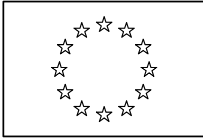

EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

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DECEMBER 2004 UPDATE OF THE STABILITY PROGRAMME OF IRELAND (2004-2007)

AN ASSESSMENT

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SUMMARY AND CONCLUSIONS[1]

The new update of the Irish stability programme, covering the period to 2007, was released and presented to the Commission on 1 December 2004, the date coinciding with the government's presentation of the budget for 2005. The update complies with the data requirements of the "code of conduct[2] on the content and format of stability and convergence programmes".

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

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

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[1] This technical analysis, which is based on information available up to 26 January 2005, accompanies the recommendation by the Commission for a Council opinion on the update of the stability programme, which the College adopted on 2 February 2005. It has been carried out by the staff of and under the responsibility of the Directorate-General for Economic and Financial Affairs of the European Commission. Comments should be sent to Zdeněk Čech (zdenek.cech@cec.eu.int).

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

results in an average general government investment ratio over the programme period well above the EU average of recent years.

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

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

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

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

Comparison of key macroeconomic and budgetary projections

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

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

1. INTRODUCTION

The updated Irish stability programme was published[3] together with the budget for 2005 on 1 December 2004. The update was sent to the European Commission the same day and covers the period up to 2007. The stability programme update is presented together with the annual budget documentation to parliament on budget day. As such, the programme also provides the macroeconomic background to the budget. There is no explicit parliamentary examination of the update, though it may be referred to in general debate on the budget.

The 2004 update complies[4] with the Code of Conduct agreed for stability and convergence programmes. However, compliance would be strengthened by a more detailed clarification of the exact role of the “contingency provisions” against unforeseen developments in the final two years of the programme.

2. MACROECONOMIC DEVELOPMENTS

The short-term prospects for the Irish economy are now projected to be more favourable than foreseen in the 2003 update. Compared with the previous update, the programme envisages a substantial upward revision of GDP growth for 2004-2005. The 2004 update projects real GDP growth to rebound to 5.3% and 5.1% in 2004 and 2005 respectively, compared with 3.3% and 4.7% in the previous programme, reflecting both higher domestic and external contributions. For the 2005-2007 period, the update projects growth of the Irish economy to remain in a narrow range of between 5% and 5½% p.a. in GDP terms. The present update projects GDP growth for 2005 somewhat higher (by 0.3 percentage points) than the pre-budget Commission services autumn 2004 forecast, but the budget for 2005 is likely to have a positive impact on economic activity (see box 1 below). A number of downside risks to the growth outlook are also mentioned in the programme, including trends in oil prices, international economic activity and the euro/dollar exchange rate. Overall, the GDP projections in the update seem plausible.

The programme scenario for 2005-2007 is based on a gradual recovery in domestic demand alongside a continuing robust performance of net exports. In 2005, the slight moderation in GDP growth reflects an assumed deceleration in investment growth, mainly as housing completions are expected to taper off after double-digit growth in 2004. In 2006 and 2007, the programme assumes that personal expenditure benefits from the impact of the release of *Special Savings Incentive Accounts*[5], *(SSIA)* which was also

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[3] The budget (and with it the stability programme update) is traditionally presented on the first Wednesday of December.

[4] The data included comply with the Code of Conduct, except for the following deviations: the table on cyclical developments has no rows for the optional cyclically-adjusted primary balance and cyclical budgetary component; the table on economic developments appears to define labour productivity growth – again optional – in GNP rather than GDP terms; the optional table on long-term sustainability is not included (see Annex 1), although the update presents the projections of the old age dependency ratio and of the accumulation of reserves in the *National Pensions Reserve Fund (NPRF).*

[5] The Finance Act in 2001 introduced *Special Savings Incentive Accounts (SSIA)*, the principal objective of which was to encourage regular savings by individuals. The main features of the scheme is that for every amount saved in the scheme (of a maximum of €254 per month), subject to eligibility conditions, the Exchequer contributes to the individual saver’s account an additional 25%. *SSIA* accounts are due to mature in 2006-2007, with the majority in the latter year. For more details on the scheme, see www.finance.gov.ie.

taken into the account in the Commission services autumn 2004 forecast. The update notes, however, that the impact of the release of *SSIA* funds on expenditure is subject to "greater than normal uncertainty". It should be mentioned that the same uncertainty holds for the projection of gross capital formation, as a gradual cooling in the housing output (from very high levels in recent years) is envisaged over the programme period. Overall, the GDP growth projected in the programme is close to the view of the Commission services and also the relative growth contributions from domestic demand and net exports are also broadly similar.

Table 1: Comparison of macroeconomic developments and forecasts

	2004		2005		2006		2007
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**
Real GDP (% change)	5.2	5.3	4.8	5.1	5.0	5.2	5.4
Contributions:							
- Final domestic demand	3.4	3.7	3.0	2.9	3.1	3.2	3.7
- Change in inventories	-0.1	-0.1	0.0	0.2	0.0	0.2	0.2
- External balance on g&s	2.0	1.8	1.8	2.0	1.9	1.8	1.6
Employment (% change)	2.4	2.4	1.7	1.9	1.5	1.5	1.4
Unemployment rate (%)	4.4	4.5	4.4	4.4	4.3	4.5	4.5
HICP inflation (%)	2.3	2.3	2.4	2.1	2.4	2.0	1.9
GDP deflator (% change)	3.0	2.8	2.5	3.2	2.0	2.7	2.6
Current account (% of GDP)	-1.6	n.a.	-1.5	n.a.	-1.3	n.a.	n.a.

Sources:
Commission services pre-budget autumn 2004 economic forecasts (COM); Updated Irish Stability Programme, December 2004 (SP)

The external assumptions underlying the programme's macro-economic projections are taken from the Commission services autumn 2004 forecast with a slowing of world output growth and a stable euro exchange rate against the dollar. For 2007 the programme assumes the same external assumptions as in 2006[6].

The budget for 2005 plans no changes to the main indirect taxes, which should help moderate consumer price inflation in the year ahead. The update projects HICP inflation to fall, averaging 2.0% over the period 2005-2007, and to be somewhat lower than the Commission services autumn 2004 forecast (2.0% against 2.4% in 2006). In 2007, the profile of HICP inflation is projected to fall further below 2%. However, as noted above, the update projects a significant pick up in private consumption expenditure in the period 2006-2007 by referring to the release of *SSIA* funds into the economy, which might pose an upward risk to the inflation projection in this period.

[6] See summary tables in the annex for basic assumptions (Table 0).

