2. Net lending of general government	-7.6	-7.5	-4.4	-2.2	-1.7
3. Interest expenditure	3.7	4.9	4.9	4.9	4.8
4. One-off and other temporary measures	0.4	-0.6	-0.1	0.0	0.0
5. Potential GDP growth (%)	-0.6	0.3	1.2	2.0	2.6
Contributions to potential growth					
- labour	-1.8	-1.1	-0.4	0.3	0.7
- capital	0.0	0.1	0.2	0.3	0.3
- total factor productivity	1.3	1.3	1.4	1.5	1.5
6. Output Gap	-1.5	-0.5	0.7	1.5	1.6
7. Cyclical budgetary component	-0.8	-0.3	0.3	0.7	0.8
8. Structural budget balance	-7.3	-6.7	-4.6	-2.9	-2.4
9. Structural primary balance	-3.6	-1.8	0.3	2.0	2.4

Notes: The structural budget balance excludes one-off measures. Rounding can affect totals.
Source: Department of Finance calculations, using the harmonised EU methodology.

The Pact requires Member States to set out a (country-specific) objective for the structural budget balance that it will strive to achieve over the medium term. For Ireland, this medium term (budgetary) objective (MTO) is a balanced budget in structural terms. From 2016 onwards, Ireland will need to make sufficient annual progress towards this MTO.

Reforms aimed at boosting the potential growth rate of the economy can play an important part in reducing the size of the structural deficit over the medium term. These policy measures can help reduce the size of the discretionary fiscal measures needed to balance the public finances, and it is the Government's intention to pursue these.

Chapter 4

Sensitivity Analysis

Summary

Heightened uncertainty is an important feature of the economic outlook at present. In order to incorporate this uncertainty into the analysis, this chapter highlights the risks to the medium term economic outlook, and provides a quantitative assessment of the impact on the public finances of alternative growth trajectories. In addition, the Department's baseline forecasts are compared with firstly, those of other institutions and secondly, the forecasts in last year's Update.

4.1. Background

The macroeconomic and fiscal outlook presented earlier in this document is the Department's baseline scenario for the short- and medium term. As is always the case, the baseline scenario hinges on a number of crucial assumptions regarding *inter alia* the prospects for demand in our main trading partners, likely movements in commodity prices, exchange rates and interest rates. In addition, assumptions need to be made in respect of the behaviour of domestic households and firms; for instance, the evolution of the household savings rate will have an important bearing on short- and medium-term prospects.

4.2. Risks to the forecasts

Risks to the central forecast emanate from both external and internal sources. Externally, for instance, a more prolonged downturn in Ireland's key international markets would negatively impact on the export performance. Such a prolonged downturn could arise from a more protracted period of deleveraging in the advanced economies or from any re-ignition of the sovereign debt crisis in the euro area.

Domestically, Ireland's household indebtedness remains high, and any unexpected increase in interest rates and/or an acceleration in the pace of debt reduction could impact negatively on domestic demand. In addition, the impact on real GDP and tax revenues of the expiry of patents in the pharmaceutical sector is difficult to estimate.

On the other hand, there are also sources of upside potential. In particular, a stronger-than-assumed global recovery would have a beneficial impact on output in Ireland by boosting exports. On the domestic front, economy-wide investment – currently at around 10 per cent of GDP – remains very low both in historical and cross-country terms. A return to more normal levels of investment could add considerably to baseline GDP projections, once business confidence and credit conditions are supportive. Finally, greater certainty regarding future prospects could reduce the need for households to maintain precautionary savings at elevated levels, potentially leading to stronger domestic demand than is currently assumed.

4.3. Sensitivity analysis

The question arises as to the impact on the economy – and in particular on the trajectory for the key fiscal variables – of any deviation from the assumptions that underpin the baseline scenario. In an effort to answer this question, model simulations using the Economic and Social Research Institute's macroeconomic model (HERMES) are presented in table 11. The analysis shows the impact on key variables of a number of shocks to the baseline scenario.[5]

As outlined below, a key uncertainty relates to the speed and scale of balance sheet repair on the part of the household sector in Ireland. The baseline scenario is predicated on a modest decline in the household savings rate over the medium term. In the event that this was not to materialise, then *ceteris paribus* domestic demand would be weaker than assumed. In this regard, model simulations suggest that a permanent increase in the savings rate of 1 percentage point compared with baseline could lead to a decrease in GDP of 0.2 per cent by 2016 and an increase in the general government deficit of 0.2 percentage points of GDP by the same year. The effect is symmetric; the impact of a permanent 1 percentage point fall in the savings rate would have a similar effect, but in the opposite direction. This is important in that there may be some scope for the savings rate to fall on the back of *inter alia* policy measures which have the potential to improve confidence and reduce uncertainty more rapidly than assumed.

[5] Note that the ESRI is currently re-estimating the model in order to produce an updated Medium Term Review later this year. Results presented here should therefore be seen as indicative.

Table 11: Impact on main aggregates

		2013	2014	2015	2016
	1% Increase in World Output				
GDP	% change compared with base	0.7	0.9	0.9	1.0
Total Revenue	% change compared with base	0.1	0.3	0.6	0.8
Total Expenditure	% change compared with base	-0.1	-0.1	0.0	0.0
Deficit-GDP Ratio	pp change compared with base	-0.1	-0.2	-0.3	-0.4
Debt-GDP Ratio	pp change compared with base	-0.4	-1.2	-1.6	-2.0
Primary Balance – GDP Ratio	pp change compared with base	-0.1	-0.2	-0.3	-0.3
	1 Percentage Point Increase in Savings Rate				
GDP	% change compared with base	-0.3	-0.3	-0.3	-0.2
Total Revenue	% change compared with base	-0.3	-0.4	-0.4	-0.4
Total Expenditure	% change compared with base	0.1	0.1	0.1	0.1
Deficit-GDP Ratio	pp change compared with base	0.2	0.2	0.2	0.2
Debt-GDP Ratio	pp change compared with base	0.5	0.7	0.9	1.0
Primary Balance – GDP Ratio	pp change compared with base	0.2	0.2	0.2	0.1
	1 Percentage Point Increase in Interest Rate				
GDP	% change compared with base	-0.3	-0.8	-1.2	-1.7
Total Revenue	% change compared with base	-0.6	-1.2	-1.1	-1.0
Total Expenditure	% change compared with base	-0.1	0.1	0.5	1.0
Deficit-GDP Ratio	pp change compared with base	0.3	0.6	0.7	1.0
Debt-GDP Ratio	pp change compared with base	1.6	1.8	2.9	4.4
Primary Balance – GDP Ratio	pp change compared with base	0.4	0.6	0.5	0.4

Source: Economic and Social Research Institute.

In terms of external risks, simulations show that a permanent increase in world demand of 1.0 per cent could increase the demand for Irish exports and lead to an increase in real GDP of 1.0 per cent by 2016. This would reduce the general government deficit by 0.4 percentage points of GDP by 2016. Again, the effect is symmetric, with weaker-than-expected global growth impacting negatively on Irish output and on the fiscal variables.

Of particular note is the potential impact of any change in (policy) interest rates. The simulations show the impact of a that a 1 percentage point increase in the rate in the first year for the following four years beginning in 2013 could reduce GDP by up to 1.7 per cent by 2016 and would add 1 percentage point to the deficit as a percentage of GDP by 2016. This large impact is due to the Irish household sector's considerable exposure to interest costs reflecting the high levels of household indebtedness accumulated in recent years. While the simulated effect is broadly symmetric, the proximity of policy rates to the zero lower bound means the potential magnitude of the effect could be larger for a rate increase compared to a rate decrease.

4.3. Range of forecasts

Table 12 compares the Department of Finance's macroeconomic forecasts for this year and next with those of other agencies, both domestic and international. The forecasts show a reasonable degree of consensus in the outlook for the Irish economy across various agencies, with the range of GDP forecasts for this year extending from 1.1 per cent to 1.3 per cent. The outlook for 2014 displays a similar pattern, with a clustering of forecasts between 2¼ and 2½ per cent.

