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2003 UPDATE OF THE STABILITY PROGRAMME OF IRELAND (2004-2006)

AN ASSESSMENT

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SUMMARY AND CONCLUSIONS[1]

The new update of the Irish stability programme was presented on the traditional first Wednesday of December (3 December 2003), together with the budget for the coming year. It largely complies with the data requirements of the "code of conduct on the content and format of stability and convergence programmes"[2].

Real GDP growth in 2003 is now expected to be lower than anticipated in the previous update (2.2% versus 3.5%), mainly reflecting a lower external contribution. The macroeconomic scenario in the programme is realistic and is broadly in line with that in the Commission's pre-budget autumn 2003 forecast. It envisages a gradual return, by 2005-2006, to growth around that generally accepted to be sustainable in the medium term, of some 5%. The potential growth rate derived with the agreed methodology applied to the data in the update initially exceeds, but, by the end of the programme, converges to this rate. HICP inflation is assumed to decline more rapidly over the period than in the Commission's forecast, from 4.0% in 2003 to 2% in the final two years of the programme, reflecting the implementation of the anti-inflation initiative under social partnership. The most dramatic drop is projected to occur in 2004.

According to new estimates provided by the Irish Department of Finance in January 2004, the general government deficit in 2003 is expected to be 0.1% of GDP, which is better than previous estimates, including that submitted with the update itself (0.4% of GDP). The new outturn is 0.6pp lower than the target set in the previous update, owing to a tax overshoot, itself mainly reflecting a booming property market and temporary factors, as well as to lower than budgeted expenditure, especially on public investment and interest payments.

The budgetary strategy in the update envisages a widening of the deficit to 1.2% of GDP on average over the period 2004-2006. The deterioration results from a cut in the expenditure ratio due to primary expenditure control that is insufficient to offset the further significant decline in the revenue ratio. The latter reflects a one-off boost to revenues in 2003 (see below), technical assumptions and a decline in "other revenues" as a proportion of GDP rather than a programme of tax cuts. The primary surplus averages 0.2% of GDP in 2004-2006.

The bulk of the budgetary deterioration occurs in 2004, when the deficit is projected to widen to 1.1% of GDP (compared to 1.2% projected in the previous update) from 0.1% in 2003. This is partly due to the mechanical effect of the one-off boost to revenues of advancing the date of payment of capital gains tax in 2003. For 2005 and 2006, deficits are projected of 1.4% of GDP (1.2% in the previous update) and 1.1% respectively. As in the previous update, the stability programme closes with a nominal deficit of just above 1% of GDP, even though, by then, the economy is forecast to have recovered to the medium-term sustainable growth rate. The update's budgetary projections seem plausible for 2004 but subject to some downward risk towards the end of the period.

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[1]This assessment has been carried out on the basis of information available as of 22.1.2004.

[2]*Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes*, document EFC/ECFIN/404/01 - REV 1 of 27.06.2001 endorsed by the ECOFIN Council of 10.07.2001.

The transition to sustainable growth in the medium term after the exceptionally high growth rates in the second half of the 1990s and the special features of the Irish economy imply that estimates of the Irish output gap are subject to an unusual margin of uncertainty. Subject to this caveat, the cyclically-adjusted deficit remains below 1% of GDP in each year, which implies continued respect of the safety margin against breaching the 3% of GDP reference value for the nominal deficit with normal macroeconomic fluctuations. The update envisages a cyclically-adjusted deficit of 0.7% of GDP in 2004. For 2005 and 2006, the update's projections imply deficits of 0.8% and 0.5% of GDP respectively in cyclically-adjusted terms. Given some risk to the headline deficit towards the end of the period, the close-to-balance requirement may not be achieved by the end of the programme period. The key conclusion is that there is little to no improvement in the budgetary position in either nominal or cyclically-adjusted terms between 2004 and 2006.

However, the projection of continued deficits in both nominal and cyclically-adjusted terms needs to be qualified. First, as in all previous Irish stability programmes, the budgetary targets for the final two years incorporate sizeable contingency provisions against unforeseen developments. In the most recent update these provisions amount to 0.4% of GDP in 2005 and 0.8% in 2006. While past experience suggests that such provisions are likely to be used, at least partly, the budgetary position would improve significantly if they were not fully absorbed. Second, the low level of the primary surpluses projected in the update reflects a significant investment effort under the National Development Plan, which keeps Exchequer-funded capital investment at close to 5% of GNP over the period 2004-2008.

General government debt is estimated to have amounted to one-third of GDP in 2003, the second lowest level in the EU. Over the period 2004-2006, both the primary balance and the interaction between the average interest rate and GDP growth continue to contribute to lowering the debt ratio, but this is broadly offset by sizeable stock-flow adjustments. The latter largely reflect the impact of the National Pensions Reserve Fund, which was set up to pre-fund future pensions liabilities and receives 1% of GNP annually from general government resources. Without the accumulation of assets in this fund, the debt ratio would be falling throughout the period.

The update reviews the government's structural reform programme which focuses on safeguarding a low tax burden and improving public services and infrastructure. It also outlines further measures to improve the control and management of public expenditure such as the extension of multi-annual budgeting to all capital spending. These policy measures are in line with the recommendations in the Broad Economic Policy Guidelines 2003-2005 to enhance the efficiency of public spending, improve the medium-term budgetary framework and prioritise the roll-out of the infrastructural elements of the National Development Plan.

On the basis of current policies, Ireland is on a sustainable path but some risks may emerge in the long run. The budgetary strategy outlined in the programme is based on the accumulation of reserve funds to pay future pension liabilities, the development of occupational pensions and measures to increase efficiency in the health care sector. Some risks may emerge if a policy of budget balance is not pursued over the long term even if the possible financing gap can be easily covered through taxation.

1. INTRODUCTION

The new update of the Irish stability programme, covering the period 2004-2006, was published together with the budget for 2004, to which it serves as an economic background, on the traditional first Wednesday of December (3 December 2003)[3]. Where possible, the assessment takes account of the revised outturn for the general government balance in 2003 announced by the Department of Finance on 5 January 2004 on the basis of the full-year cash Exchequer accounts. The update largely complies with the *Code of conduct*[4], but compliance would be strengthened by a more thorough explanation of the exact role of the "contingency provisions against unforeseen developments" in the final two years of the programme (see below).

The update confirms that the Irish government is committed to respecting the Stability and Growth Pact, which is credited as providing the overall framework for budgetary policy. The budgetary strategy is based on the objective of "continued budgetary sustainability into the medium term". For this, the update specifies that "the growth of public expenditure must continue to be kept in line with revenue growth".

2. MACROECONOMIC DEVELOPMENTS

2.1. Developments in 2003

Table 1 compares macro-economic forecasts for 2003 from three documents: (i) the previous update; (ii) the Commission's autumn 2003 forecast; and (iii) the new update of the stability programme. Because the previous update claimed that the Irish budget may be more responsive to GNP developments, economic growth figures are also given for GNP where available.