Table 2: Sources of potential output growth

	2004		2005		2006		2007
	COM	SP[3]	COM	SP[3]	COM	SP[3]	SP[3]
Potential GDP growth[1]	6.3	6.3	6.0	5.9	5.7	5.7	5.1
Contributions:							
- Labour	1.8	1.7	1.5	1.5	1.4	1.4	0.9
- Capital accumulation	1.8	1.8	1.7	1.7	1.7	1.6	1.5
- TFP	2.6	2.7	2.6	2.6	2.5	2.6	2.6
Output gap[1,2]	-0.8	-1.0	-1.9	-1.8	-2.6	-2.3	-2.0

Notes:
[1]based on the production function method for calculating potential output growth
[2]in percent of potential GDP
[3]Commission services calculations on the basis of the information in the stability programme update (SP)

Sources:
Commission services autumn 2004 economic forecasts (COM); Commission services calculations

Table 2 presents estimates of potential growth on the basis of the information provided in the programme, according to the commonly agreed methodology as calculated by Commission services. The results are very similar to those presented in the Commission services autumn 2004 forecast and the same holds for the relative growth contributions from individual components (labour, capital accumulation and TFP). The output gap is estimated to remain negative throughout the programme period, widening until 2006 and narrowing only in 2007. However, as noted in the update and also in previous assessments, estimated output gaps in Ireland are subject to an unusual margin of uncertainty because of the difficulty in obtaining reliable estimates of potential growth after the extraordinary growth performance and structural change over the last decade[7].

3. BUDGETARY IMPLEMENTATION IN 2004

For 2004, the 2003 update of the stability programme targeted a general government deficit of 1.1% of GDP. In the September 2004 EDP notification the deficit projection was revised down to 0.4% of GDP. The Commission services autumn 2004 forecast pointed, mainly on the basis of better than anticipated tax receipts (including one-off revenues from Revenue Commissioners special investigations) and some savings on expenditure, to a deficit of 0.2% GDP. The outturn for the general government balance estimated in the new update is for a surplus of 0.9% of GDP.

The main reason for the far better outcome than initially targeted is to be found mainly on the revenue side, though there is also estimated to have been some undershooting on the expenditure side. As shown in table 3 below, the revenue ratio is estimated to be 1.7 percentage points higher than indicated in the 2003 update, mainly because of the sizeable tax overshoot. The more detailed cash Exchequer data, available for the year 2004 as a whole[8], reveal that, with corporation tax and excise duties broadly on target, it is personal income tax, VAT and stamp duty that have significantly over-performed in 2004. This is consistent, firstly, with a higher level of economic activity and property

[7] The programme refers to "considerable uncertainty surrounding estimates of the output gap in a small and very open economy which has undergone considerable structural change over the last decade".
[8] Cash Exchequer data for 2004 as a whole were released on 5 January 2005. At the same time, the Irish authorities confirmed that the estimated general government balance for 2004 is a surplus of 0.9% of GDP, unchanged from that indicated in the update. For more details, see: http://www.finance.gov.ie/viewdoc.asp?DocID=2782.

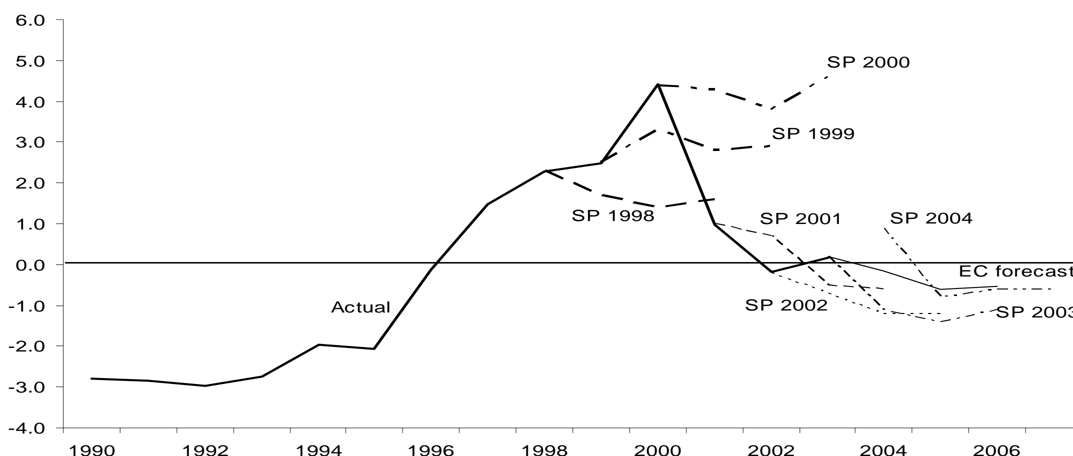
transactions than assumed in the previous update and, secondly, with the higher than expected yields of one-off receipts, in particular those arising from the special investigations by the Revenue Commissioners (estimated at 0.5% of GDP in the update)[9]. As regards expenditures, general government investment is estimated to have been lower than budgeted (including 0.2% of GDP one-off savings related to the introduction of a capital envelopes facility in 2004)[10], while there were also some savings in the area of interest payments. In combination with higher GDP, this implies that the expenditure ratio for 2004 is now 0.3 percentage points lower than indicated in the 2003 update. As the update notes, excluding all one-off factors would mean that "the underlying budget balance in 2004 is a surplus of the order of 0.1% of GDP"[11].

4. BUDGETARY TARGETS AND THE MEDIUM-TERM PATH OF THE PUBLIC FINANCES

4.1. Evolution of budgetary targets in successive programmes

The updated projections are a general government deficit of 0.8% of GDP in 2005 and 0.6% of GDP in the final two years of the programme. The nominal budget balances are expected to strengthen against the previous update by 0.6 and 0.5 percentage points of GDP for 2005 and 2006 respectively (Figure 1), but the GDP growth projections were also revised upwards as compared to those in the two previous programmes (see above). However, the programme closes with a nominal deficit of above 0.5% of GDP when the economy is growing at a pace close to its medium-term sustainable rate.

Figure 1: Evolution of budgetary targets in the stability programme of Ireland



Sources: Commission services autumn 2004 economic forecast; stability programme

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[9]The documentation included in the budget for 2005 projects a tax overshoot of €2.3 billion, equivalent to 1.5% of GDP. The update suggests that special investigations by the Revenue Commissioners are expected to yield €670 million (0.5% of GDP), which was in January 2005 revised to €695 million (see http://www.finance.gov.ie/viewdoc.asp?DocID=2782).

[10] This facility allows for a carryover of up to 10% of departmental capital spending allocations into the following year; for central government investment, the update notes that a part of departmental spending allocations (0.2% of GDP) will be carried over into 2005. The update, without providing further details, also mentions "other minor one-off factors" that improve the general government balance in 2004.

[11] Applying the commonly agreed methodology, the calculations of the cyclically adjusted balance on the basis of the budgetary projections from the 2003 update reveal that the stance of fiscal policy was planned to be broadly neutral in 2004. On the basis of the 2004 update, adjusting for 'one-off' factors significantly influencing the general government balance, estimates suggest that the fiscal stance was actually restrictive in order of ½% of GDP.