Table 12: Range of forecasts

		Annual % change			
2013		**GDP**	**GNP**	**HICP**	**Employment**
Department of Finance	April '13	1.3	0.8	1.2	0.4
Central Bank of Ireland	April '13	1.2	0.6	1.5	0.3
IMF	April '13	1.1	0.1	1.3	0.1
Consensus*	April '13	1.3	0.2	1.5	0.2
ESRI	January '13	1.3	-2.0	1.7	0.0
European Commission	February '13	1.1	n.a.	1.3	0.1
OECD	November '12	1.3	n.a.	1.3	n.a.

		Annual % change			
2014		**GDP**	**GNP**	**HICP**	**Employment**
Department of Finance	April '13	2.4	1.8	1.8	1.1
Central Bank of Ireland	April '13	2.5	1.6	1.2	1.2
IMF	April '13	2.2	1.5	1.3	0.9
Consensus*	April '13	2.3	1.6	1.6	0.8
ESRI	January '13	2.3	1.4	2.0	0.4
European Commission	February '13	2.2	n.a.	1.3	0.9
OECD	November '12	2.2	n.a.	0.7	n.a.

Source: Institutions cited.
*The average macroeconomic forecasts from a number of agencies, both international and domestic.

4.5. Comparison with last year's Update

Table 13 compares the current projections for growth, the fiscal balance and public debt with those that underpinned the 2012 Update of the Stability Programme. In last year's Update, GDP in 2013 was projected to increase by 2.2 per cent; the current forecast is for GDP growth of 1.3 per cent. The downward revision in large part reflects the less favourable external economic environment, with the downgrading of forecasts for our key export markets compounding the effects of the patent expiry in the pharma-chem sector. Notwithstanding this, the underlying deficit projection remains broadly unchanged at 7.4 per cent, in line with requirements of the excessive deficit procedure.

Table 13: Comparison with previous Update

	2012	2013	2014	2015	2016
Real GDP growth (%)					
- Previous forecast	0.7	2.2	3.0	3.0	n.a.
- Current update	0.9	1.3	2.4	2.8	2.7
- Difference	0.2	-0.9	-0.6	-0.2	n.a.
Net lending of general government (% of GDP)					
- Previous forecast	-8.3	-7.5	-4.8	-2.8	n.a.
- Current update	-7.6	-7.4	-4.3	-2.2	-1.7
- Difference	0.7	0.1	0.5	0.6	n.a.
General government gross debt (% of GDP)					
- Previous forecast	117.5	120.3	119.5	117.4	n.a.
- Current update	117.6	123.3	119.4	115.5	110.8
- Difference	-0.1	-3.0	0.1	1.9	n.a

Source: 2012 – CSO; 2013 to 2016 – Department of Finance.
Note that rounding can affect totals. 2016 is forecast for the first time

Chapter 5

Quality and Institutional Features of Public Finances

Summary

A number of important improvements to the budgetary system have been implemented since the last Update in response to well-identified needs at national level, as well as in light of the evolving fiscal architecture at European level. On the expenditure side, key developments include the introduction of legislation to provide for multi-annual expenditure ceilings, performance-based budgeting, and a move to greater *ex ante* scrutiny by the Oireachtas. On the revenue side, the main innovation has been the introduction of the local property tax, the first system of recurrent property taxation in Ireland since the 1990s. The Fiscal Responsibility Act was enacted in late 2012 and provides for, *inter alia*, implementation at national level of the Treaty on Stability, Co-ordination and Governance and the fiscal rules comprised in the EU "six-pack", including the debt rule and budgetary rule. Recent agreement on the "two-pack" of European Regulations will have further implications, including an earlier Budget than the traditional December date.

The chapter also responds the Irish Fiscal Advisory Council's most recent Fiscal Assessment Report published in early 2013. The Department notes that, given the savings expected from the promissory note restructuring in 2014 and 2015, it is no longer calling for an accelerated pace of fiscal adjustment, given that a safety margin from these savings is now in place.

5.1. Developments on the expenditure side

The main development on the expenditure side for 2013 arises in relation to the introduction of a legislative underpinning for medium-term expenditure. The Ministers and Secretaries (Amendment) Bill was published in 2012 and will shortly be considered by the Oireachtas. The Bill, when enacted, will put in place binding multi-annual ceilings on both the aggregate level of gross expenditure and also on expenditure at a Departmental level. This will effectively operationalise the 'Expenditure Benchmark', an upper limit on general government expenditure introduced as part of the so-called "six-pack" of measures introduced at a European level to improve economic governance across the EU.

Once the Bill has been enacted, Departments will be provided with the detailed rules that will apply with regard to the implementation of the new medium-term expenditure framework centred upon the principles of transparency and openness and the necessity for clear medium-term planning so that available resources are deployed, managed and re-allocated (as appropriate) to best effect. The features of the new model include:

- limited carryover of unspent current funding from one year to the next (capital carryover is already permitted in certain circumstances);
- the retention of a proportion of the funding arising from certain categories of asset disposal;

- the application of an offsetting adjustment in the envelope for the following year for any Departments which fail to manage within their expenditure ceiling; and
- 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 perfectly amenable to multi-annual planning and control.

All of these mechanisms will be subject to detailed safeguards.

This framework also encompasses 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, to enable the Government to meet its overall budgetary objectives, to maximise the scope for reform and restructuring across the public services, and to realign the allocations with the Government's new priorities.

Other initiatives being progressed are as follows:

Performance-based budgeting

In the Comprehensive Expenditure Report 2012-14, the Government announced that it was modernising the Estimates process by building performance information into the heart of the budgetary documentation. The performance budgeting initiative has adopted a single, coherent method of presenting public service performance information to show what public service outputs and outcomes are being delivered with public funds.

Over the last year, significant progress has been made on two key elements of this initiative:

(i) Performance information has been included for almost every Vote in the 2013 Estimates. This element of the performance budgeting initiative facilitates the Oireachtas in holding Ministers and Departments to account for the effective and efficient use of resources.

(ii) The Government has decided to extend the Ireland Stat project to all Votes following the successful completion of its pilot phase. Ireland Stat is a public-facing portal that builds on the progress already made in the Estimates and is aimed at disseminating public service performance information to an even wider and more diverse audience.[6]

Public Spending Code

The Department of Public Expenditure and Reform recently introduced a new, consolidated Public Spending 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

[6] www.irelandstat.gov.ie

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.

Whole-of-year budgeting

The "whole of year budgeting" process was introduced at the end of 2011 and enables Oireachtas Committees to participate in the annual Estimates process in an *ex-ante* fashion with Departments and discuss these Estimates in an *ex-post* fashion. Committees now engage with Ministers and their Departments to exchange views on how the fixed allocations for future years should be allocated to best effect. These perspectives are then taken into account by Government as the Estimates allocations are considered over the remainder of the year.

The Committees are informed by the range of Value-For-Money Reviews and focused policy analyses generated on an on-going basis as part of the Government's new Public Spending Code. The Estimates for the coming year are then published as part of the annual Budget process having been informed by the input of the Oireachtas Committees over the preceding year – an improvement over the previous practice where Committees usually can only engage <u>after</u> the money is spent or allocated.

5.2. Developments on the revenue side

It is generally acknowledged that in the latter period of the last decade the tax base in Ireland was excessively reliant on cyclical and transaction-based revenues, which led to tax revenue falling faster than economic output during the 2008-10 period. Since then, significant and wide-ranging revenue raising measures have been introduced. The tax system is being restructured so that it is based on more stable and less cyclical sources of tax revenue. The introduction of the local property tax (LPT) in 2013 is an important step in that process.

Table 14 sets out the composition of tax revenues since 2007. In 2007, capital gains taxes, capital acquisitions tax and stamp duties contributed about 14 per cent of tax revenues. Last year, this stood at closer to 6 per cent. In 2007, 29 per cent of all tax revenue came from income tax while by last year this figure had increased to 41 per cent.

Table 14 : Share of tax take by tax head

	2007	2008	2009	2010	2011	2012
			%			
Customs and Excise	12.9	14.0	14.9	15.5	14.5	13.5
Capital Taxes	7.4	4.3	2.4	1.8	1.9	1.9
Stamps	6.7	4.0	2.8	3.0	4.1	3.9
Income Tax*	28.7	32.3	35.8	35.5	40.5	41.4
Corporation Tax	13.5	12.4	11.8	12.4	10.3	11.5
Value Added Tax	30.7	32.9	32.3	31.3	28.6	27.8

*Inclusive of Training and Employment Levy
Source: Department of Finance

Tax reform has been designed to enhance economic growth potential and to minimise the increase in distortionary taxation on labour.