Table 1. Macro-economic developments in 2003: forecasts versus estimated outturns

	previous update	Commission's autumn 2003 forecast	new update
Year-on-year growth rates			
Real GDP	**3.5**	**1.6**	**2.2**
Nominal GDP	7.2	3.1	4.4
Real GNP	**2.2**	**n.a.**	**2.5**
Nominal GNP	6.2	n.a.	6.2
Contributions to real GDP growth:			
- Final domestic demand	1.3	1.3	1.6
- Change in stocks	0.2	0.0	0.2
- External balance on g&s	1.9	0.3	0.4
HICP inflation (%)	**4.2**	**4.1**	**4.0**
GDP deflator (% change)	3.5	1.5	2.2
Source: December 2002 and December 2003 updates of the Irish stability programme; Commission's autumn 2003 forecast			

[3]All budget documents, including the stability programme, can be downloaded from www.budget.gov.ie.

[4]The tables in the update provide not only the required but also the optional information indicated in the *Code*, except for a table on long-term sustainability, which is not included. The update also shows some useful supplementary information, for instance on stock-flow adjustments. There are some minor deviations from the model tables supplied in the *Code*: the table on cyclical developments has no row for the cyclically-adjusted *primary* balance, while the table on economic developments defines labour productivity in GNP rather than GDP terms.

Estimated real GDP growth in the new update is well below that projected in the previous update, reflecting a lower than expected external contribution, and is somewhat higher than in the Commission's forecast. In nominal terms, GDP growth is also expected to be much weaker than foreseen in the previous update (but nominal GNP growth is as expected). Average HICP inflation is expected to be marginally lower than envisaged in the previous update.

2.2. External economic assumptions

The external assumptions underlying the update's macro-economic projections are taken from the Commission's autumn 2003 forecast over the latter's forecast horizon (*i.e.* up to 2005) and depict world GDP growth to accelerate from a weak first half of 2003 to some 4% in 2004-2005. For 2006, the update assumes the same numbers for the external variables as in 2005.

2.3. Developments in 2004-2006

Table 2 presents the Commission's *pre-budget* autumn 2003 forecast and the macro-economic projections of the update for the period 2004-2006. The two forecasts depict a broadly similar scenario of a gradual pick-up towards Ireland's sustainable growth in the medium term, which is generally accepted to be around 5%. The main difference is that the update projects somewhat weaker growth in 2004-2005 due to a lower external contribution. The update thus takes a realistic to relatively cautious view of the pace of the upturn. Even so, the update emphasises "significant downside risks", emanating from (i) the pace and strength of the international recovery and (ii) the challenge of accession to Irish exports and inward foreign direct investment.

Table 2. Macro-economic developments and forecasts, 2004-2006

	2004		2005		2006	
	COM	**SP**	**COM**	**SP**	**COM**	**SP**
Real GDP (% change)	3.7	3.3	4.9	4.7		5.2
Real GNP[1] (% change)	3.1	3.0	3.9	3.9		4.4
Contributions to GDP growth:						
- Final domestic demand	2.1	2.3	2.6	2.7		3.1
- Change in stocks	0.0	0.2	0.0	0.2		0.2
- External balance on g&s	1.6	0.8	2.2	1.8		1.9
Employment (% change)	1.0	1.3	1.3	1.5		1.3
HICP inflation (%)	3.0	2.3	2.7	2.0		2.0
GDP deflator (% change)	3.2	3.6	2.7	2.9		2.4
	COM	**SP[4]**	**COM**	**SP[4]**	**COM**	**SP[4]**
Potential growth[2]	5.9	5.7	5.7	5.4	5.3	5.2
Contributions to pot. growth:						
- labour	*1.7*	*1.5*	*1.6*	*1.4*	*1.3*	*1.2*
- capital accumulation	*1.4*	*1.4*	*1.4*	*1.3*	*1.3*	*1.3*
- TFP	*2.7*	*2.7*	*2.6*	*2.6*	*2.6*	*2.6*
Output gap[2,3]	-1.8	-1.2	-2.6	-1.8	n.a.	-1.8

Source: COM: Commission services autumn 2003 forecast (pre-budget); SP: December 2003 update of the Irish stability programme; ECFIN calculations

Notes:

[1]COM: GNI at constant prices using the GDP deflator

[2]based on the production function method for calculating potential output growth

[3]in percent of potential GDP

[4]ECFIN calculations on the basis of the information in the December 2003 update of the stability programme

Applying the commonly agreed method[5] to the update's macro-economic outlook produces estimates of potential growth that are broadly comparable to if slightly lower than in the Commission's autumn 2003 forecast. The difference is explained by a smaller contribution from labour to potential output growth in the update, which in turn owes to a higher implied NAIRU. The output gap, which reached around +6% of GDP in 2000, is calculated to turn negative in 2004 and to remain negative until the end of the programme period. As stressed in previous assessments and also in the update, estimated output gaps for Ireland must be treated with caution because of the difficulty in obtaining reliable estimates of Irish potential growth after the exceptional boom in the second half of the nineties and because of the special features of the economy, such as the very large contribution to overall productivity growth from a relatively restricted number of sectors accounting for a small proportion of the workforce[6].

The budget for 2004 plans a more limited indirect tax hike than in previous budgets (see also below) and is estimated to add less than 0.4 percentage points to the CPI[7]. The update predicts a significant decline in HICP inflation, from an estimated 4.0% in 2003 to 2.3% in 2004 and a further moderation to 2.0% thereafter; the Commission’s pre-budget forecast is less optimistic on inflation prospects. The update stresses that bringing inflation down further towards the euro area average is a key priority of economic policy in view of recent competitiveness losses and refers to the “anti-inflation initiative” set up under social partnership in the course of 2003 to tackle the domestic sources of inflation.

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

3.1. Developments in 2003

The previous update of the stability programme announced a target of 0.7% of GDP for the general government deficit in 2003. By autumn 2003, a tax undershoot of some 0.4% of GDP, partially offset by savings on expenditure, was widely expected, leading to deficit projections of 0.9% of GDP by the authorities and the Commission[8]. However, the estimated outturn contained in the new update is for a smaller deficit of just 0.4% of GDP and in January, based on full-year Exchequer returns, the Department of Finance announced a new estimate for the deficit of 0.1% of GDP.

Table 3 compares targets with expected outturns for the main revenue and expenditure categories, all expressed as a percentage of GDP. The left panel displays the outturn estimated in December 2003 (published together with the updated stability programme). The right panel shows the revised outturn of 0.1% of GDP and ECFIN estimates of the revenue/expenditure breakdown based on the 2003 Exchequer returns published in

[5]Endorsed by the ECOFIN Council on 12.7.2002.

[6]The update refers in particular to “shifts in productivity, labour force participation and migration patterns” and to the difficulty in identifying an Irish economic cycle given the amount of structural change.

[7]This compares with an 0.9pp impact in the preceding two budgets. Increases in fees and user charges announced with the partial spending plans for 2004 (the Abridged Estimates published in November 2003) have an additional impact of about 0.1-0.2pp on the CPI in 2004.

[8]September 2003 EDP notification and Commission services autumn 2003 forecast respectively.

January 2004. The deviation from target of the overall balance by 0.6pp of GDP owes to favourable developments for expenditure and tax receipts[9]:

- savings on expenditure were made in the areas of interest payments and especially public investment, which more than offset an overrun on current primary spending;
- a sizeable tax overshoot is consistent with a higher level of economic activity and a higher tax intensity than planned[10]. It is driven by the remarkable performance of capital taxes, which were boosted by the booming property market and the advancement of the date of payment of capital gains tax announced in the budget for 2003. They are estimated to have yielded 0.4pp of GDP more than planned. Excluding capital taxes, tax receipts were somewhat below target[11].