As in the previous updates, the budgetary targets for the final two years incorporate sizeable "contingency provisions" against unforeseen developments, which make the evaluation of the planned budgetary trajectory somewhat more difficult. As past experience suggests[12], however, these provisions appear more likely to be used than not. As compared to the previous update, the size of the provisions remains unchanged and amount to 0.4% and 0.8% of GDP for the final two years of the programme (2006 and 2007 respectively). The 2005 budget documentation does not specify the amount of the "technical provisions" under the expenditure and tax headings for possible future budgets[13].

Table 3: Evolution of budgetary targets in successive programmes

		2003	2004	2005	2006	2007
General government balance (% of GDP)	**SP December 2004**	**0.1**	**0.9**	**-0.8**	**-0.6**	**-0.6**
	SP December 2003	-0.4	-1.1	-1.4	-1.1	n.a.
	SP December 2002	-0.7	-1.2	-1.2	n.a.	n.a.
General government expenditure (% of GDP)	**SP December 2004**	**34.3**	**34.3**	**35.0**	**34.5**	**33.8**
	SP December 2003	34.6	34.6	34.2	33.6	n.a.
	SP December 2002	35.1	34.7	34.1	n.a.	n.a.
General government revenues (% of GDP)	**SP December 2004**	**34.4**	**35.2**	**34.2**	**33.8**	**33.2**
	SP December 2003	34.1	33.5	32.9	32.5	n.a.
	SP December 2002	34.4	33.5	32.9	n.a.	n.a.
Real GDP (% change)	**SP December 2004**	**3.7**	**5.3**	**5.1**	**5.2**	**5.4**
	SP December 2003	2.2	3.3	4.7	5.2	n.a.
	SP December 2002	3.5	4.1	5.0	n.a.	n.a.
Sources: *Irish updated stability programmes (SP), December 2002, December 2003 and December 2004*						

4.2. Budgetary targets in the updated programme

The new update confirms the government's commitment to maintaining sound public finances, including their long-term sustainability. The main objective of the budgetary strategy is to conform to the requirements of the Stability and Growth Pact. At the same time, the new update also confirms the government's intention to maintain a high level of investment over the programme period.

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[12] For a detailed analysis, see the box in the Commission services assessment of the 2003 update of the stability programme: http://europa.eu.int/comm/economy_finance/about/activities/sgp/country/commwd/ie/com_ie20032004.pdf .

[13] The projections in the budget for 2004 included, in addition to the "contingency provision", also "technical provisions" with a full-year cost of 0.45% of GDP in 2005 and 2006. The 2003 budgetary documentation provided for technical provisions at a full year cost of 0.7% of GDP in 2004 and 2005.

Table 4: Composition of the budgetary adjustment

(% of GDP)	2003	2004	2005	2006	2007	Change: 2007-2004
Revenues	34.4	35.2	34.2	33.8	33.2	**-2.0**
of which:						
- Taxes & social security contributions	30.8	31.7	30.8	30.5	30.1	**-1.6**
- Other (residual)	3.6	3.5	3.4	3.3	3.1	**-0.4**
Expenditure	34.3	34.3	35.0	34.5	33.8	**-0.5**
of which:						
- Primary expenditure	33.0	33.1	33.7	33.3	32.5	**-0.6**
of which:						
Gross fixed capital formation	3.9	3.5	3.9	3.9	3.7	**0.2**
Consumption	15.9	16.0	16.2	16.0	15.8	**-0.2**
Transfers other than in kind & subsidies	9.6	10.1	10.0	9.9	9.8	**-0.3**
Other (residual)	3.6	3.5	3.6	3.5	3.2	**-0.3**
- Interest payments	1.3	1.2	1.3	1.2	1.3	**0.1**
Budget balance	**0.1**	**0.9**	**-0.8**	**-0.6**	**-0.6**	**-1.5**
Primary balance	**1.4**	**2.1**	**0.6**	**0.6**	**0.7**	**-1.4**

Sources:
Updated Irish Stability Programme, December 2004; Commission services calculations

As shown in Table 4, the headline budget balance is projected to deteriorate from an expected surplus of 0.9% of GDP in 2004 to deficits of 0.8% of GDP in 2005 and 0.6% in 2006-2007 (including "contingency provisions"). The profile of the primary surplus is similar, falling from 2.1% in 2004 to stabilise at just above ½% of GDP in the remainder of the programme period. Both the headline and primary balances fall by about 1.5 percentage points of GDP between 2004 and 2007. However, as the update notes, excluding all one-off factors would mean that the underlying budget surplus in 2004 would be lower by about 0.8 % of GDP (see above).

The cyclically-adjusted balance is estimated by Commission services (by applying the commonly agreed methodology to the information in the update) to be in surplus throughout the projection period, with the exception of a deficit of 0.2% of GDP in 2005 (Table 5). The particular uncertainties of these estimates in the case of Ireland, given those attached to determining the output gap, should nevertheless be noted.[14] Estimates of changes in the fiscal stance are subject to the same caveat. In 2005, the cyclically-adjusted budget balance worsens from a surplus of 1.2% of GDP in 2004 to a deficit of 0.2% in 2004, pointing to a substantial fiscal loosening. With the output gap widening from -1.0% in 2004 to -1.8% of potential GDP in 2005, this loosening appears counter-cyclical. However, it should again be noted that a significant portion of the fiscal balance deterioration in 2005 is due to the non-recurrence of 2004 one-off factors, in particular of tax receipts from the Revenue Commissioner's special investigations. The fiscal stance is estimated to remain broadly neutral over 2006 and 2007.

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[14] As stressed in previous assessments, the estimated output gaps must be treated with a high degree of caution in the case of small and open economy as Ireland, in particular because of the current transition to more sustainable growth after the exceptionally high growth rates in the second half of the 1990s. The programme also notes another reason for caution when interpreting CABs in the case of Ireland, namely the uncertainty regarding the budget sensitivity. The update presents CAB calculations based on an estimated sensitivity of 0.42, with results obtained with a sensitivity of 0.32 (also adopted by Commission services) presented in a footnote.

The weakening of the general government balance in 2005, apart from reflecting the non-recurrence of one-off revenues boosting the 2004 outcome, also results from expansionary measures introduced in the 2005 budget (see box 1). On the expenditure side, the acceleration in growth of current discretionary expenditure from 6.7% in 2004 to 10.1% in 2005 reflects mainly the measures to increase welfare spending. The multi-annual projections on a cash basis included in the budget for 2005 also reveal that the growth rate of current discretionary spending (excluding contingency provisions) is being held to around 7.2% and 6.7% in the final two years of the programme[15], well below nominal GDP growth (projected at around 8% p.a. over the period 2004-2007). In comparison to 2004, capital formation (as a percentage of GDP) is planned to increase by 0.4 percentage points. On the revenue side, the 2005 budget lowers the tax-take by about 0.5% of GDP compared to a no-policy change scenario[16], mainly due to a personal income tax relief. The reduction in the overall tax ratio is, however, more pronounced because of the mechanical effect of the dropping out of the one-off tax revenues recorded in 2004. Between 2005 and 2007, both the expenditure and revenue ratios are projected to decline by around 1 percentage point[17], leading to a small improvement in the headline balance (of 0.2 percentage points. of GDP).