The main structural reform to the tax system over the course of the last year has been the introduction of the local property tax (LPT). It is levied at 0.18 per cent of property value up to €1 million and at 0.25 per cent above that level and is designed to be a stable and predictable source of revenue, to raise €500 million in a full year. Ireland has not had a system of recurrent property taxation since the mid-1990s. The LPT will come into effect from 1 July 2013. Limited and carefully designed deferrals and exemptions have been included, with the aim of ensuring the social equity of the tax.

5.3. European developments

The European Semester 2013

According to the European Semester procedure, in formulating their plans for structural reforms and budgetary policies in 2013, Member States should take into account the guidelines issued by the Spring European Council, held on March 14-15 2013.

The five agreed EU economic policy priorities are:

- differentiated, growth-friendly fiscal consolidation,
- restoring normal lending to the economy,
- promoting growth and competitiveness,
- tackling unemployment,
- modernising public administration

With regard to budgetary policies, the European council stressed the need for fiscal consolidation while at the same time ensuring economic growth. The Council emphasised that particular priority should be given to supporting youth employment and promoting growth and competitiveness.

The "two-pack"

Political agreement on the 'two-pack' of economic governance regulations was reached under the stewardship of the Irish Presidency of the Council of the European Union in February 2013.

These draft regulations concern:

- common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficits in euro area Member States; and

- the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area.

The "two-pack" was subsequently approved by the European Parliament and ECOFIN and it is expected that the measures will be formally adopted in May or June

2013. The “two-pack” introduces a strengthened budgetary surveillance procedure which will be a key addition to the economic governance regime of the euro area. It is designed to both prevent crises of the current variety and to put in place a more effective resolution mechanism when they do occur. In practical terms, it means that a stronger coordination mechanism for budgetary procedures will be in place for 2014 across the euro area. In addition, under the “two-pack”, a post-programme surveillance process will be put in place and maintained for a member country exiting a financial assistance programme, until the balance outstanding under EU-sourced assistance falls below 25 per cent of the total.

5.4. National budgetary rules

Fiscal Responsibility Act 2012

A constitutional referendum to ratify the Treaty on Stability, Co-ordination and Governance in the EMU (TSCG) was passed by the Irish electorate on 31 May 2012. Subsequently, the Fiscal Responsibility Act 2012 (FRA 2012) was signed into law on 27 November 2012. The Act provides for *inter alia*, the implementation of Articles 3 and 4 of the Fiscal Compact into domestic Irish law.

The Act imposes a duty on the Government to endeavour to secure that the budgetary rule and the debt rule, which are provided for in the Act, are complied with.

The **budgetary rule** requires that:

- the budgetary position of General Government must be in balance or in surplus and that this will be satisfied if the annual structural balance is at the medium-term budgetary objective (MTO); or

- the annual structural balance of General Government is complying with the adjustment path toward the MTO as set in accordance with the Stability and Growth Pact (SGP); unless

- a failure to achieve the MTO or remain on the adjustment path towards it is due to the existence of exceptional circumstances, as defined under the SGP.

If there is a failure to comply with the budgetary rule and the deviation from the MTO or the adjustment path is more than 0.5 per cent of GDP and exceptional circumstances do not apply, then the Government will be required to implement a correction mechanism. The provisions of this correction mechanism have been drafted in light of the Common Principles adopted by the European Commission.[7]

The Act also provides for the implementation of the debt rule in line with the requirements of the SGP. The **debt rule** requires that General Government debt in excess of 60 per cent of GDP must be reduced by one twentieth of the excess over this limit each year. In Ireland’s case, the debt rule will apply in full three years after it has exited its current Excessive Deficit Procedure in 2015.

[7] COM(2012) 342 final

On 31 December 2012, the Irish Fiscal Advisory Council was placed on a statutory basis, and assigned the monitoring and assessment functions required of an independent national institution under the TSCG. The functions already assigned to the Council on an administrative basis were also included in the Act. These functions include assessing the official spring and autumn macroeconomic and budgetary forecasts produced by the Department of Finance and, in relation to annual budgets and stability programme updates, the fiscal stance for the year or years concerned.

Domestic implications of the "two-pack"

The "two-pack" has several direct implications for the existing budgetary process. These include:

- The draft budget for central government and the main parameters of the draft budgets for all the other sub-sectors of the general government must be published by the 15th of October each year;
- Both the national medium-term fiscal plan/Stability Programme Update and the draft budget must be based on independent macroeconomic forecasts which are defined as forecasts produced or endorsed by independent bodies; and
- The budget for the central government must be adopted or fixed upon and published by the 31st of December each year.

The implications of these changes are that much of the existing budgetary process, which normally is completed in the first week of December, will have to be finalised much earlier in order to allow for Budget Day to take place on or shortly before October 15 each year. The corresponding Finance Bill, implementing measures in relation to taxation announced in the Budget will be required to complete passage through the Oireachtas before it rises in December each year. The detailed Estimates for Public Services for the year ahead will be submitted to Dáil Éireann before it rises in December. Finally, the role of independently endorsing the macroeconomic forecasts on which Budget 2014 is based is to be assigned to the Irish Fiscal Advisory Council and legislation providing for this is in preparation.

5.5. Response to Irish Fiscal Advisory Council's April Report

The Irish Fiscal Advisory Council was placed on a statutory basis at the end of December 2012, following the enactment of the Fiscal Responsibility Act 2012 (FRA). Its fourth assessment report was published in April 2013[8]. The Council assessed the macroeconomic and fiscal projections set out by the Government in Budget 2013, and the appropriateness of the fiscal stance. Finally, it assessed Government compliance with the budgetary rule as set out in the FRA. The Fiscal Assessment Report has been considered in the preparation of this document.

In summary, the Council is largely supportive of current policy of fiscal adjustment and in light of recent developments; it is no longer calling for additional consolidation to build up a margin of safety for 2014 and 2015. Based on these recent

[8] http://www.fiscalcouncil.ie/publications/fiscal-assessment-report-april-2013/

developments, most notably the restructuring of the Promissory Note, the Council concludes that a deficit of circa 2 per cent of GDP in 2015 is achievable, subject to Government following the Council's recommendation that the planned €5.1 billion of consolidation measures in 2014 and 2015 are implemented. It is reasonable to state that the fiscal expectations of the Fiscal Council, though a little more optimistic, are broadly in line with the official forecasts in this SPU.

In line with standard budgetary procedure, the Government's formulation of Budget 2014 will, in addition to taking all emerging economic and fiscal developments into account, consider fully the outputs of the European Semester process and the recommendations made by the Fiscal Council in its reports.

In relation to the macro-economic trends and structural fiscal analysis, the Council report notes that, given the deterioration in the external environment since Budget day, including weaker-than-expected activity in some major trading partners and exchange rate appreciation, achieving the 1.5 per cent GDP growth forecast for this year will be challenging, although growth is expected to be in positive territory. The Council also suggests downside risks to the medium-term forecasts. The forecast for 2013 in this Stability Programme has been revised downwards to 1.3 per cent mainly on foot of the less favourable external environment.

The report assesses the approach to macroeconomic forecasting in the Department and finds that this is in line with the approach used by the ESRI and the Central Bank.

The Council also suggests that given the complexities involved in assessing and projecting potential output, a more comprehensive set of methodologies should be put in place by the Department of Finance. The Department is tied into the harmonised approach for the purpose of EU commitments but is conscious of the need to look at other approaches. With this in mind, the Department held an external seminar on this matter last year and further work is envisaged in the future.

The Council notes the budgetary outturn in 2012 was significantly better than estimated by the Department of Finance, and that it appears that Ireland's general government deficit will be significantly below 8 per cent, as against the Excessive Deficit Procedure target of 8.6 per cent in 2012. The Council also states that the 2013 deficit target of 7.5 per cent looks achievable. In relation to both predictions, the Council is correct. The general government deficit for 2012, as reported by the CSO to Eurostat in the EDP return published on 22nd April last, was 7.6 per cent. Though an extremely welcome development, it should be noted that not all of this performance was due to repeating factors. In particular, the Spectrum auction in 2012 brought in significantly higher revenues than had been anticipated at the time of Budget 2012 and the bank guarantee scheme was kept in place for the full year, resulting in higher than projected revenues. This scheme has since ended.