Table 3. Implementation of the 2003 budget: selected aggregates[1]

	plan[2]	**estimated outturn[3]**	**difference**		**revised outturn[4]**	**difference**
	(1)	(2)	(3) =(2)–(1)	in €mio	(4)	(5) = (4)–(1)
General government balance	**-0.7**	**-0.4**	**-0.2**	**291**	**-0.1**	**-0.6**
Revenues	**32.7**	**32.7**	**-0.1**	**120**	**32.8**	**0.1**
- taxes (incl. soc. sec. contributions)	28.9	29.0	0.1	321	29.2	0.3
* *of which: all taxes excl. capital taxes*	*28.1*	*27.9*	*-0.2*	*-168*		
* *of which: capital taxes*	*0.8*	*1.2*	*0.4*	*489*		
- other receipts	3.8	3.6	-0.2	-201	3.6	-0.2
Expenditure	**33.4**	**33.1**	**-0.3**	**-171**	**33.0**	**-0.4**
- primary expenditure	31.8	31.6	-0.2	-49	31.5	-0.3
* *of which: transfers and subsidies*	*13.2*	*13.1*	*0.0*	*48*		
* *of which: current expenditure on g&s*	*14.6*	*14.6*	*-0.0*	*98*		
* *of which: GFCF*	*4.1*	*3.9*	*-0.2*	*-193*		
- interest payments	1.6	1.5	-0.1	-122	1.5	-0.1
General government debt	**34.0**	**33.1**	**-0.9**	**n.a.**		

Source: Budgets for 2003 and 2004; Exchequer returns for 2003; ECFIN calculations
Notes:
[1]In percent of GDP, unless indicated otherwise. All aggregates according to the "national accounts classification" of the 2003 and 2004 budgets, which is in line with ESA95 but social security contributions, transfers and overall revenues and expenditure do not correspond to Commission Regulation (EC) No 1500/2000 of 10.7.2000. Rounding may affect totals.
[2]Taken from the budget for 2003
[3]Taken from the budget for 2004
[4]New outturn for the general government balance taken from the 2003 Exchequer returns; ECFIN estimates for components

The budgetary projections in the previous update showed that the stance of fiscal policy was planned to be restrictive to the tune of around ½% of GDP. The updated cyclically-

[9]As clarified by the Department of Finance, seemingly lower than targeted "other receipts" (in particular transfers from abroad) in fact reflect a re-classification of certain transactions since the budget for 2003 was drawn up.

[10]While both real and nominal GDP growth were lower than anticipated in the previous update, the *level* of 2003 nominal GDP is now estimated to be higher.

[11]Stamp duties (from the Exchequer cash accounts) also benefited from a buoyant property market and were 16% higher than budgeted. Together, capital taxes and stamp duties, which represented just 7% of the total tax take in 2002 (in Exchequer terms), are estimated to have yielded 0.6% of GDP more than anticipated. Stripping out these two items, the "underlying" performance of tax receipts in 2003 was rather disappointing with an undershoot (in terms of the Exchequer accounts) of 0.3% of GDP, which however is still better than the undershoots recorded in 2001-2002.

adjusted balances presented in Table 6 below show that the degree of tightening turned out to be about twice as high (taking into account a one-off related to capital gains tax boosting revenues in 2003 by about 0.4pp of GDP – see below).

The lower debt ratio than planned reflects base effects (as well as a higher than expected level of nominal GDP) given a downward revision of the debt ratio for 2002 by around 2 percentage points compared to the previous update.

3.2. Programme overview

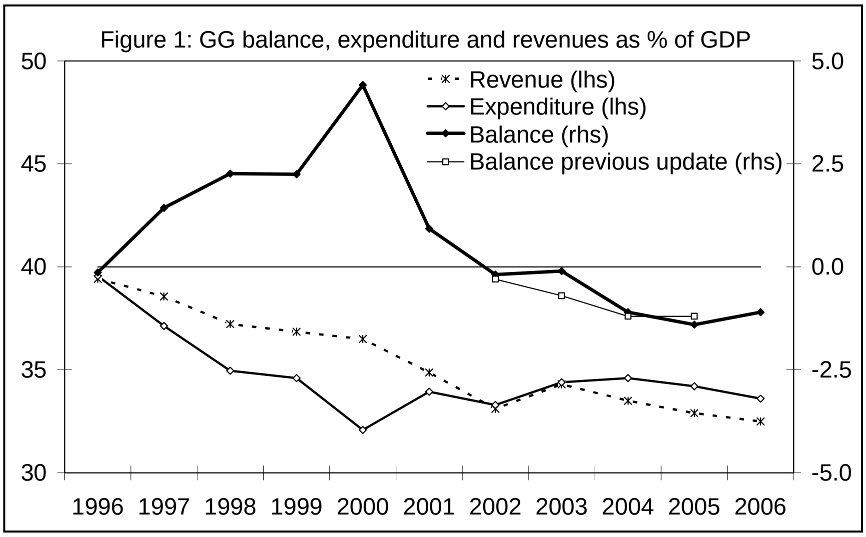

Figure 1 shows that the general government balance fell by some 4½pps of GDP between the 2000 peak and 2003, due in broadly equal measure to a drop in the revenue ratio and a rise in the expenditure ratio[12]. For the period 2003-2006, the new update targets a much smaller deterioration, by around 1pp of GDP. The deficit is projected to average 1.2% over the period 2004-2006, slightly worse than the 1% of GDP average deficit for the period 2003-2005 envisaged in the previous update. For 2004, the deficit target of 1.1% of GDP is marginally better than that set in the previous update (1.2%) but the opposite holds for 2005 (1.4% against 1.1%). The primary surplus averages 0.2% of GDP over the period 2004-2006.

Table 4. Size of contingency provisions in successive stability programmes (% of GDP)

Stability programme covering year *t* to year *t+2*	Contingency provision in year *t+1*	Contingency provision in year *t+2*
Original programme, 1999-2001	0.4	0.8
December 1999 update, 2000-2002	0.9	1.7
December 2000 update, 2001-2003	0.4	0.8
December 2001 update, 2002-2004	0.8	1.1
December 2002 update, 2003-2005	0.4	0.8
December 2003 update, 2004-2006	0.4	0.8
Source: Successive stability programmes		

As in previous programmes, however, the medium-term budgetary strategy is not well-defined. In particular, the budgetary projections for the final two years cannot qualify as "hard targets" because, in line with past practice, they incorporate:

[12]The graph is based on the revised outturn for the balance in 2003 published in January, with ECFIN estimates for the breakdown into revenue and expenditure.

- *contingency provisions* against unforeseen developments, such as "variability in tax buoyancy and exceptional costs arising in areas of public expenditure". These provisions amount to 0.4% of GDP in 2005 and 0.8% in 2006 in the current programme, but have been higher in some previous updates (Table 4)[13]. As in the previous update, the contingency provisions have been assigned 50:50 to receipts and expenditure in the budgetary projections, on a pro-rata basis across all headings.
- *technical provisions* for unspecified future budget measures, the size of which is subject to review "in light of emerging economic conditions". These hypothetical budgets carry a full-year cost of 0.45% of GDP in 2005-2006, lower than in the previous update (0.7% of GDP for 2004-2005)[14].