The projected path of negative nominal balances needs to be also qualified in the light of the high level of public investment in Ireland. The update is consistent with the government's commitment to addressing the significant "infrastructural deficit" in Ireland primarily in the framework of the 2000-2006 *National Development Plan (NDP)*. Overall, this results in an average public investment ratio over the programme period of just below 4% of GDP (almost 5% of GNP).

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[15] The budgetary documentation does not describe particular measures driving the deceleration in discretionary spending in 2006 and 2007 nor possible use of the "contingency provisions" in this respect.

[16] This compares to an initially planned increase of the tax take of around 0.1% of GDP in the budget for 2004 (mainly due to a planned increase in excise duties yields).

[17] Table 5 reveals that the tax burden in the programme drops by 0.7 percentage points between 2005 and 2007, of which 0.1 percentage points represents the ending from 2006 of a temporary levy on financial institutions charged from 2003. Part of the fall in the tax burden is likely to owe to the factoring in of the "contingency provisions", but this is not specified by the update in greater detail.

Box 1: The budget for 2005

The main measures on the revenue side in the 2005 budget include an upward adjustment of the standard tax band for personal income, after two years of keeping the tax band unchanged, and some further relief through changes in stamp duty. On the expenditure side, the social welfare package is somewhat more generous than in 2004. A further rise in capital spending is also foreseen, focusing in particular on improvements in transport infrastructure. The budget is likely to have a stimulatory effect on economic activity but no direct impact on inflation via indirect tax changes.

The main measures on the revenue side are (1) a widening of the tax band for personal income tax and (2) changes in stamp duty. VAT and excise duties remain broadly unchanged.

- Personal income tax measures. The standard rate band is widened by €1,400. The employee tax credit increases by €230 and personal credits by €60/120 (single/married), with the stated aim of taking minimum wage earners out of the tax net. There are no changes to personal income tax rates, with these remaining at 20% (standard rate) and 42% (top rate). The tax package measures are estimated to cost around 0.4% of GDP in a full year.
- Stamp duties. Stamp duty on first-time purchases of second-hand properties up to €317,500 in value is abolished and reduced rates apply on such purchases up to €635,000 (with cost of less than 0.1% of GDP in a full year).

On the spending side, the main measures in the budget and the November *abridged estimates,* are (1) increases in social welfare rates; and (2) significant increases in capital spending, notably focused on transport.

- Social welfare package. Social welfare improvements amount to an additional €874 million in a full year. Weekly social benefits, including old age pensions, and child benefit payments increase by between €10 and €14. Further measures have been announced to support and reinforce equal participation in society by people with disabilities. The full-year cost of the social welfare package has somewhat increased compared to the budget for 2004 (from 0.4% to some 0.6% of GDP in 2005 in a full year costs).
- Capital spending. The available envelope for Exchequer-funded capital spending (in cash terms) is estimated at €6.3 billion in 2005, almost 20% up on the expected 2004 cash outturn. This amount includes €334 additional capital for 2005 (around 0.2% of GDP) and a carry-over from unspent allocations in 2004 amounting to €237 million. The Exchequer-funded allocation to the Department of transport is raised by €180 million (to €1.75 billion).

The risks attached to the budgetary targets appear broadly balanced. On the one hand, the tax elasticity (excluding contingency provisions) underlying the tax forecast[18] appears to be plausible[19] and the existence of the contingency provisions might point to a better than projected outturn. As regards expenditures, Ireland has also recently shown encouraging progress in adhering to expenditure targets (see box 2), suggesting that various measures taken to strengthen control are proving. On the other hand, there are also some risks that the general government balance might turn out weaker that projected in the update. The multi-annual projections included in the budget for 2005 show a somewhat restrained growth rate of current discretionary spending in the outer years of the programme (see above). The fact that the size of the "technical provisions" (see above), covering both tax

[18] The update adopts a tax elasticity for the programme period (adjusting for measures in the budget for 2005 and one-off factors in 2004) broadly in line with the average of 1.0 calculated by the Department of Finance for the period 1989-1997 (see respectively table 1, p. D5 in the 2005 budget documentation and *Report of the Tax Forecasting Methodology Group*, November, 1998).

[19] The termination of the SSIA scheme might also contribute to higher tax revenue in 2006 and 2007. For a detailed analysis of possible budgetary impact, see the Commission services assessment of the 2002 stability programme update.

and spending, was not specified in the update, as compared to previous updates, also represents a downside risk. The multi-annual expenditure projections are therefore subject to implementation risk.

Table 5: Output gaps and cyclically-adjusted (primary) balances (CA(P)B)

	2003		2004		2005		2006		2007	Change: 2007-2004
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**
Budget balance[2]	0.1	0.1	-0.2	0.9	-0.6	-0.8	-0.5	-0.6	-0.6	-1.5
Output gap[1,3]	0.2	0.0	-0.8	-1.0	-1.9	-1.8	-2.6	-2.3	-2.0	-1.0
CAB[1,2]	0.1	0.1	0.1	1.2	0.0	-0.2	0.3	0.1	0.0	-1.2
CAPB[1,2]	1.4	1.4	1.4	2.4	1.3	1.2	1.6	1.3	1.3	-1.1

Notes:
[1] SP (stability programme): Commission services calculations on the basis of the information in the programme
[2] in percent of GDP
[3] in percent of potential GDP
Sources:
Commission services (pre-budget) autumn 2004 economic forecasts (COM); Commission services calculations

Taking into account this balance of risks, the budgetary stance in the programme seems sufficient to maintain the medium-term objective of a budgetary position of close-to-balance or in surplus of the Stability and Growth Pact throughout the programme period. Furthermore, there is a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations[20].