The Council notes that the Exchequer deficit was consistently over-estimated in 2012, in part because the revenue outturn for 2012 exceeded the Budget 2012 forecast by €1.6 billion. The Report acknowledges that much of this was due to technical and timing factors including the late receipt of Corporation Tax income, a reclassification of PRSI receipts to income tax, larger than expected receipts from the

Spectrum auction in November 2012 and the distortionary effect of repayments by the Social Insurance Fund of an Exchequer advance. The payment of the promissory note with a Government bond instead of cash in April also affected the Exchequer deficit.

The Council has noted that the publication of the Monthly EBR profiles 2013 which they state “presented a very informative outline” of revenue and expenditure over the course of 2013. The publication of this material follows on from the Department’s 2012 statement of strategy which “requires a heightened effort on our part to communicate with all our stakeholders”.

The Council raises some concerns about the implementation of planned future expenditure adjustment measures. In this context, it should be noted, that, despite some particular pressures last year, overall gross Departmental expenditure in 2012 was in line with the target. The Council also notes that improved monitoring in the Health area should help underpin savings.

The Council notes that the aim of the new multi-annual expenditure ceilings framework is to encourage more medium-term expenditure planning and adherence to budgetary targets. In this context it raises a concern over the “binding” nature of the expenditure ceilings. The Ministers and Secretaries (Amendment) Bill 2012, when enacted later this year, will put expenditure ceilings on a statutory basis. These ceilings will be operated in the context of the overall fiscal framework agreed at a European level particularly the “expenditure benchmark” in the Stability and Growth Pact, which has already introduced an over-arching limit on general government expenditure for Ireland. While binding, this limit allows for flexibility in expenditure on a number of areas, including; unemployment benefits, European co-funded payments and expenditure financed through discretionary revenue increases. In effect, the Ministers and Secretaries (Amendment) Bill translates these European level principles and rules of expenditure management into an operational format for the Irish cash-based Exchequer system.

Under the Fiscal Responsibility Act 2012, the Council must assess Ireland’s compliance with the budgetary rule introduced under the Fiscal Compact. The Council finds that, as per the projections under Budget 2013, Ireland will comply with the adjustment path required under the budgetary rule in 2013, 2014 and 2015. The debt rule does not fully apply to Ireland until 2019.

While noting the importance of consistency across countries, the Council suggests that an independent and convincing domestic methodology for calculating the structural balance with good methodological underpinnings could be used if the EC methodology was seen to be giving significantly misleading signals. In this case, the Council believes it could then assess Ireland’s compliance to the rule based on the domestic calculations.

The Council highlights the sensitivity of our debt-to-GDP ratio to changes in economic growth, emphasising the importance of the forecast GDP growth materialising.

The Council's analysis of tax forecasts is of value in showing that tax errors have, since 1997, primarily related to the construction sector. As the report highlights, while accounting for a relatively small portion of the total tax yield, capital taxes contributed to the majority of the estimated tax forecasting error. Indeed, the difficulty related to the forecasting of capital taxes was documented previously by the 2008 Tax Forecasting Methodology review group. Revenues from CGT and CAT do not have as consistent a relationship with economic growth as other sources of tax would, such as income tax or VAT, and are, therefore, more difficult to forecast. This problem is not unique to Ireland. Capital taxes (and indeed Stamp Duties) are more dependent on activity in asset markets (property and shares), which are prone to more pronounced movements in volume and price than the wider economy and are thereby more volatile in behaviour. However, as illustrated by the Council's analysis covering the period 2010-2012, the contribution of forecast errors from capital taxes has reduced significantly.

The Department of Finance notes the Council's interesting discussion on fiscal multipliers, including an overview of the competing opinions among international organisations. This additional information is a useful contribution to the debate, both for the public and for policy consideration. The Council suggests that the main argument for back-loading is the impact of fiscal multipliers, while front-loading can increase creditworthiness within the market, and provide household and business confidence. It must be noted that political considerations and consolidation fatigue can also be a factor in the timing of the adjustment process.

Chapter 6

Long-Term Sustainability of Public Finances

Summary

While the immediate budgetary challenge is to correct the excessive deficit and, thereafter, to start moving towards a balanced budget in structural terms, demographic developments in the coming decades will likely put an increasing strain on the public finances in Ireland. Ireland's population is currently one of the youngest in Europe, and the ageing population over the coming decades will mean increased outlays on pensions, healthcare and long-term care provision. At the same time, the share of the population tasked with financing this increased expenditure is set to contract. Policies undertaken in recent years to address this challenge include legislation to increase the state pension age over time, a multi-year nominal freeze in State pension rates of payment, reductions in public service pay, reform of public service pensions, and moves to put long-term care on a more sustainable basis. Policies that encourage labour supply will also remain essential to boost potential output over the long run.

6.1. Long-term budgetary prospects

The latest long-term demographic projections from EUROSTAT[9] suggest a significant demographic shift in the composition of the Irish population in the coming decades. In particular, the number of older people – defined as those aged 65 and over – is expected to rise considerably, in both absolute and relative terms. At present, the older age cohorts constitute about 12 per cent of the total population; this figure is expected to rise to 22 per cent of the population by 2060. In contrast, the share of the population aged 15-64 is projected to gradually fall from around 67 per cent at present to about 60 per cent in 2060. This compositional shift will mean a substantial rise in the old-age dependency ratio – by 2060 there will be about three people of working age for every person over 65, compared with a ratio of six to one today.

The prospect of a 'greying' population poses significant challenges to the public finances of many EU Member States, including Ireland. Given the importance of this issue the Economic Policy Committee in conjunction with the European Commission undertake an assessment of the situation in all Member States every three years. By definition, the analysis involves technical assumptions and, given the time horizon involved, is subject to considerably uncertainty. Nevertheless, it provides a useful tool in demonstrating the scale and timing of age-related fiscal challenges and facilitating the development of policies to mitigate the effects.

The latest analysis[10] – undertaken in 2012 – indicates that public spending on pensions, health and long-term care in Ireland will increase from 18 per cent of GDP

[9] EUROSTAT (2010), EUROPOP 2010
[10] http://ec.europa.eu/economy_finance/publications/european_economy/2012/pdf/ee-2012-2_en.pdf

in 2010 to 21 per cent by 2030 and to 26 per cent by 2060 (see table 15). Educational expenditure is projected to remain broadly unchanged over the period, while unemployment benefit expenditure is expected to fall, in line with more benign labour market conditions over the very long term.

Table 15: Long-term spending projections

% of GDP unless otherwise stated	**2010**	**2020**	**2030**	**2040**	**2050**	**2060**
Total age-related expenditures	26.6	30.2	29.1	30	32.7	33.6
Total pension expenditure	9.3	11.5	11.4	12.5	14.3	15.0
Social security pensions	7.5	9.0	9.0	10.0	11.4	11.7
Old-age and early pensions	*5.6*	*7.0*	*7.0*	*7.9*	*9.4*	*9.7*
Other pensions	*1.9*	*1.9*	*1.9*	*2.0*	*2.0*	*2.0*
Occupational pensions (Public Service)	1.8	2.5	2.4	2.5	2.9	3.3
Health care	7.3	7.2	7.7	8.1	8.2	8.3
Long-term care	1.1	1.3	1.5	1.9	2.3	2.6
Education expenditure	6.3	7.1	6.5	6.0	6.5	6.4
Other age-related expenditures (Unemployment benefit)	2.6	3.1	2.0	1.5	1.4	1.3
Underlying Assumptions	**2010**	**2020**	**2030**	**2040**	**2050**	**2060**
Labour productivity growth	1.8	1.8	1.5	1.5	1.5	1.5
Potential GDP (growth rate)	-1.5	3.3	2.7	1.8	2.0	2.3
Participation rate males aged 15-64	77.2	74.6	72.1	72.4	72.0	71.3
Participation rate females aged 20-64	62.0	63.9	63.9	64.2	63.0	63.1
Total participation rates aged 15-64	69.6	69.2	68.0	68.3	67.6	67.3
Unemployment rate	13.7	13.4	7.1	6.3	6.1	6.0
Population aged 65+ over total population	11.5	14.6	17.7	20.3	22.9	21.9

Source: Economic Policy Committee and European Commission, the 2012 Ageing Report, Economic and Budgetary Projections for the EU-27 Member States (2010-2060)

6.2. Policy Strategy

In recognition of the significant challenges an ageing population poses to the long-term sustainability of the public finances, a number of measures have already been introduced to address this issue in Ireland. These policies, while designed to achieve significant savings for the State, are framed in such a way as to safeguard the welfare needs of older members of society. Some of these measures are outlined below.