Table 5. Composition of the budgetary adjustment (% of GDP)

	2002	2003[1]		2004	2005	2006	2006-2003[1]	
Revenue	**33.1**	**34.1**	**(34.3)**	**33.5**	**32.9**	**32.5**	**-1.6**	**(-1.8)**
of which:								
- Taxes & soc. sec. contributions	29.4	30.3		30.1	29.8	29.5	-0.8	
- Other (residual)	3.7	3.8		3.4	3.1	3.0	-0.8	
Expenditure	**33.3**	**34.6**	**(34.4)**	**34.6**	**34.2**	**33.6**	**-1.0**	**(-0.8)**
of which:								
- Primary expenditure	31.7	33.0		33.3	32.8	32.2	-0.8	
of which:								
Gross fixed capital formation	4.4	3.9		3.8	3.9	3.8	-0.1	
Consumption	15.0	15.8		16.1	15.8	15.6	-0.2	
Transfers & subsidies	9.1	9.7		9.8	9.7	9.5	-0.2	
Other (residual)	3.3	3.6		3.6	3.4	3.3	-0.3	
- Interest payments	1.4	1.5		1.4	1.4	1.4	-0.1	
Budget balance	**-0.2**	**-0.4**	**(-0.1)**	**-1.1**	**-1.4**	**-1.1**	**-0.7**	**(-1.0)**
Primary balance	**1.2**	**1.0**	**(1.4)**	**0.3**	**0.1**	**0.3**	**-0.7**	**(-1.1)**

Source: December 2003 update of the stability programme; Exchequer returns for 2003; ECFIN calculations
Notes:
[1]Revised 2003 outturn (based on 2003 Exchequer returns and ECFIN calculations) in parentheses

Bearing in mind these qualifications, Table 5 presents the evolution of selected budgetary aggregates as a percentage of GDP until 2006. The last column displays the evolution between 2003 and 2006 as a summary of the composition of the planned adjustment over the period. Both the nominal and the primary balance fall by about 1pp of GDP. On the one hand, a gradual drop in the revenue-to-GDP ratio sets in after 2003, spread broadly equally over the tax burden (defined as the sum of taxes and social security contributions as a percentage of GDP) and the non-tax revenue ratio. On the other hand, the expenditure ratio is projected to increase somewhat further in 2004 (on the estimated revised outturn for 2003) but to decline thereafter. The budgetary strategy adopted in the update can therefore be described as containing the pace of budgetary deterioration

[13]The contingencies in the 2000-2002 programme were relatively large to take account of the implications for public sector pay of the national agreement, the *Programme for Prosperity and Fairness* (PPF), which was being negotiated at the time of the presentation of the budget/stability programme update. Regarding the huge provisions in the 2002-2004 update, the authorities referred to the greater degree of uncertainty surrounding the economic outlook.

[14]These technical provisions cover only taxation and *current* spending measures. In the update's budgetary projections, they have been allocated to various tax and expenditure components.

witnessed in the recent past, with a widening deficit over the period stemming from insufficient action on the expenditure side to offset the deteriorating revenue share.

Table 6 compares output gaps, cyclically-adjusted balances (CABs) and cyclically-adjusted primary balances (CAPBs) derived from applying the commonly agreed method to the macro-economic scenario and budgetary projections in the update (but using the revised 2003 outturn) with those from the Commission's autumn 2003 forecast. It is important to note that the latter was prepared in advance of the budget, so the 2004 and 2005 projections are under a no-policy change scenario; it also envisaged a much worse outcome for the deficit in 2003. Given the uncertainty surrounding estimates of the output gap mentioned above, Irish CABs must be interpreted with more than the usual degree of caution[15]. The CAB is estimated to have troughed in 2002 with a sizeable improvement in 2003. Over the period 2003-2006 as a whole, neither the CAB nor the CAPB change significantly, which suggests a broadly neutral fiscal policy stance.

Table 6. Output gaps and cyclically-adjusted (primary) balances[4,5]

	Updated stability programme				**Commission's autumn 2003 forecast**			
	Budget target[1]	**Output gap[2,3]**	**CAB[1,3]**	**CAPB[1,3]**	**Budget balance[1]**	**Output gap[2]**	**CAB[1]**	**CAPB[1]**
2002	-0.3	5.0	-1.9	-0.5	-0.3	5.0	-1.9	-0.5
2003	-0.1	1.1	-0.5	1.0	-0.9	0.3	-1.0	0.5
2004	-1.1	-1.2	-0.7	0.7	-1.2	-1.8	-0.6	0.9
2005	-1.4	-1.8	-0.8	0.6	-1.1	-2.6	-0.2	1.1
2006	-1.1	-1.8	-0.5	0.9				
2006-2003	**-1.0**		**0.0**	**-0.1**				

Source: Commission services autumn 2003 forecast (pre-budget); ECFIN calculations on the December 2003 update of the stability programme
Notes:
[1]as % of GDP
[2]as % of potential GDP
[3]ECFIN calculations on the basis of the information in the programme
[4]2002: excluding UMTS receipts of 0.2% of GDP
[5]using the revised outturn for 2003

3.3. Targets and adjustment in 2004[16]

For 2004, the update targets a deficit of 1.1% of GDP, which is 0.1pp better than the target for 2004 set in the previous update (although the outturn for 2003 was expected to be 0.2pp better when the new update was drawn up). The deterioration compared to the (revised) expected outturn of 0.1% in 2003 partly reflects the mechanical effect of advancing the date of payment of capital gains tax in 2003. The Department of Finance estimates the size of this one-off at €480 million or 0.4% of 2003 GDP.

[15]The update discusses a second reason for caution when interpreting CABs, *viz.* the uncertainty regarding the size of the budget sensitivity. The update presents CABs based on the ECB estimate of 0.42, with results obtained with the OECD sensitivity of 0.32 (also adopted by the Commission) relegated to a footnote.

[16]For this section, the information in Table 5 is supplemented with the documents making up the budget for 2004, in particular the national accounts classification of the budget, which is expressed in values rather than percentages of GDP and thus allows for a more accurate assessment.

On the revenue side, the budget for 2004 increases the tax take by just 0.1% of GDP compared to a no-policy change scenario (0.9% of GDP in the previous budget). An increase in excise duties yields 0.2% of GDP and offsets the loss from modest personal income tax relief[17]. The overall tax ratio in Table 5 nonetheless declines in 2004 because of the one-off related to capital gains tax. While the tax elasticity underlying the tax forecasts may look somewhat optimistic[18], a favourable base effect from a higher than expected tax yield in 2003 together with the relatively cautious economic outlook probably neutralise this risk to the tax projections. The fall of the overall revenue ratio is more pronounced than that of the tax burden, owing to a fall in non-tax revenue as a percentage of GDP (transfers from the rest of the world; property income).

On the expenditure side, there is a further mild shift in emphasis from capital to current spending, with gross fixed capital formation rising 3.3% compared to 8.1% for current primary spending (on the basis of the old outturn). The latter is absorbed by a social welfare package[19] and a strong rise in the public wage bill reflecting "normal" pay rises under the latest national agreement (*Sustaining Progress*) and additional increases under "benchmarking"[20]. As spending on capital formation and interest payments represent a lower share of GDP than in 2003, the rise in the overall spending ratio is limited to just 0.2pp of GDP (on the new outturn).