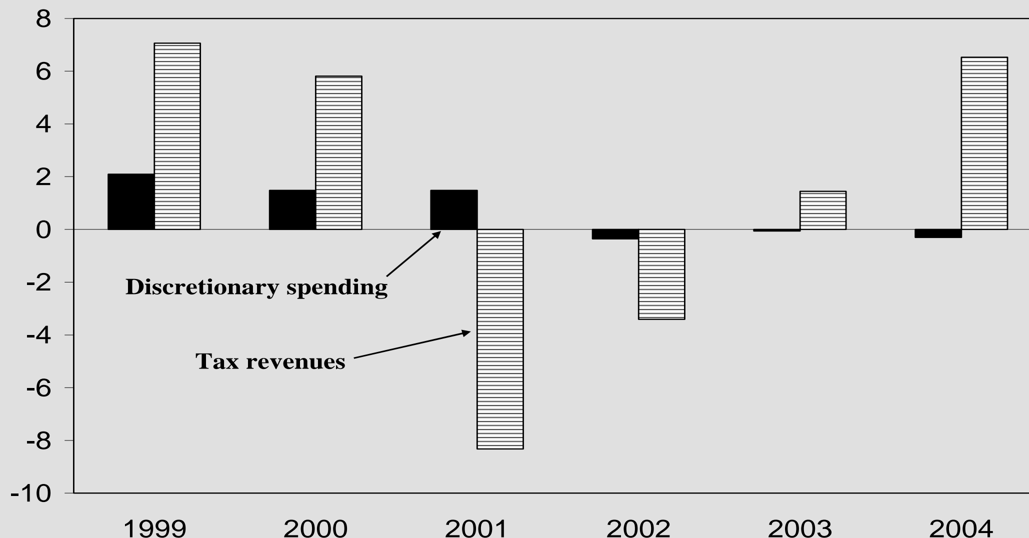
[20] The most recent Commission services calculation of the "minimal benchmark" for Ireland indicates that a budgetary safety margin of 1.7% of GDP is necessary to avoid the 3% of GDP deficit reference value being breached in the event of normal macroeconomic fluctuations, implying that the cyclically-adjusted deficit should be no higher than 1.3% of GDP (see Public Finance Report, 2002).

Box 2: Public expenditure – progress in achieving the targets

The new update states that "the arrangements for control and management of public expenditure are continuing to work well". This was not always the case in the past, when expenditure overruns were often recorded. This created the basis for the recommendation in the framework of the 2003-2005 Broad Economic Guidelines (BEPGs), that Ireland should "*enhance the efficiency of public expenditure and improve revenue and expenditure planning in a stability-oriented medium-term framework building on the range of measures recently introduced to improve the planning, management and control of expenditure*".

The figure below reveals the improvement in 'intra-year' expenditure control. On the revenue side, taxes appear to be much more volatile, but this rather reflects frequent swings in economic growth and unexpected one-off revenues. On the other hand, outturns for discretionary ('voted') spending have become closer to target over time, being marginally below target in 2002 and 2003, and with the same expected for 2004 (in particular due to capital under-spending). As from 2002, the government took measures to strengthen the monitoring of expenditure, with (i) reports on emerging trends in key departments being submitted to the government on a monthly basis; (ii) the introduction of further structural measures to improve expenditure management and control (including revised arrangements for managing capital spending and the provision of incentives for departments to produce savings); (iii) the publication of intra-year spending (and also tax) profiles.

Figure: Ireland - outturn vs. target for discretionary spending and taxes
(Exchequer cash accounts; deviation in per cent)



Source: Department of finance, Commission services calculations

As regards planning of expenditure in the years ahead, multi-annual capital envelopes have been introduced in 2004, which should significantly strengthen the planning of infrastructural investment. However, there is scope for further improvements in framing medium-term projections of current spending in the budget and stability programme updates, which also include "technical provisions" and "contingency provisions". In particular, while the contingency provisions increase the room for discretion in the years ahead, in their present form they also make the budgetary projections less transparent. The expenditure control would be therefore further strengthened by the formulation of a comprehensive framework, including the clarification of the status of contingency provisions, to guide also current spending in the medium term.

4.3. Sensitivity analysis

Like the previous update, the new programme assesses the sensitivity of the public finances with respect to economic activity. It is estimated that a 1 percentage point deviation from the expected growth rate would change the budget ratio by around ½ percentage point in 2005. In the outer years of the programme, the cumulative impact of

this scenario (1 percentage point deviation from expected growth rate) on the general government balance would be up to 1.2 and 0.9 percentage points in 2006 and 2007 respectively. A 1 percentage point change in the interest rate assumption is estimated to modify growth by as much as 1/3 percentage points after three years, with a similar 1/3 percentage point impact on the budget ratio. These sensitivity estimates appear to be similar to the ones in the previous update.

The cyclically-adjusted balances are also likely to be affected by such deviations from expected growth, as the growth changes are likely to affect potential output. Commission services simulations of the cyclically-adjusted balances under the assumptions of (i) a sustained 0.5 percentage points deviation from the growth targets in the programme over the 2004-2007 period; (ii) trend output based on the HP-filter[21] and (iii) no policy response (notably, the expenditure level is as in the central scenario)[22], reveal that, by 2007, the cyclically-adjusted balance is around 0.4percentage points of GDP above/below the central scenario. Hence, according to this exercise, in the case of persistently lower growth, additional measures of around 0.4 percentage points of GDP would be necessary to keep the public finances on the path targeted in the central scenario. This partial analysis also suggests that even if economic growth were weaker than expected, a fiscal position "close to balance or in surplus" would still be broadly achieved towards the end of the programme period.

5. EVOLUTION OF THE DEBT RATIO

Thanks to Ireland's extraordinarily high nominal growth and sizeable budget surpluses, the debt ratio fell substantially in the second half of the 1990s. A further reduction took place in the period up to 2003. General government debt is now estimated to have been 30.5% of GDP in 2004, well below the 60% of GDP Treaty reference value. This is a significantly lower ratio than the projection in the previous update (33.3 % of GDP), reflecting mainly a better-than-expected outturn for the primary balance.

Over the period 2005-2007, the debt ratio is now projected broadly to stabilise at close to 30% of GDP, rather than at around 33% as in the previous update. Table 6 shows that both the primary balance and the interaction between interest payments and nominal GDP growth ("snow-ball effect") are projected to contribute to lowering the debt ratio, but this is broadly offset by stock-flow adjustments. Sizeable stock-flow adjustments reflect mainly the impact of asset accumulation in non-general government instruments by the *National Pensions Reserve Fund* (*NPRF* – see also section 7), which was established in 2001 to pre-fund future pension liabilities and receives an equivalent of 1% of GNP annually from general government resources[23]. Without the accumulation of such assets, the debt ratio would be falling significantly throughout the programme period.

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[21] In the absence of a fully-specified macro-economic scenario that would underlie such deviations, it is not possible to derive new estimates of potential growth from the agreed production function method.

[22] The effect of lower/higher growth on revenues is captured by using the conventional sensitivity parameters adopted in cyclical adjustment procedures.

[23] The update does not foresee privatisation receipts over the programme period.