Public Service Pay

With effect from 1 January 2010, public service pay was cut by an average of 6.5 per cent (with reductions of a minimum of 5 per cent applying to those at the lower end of the earnings spectrum up to a maximum reduction of 30 per cent for certain political officeholders). This cut, allied with an effective nominal 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. As a detailed set of recommendations produced by the Labour Relations Commission which were estimated to deliver an additional €1 billion reduction in public service pay and pension costs by 2015 were not accepted by a ballot of union members, it will now be necessary for the Government to decide on and secure alternative measures that will deliver the additional pay and pensions savings of €300 million for 2013 and €1 billion by 2015 to meet public expenditure targets.

State Pension

Significant reforms have been undertaken in recent years to address the level of expenditure on the social security State pension. These include:

- Legislation passed in 2011 will increase the State pension qualifying age to 66 years of age in 2014, 67 in 2021 and 68 in 2028;
- Increasing the requisite number of years to qualify for a State pension from 5 years to 10 years;
- Adopting a new "total contributions approach" for those reaching State pension age from 2020, to replace the current averaging system;
- The value of the state pension has been frozen in nominal terms for the duration of the EU-IMF programme.

Public Service Pensions

A new single pension scheme for all new entrants to the public service came into force on the 1st of January 2013. The scheme, which is a commitment under the EU-IMF Programme, is estimated to lower the cost of public service pension provision by about a third over the long term.

The primary mechanisms through which these savings will be made are as follows:

- The calculation of pensions on the basis of career-average earnings, replacing the previous system in which pensions were based on final salary;
- The modification of pension indexation – the new scheme provides for post-retirement pension increases to be linked to consumer prices and not wages of existing public servants;
- A phased increase in the minimum pension age; the single scheme minimum pension age has been set at 66 years from scheme commencement in 2013, and will rise in step with changes in the statutory State Pension age to 67 in 2021 and 68 in 2028.

Long-term Care

The *Nursing Homes Support Scheme* aims to put 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 Department of Health is to shortly begin seeking tenders for the carrying out a review of this scheme, with the final report scheduled for completion this year.

Conclusion

Notwithstanding the measures already taken (or in train), the scale of the task is such that additional policy measures will be required in due course in order to safeguard the long-term sustainability of the public finances. Such measures may seek to enable higher employment rates of older workers or put in place policies that support higher labour productivity, thus contributing further to fiscal sustainability as well as to more adequate retirement incomes in the future.

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

Summary

Significant progress has been made in terms of implementing the recommendations addressed to Ireland in December 2010 as part of the excessive deficit procedure. The deficit targets have been met for each year, and Ireland is on course to bring the deficit below 3 per cent of GDP in 2015. Wide-ranging institutional reforms have been implemented to improve the management of the public finances.

7.1. Background

The purpose of this chapter is to report on progress made in the implementation of the recommendations addressed to Ireland in the context of the Excessive Deficit Procedure (EDP).

Article 126(1) of the Treaty on the Functioning of the EU (hereafter the 'Treaty') requires Member States to avoid excessive deficits. Protocol 12 annexed to the Treaty specifies the reference values as 3 per cent of GDP in respect of general government deficits and 60 per cent of GDP in respect of general government debt; budgetary developments in excess of these reference values can trigger the 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.

Between April 2009 and July 2010, a number of additional steps in the procedure were taken (see Stability Programme Update, April 2012).

In December 2010, as part of the EU-IMF programme, the Council adopted revised recommendations to Ireland and extended the deadline for correction of the excessive deficit to 2015. The recommendations included the requirement to implement budgetary measures to ensure that the annual fiscal deficit (excluding direct support for the banking sector) was at or below pre-determined ceilings over the 2011-15 period (see table 16 below). In order to achieve these nominal targets, the Council recommended an improvement in the structural budget balance of at least 9½ per cent of GDP over 2011-2015. In addition, the Council recommended various institutional reforms in order to limit risks to the budgetary adjustment.

Finally, the Council requested the Irish authorities to report on the implementation of these recommendations in each Update of Stability Programme between 2011 and 2015.

7.2. Progress in implementing the Council's recommendations

Significant progress has been made in implementing the recommendations addressed to Ireland in December 2010[11].

In relation to the fiscal targets completed to date, the actual outturn in both 2011 and 2012 was well below the ceiling imposed by the Council (see table 16). For 2013, consolidation measures amounting to around 2.1 per cent of GDP were adopted in order to ensure that the ceiling is respected. As outlined earlier in this document, the current projection is for a deficit of 7.4 per cent of GDP. Consolidation amounts have also been specified for both 2014 and 2015 (outlined in table 2 of this document) which, taken in conjunction with modest economic growth, are expected to result in a correction of the excessive deficit within the timeline established by the Council.

Table 16: 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
Underlying general government balance*	-9.1	-7.6	-7.4	-4.3	-2.2

Source: Department of Finance.
* excluding support for the banking sector.

In relation to the fiscal effort recommended by the Council, the total fiscal consolidation already implemented for 2011-2013, together with the additional consolidation planned for 2014-2015 amounts to around 11 per cent of GDP. In addition, considerable progress has also been in respect of institutional reforms (see Chapter 5 for more details).

In summary, therefore, the Council recommendations to Ireland are being implemented, and the excessive deficit will be corrected in 2015.

[11] http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/104-07_council/2010-12-07_ie_126-7_council_en.pdf

Chapter 8

Adjustment Path to Medium-Term Budgetary Objective - Illustrative scenario

As outlined earlier in this document, Ireland is on track to correct its excessive deficit by 2015. Thereafter, the public finances in Ireland will no longer be subject to the corrective arm of the Stability and Growth Pact (the 'pact') but subject to the requirements of the preventive arm <u>and</u> the Treaty on Stability, Co-ordination and Governance (the 'fiscal compact').

The preventive arm of the pact requires Member States to set out a (country-specific) objective for the structural budget balance that they will strive to achieve over the medium term. For Ireland, this medium term (budgetary) objective (MTO) is for a balanced budget in structural terms. From 2016 onwards, therefore, the requirement is that the general government deficit (after adjusting for the impact of the cycle) is converging at a sufficiently rapid pace towards balance.

It is important to stress that in an economy such as Ireland's, where the growth potential is reasonably strong, improvements in the structural budgetary position can be achieved on a phased basis without necessarily involving additional discretionary taxation and spending measures. Instead, maintaining expenditure growth below the (nominal) growth rate of potential output (assuming a tax to nominal GDP elasticity of unity) would result in a structural improvement in the fiscal position. In other words, prudent management of the public finances will go a long way towards achieving the MTO.

In addition, reforms aimed at boosting the potential growth rate of the economy can play an important part in reducing the size of the structural deficit over the medium term. These policy measures can help reduce the size of the discretionary fiscal measures needed to balance the public finances, and it is the Government's intention to pursue these.

The table below sets out, on a <u>purely technical and indicative basis</u>, assumptions for the key variables needed to assess the path towards the MTO from 2016 onwards.

The starting point is the estimate of the structural balance in 2015 – which is estimated to be a deficit of 2.9 per cent of GDP. On the basis of the harmonised approach, the output gap at this stage is positive, amounting to 1.5 per cent of GDP, which seems implausible (problems with the one-size-fits-all approach have been outlined previously). Nevertheless for the purpose of this exercise, the output gap is assumed to close over the following number of years in a broadly linear manner. This results in a somewhat lumpy profile for aggregate demand growth.

Total revenue is assumed to increase in line with nominal GDP, while expenditure is assumed to increase by 1 per cent per annum. <u>Again it must be stressed that this is purely an illustrative scenario.</u> The resulting headline and structural balances are set out in table 17.

As is evident, limiting expenditure growth to a rate below the potential growth rate of the economy results in a convergence of the structural balance towards the MTO by the end of this decade.