In cyclically-adjusted terms, the deficit worsens by 0.2pp of GDP (see Table 6 above). However, the year-on-year comparison in 2004 is again affected by the one-off measure on capital gains tax, so the underlying balance (*i.e.* the CAB adjusted for significant one-offs) in 2003 is 0.4pp worse than printed in the table[21]. The budgetary position in 2004

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[17]As in the previous budget, the only relief granted is an increase in the employee tax credit. None of the other parameters of the personal income tax system are changed, implying that, for the second year in a row, the system is only partially adjusted for inflation. As a result, the estimated proportion of taxpayers paying tax at the top rate of 42% - there are only two rates in Ireland - rises from 27.9% in 2002 over 30.5% in 2003 to 33.4% in 2004 (on a post-budget basis).

[18]Using the Exchequer returns for 2003, which are admittedly on a cash basis and only for central government but at the same time represent the most up-to-date information available, the tax-to-GDP elasticity in 2003 is estimated at 2.1. Excluding capital taxes and stamp duties, the two categories most affected by temporary factors and the booming property market, this drops to 1.1, just above the long-term average of 1 calculated by the Department of Finance for the period 1989-1997 (see *Report of the Tax Forecasting Methodology Group*, November 1998). For 2004, the budget adopts the same value of 1.1 even tough indirect tax rates were raised to a much lower extent than in 2003 (direct tax relief is by contrast on a broadly similar scale).

[19]The increases in social welfare rates in the budget for 2004 (by between 6 and 8%, well ahead of inflation) come at a full-year cost of 0.4% of GDP, the same as in the budget for 2003.

[20]The benchmarking process was launched in mid-2000 to align pay scales in the public sector with those in the private sector for comparable jobs. The benchmarking body's report of mid-2002 recommended pay increases by grade leading to an 8.9% rise in public sector pay costs. Under *Sustaining Progress*, the first instalment (25%; backdated to December 2001) was paid in 2003 without strings attached, while payment of the remainder, in early 2004 (50%) and mid-2005 (25%), is conditional on further progress on flexibility and modernisation and on maintenance of the industrial peace.

[21]There are other one-offs one may want to consider when assessing the budgetary position and making year-on-year comparisons of CABs. For instance, the budgetary position is artificially improved by a temporary levy on financial institutions of 0.1% of GDP annually over the period 2003-2005. Further, the backdated element of the benchmarking awards for the period December 2001-December 2002 (some 0.2% of GDP) affects the CAB in 2003. Also, an ongoing investigation into tax evasion has yielded important additional revenues in recent years. There are other non-permanent measures that have an impact

allows for a sufficient safety margin against breaching the 3% of GDP threshold for the nominal deficit under normal cyclical fluctuations.

3.4. Targets and adjustment in 2005-2006

As shown in Table 5 above, the headline deficit is projected to widen further in 2005, by 0.3pp of GDP, to 1.4% of GDP but to recover to 1.1% of GDP in 2006, equal to the target for 2004.

The tax burden drops by 0.6pp between 2004 and 2006, some 0.4pp of which reflects the impact of the contingency provisions. The temporary levy on financial institutions 2003-2005 accounts for a further 0.1pp. Excluding these elements, the tax burden thus remains broadly constant. Non-tax revenues as a percentage of GDP fall by 0.4pp of GDP, half of which is due to property income failing to keep pace with GDP growth. There is thus a drop by 1pp of GDP in the overall revenue share. This is matched by a 1pp drop in the expenditure ratio, which falls almost entirely on current primary spending. The multi-annual projections in the budget for 2004 for the cash Exchequer accounts show that the growth rate of current discretionary spending (excluding contingency provisions but including technical provisions for future budgets) is being restrained from an estimated 7.5% in 2004 to 6.2% in 2005 and 5.0% in 2006; for 2005 and 2006, this is well below projected nominal economic growth. The experience with expenditure control before 2003 would suggest that bringing this about is subject to risks but the various measures recently taken to strengthen control (see also Section 5 below) and the underspend in 2003, which admittedly owes mainly to savings on other categories than primary discretionary spending, are more encouraging. Another uncertainty regarding the expenditure projections is the evolution of the public sector pay bill after 2004 in the absence of a new pay clause under social partnership (for 2005, the only 'certainty' is the payment of the last quarter of the benchmarking awards in the middle of the year). Overall, there appears to be some downside risk to the budgetary projections towards the end of the programme period.

If the contingency provisions are excluded, the fall in the revenue ratio between 2004 and 2006 becomes 0.6pp of GDP and the cut in the expenditure share 1.4pp of GDP. This would result in a significant improvement of the budgetary position in both nominal and cyclically-adjusted terms. The accompanying box tentatively concludes that contingency provisions are more likely to be used than not, albeit not necessarily in their entirety.

According to the cyclically-adjusted balances in Table 6, the fiscal stance in the period 2005-2006 can be characterised as broadly neutral. In levels, the cyclically-adjusted deficits remain below 1% of GDP in each year, which implies continued respect of the safety margin against breaching the 3% of GDP reference value for the nominal deficit with normal macroeconomic fluctuations. The close-to-balance requirement of the Stability and Growth Pact may not be achieved by the end of the programme period given some downside risk to the trend budgetary projections (although non-use of the

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over a longer time horizon but at least until 2006, so the budgetary position will only be affected after the programme period. These are the gradual advancement of the date of payment of corporation tax over the period 2002-2006 (at an annual yield of around 0.7% of GDP), which is less than offset by the cost of the special savings incentive scheme over the period 2001-2007 (0.3 to 0.4% of GDP annually). Finally, one could argue that the major investment effort under the National Development Plan, which keeps Exchequer-funded capital investment at close to 5% of GNP over the period 2004-2008 (well above the EU average), constitutes a further sizeable but non-permanent burden on the public finances.

contingency provisions would be an upward risk) and a lack of information on the envisaged measures in the outer years of the programme. In addition, as in the previous programme, the projections in the new update close with a nominal deficit of just above 1% of GDP, even though, by then, the economy is forecast to have recovered to the medium-term sustainable growth rate.

Box: The recent experience with contingency provisions

As a rough guide to the eventual use of the contingency provisions in subsequent budgets, the table sketches the evolution of the envelope for discretionary spending and of the tax revenue projection for the years 2003 and 2004 in successive budgets' multi-annual projections[22]. For the year 2003, regardless of whether one takes account of the contingency provisions or not, the eventual spending envelope in the budget for 2003 was higher than foreseen two years earlier in the budget for 2001, but lower than envisaged in the budget for 2002, while the total tax take projected in the budget for 2003 was lower than anticipated in the two preceding budgets. For the year 2004, the spending envelope in the budget for 2004 is lower than allowed in the budget for 2002 but identical to that envisaged in the budget for 2003 after making allowance for the contingency provision, while projected tax receipts are well below the projections made in the 2002 budget but broadly correspond to the tax projection in the 2003 budget on the condition that about one-third of the contingency provision is incorporated.

From this, the following conclusions can be drawn, which must be considered as tentative in view of the small sample. First, the guidance in these multi-annual projections *cum* contingency provisions seems to be limited to the 2004 projections included in the budget for 2003. Second, the contingency provisions appear more likely to be used than not, though not necessarily in their entirety.