Table 6: Debt dynamics

	average 2000-2003	2004		2005		2006		2007
	COM	COM	SP	COM	SP	COM	SP	SP
Government gross debt ratio	**34.8**	**30.7**	**30.5**	**30.7**	**30.1**	**30.6**	**30.1**	**30.0**
Change in debt ratio (1 = 2+3+4)	-4.1	-1.3	-1.6	-0.1	-0.4	-0.1	0.0	-0.1
Contributions:								
- **Primary balance** (2)	**-2.9**	**-1.2**	**-2.1**	**-0.7**	**-0.5**	**-0.8**	**-0.6**	**-0.7**
- **"Snow-ball" effect** (3)	**-2.4**	**-1.2**	**-1.3**	**-0.8**	**-1.1**	**-0.7**	**-1.1**	**-1.0**
- Interest expenditure	1.6	1.4	1.2	1.3	1.3	1.3	1.2	1.3
- Real GDP growth	-2.3	-1.5	-1.6	-1.4	-1.4	-1.4	-1.4	-1.5
- Inflation (GDP deflator)	-1.6	-1.0	-0.9	-0.7	-0.9	-0.6	-0.8	-0.8
- **Stock-flow adjustment** (4)	**1.1**	**1.0**	**1.8**	**1.4**	**1.2**	**1.4**	**1.7**	**1.6**
- Cash/accruals	0.2							
- Accumulation of financial assets	1.0							
of which: Privatisation proceeds	-0.5							
- Valuation effects & residual adj.	-0.1							

Note:
The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect.
Sources:
Stability programme update (SP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations

6. STRUCTURAL REFORM AND THE QUALITY OF PUBLIC FINANCES

The update provides an overview of the government's structural reform programme that, while referring to a maintaining a low tax burden, focuses on enhancing the quality of public services and increasing the efficiency of public investment. This section focuses on measures related to the country-specific 2003-2005 Broad Economic Policy Guidelines (BEPGs) in the area of public finances, which recommended the Irish authorities to: (i) enhance the efficiency of public spending; (ii) improve the medium-term budgetary framework; and (iii) prioritise the infrastructural elements of the National Development Plan (NDP).

As regards (i) the update reviews recent measures for improving the management and control of public expenditures (see also Box 2 above). In particular, the expenditure review initiative (ERI) seeks to provide a basis for more informed decisions on priorities within programmes and the procurement management reform initiative aims to improve cost control of projects by transferring to contractors some risks related to financial management of the projects. Concerning (ii) the medium-term budgetary framework, the programme reviews the recent introduction of the system of rolling five-year spending envelopes in all areas of capital spending. For the first time, departments are allowed to carry forward capital expenditure savings (estimated at 0.2% of GDP in 2004) to the next year[24]. Within the multi-annual envelopes, the government continues to encourage investments through 'public-private partnerships' (*PPPs*), thereby aiming to accelerate

[24] Cf . Section 3.

project delivery. An extended 10-year envelope for investment in transport is also under consideration[25]. On (iii) investment in infrastructure, the second five-year departmental capital envelopes for the period 2005-2009 maintain Exchequer-funded capital investment at a high level of just below 4% of GDP a year (almost 5% of GNP), reflecting the government's priority of strengthening infrastructure. Overall, the approach to public investment, including multi-annual budgeting, should enhance efficiency and increase the transparency of public expenditures.

As regards structural reform, the update also reviews, as another element in the drive for value for money, the ongoing reform in the health services, and envisages further reform steps in the years ahead, including the establishment of the health service executive in 2005. The programme also looks at developments in public service pay, including the government's intention to continue linking payments under national agreements to agreed changes in public services , as in the 2004 mid-term review of the current national agreement *Sustaining Progress*. The already-agreed "benchmarking" wage increases[26] in the public sector are conditional on verifiable progress in public sector modernisation and flexibility. In the course of 2005, the next public service benchmarking exercise is expected to begin, with a report foreseen for 2007.

Overall, measures outlined in the update are consistent with the relevant country-specific BEPGs with budgetary implications. However, compliance with the recommendation to strengthen the medium-term budgetary framework would be further enhanced by greater transparency regarding the potential use of the "contingency provisions" in the final two years of the programme and thus the nature of the medium-term projections for current spending (see also Box 2).

7. THE SUSTAINABILITY OF THE PUBLIC FINANCES

The assessment of the sustainability of Irish public finances is based on an overall judgement of the results of quantitative indicators and qualitative features. The quantitative indicators project debt development according to two different scenarios, to take into account different budgetary developments over the medium term. The "programme" scenario (baseline) assumes that the medium-term objective set in the programme is actually achieved, while the "2004" scenario assumes that the underlying primary balance remains throughout the programme period at the 2004 level.

The graph below presents gross debt developments according to the two different scenarios. On the basis of the programme and additional information provided in the framework of the exercise conducted by the Economic Policy Committee, age-related expenditure is foreseen to increase by 4.5% of GDP between 2008 and 2050 (see Annex 2 for a breakdown of different age-related expenditures). Gross debt is projected to slightly decrease during the next 15 years as Ireland maintains a balanced budget. The rise in age-related expenditures would, however, modify gross debt trends thereafter:

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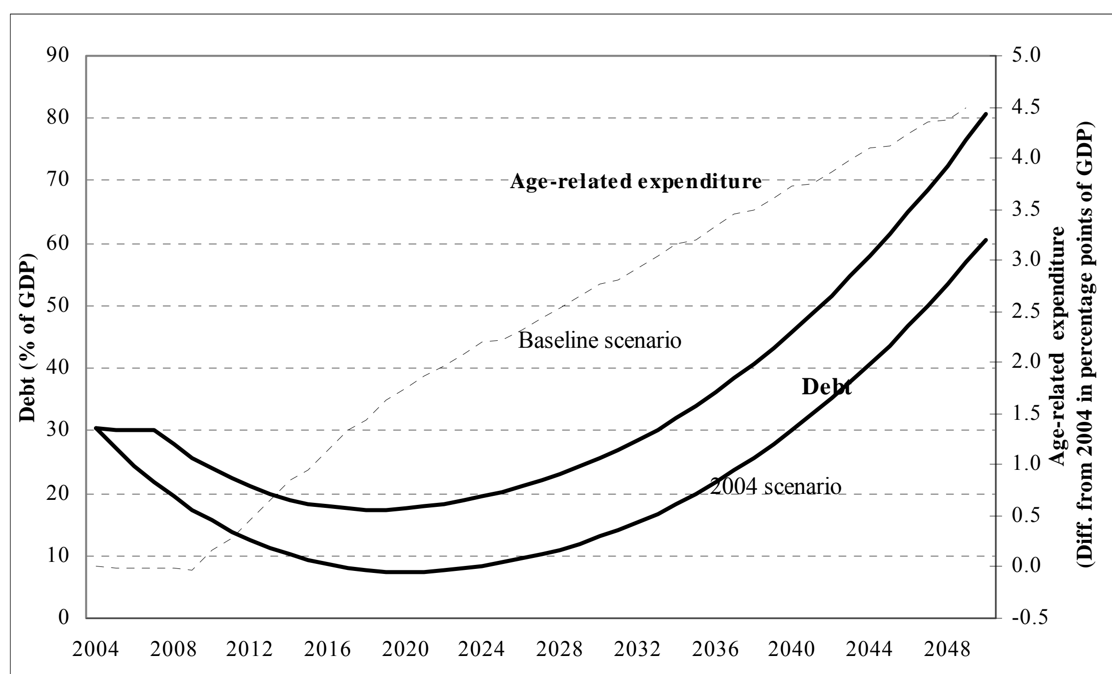
[25] Budget speech of the Minister of Finance, 1.12.2004.