Table 17: Budgetary plans

% of GDP	2016	2017	2018	2019
1. General government balance	-1.7	-1.2	-0.3	0.8
2. Structural balance	-2.4	-1.7	-0.4	1.0
3. Cyclical budgetary component	0.8	0.5	0.1	-0.2
4. One-offs and other temporary measures	0.0	0.0	0.0	0.0
5. General government balance	-1.7	-1.2	-0.3	0.8
6. Total revenues	34.8	34.5	34.2	33.9
6a. Total revenues at unchanged policy from 2012	n.a.	n.a.	n.a.	n.a.
7. Total expenditure	36.5	35.8	34.5	33.1
Amounts to be excluded from the expenditure benchmark				
7a. Interest expenditure	4.8	4.8	4.8	4.7
7b. Expenditure on EU programmes fully matched by EU funds revenue	0.2	0.2	0.2	0.2
7c. Cyclical unemployment benefit expenditure***	-0.4	-0.5	-0.5	-0.4
7d. Effect of discretionary revenue measures	n.a.	n.a.	n.a.	n.a.
7e. Revenue increases mandated by law	0.0	0.0	0.0	0.0
8. Tax burden*	31.5	31.3	31.2	30.9
9. Gross debt**	110.8	107.9	103.6	97.9

*As defined in table 2a of the Code of Conduct
**As defined in Regulation 479/2009 (not an ESA concept)
*** Methodology set out in annex 3

Table 18: Macroeconomic assumptions

	2016	2017	2018	2019
1 Real GDP growth	2.7	2.3	3.0	3.5
2. Nominal GDP growth	4.2	3.8	4.3	4.8
3 GDP deflator growth	1.4	1.5	1.3	1.3
Potential GDP growth	2.6	2.9	3.7	4.1
Output gap	1.6	1.0	0.3	-0.3
Employment persons (000s)	1.4	1.5	1.5	1.5
Hours worked	0.6	0.6	0.6	0.6
Unemployment rate	12.3	11.5	11.0	11.0
Gross fixed capital formation	4.5	7.0	8.0	10.0
Compensation per employee	3.3	3.2	3.7	3.7

Source: Department of Finance calculations
Note: figures may not sum due to rounding

Annex 1

Supplementary Data

Table A1.1: General government budgetary forecasts 2012-2016

	ESA	2012	2012	2013	2014	2015	2016
		€m	% of GDP				
Net lending (EDP B.9) by sub-sector							
1. General government (=6-7)	S.13	-12,461	-7.6	-7.5	-4.4	-2.2	-1.7
2. Central government	S.1311	-12,433	-7.6	-7.5	-4.4	-2.2	-1.7
3. State government	S.1312						
4. Local government	S.1313	-47	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	19	0.0	0.0	0.0	0.0	0.0
General government (S.13)							
6. Total Revenue	TR	56,593	34.6	35.0	35.2	35.3	34.8
7. Total Expenditure	TE	69,053	42.2	42.5	39.6	37.5	36.5
8. Net lending/borrowing (=6-7)	B.9	-12,461	-7.6	-7.5	-4.4	-2.2	-1.7
9. Interest expenditure	D.41	6,133	3.7	4.9	4.9	4.9	4.8
10. Primary balance (=1+9)		-6,328	-3.9	-2.6	0.5	2.7	3.1
11. One-off and other temporary measures		732	0.4	-0.6	-0.1	-0.0	-0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		39,694	24.3	25.0	25.7	26.0	25.7
12a. Taxes on production and imports	D.2	18,032	11.0	11.2	11.4	11.5	11.2
12b. Current taxes on income, wealth etc.	D.5	20,903	12.8	13.2	13.8	14.3	14.3
12c. Capital taxes	D.91	759	0.5	0.5	0.5	0.2	0.2
13. Social contributions	D.61	9,506	5.8	5.8	5.8	5.6	5.5
14. Property Income	D.4	2,257	1.4	1.7	1.3	1.4	1.3
15. Other		5,136	3.1	2.5	2.4	2.3	2.2
16. (=6) Total revenue (=12+13+14+15)	TR	56,593	34.6	35.0	35.2	35.3	34.8
p.m.: Tax burden		49,616	30.3	31.0	31.7	31.9	31.5
Selected Components of Expenditure							
17a. Compensation of employees	D.1	18,784	11.5	11.2	10.2	9.2	8.9
17b Intermediate consumption	P.2	8,563	5.2	5.1	4.8	4.6	4.5
18. Social payments (18 = 18a+18b)		28,666	17.5	16.8	16.0	15.1	14.6
18a. Social transfers in kind supplied via market producers	D.63	4,060	2.5	2.3	2.2	2.0	1.9
18b. Social transfers other than in kind	D.62	24,606	15.0	14.5	13.8	13.2	12.7
19=9 Interest expenditure	D.41	6,133	3.7	4.9	4.9	4.9	4.8
20. Subsidies	D.3	639	0.4	0.3	0.2	0.2	0.2
21. Gross fixed capital formation	P.51	3,348	2.0	1.9	1.8	1.7	1.7
22. Other		2,920	1.8	2.4	1.8	1.7	1.6
23=7 Total expenditure (=17+18+19+20+21+22)	TE	69,053	42.2	42.5	39.6	37.5	36.5
p.m. : Government consumption (nominal)	P.3	29,135	17.8	18.4	17.0	15.5	15.0

Sources: Department of Finance, Department of Public Expenditure & Reform, CSO and NTMA estimates

Notes:

Item 1: Net lending by general government is identical with the general government balance.

Item 9 & 19: Interest expenditure by general government is calculated on an accruals basis and includes interest rate swaps.

Item 12a: Taxes on production and imports include VAT, customs, excise and stamp duty, local authority rates, the non-household part of motor tax and stamps collected by the Risk Equalisation Fund.

Item 12b: Current taxes on income and wealth comprise income tax, capital gains tax, corporation tax, the household part of motor tax and the household charge/property tax.
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 18: 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 21: Gross fixed capital formation is the net acquisition of produced fixed assets such as construction and machinery. The value in this table is net of the sale of non-financial assets.

Table A1.2: General government budgetary forecasts 2012-2016

Description	ESA code	2012	2013	2014	2015	2016
Revenue						
Taxes on production and imports	D.2	18,032	18,875	19,855	20,820	21,240
Current taxes on income, wealth	D.5	20,903	22,180	24,100	25,915	27,025
Capital taxes	D.91	759	850	845	390	400
Social contributions	D.61	9,506	9,785	10,085	10,245	10,430
Property Income	D.4	2,257	2,775	2,345	2,460	2,485
Other		5,136	4,275	4,190	4,205	4,180
Total revenue	TR	56,593	58,740	61,420	64,035	65,760
Expenditure						
Compensation of employees	D.1	18,784	18,725	17,770	16,750	16,880
Intermediate consumption	P.2	8,563	8,555	8,405	8,305	8,580
Social payments	D.6	28,666	28,200	27,820	27,480	27,585
Interest expenditure	EDP_D.41	6,133	8,240	8,480	8,910	9,170
Subsidies	D.3	639	455	410	420	430
Gross fixed capital formation	P.51	3,348	3,180	3,130	3,125	3,275
Other		2,920	3,965	3,080	3,030	3,065
Total expenditure	TE	69,053	71,320	69,095	68,020	68,985
General government balance	B.9=TR-TE	-12,461	-12,575	-7,675	-3,990	-3,220
Banking measures affecting GGB		0	75	135	35	35
Underlying general government balance		-12,461	-12,500	-7,540	-3,955	-3,185
Underlying GGB as % of GDP		-7.6	-7.4	-4.3	-2.2	-1.7

Sources: Department of Finance, Department of Public Expenditure & Reform, CSO and NTMA estimates
Notes:
Rounding may affect totals.
Table A1.2 is a reproduction of Table A1.1 showing the main aggregates of government revenue and expenditure at nominal values. The table is consistent with the table of general government revenue and expenditure transactions published in the CSO release 'Government Finance Statistics, Annual Results.' The data in this table for 2012 can be matched with the 2012 data in tables 1 and 4 of the CSO release.