Table. Contingency provisions in practice (in € million)[1]

	Discretionary spending allocation in budget for year…			**Tax revenue projection in budget for year…**		
year t	**t-2**	**t-1**	**t**	**t-2**	**t-1**	**t**
2003						
- excl. cont. prov.	29218	31638	**30759**	36950	32957	**31646**
- incl. cont. prov.	29790	32163	/	36379	32432	/
2004						
- excl. cont. prov.	34107	32628	**32917**	35578	33584	**33400**
- incl. cont. prov.	34882	32917	/	34803	33295	/

Source: Budgets for 2001, 2002, 2003 and 2004 (Exchequer accounts in cash terms)
Notes:
[1]In line with the practice in the last two updates of the stability programme, the contingency provisions are split in two. In the rows "incl. cont. prov.", one half is added to the projection of discretionary spending and the other is subtracted from the tax projections.

3.5. Sensitivity analysis

The update reports that a 1pp deviation from the expected GDP growth rate would change the budget ratio by ½pp in the first year and by just below 1pp in the third year. A 1pp change in the interest rate assumption is estimated to modify growth by as much as ⅓pp within three years, with a similar impact on the budget ratio over the same horizon.

[22]The contingency provisions are thus not allocated to *overall* spending and revenues. This avoids some complications that would arise from comparing overall spending and receipts over the years, such as the uneven recourse to non-Exchequer servicing of the national debt.

These sensitivity estimates are somewhat more favourable than in previous updates. The cumulative impact of a sustained 0.5 pp deviation from the growth target over the 2004-2006 period would thus entail a budget ratio that is around ½pp of GDP off the target of -1.1% of GDP in 2006.

The cyclically-adjusted balances are also likely to be altered by such a deviation from expected growth, because persistently higher/lower growth can be expected to affect potential output. Commission simulations of the resulting CABs under the assumptions of (i) a sustained 0.5pp deviation from the growth targets in the update over the 2004-2006 period; (ii) trend output based on the HP-filter[23] and (iii) no policy response (notably, the expenditure level is as in the central scenario[24]), reveal that, by 2006, the CAB is 0.3pp of GDP above/below the central scenario. This represents a tentative estimate of the additional adjustment necessary to achieve the nominal targets in the programme in the case of a growth shortfall.

3.6. Debt ratio

Thanks to high nominal growth and sizeable surpluses, the Irish debt ratio fell quickly in the mid-nineties and, at 38% of GDP, became the second lowest in the EU in 2000. In the new update, a downward revision of the debt ratio for 2002 by around 2 percentage points compared to the previous update translates into a better outcome for the entire programme period, so that government debt represents around 33% of GDP throughout the period rather than 34 to 35% in the previous update.

Table 7. Decomposition of changes in the government debt ratio (% of GDP)

	2002	2003	2004	2005	2006
Government debt ratio	**32.4**	**33.1**	**33.3**	**33.5**	**33.3**
Total change in government debt ratio	-3.7	+0.7	+0.2	+0.2	-0.2
of which:					
Contribution of primary balance	-1.2	-1.0	-0.3	-0.1	-0.3
Contribution of interest and nominal GDP growth	-2.7	0.0	-0.8	-1.0	-1.0
Contribution of stock-flow adjustment	0.2	1.7	1.3	1.3	1.1
due to the National Pensions Reserve Fund	*1.0*	*1.0*	*1.0*	*1.0*	*1.0*
=> remaining stock-flow adjustment	-0.8	0.7	0.3	0.3	0.1

<u>Source</u>: ECFIN calculations on figures provided in the stability programme update

<u>Note</u>: calculations based on the budget constraint equation

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

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

Table 7 shows that both the primary balance and the interaction between the average interest rate and GDP growth continue to contribute to lowering the debt ratio. In 2003-2005, however, this is more than offset by sizeable stock-flow adjustments. These largely reflect the impact of the National Pensions Reserve Fund, which was set up to pre-fund future pensions liabilities and receives 1% of GNP annually from general government

[23]In the absence of a fully-specified macro-economic scenario that would underlie such deviations, it is obviously impossible to derive new estimates of potential growth from the agreed production function method.

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

resources. Without the accumulation of non-government assets in this fund, the debt ratio would be falling throughout the period[25].

4. THE QUALITY OF THE PUBLIC FINANCES

The update reviews the government's structural reform programme, which focuses on safeguarding a low tax burden[26] and improving public services and infrastructure. The update also discusses further measures to improve the control and management of public spending. The following paragraphs outline the main measures that are consistent with the broad economic policy guidelines (BEPGs) for 2003-2005. On budgetary policy, these recommended to (i) enhance the efficiency of public spending, (ii) improve the medium-term budgetary framework and (iii) prioritise the roll-out of the infrastructural elements of the National Development Plan 2000-2006 (NDP)[27].

One of the main measures detailed in the update is the extension of multi-annual budgeting (rolling five-year envelopes) from public transport capital projects to all areas of *capital spending* with effect from 2004. This not only constitutes an obvious strengthening of the budgetary framework, but is also consistent with the remaining two guidelines mentioned above. The first five-year envelopes for capital spending by department (for the period 2004-2008) keep Exchequer-funded capital investment at close to 5% of GNP and reflect the government's decision to treat infrastructure as the key priority for investment over the remainder of the NDP period, in line with the third guideline. Further, by providing greater certainty for government departments and public bodies, the practice of multi-annual envelopes should enhance the efficiency of capital expenditure planning and management[28], as should the introduction of revised capital appraisal procedures from 2004. Other plans to improve value for money in capital spending include (i) legislation to speed up the planning and environment impact assessment process and (ii) cost-saving changes to public construction contracts, for instance by ensuring that a greater proportion of the risks of inflation and other cost increases are borne by contractors and by reducing reliance on consultants through a greater use of the "design, build and transfer" model. The multi-annual envelopes comprise a mixture of Exchequer and public private partnership (PPP) allocations (of which the cost of servicing the capital finance and maintenance will be met by the Exchequer over the lifetime of each contract). In addition, PPP projects financed by user

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[25]On the remaining stock-flow adjustment, the update specifically mentions (i) the Social Insurance Fund, which benefits from an Exchequer subvention if required but has been in surplus since 1997; and (ii) the increase in local authorities' debt (accounting for 0.4 to 0.6pp annually), which is partly for social housing purposes to be passed on to households in the form of local authority mortgages. The negative remaining stock-flow adjustment in 2002 partly reflects the transfer from the Central Bank (0.5% of GDP).

[26]As explained above, the scale of direct tax relief in the budget for 2004 is quite modest and implies a partial adjustment only of the personal tax system for inflation (as in the budget for 2003). The budget for 2003 announced several measures to broaden the tax base (to impact on revenues in future years), for instance by terminating a range of tax incentive schemes in the property and film sectors by end-2004; the budget for 2004 now proposes to postpone the envisaged termination date of these schemes to mid-2006 and end-2008 respectively.

[27]The BEPGs also recommended that measures be taken to raise the level of R&D. The budget for 2004 proposes to introduce a tax credit for R&D expenditure from 2004. Details are to be set out in the February 2004 Finance Bill.

[28]As part of the capital envelope system, departments are allowed to carry over from one year to another up to 10% of each year's unspent capital allocation by subhead.

charges are foreseen. The aim is to increase the proportion of public investment undertaken by the private sector from 3% in 2004 to 15% by 2008.

Another element in the drive for value for money is the government's *health reform programme* announced in June 2003. Its main elements are: a rationalisation of the existing health service agencies, the establishment of a national health service executive, the decentralisation of budgetary responsibility and the modernisation of planning and reporting processes. Implementation is currently underway but will take several years to complete.