[26] "Benchmarking" is a process set up in Ireland to align public sector wage rates with those for similar jobs in the private sector.

gross debt is projected to reach 80% of GDP in 2050, which could lead to an explosive path of gross debt beyond that date[27].

Long-term sustainability: summary results



Sustainability indicators

	S1*	S2**	RPB***
Baseline scenario	0.4	2.1	3.6
2004 scenario	0.0	1.8	3.4

Notes:
* It indicates the required change in tax revenues as a share of GDP over the projection period that guarantees to reach debt to GDP ratio of 60% of GDP in 2050.
** It indicates the change in tax revenues as a share of GDP that guarantees the respect of the intertemporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon to the debt as existing at the outset of the projection period; p.m. debt to GDP ratio in 2050: -37.2%
*** Based on S2, the Required Primary Balance (RPB) indicates the average minimum required cyclically adjusted primary balance as a share of GDP *over the first five years* of the projection period that guarantees the respect of the intertemporal budget constraint of the government for this period.

On the basis of the debt projections, it is possible to calculate a set of sustainability indicators to measure the gap between the current policies and a sustainable one. The S1 indicator shows the permanent change in the primary balance in order to have a debt-to-GDP ratio in line with the 60% of GDP Treaty reference value in the very long run (year 2050)[28]. S2 shows the gap between the current tax policies and those that would ensure respect of the inter-temporal budget constraint given the future impact of ageing on public expenditure, namely the change in the tax ratio that would equate the present discounted value of future primary balances to the current stock of gross debt. According

[27] It should be recalled that, being a mechanical, partial equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels is not a forecast of likely outcomes and should not be taken at face value.
[28] The respect of the underlying debt path does not ensure sustainability over an infinite horizon, but only that debt remains below 60% up to 2050. In most cases, this would imply an increasing trend and possible imbalances after the end of the projection period.

to the latter, in order to tackle the cost of ageing entirely through a budgetary strategy, Ireland should increase its tax ratio permanently by around 2 percentage points, compared with the one projected at the end of the programme period. This would lead to a sustainable debt ratio of around -37% of GDP by the middle of the century[29]. The budgetary effort over the first 5 years of the projections (i.e. after the end of the programme period) to respect the inter-temporal budget constraint requires a primary surplus of 3.6% of GDP on average, 2 percentage points higher than the one projected for the last year of the programme period (measured in underlying terms).

In interpreting these results, several factors must be taken into account. First, the key instrument to cope with increasing age-related expenditure is the *National Pensions Reserve Fund* (see also section 5 above), with the aim of pre-funding future pension liabilities and smoothing the pension burden between generations. The NPRF held assets of around 7% of GDP at end-2004. This leads to a current adjusted gross debt ratio of about 23% that helps in coping with the future cost of ageing (see annex 2)[30]. Second, some reforms designed to modernise the public service pension system, only implemented in 2004, should have a positive effect on the long-term sustainability of the public finances. In particular, the minimum pension age was raised and the compulsory retirement age was removed for most new public servants. As regards private pension arrangements, the government aims to increase coverage from 59% to 70% of the workforce aged over 30. In pursuit of this goal, the Pensions Board, a regulatory body for occupational pension schemes and Personal Retirement Savings Accounts (PRSAs), is expected to deliver a report to the government in 2006, suggesting possible improvements in incentives. The government's health reform programme, expected to progress further in 2005, should increase the efficiency and control of healthcare expenditures, with a positive budgetary impact over the long run.

However, the long-term fiscal projections assume that labour market participation in Ireland will increase significantly up to 2050. This largely builds on the government's commitment to improve labour force participation rates, especially among females and older age groups. Female labour force participation rates in Ireland have risen over the last decade, but further growth might be needed to meet projected targets. In this respect, the commitment to and actual delivery of childcare facilities under the 2000-2006 National Development Plan (NDP) should support the employment of parents using such services. As regards older workers, however, a new provision of the public service pension system reform is expected to provide for an early retirement option (at the age of 50 or 55) of public servants, drawing actuarially reduced benefits, as from 2005. This measure might work against increased labour supply in Ireland over the long run[31].

Annex 1: Summary tables from the stability programme update

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[29] The debt ratio of around -37% in 2050 according to the S2 indicator illustrates that the sustainability gap is higher in order to ensure a sustainable evolution of gross debt beyond 2050, compared with the S1 indicator, which illustrates that a lower tax increase is compatible with the 60% reference value in 2050.

[30] The S2 indicator is calculated on a gross debt basis. In the case of Ireland, for illustrative purposes, should it be calculated on the basis of adjusted gross debt, the S2 indicator (baseline scenario) would be somewhat smaller at about 1.9.

[31] On the other hand, this measure might increase mobility in employment.

Table 0. Basic assumptions

		2004	2005	2006	2007
Short-term interest rate (annual average)		2.1	2.6	3.5	3.5
Long-term interest rate[3] (annual average)		4.2	4.6	4.8	4.8
USA: short-term (3-month money market)		n.a.	n.a.	n.a.	n.a.
USA: long term (10-year government bonds)		n.a.	n.a.	n.a.	n.a.
USD/€exchange rate[3] (annual average)		1.23	1.24	1.24	1.24
Nominal effective exchange rate (euro area)		n.a.	n.a.	n.a.	n.a.
Nominal effective exchange rate (EU)		n.a.	n.a.	n.a.	n.a.
World excluding EU,GDP growth		5.7	4.8	4.6	4.6
US		n.a.	n.a.	n.a.	n.a.
Japan		n.a.	n.a.	n.a.	n.a.
EU-25 GDP growth		2.5	2.3	2.4	2.4
Growth of relevant foreign markets		7.8	6.7	6.5	6.5
World import volumes, excluding EU		11.6	8.8	8.3	8.3
World import prices, (goods, in USD)		n.a.	n.a.	n.a.	n.a.
Oil prices, (Brent, USD/barrel)		39.3	45.1	40.1	40.1
Non-oil commodity prices (in USD)		n.a.	n.a.	n.a.	n.a.