Table A1.3: Comparison of vintages of Receipts and Expenditures 2013

Document		Budget 2013 2013	SPU 2013 2013	difference	notes
Revenue					
Taxes on production and imports	D.2	18,440	18,875	435	1
Current taxes on income, wealth	D.5	21,860	22,180	320	2
Capital taxes	D.91	850	850	0	
Social contributions	D.61	9,730	9,785	55	
Property Income	D.4	2,640	2,775	135	3
Other		4,100	4,275	175	
Total revenue	TR	57,620	58,740	1,120	
Expenditure					
Compensation of employees	D.1	18,690	18,725	35	
Intermediate consumption	P.2	8,510	8,555	45	
Social payments	D.631, D62	26,200	28,200	1,995	4
Interest expenditure	EDP_D.41	9,250	8,240	-1,010	5
Subsidies	D.3	470	455	-15	
Gross fixed capital formation	P.51	3,070	3,180	110	
Other		4,170	3,965	-205	6
Total expenditure	TE	70,370	71,320	950	
General government balance	B.9=TR-TE	-12,745	-12,575	170	
Underlying balance		-12,645	-12,500	145	

Source: Department of Finance estimates
Notes: Rounding may affect totals.
Table A1.3 compares the 2013 revenue and expenditure figures of general government given in the current SPU document with their equivalents at the time of the earlier Budget 2013 publication in December 2012.
The current forecasts of receipts and expenditures for 2013 use the allocations given in the Revised Estimates for Public Services 2013, published by the Department of Public Expenditure and Reform, detail that was not available at Budget time. The most recent estimates of planned transactions from the central fund, government bodies and local government are also used in the forecasts for the current year. The tables are also updated in the light of new 2012 receipts and expenditure data produced by the CSO to ensure a smooth transition from outturn to forecast year.
The receipts and expenditures are both higher in the later document by about €1 billion. The main items contributing to these changes explained in the notes:

Revenues

1. The statistical treatment of the new Risk Equalisation Fund adds about €400m to tax receipts, D.2, and €400m to social payments D.62.This fund has a neutral effect on the general government balance.
2. The improvement in D.2 Current taxes on income, wealth is mainly driven by better than expected taxes in 2012 which have a carryover effect into later years.
3. Further Central Bank income of approximately €100m is included in the current figures for property income.

Expenditures

4. Of the €2 billion increase in social payments, €1.2 billion is due to a reclassification of an item from ‘other expenditure’ category to the ‘social payments’ category; €400m arises from the Risk Equalisation Fund mentioned in note 1; other adjustments are due to the realignment of social payments with the equivalent 2012 base-year outturn tables produced by the CSO, including the CSO’s estimates for social payments from the HSE and social transfers-in-kind.
5. The net effect of the February promissory note transaction is to reduce the interest bill in 2013 by about €1 billion.
6. An estimated €1.15 billion of payments by the Minister of Finance are required under the ELG and derivative guarantees as a result of the IBRC liquidation. This adds €1.15 to the ‘other expenditure’ category. This increase is offset by the reclassification of transfer payment to D.62 mentioned in note 4.

Table A2: Explanation of net differences between the Exchequer borrowing requirement and general government balance, 2012-2016

€ million	2012	2013	2014	2015	2016
(a) Exchequer balance	-14,891	-11,230	-8,940	-4,900	-2,005
(b) Exclude equity and loan transactions	2,319	-1,540	355	0	-2,015
(c) Adjust for interest accrual	-447	-465	80	-30	75
(d) Adjust for tax accruals	-125	155	205	200	165
(e) Adjust for other accruals	263	65	-20	-35	-125
(f) Impact of NPRF	334	560	585	610	610
(g) Transactions between government bodies	147	-350	-180	-90	-75
(h) Net lending/borrowing of non-commercial State sponsored bodies	-34	235	235	245	145
(i) Net Surplus of the Social Insurance Fund	19	0	0	0	0
(j) Net (Borrowing)/Surplus of Local Government	-47	0	0	0	0
(k) General government balance (=a to j)	-12,461	-12,575	-7,680	-4,000	-3,230
(l) Financial sector measures affecting the balance		75	135	35	35
(m) Underlying general government balance	-12,461	-12,500	-7,550	-3,965	-3,195
(n) Underlying general government balance as % of GDP	-7.6	-7.4	-4.3	-2.2	-1.7
(o) Nominal GDP	163,595	167,900	174,275	181,550	189,125

Sources: Department of Finance, Department of Public Expenditure and Reform, CSO and NTMA estimates

Notes

- 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.
- The general government balance 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'.
- The general government balance 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) Equity and loan transactions are excluded on the basis that they affect the composition but not the level of assets and liabilities.
  - c) Interest is recorded on an accrual basis.
  - d) Certain taxes are time-adjusted to reflect the economic period to which they refer.
  - e) This adjustment includes accruals of Departmental balances, EU transfers, and the impact of the capital envelopes facility.
  - f) The National Pensions Reserve Fund (established in 2001) is within the general government sector. These figures include income earned on the investments made by the NPRF.
  - g) Transfers between units within the general government sector do not affect the general government balance.
  - h, i, j) The balance of non-exchequer bodies such as non-commercial state bodies, the Social Insurance Fund and local government add to the general government balance.
  - l) This relates to financial assistance measures expected within the Credit Union sector.
  - m) The underlying balance excludes the effect of capital injections into financial institutions and is the measure used in the targets set under the EU/IMF programme

Table A3: Projected general government interest expenditure 2013-2016

	2013	2014	2015	2016
		€ millions and %		
National Debt Cash Interest	7,615	8,420	8,750	9,075
% tax revenue	*19.9*	*20.6*	*20.2*	*20.2*
% of GDP	*4.5*	*4.8*	*4.8*	*4.8*
National Debt Cash Interest Accruals	265	-65	45	-60
Consolidation and Grossing Adjustments	55	10	10	50
Accrued promissory note interest	225	10	10	10
Other	80	105	95	95
Total Interest on ESA95 basis (EDP_D.41)	8,240	8,480	8,910	9,170
% total General Government revenue	14.0	13.8	13.9	13.9
% of GDP	*4.9*	*4.9*	*4.9*	*4.8*

Sources: Department of Finance, NTMA
Note: Rounding may affect totals.

Table A4: Projected movement in general government debt 2012-2016

Description	2012	2013	2014	2015	2016
			€ billion		
Opening general government debt	169.2	192.5	207.0	208.2	209.7
Exchequer borrowing requirement	14.9	11.2	8.9	4.9	2.0
Change in Exchequer Deposits	6.2	3.6	-7.3	-3.0	-1.9
Net lending of local government and NCSSBs	0.6	-0.5	-0.3	-0.3	-0.2
Change in collateral held	1.3	0.1	-0.4	-0.2	-0.3
Other*	0.4	0.1	0.2	0.1	0.2
Closing general government debt	192.5	207.0	208.2	209.7	209.5
General government debt to GDP ratio (%)	117.6	123.3	119.4	115.5	110.8

Source: Department of Finance, NTMA and CSO
Notes:
Rounding may affect totals.
* Includes the effect of issuance and cancellation of debt above and below par.

Table A5: General government debt developments

(% of GDP)	2012	2013	2014	2015	2016
Gross debt	117.6	123.3	119.4	115.5	110.8
Change in gross debt (=1+2+3)	11.2	5.6	-3.8	-3.9	-4.7
Contributions to change in gross debt ratio:					
1. General government deficit	7.6	7.5	4.4	2.2	1.7
2. Stock-flow adjustment	6.6	1.2	-3.7	-1.4	-1.8
3. Nominal GDP contribution to Δ in debt ratio	-3.0	-3.0	-4.5	-4.8	-4.6
Composition of GGB					
4. General Government Balance	-7.6	-7.5	-4.4	-2.2	-1.7
5. Interest expenditure	-3.7	-4.9	-4.9	-4.9	-4.8
6. Primary balance (=4-5)	-3.9	-2.6	0.5	2.7	3.1
Composition of stock-flow adjustment					
7. Change in liquid assets	3.8	2.1	-4.2	-1.7	-1.0
8. Interest adjustments	-0.3	-0.3	0.0	0.0	0.0
9. Equity transactions	1.4	-0.9	0.2	0.0	-1.1
10.Accrual adjustments	0.1	0.1	0.1	0.1	0.0
11.Impact of NPRF	0.2	0.3	0.3	0.3	0.3
12.Collateral held	0.8	0.1	-0.2	-0.1	-0.1
13.Net discounts	0.4	0.0	0.1	0.1	0.1
14.Other	0.3	-0.3	-0.1	-0.1	-0.1
Memorandum item:					
Average interest rate (%)	3.6	4.3	4.1	4.3	4.4

Sources: NTMA, Department of Finance

Notes:

Rounding may affect totals

The average interest rate is calculated by dividing the general government interest expenditure for the year by the stock of general government debt outstanding at the end of the previous year.