Finally, the *benchmarking process* in the public sector should also contribute to achieving better value for money. Payment of three-quarters of the average 8.9% pay rise under benchmarking is conditional on verifiable progress on modernisation and flexibility and maintenance of the industrial peace. In the course of 2003, the necessary arrangements (action plans, performance verification groups) were put in place to monitor such progress and the first verification evaluations took place.

Taken together, these measures imply that good progress is being made in addressing the guidelines with budgetary implications in the BEPGs. However, compliance with the recommendation to strengthen the medium-term budgetary framework would be further enhanced by the clarification of the nature of the current multi-annual projections in the budget and the stability programme (in particular the role of the technical and contingency provisions) and by developing a norm-based framework to guide spending in the medium-term.

5. THE SUSTAINABILITY OF THE PUBLIC FINANCES

5.1. Quantitative indicators

The assessment of the sustainability of Irish public finances is based on both quantitative and qualitative indicators. The quantitative indicators are run on the basis of a commonly agreed methodology by the Economic Policy Committee (EPC)[29]. The purpose of the indicators is to signal possible imbalances on the basis of current policies and projected age-related expenditure trends. However, the limitations of this exercise are clear and results of these quantitative indicators need to be interpreted with caution. 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 possible or even likely outcomes and should not be taken at face value. Instead, the indicators are a tool to facilitate the policy debate and at best provide an indication of the timing and scale of emerging budgetary challenges that could occur on the basis of "no policy change".

The updated Irish stability programme does not present new projections on age-related expenditures. Thus, the assessment is based on information on age-related expenditures provided last year and on the EPC common budgetary projections. The medium-term scenario of the updated programme is used to take into account the latest available information.

[29]See the Report "The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme" (October 2003), available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

Table 8. Long-term sustainability: summary results

Main assumptions - baseline scenario (as % GDP)	2007	2010	2020	2030	2040	2050	changes
Total age-related spending	16.9	16.9	18.9	20.1	21.2	22.3	5.4
Pensions	4.7	5.0	6.7	7.6	8.3	9.0	4.3
Health care	7.1	7.2	7.7	8.2	8.7	9.1	2.0
Education*	4.0	3.7	3.5	3.3	3.3	3.2	-0.8
Unemployment benefits*	1.03	1.01	0.98	0.99	0.97	0.97	-0.05
*Total primary non age-related spending***	15.3						
*Total revenues***	33.5						

* EPC projections

** constant

Results (as % GDP)	2007	2010	2020	2030	2040	2050	changes
Programme scenario							
Gross debt	31.4	26.8	26.7	44.6	79.3	134.2	102.8
Net borrowing	-0.2	-0.1	-2.1	-4.2	-7.2	-11.1	-11.0
2003 scenario							
Gross debt	29.9	27.2	33.3	58.3	101.8	167.5	137.6
Net borrowing	-0.7	-0.7	-3.0	-5.5	-9.0	-13.5	-12.8

Sustainability gap	S1*	S2**
Programme scenario	2.1	2.7
2003 scenario	2.7	3.0

* S1 measures the difference between the current tax ratio and the tax ratio that would ensure a debt level in 2050 as resulting from a balance budget position over the projection period. A positive sustainability gap indicates that there is a financing gap to reach this debt level in 2050. P.m. debt to GDP ratio at the end of the period: 4.8%

** S2 indicates the change needed in tax revenues as a share of GDP that guarantees the respect of the interteporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

The quantitative indicators project debt and budget balance developments according to two different scenarios, to take into account uncertainties over the medium term. The “programme” scenario is calculated on the following basis:

- Macroeconomic assumptions on GDP growth from 2007 onwards, interest rates and inflation are based on the agreed assumptions used in the EPC;

- The projections for age-related expenditures come from last year’s stability programme, complemented with the EPC harmonised projections;

- The projections for government revenues come from the programme. They are kept constant at the (cyclically-adjusted) level in 2006;

- The starting point for gross debt and the primary balance are the 2006 levels reported in the programme.

A “2003 position” scenario is based on the budgetary data for 2003 in the programme. Debt levels are extrapolated from 2007 to 2050 assuming that no budgetary consolidation is achieved, *i.e.* the cyclically-adjusted primary balance in 2006 remains the same as the 2003 level and no stock-flow operations take place.

Table 8 presents the debt and the budget balance developments according to the two different scenarios. Pension and health care expenditure projections come from last year’s programme while education and unemployment benefit projections rely on the EPC common exercise. Overall, age-related expenditure is foreseen to increase by 5.4% of GDP between 2007 and 2050. Compared with last year’s assessment some savings that limit the impact of an ageing population on the public finances are foreseen in education expenditure.

It is possible to verify whether the projected level of debt respects the requirement to stay below 60% of GDP reference value for public debt at all times. Failure to do so would *a priori* indicate that there may be a risk of budgetary imbalances emerging in the light of an ageing population and that measures may be required to place public finances on a more sustainable footing.

According to the quantitative indicators solely, risks of budget imbalances in the future cannot be completely ruled out. On current policies, the debt is expected to rise after the impact of ageing takes place, in particular as a consequence of increased pension expenditure. The situation will deteriorate further if the cyclically-adjusted primary balance remains constant over the programme period, *i.e.* if Ireland fails to consolidate its budget.

A sustainability gap therefore cannot be excluded in the long run.

5.2. Additional qualitative features

As underlined in the EPC-report[30], several qualitative factors should be taken on board to avoid a mechanistic interpretation of the quantitative indicators. On the positive side, the accumulation of an annual contribution of 1% of GNP will partially pre-fund the pension system and increase the long-term sustainability of public finances[31]. Also, the current level of the gross debt-to-GDP ratio is limited, offering some room to increase age-related expenditures in the long run. Finally, the foreseen health care reform should increase the efficiency in the health sector, with a positive budgetary impact. However, if the full impact of ageing materialises and the tax burden remains constant at the current level, some imbalances cannot be excluded. Nevertheless, both the accumulation of funds and the possibility to raise taxes if imbalances arise put Ireland on a safe position path, even if long-term trends need to be carefully monitored in order to intervene promptly if imbalances start to arise.

5.3. Overall assessment

Based on an assessment of the quantitative indicators as well as other qualitative considerations, Ireland is on a sustainable path on current policies but some risks may emerge in the long run. The budgetary strategy outlined in the programme is based on the accumulation of reserve funds to pay future pension liabilities, the development of occupational pensions and measures to increase the efficiency in the health care sector. Some risks may emerge if a policy of a balanced budget is not pursued over the long term but the possible financing gap can be easily covered through taxes. Securing an adequate primary surplus is essential to ensure that the public finances are on a sustainable footing.

[30] See previous footnote.

[31] At the end of 2003, the National Pension Reserve Fund's assets represented 7% of GDP. The annual contribution of 1% of GNP has to be made until at least 2055, while drawdowns are to begin in 2026.