Table 1. Growth and associated factors

	ESA Code	2003	2004	2005	2006	2007
GDP *growth* at *constant* market prices (7+8+9)	B1g	3.7	5.3	5.1	5.2	5.4
GDP *level* at *current* market prices	B1g	n.a.	146,025	158,400	171,250	185,200
GDP deflator		1.6	2.8	3.2	2.7	2.6
HICP change		n.a.	2.3	2.1	2.0	1.9
Employment growth		1.9	2.4	1.9	1.5	1.4
Labour productivity growth		n.a.	2.2	2.6	3.2	3.4
Sources of growth: percentage changes at constant prices						
1. Private consumption expenditure	P3	2.6	2.8	4.1	5.4	6.4
2. Government consumption expenditure	P3	2.5	2.7	2.9	2.9	2.9
3. Gross fixed capital formation	P51	5.6	8.5	2.5	1.6	1.6
4. Changes in inventories and net acquisition of valuables as a % of GDP	P52 + P53	n.a.	n.a.	n.a.	n.a.	n.a.
5. Exports of goods and services	P6	-0.8	5.6	7.0	7.4	6.9
6. Imports of goods and services	P7	-2.3	4.4	5.7	6.4	6.2
Contribution to GDP growth						
7. Final domestic demand (1+2+3)		n.a.	3.7	2.9	3.2	3.7
8. Change in inventories and net acquisition of valuables (=4)	P52 + P53	n.a.	-0.1	0.2	0.2	0.2
9. External balance of goods and services (5-6)	B11	n.a.	1.8	2.0	1.8	1.6

Table 2. General government budgetary developments

% of GDP	ESA code	2003	2004	2005	2006	2007
Net lending (B9) by sub-sectors						
1. General government	S13	0.1	0.9	-0.8	-0.6	-0.6
2. Central government	S1311	-0.3	0.9	-0.7	-0.8	-0.8
3. State government	S1312					
4. Local government	S1313	0.2	-0.2	-0.2	-0.1	-0.1
5. Social security funds	S1314	0.2	0.2	0.2	0.3	0.3
General government (S13)						
6. Total receipts	ESA	34.4	35.2	34.2	33.8	33.2
7. Total expenditures	ESA	34.3	34.3	35.0	34.5	33.8
8. Budget balance	B9	0.1	0.9	-0.8	-0.6	-0.6
9. Net interest payments		0.3	0.2	0.3	0.2	0.3
10. Primary balance		1.4	2.1	0.6	0.6	0.7
Components of revenues						
11. Taxes	D2+D5	24.9	25.7	24.9	24.7	24.4
12. Social contributions	D61	5.9	6.0	5.9	5.8	5.7
13. Interest income	D41	1.0	1.0	1.1	1.0	0.9
14. Other		2.6	2.6	2.4	2.3	2.1
15. Total receipts	ESA	34.4	35.2	34.2	33.8	33.2
Components of expenditures						
16. Collective consumption	P32	5.6	5.6	5.7	5.6	5.6
17. Social transfers in kind	D63	10.3	10.4	10.5	10.4	10.2
18. Social transfers other than in kind	D62	9.0	9.5	9.4	9.3	9.2
19. Interest payments	D41	1.3	1.2	1.3	1.2	1.3
20. Subsidies	D3	0.6	0.6	0.6	0.6	0.6
21. Gross fixed capital formation	P51	3.9	3.5	3.9	3.9	3.7
22. Other		3.7	3.6	3.6	3.4	3.2
23. Total expenditures	ESA	34.3	34.3	35.0	34.5	33.8

Table 3. General government debt developments

% of GDP	ESA code	2003	2004	2005	2006	2007
Gross debt level		32.1	30.5	30.1	30.1	30.0
Change in gross debt		-0.3	-1.6	-0.3	-0.1	-0.1
Contributions to change in gross debt						
Primary balance		-1.4	-2.1	-0.6	-0.6	-0.7
Interest payments	D41	1.3	1.2	1.3	1.2	1.3
Nominal GDP growth	B1g	-1.3	-2.5	-2.4	-2.3	-2.3
Other factors influencing the debt ratio		0.0	0.5	0.2	0.3	0.2
Of which: Privatisation receipts		-	-	-	-	-
p.m. implicit interest rate on debt		4.1	4.0	4.5	4.3	4.4

Table 4. Cyclical developments

% of GDP	ESA Code	2003	2004	2005	2006	2007
1. GDP growth at constant prices	B1g	3.7	5.3	5.1	5.2	5.4
2. Actual balance	B9	0.1	0.9	-0.8	-0.6	-0.6
3. Interest payments	D41	1.3	1.2	1.3	1.2	1.3
4. Potential GDP growth		6.5	6.4	6.0	5.8	5.2
5. Output gap		-0.1	-1.1	-1.9	-2.4	-2.1
6. Cyclical budgetary component		-	-	-	-	-
7. Cyclically-adjusted balance (2-6)		0.1	1.4	0.0	0.4	0.3
8. Cyclically-adjusted primary balance (7-3)		-	-	-	-	-

Table 5. Divergence from previous update

% of GDP	ESA Code	2003	2004	2005	2006	2007
GDP growth	B1g					
previous update		2.2	3.3	4.7	5.2	-
latest update		3.7	5.3	5.1	5.2	5.4
Difference		1.5	2.0	0.4	0.0	-
Actual budget balance	B9					
previous update		-0.4	-1.1	-1.4	-1.1	-
latest update		0.1	0.9	-0.8	-0.6	-0.6
Difference		0.5	2.0	0.6	0.5	-
Gross debt levels						
previous update		33.1	33.3	33.5	33.3	-
latest update		32.1	30.5	30.1	30.1	30.0
Difference		-1.0	-2.8	-3.4	-3.2	-

Table 6. Long-term sustainability of public finances [32]

No table included in the December 2004 update of the stability programme[33]

[32] According to the Code of Conduct, the table on the long-term sustainability of public finances, if provided, should be updated at least every three years. The Irish authorities provided the required table in the 2002 stability programme update.

[33] The update presents the projections of the old age dependency ratio and of the accumulation of reserves in the *National Pensions Reserve Fund (NPRF).*

Annex 2: Long-term sustainability of public finances in Ireland – quantitative scenarios

Main assumptions - baseline scenario (as % GDP)	**2008**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Total age-related spending	15.2	15.2	16.8	17.8	18.8	19.7	4.5
Pensions	4.1	4.3	5.7	6.5	7.1	7.7	3.6
Health care	6.1	6.2	6.6	7.0	7.4	7.8	1.7
Care of the elderly	1.0	1.0	1.0	1.0	1.0	1.0	0.0
Education*	3.9	3.7	3.5	3.3	3.3	3.2	-0.7
Unemployment benefits	1.0	1.0	1.0	1.0	1.0	1.0	0.0
*Total primary non age-related spending***	17.3						
*Total revenues***	34.1						

*EPC projections
** constant

Results (as % GDP)	**2008**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Baseline scenario							
Gross debt	27.8	23.9	17.6	25.6	45.9	80.7	52.9
i + 0.5*	27.9	24.3	19.0	28.2	50.8	89.8	61.9
Adjusted gross debt**	17.3	12.0	5.2	12.0	30.5	62.6	45.3
2004 scenario							
Gross debt	19.5	15.5	7.4	13.0	30.1	60.6	41.1
i + 0.5*	19.6	15.8	8.2	14.4	32.8	66.1	46.6
Adjusted gross debt**	9.0	3.6	-4.9	-0.6	14.7	42.5	33.6

* i + 0.5 represents the evolution of debt under the assumption of the nominal interest rate being 50 basis points higher throughout the projection period.

** Adjusted gross debt equals Gross debt (Maastricht) net of consolidated public pension fund assets in the general government sector accumulated for the strict purpose of covering pension-related expenditure.