Table A6: Breakdown of revenue

	2012	2012	2013	2014	2015	2016
	€ billion	% of GDP				
Total revenue at unchanged policies[1]	56.6	34.6	35.0	35.2	35.3	34.8
Discretionary revenue[2]	1.6	1.0	0.9	0.6	0.4	0.0

Source: Department of Finance

Notes: [1]Total general government revenue on the basis of policies already implemented up to and including Budget 2013 and for 2014-2015 as set out in the Medium-Term Fiscal Statement (MTFS) of November 2012.

[2]Discretionary revenue measures include PRSI adjustments and are inclusive of carry-over from previous years. The figures reflect yield as estimated on a static basis and do not take account of second order economic impacts. 2013 figure is as per Budget 2013. Discretionary revenue figures for 2014-2015 are as set out in the Medium-Term Fiscal Statement (MTFS) of November 2012. The precise level and make-up of the discretionary revenue measures to be introduced by Government will be decided at a later stage.

Table A7: Expenditure developments

	2012	2012	2013	2014	2015	2016
	€ million	% of GDP				
Expenditure on EU Programmes fully matched by revenue from EU funds	360	0.2	0.2	0.2	0.2	0.2
Expenditure fully matched by mandated revenue increases*	0.0	0.0	0.0	0.0	0.0	0.0
Non-discretionary changes in unemployment benefit expenditure**	0.3	0.2	-0.1	-0.3	-0.3	-0.4

Source: Departmental calculations, Department of Public Expenditure and Reform.
* Revenue increases are currently going towards deficit reduction.
** Estimated impact of Live Register forecasts on Jobseeker payment expenditure, technical methodology set out in annex

Table A8: Contingent liabilities

	2012
	% of GDP
Public guarantees	69.8
of which linked to the financial sector	69.8

Source: Department of Finance

Annex 2

Ireland's National Reform Programme
Summary of Progress

The National Reform Programme (NRP) 2013 Update sets out Ireland's progress towards its headline targets under the Europe 2020 Strategy. It is presented within the framework of the enhanced economic governance arrangements underpinning the European Semester and in tandem with the medium-term macroeconomic outlook provided by Ireland's 2013 Stability Programme Update.

Employment
<u>Headline Target:</u> To raise to 69-71 per cent the employment rate for women and men aged 20-64, including through the greater participation of young people, older workers 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.

The NRP 2013 Update outlines the Government's *Action Plan for Jobs* and *Pathways to Work* twin strategies which aim to increase employment and reduce unemployment. The *Action Plan for Jobs 2013* contains a total of 333 actions for delivery across Government Departments and State Agencies to support job creation. The *Pathways to Work* strategy, comprising labour market activation measures, gives renewed focus to targeting long-term unemployment and ensuring that as many as possible of job vacancies created are filled by people from the Live Register. In addition, the NRP details measures being implemented in relation to removing bottlenecks in the Irish labour market and youth unemployment.

Research and Development (R&D)
<u>Headline Target:</u> Improving 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 per cent of GNP (approximately equivalent to 2.0 per cent of GDP).

The NRP 2013 Update outlines Government policy in relation to research prioritisation, recent developments such as the National Intellectual Property Protocol and associated structures, and tax incentives for R&D Investment.

Climate Change
<u>Headline Target:</u> Reduce greenhouse gas emissions in the non-traded sector by 20 per cetn compared with 2005 levels; increase the share of renewables in final energy consumption to 16 per cent by 2020; to move towards a 20 per cent increase in energy efficiency.

The NRP 2013 Update provides information on the advancement of policy strategies such as the recently published Heads of the *Climate Action and Low-Carbon Development Bill* as well as progress regarding the *Renewable Energy Action Plan* and the *National Energy Efficiency Action Plan*.

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 per cent; to increase the share of 30-34 year olds who have completed tertiary or equivalent education to at least 60 per cent.

The NRP 2013 Update provides progress on various strategies, including the *National Action Plan on Delivering Equality of Opportunity in Schools*, the *Literacy and Numeracy Strategy*, reform of the Junior Cycle of Secondary Education and the development of a new Integrated Model of Service Delivery called *One Child, One Team, One Plan.*

Poverty

Headline Target: To reduce the number experiencing consistent poverty to 4 per cent by 2016 (interim target) and to 2 per cent or less by 2020, from the 2010 baseline rate of 6.2 per cent.

The Irish contribution to the Europe 2020 poverty target is to reduce by a minimum of 200,000 the population in combined poverty (either consistent poverty, at-risk-of-poverty or basic deprivation).

The NRP 2013 Update outlines Ireland's actions to achieve its target including efforts to minimise the impact of fiscal consolidation on the most vulnerable. It provides details of the Advisory Group on Tax and Social Welfare's report on reform of child and family income support, the *National Action Plan for Social Inclusion* and the recently developed *Social Inclusion Monitor*.

Annex 3

Cyclical Unemployment Calculation Methodology

The cyclical component of unemployment-related expenditure is unemployment expenditure which is related to the position of the economic cycle. Cyclical unemployment expenditure can be positive (negative output gap, economy operating below potential) or negative (positive output gap, economy operating above potential). For Ireland the methodology for calculating the cyclical component is set out below.

First, estimates of the NAWRU (non-accelerating wage rate of unemployment) for Ireland are calculated using the harmonised EU approach[i] for each year to 2016. These NAWRU estimates are compared with Department of Finance forecasts for the actual standardised unemployment rate (SUR) for each year. The difference represents the cyclical component of unemployment, which can be positive or negative depending on the position of the cycle. These are then expressed in Live Register terms, i.e. the national claimant count which measures claims in payment. Broadly speaking, estimates suggest that a one percentage point change in the SUR equates to a 30,000 change in the Live Register.

Next, an estimate of the average payment per Live Register claimant must be made. To calculate the average annual cost per person on the Live Register, take the total cost of the Jobseekers Allowance (JA) and Jobseekers Benefit (JB) schemes in a year and divide that by the weekly average Live Register figure for that year. This amounted to €8,670 per person on the Live Register per person in 2012. The average cost per person is projected to €8,092 in 2015 and is projected to remain constant thereafter. This drop in average payment value can be attributed to the increased focus on activating the long-term unemployed (historically the members of the Live Register whose payments are highest). Recent Budget measures such as the 2013 measure which reduces the length of duration of Jobseekers Benefit (a social insurance-based entitlement) from 12 months to 9 months will also contribute.

Finally, average payment per Live Register claimant is multiplied by the difference between NAWRU and SUR, multiplied by the equivalent in Live Register terms. This is then expressed as a share of GDP, taken from the Department of Finance's most recent forecasts (formula set out below). The methodology provides the intuitive result that cyclical unemployment expenditure is *positive*, given spare capacity in the economy and weak labour demand. The EU methodology can provide challenging results for smaller member states however, and in Ireland's case suggests that the output gap will be positive (economy operating *above* potential) in the post-2014 period. At face value this suggests that cyclically-related *savings* in unemployment expenditure will be made at that point.

$$CEXP_t = \frac{(SUR_t - NAWRU_t) \times LRE \times LRC_t}{GDP_t}$$

CEXP: cyclical component of unemployment expenditure as a share of GDP
SUR: Standardised unemployment rate (forecast)

NAWRU: Non-accelerating wage rate of unemployment

LRE: Live Register equivalent of one percentage point change in SUR (assumed at 30,000)

LRC: Average cost per Live Register claimant

GDP: Gross domestic product at current market prices (forecast)

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[i] 'The production function methodology for calculating potential growth rates and output gaps' by Francesca D'Auria, Cécile Denis, Karel Havik, Kieran Mc Morrow, Christophe Planas, Rafal Raciborski, Werner Röger and Alessandro Rossi (European Commission, Directorate-General for Economic and Financial Affairs) (July 2010)