ANNEX: SUMMARY TABLES FROM THE DECEMBER 2003 UPDATE OF THE STABILITY PROGRAMME

Table A.0: Basic assumptions

	2003	2004	2005	2006
Short-term interest rate (annual average)	**2.3**	**2.3**	**3.2**	**3.2**
Long-term interest rate (annual average)	**4.1**	**4.4**	**4.8**	**4.8**
USA: short-term (3-month money market)				
USA: long term (10-year government bonds)				
US$/€ exchange rate (annual average)	**1.13**	**1.16**	**1.15**	**1.15**
World excluding EU, GDP growth	**4.0**	**4.6**	**4.6**	**4.6**
USA GDP growth				
Japan GDP growth				
EU-15 GDP growth	**0.8**	**2.0**	**2.4**	**2.4**
Growth relevant foreign markets	**2.8**	**5.8**	**6.8**	**6.8**
World import volumes, excluding EU	**6.3**	**8.3**	**8.6**	**8.6**
World import prices (manufactured goods in USD)				
Oil prices (Brent USD/barrel)	**28.3**	**25.6**	**24.1**	**24.1**
Non-oil commodities prices (in USD)				

Table A.1: Growth and associated factors

	2002	2003	2004	2005	2006
GDP growth at constant market prices (7+8+9)	**6.9**	**2.2**	**3.3**	**4.7**	**5.2**
GDP *level* at current market prices (€ bn.)		**135.2**	**144.8**	**156.0**	**168.0**
GDP deflator	**5.4**	**2.2**	**3.6**	**2.9**	**2.4**
HICP change		4.0	2.3	2.0	2.0
CPI change	4.6	3.5	2.5	2.5	2.4
Employment growth	**1.4**	**1.0**	**1.3**	**1.5**	**1.3**
Labour productivity growth [32]		4.8	5.0	4.9	4.8
Sources of growth: percentage changes at constant prices					
1. Private consumption expenditure	**2.7**	**2.4**	**3.6**	**4.1**	**4.8**
2. Government consumption expenditure	**9.4**	**4.2**	**2.1**	**2.3**	**2.5**
3. Gross fixed capital formation [33]	**-0.6**	**-0.4**	**1.3**	**1.9**	**2.2**
4. Changes in inventories and net acquisition of valuables as a % of GDP					
5. Exports of goods and services	**6.2**	**-4.0**	**3.9**	**6.8**	**7.1**
6. Imports of goods and services	**2.3**	**-6.0**	**3.6**	**5.8**	**6.1**
Contribution to GDP growth					
7. Final domestic demand		**1.6**	**2.3**	**2.7**	**3.1**
8. Change in inventories and net acquisition of valuables		**0.2**	**0.2**	**0.2**	**0.2**
9. External balance of G&S		**0.4**	**0.8**	**1.8**	**1.9**

[32]Growth of GNP at constant market prices per person employed.

[33]Including changes in inventories and net acquisition of valuables.

Table A.2: General government budgetary developments

In % of GDP	**2002**	**2003**	**2004**	**2005**	**2006**
Net lending by sub-sectors					
General government	**-0.2**	**-0.4**	**-1.1**	**-1.4**	**-1.1**
Central government	**0.1**	**-0.4**	**-1.1**	**-1.5**	**-1.3**
State government					
Local government	**-0.1**	**-0.2**	**-0.1**	**-0.1**	**-0.1**
Social security funds	**-0.2**	**0.2**	**0.1**	**0.2**	**0.3**
General government					
Total receipts	**33.1**	**34.1**	**33.5**	**32.9**	**32.5**
Total expenditures	**33.3**	**34.6**	**34.6**	**34.2**	**33.6**
Budget balance	**-0.2**	**-0.4**	**-1.1**	**-1.4**	**-1.1**
Net interest expenditure	**0.2**	**0.2**	**0.4**	**0.4**	**0.4**
Primary balance	**1.2**	**1.0**	**0.3**	**0.1**	**0.3**
Components of revenues					
Taxes	23.7	24.5	24.4	24.1	24.0
Social contributions	5.7	5.8	5.7	5.7	5.5
Interest income	1.2	1.3	1.1	1.0	1.0
Other	2.5	2.5	2.3	2.1	2.0
Total receipts	33.1	34.1	33.5	32.9	32.5
Components of expenditures					
Collective consumption	5.5	5.8	5.9	5.8	5.7
Social transfers in kind	9.5	10.0	10.2	10.0	9.9
Social transfers other than in kind	8.3	9.1	9.2	9.1	8.9
Interest expenditure	1.4	1.5	1.4	1.4	1.4
Subsidies	0.8	0.6	0.6	0.6	0.6
Gross fixed capital formation	4.4	3.9	3.8	3.9	3.8
Other	3.3 [34]	3.6	3.6	3.4	3.3
Total expenditures	33.3	34.6	34.6	34.2	33.6

Table A.3: General government debt developments

In % of GDP	**2002**	**2003**	**2004**	**2005**	**2006**
Gross debt level	**32.4**	**33.1**	**33.3**	**33.5**	**33.3**
Change in gross debt	**-3.7**	**0.7**	**0.2**	**0.2**	**-0.2**
Contribution to change in gross debt					
Primary balance	**-1.2**	**-1.0**	**-0.3**	**-0.1**	**-0.3**
Interest expenditure	**1.4**	**1.5**	**1.4**	**1.4**	**1.4**
Impact of nominal GDP growth	**-4.1**	**-1.4**	**-2.2**	**-2.4**	**-2.4**
Net Receipts of Social Security Funds [35]	0.8	1.1	1.1	1.2	1.3
Other factors influencing the debt ratio	-0.6	0.5	0.2	0.1	-0.2
Of which: Privatisation receipts	-0.1	–	–	–	–
Increase in local authorities' debt [36]	0.6	0.5	0.4	0.4	0.4
p.m. implicit interest rate on debt	4.4	4.6	4.5	4.4	4.4

[34] Corrected.

[35] Central government transfers, contributions and investment income.

[36] Substantially offset by increased mortgage assets.

Table A.4: Cyclical developments

In % of GDP	2002	2003	2004	2005	2006
GDP growth at constant prices	**6.9**	**2.2**	**3.3**	**4.7**	**5.2**
Actual balance	**-0.2**	**-0.4**	**-1.1**	**-1.4**	**-1.1**
Interest expenditure	**1.4**	**1.5**	**1.4**	**1.4**	**1.4**
Potential GDP growth	7.0	6.3	5.9	5.6	5.2
Output gap	5.0	1.0	-1.5	-2.3	-2.3
Cyclical budgetary component					
Cyclically adjusted balance [37]	-2.3	-0.8	-0.5	-0.4	-0.1
Cyclically-adjusted primary balance					

Table A.5: Divergence from previous update

In % of GDP	2002	2003	2004	2005	2006
GDP growth *(% change)*					
previous update	**4.5**	**3.5**	**4.1**	**5.0**	**–**
latest update	**6.9**	**2.2**	**3.3**	**4.7**	**5.2**
difference	**2.4**	**-1.3**	**-0.8**	**-0.3**	**–**
Actual budget balance					
previous update	**-0.3**	**-0.7**	**-1.2**	**-1.2**	**–**
latest update	**-0.2**	**-0.4**	**-1.1**	**-1.4**	**-1.1**
difference	**0.1**	**0.3**	**0.1**	**-0.2**	**–**
Gross debt levels					
previous update	**34.1**	**34.0**	**34.5**	**34.9**	**–**
latest update	**32.4**	**33.1**	**33.3**	**33.5**	**33.3**
difference	**-1.7**	**-0.9**	**-1.2**	**-1.4**	**–**

Table A.6: Long-term sustainability of public finances

No table included in the December 2003 update of the stability programme

[37] The update includes the following footnote: “If a budget sensitivity of 0.32 were used, the equivalent CABs for 2003 to 2006 would be -0.7%, -0.6%, -0.6% and -0.4% respectively.”