Ireland – Stability Programme

December 2004 Update

Foreword

This document updates Ireland's Stability Programme. It includes macroeconomic projections up to 2007 and takes account of the measures adopted in Budget 2005.

This Update has been prepared in conjunction with Budget 2005 and is being presented to Dáil Éireann on Budget Day, 1 December 2004. As such, it also provides the economic background to Budget 2005.

The document has been prepared in accordance with Council Regulation (EC) No. 1466/97, which sets out the rules covering the content of Stability Programmes, and conforms to the revised Opinion on the content and format of Stability and Convergence Programmes agreed by the Economic and Financial Committee of the EU in June 2001.

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Chapter 1 - Overall Policy Framework and Objectives

Government Objectives

The Government's economic and budgetary strategy is based on pursuing economic growth and full employment as the basis of continued prosperity and enhanced living standards for all. The key policies that underpin this overall strategy can be summarised as follows:

- maintaining sustainable public finances while pursuing a budgetary policy which facilitates the recovery of economic competitiveness;
- fostering employment and economic growth;
- enhancing public services and delivering further improvements to those on low incomes;
- continuing to redress the infrastructural deficit to provide the basis for future economic growth.

The framing of medium-term budgetary policy in accordance with the requirements of the Stability and Growth Pact facilitates confidence, investment and growth, and thereby supports the Government objectives for jobs, prosperity and balanced economic development. In particular, the growth of public expenditure must continue to be correlated with revenue growth, consolidating the achievements of recent years, and ensuring budgetary sustainability going forward. The Government is determined that Ireland's public finances will be well-placed to address additional fiscal pressures over the longer term, including the budgetary consequences of an ageing population.

Economic Outlook

The global economic recovery has maintained momentum in 2004 and this recovery will continue to benefit Ireland going forward.

Ireland is now moving back towards a sustainable level of annual growth and this is reflected in our forecast for average growth rates of 5.3% and 4.8% in GDP and GNP terms over 2005-2007. In 2004, growth in GDP of 5.3% and GNP of 4.9% is forecast for the year compared with GDP of 3.7% and GNP of 2.8% in 2003. The European Commission expect euro area growth to average 2.1% this year.

The outlook for employment in 2005-2007 is positive and is expected to grow by an average of 1.6%. The unemployment rate is expected to average 4.5% over the period. Inflation is expected to remain much closer to the euro area average over the 2005-2007 period than was the case in the last three years and CPI inflation is expected to average 2.4%.

Budgetary Stance

The projected budgetary position over the period 2005-07 (summarised in Table 1 below) is for a "headline" General Government budget deficit of 0.8% of GDP in 2005 followed by deficits of 0.6% in 2006 and again in 2007. The underlying (structural) budget balance, moving from a balanced position in 2005 to a surplus of 0.3% in 2007, respects the terms of the Stability and Growth Pact. The debt-to-GDP ratio will be maintained at the second lowest in the euro area – around 30% for the forecast period – in line with the Government's long-term priorities outlined above. The assets of the National Pensions Reserve Fund are estimated to be 7.6% of GDP at the end of 2004.

Table 1 – General Government Balance and Prospective Debt Ratio (% of GDP)

% of GDP	2004	2005	2006	2007
General Government Balance	0.9	-0.8	-0.6	-0.6
Cyclically-adjusted Balance	1.4	0.0	0.4	0.3
Debt Ratio (year end)	30.5	30.1	30.1	30.0

Source: Department of Finance

Chapter 2 – Economic Outlook

2.1 Summary[1]

A recovery in international economic conditions contributed to an improved performance in the Irish economy in 2004, with growth now estimated to be 5.3% in GDP and 4.9% in GNP terms.

Relatively strong growth is expected to continue in 2005, with GDP and GNP forecast to grow by 5.1% and 4.7% respectively. A modest acceleration is expected in 2006 and 2007. However, there are a number of downside risks to global growth prospects, including uncertainty about oil price developments, the possibility that the international economic recovery may be softer than currently expected and the potential for the euro to appreciate further against the dollar. The realisation of any of these risks could impact negatively on Irish growth going forward.

Despite relatively modest economic growth in recent years, the labour market has remained resilient. This year, employment growth has accelerated to an estimated 2.4%, and a further expansion of employment is projected over the forecast period 2005-2007. As a result, the unemployment rate is expected to remain low over this period. CPI Inflation is estimated at 2.2% in 2004, its lowest rate of increase since 1999. Inflation is projected to remain relatively moderate over the forecast period.

Table 2 – Economic and Budgetary Indicators: 1999-2004

% volume change unless otherwise indicated	1999	2000	2001	2002	2003	2004
GNP	8.7	10.1	3.8	1.5	2.8	4.9
GDP	11.1	9.9	6.0	6.1	3.7	5.3
Personal consumption	8.7	9.0	5.5	2.8	2.6	2.8
Public consumption	7.4	8.0	10.9	8.6	2.5	2.7
Fixed investment (including stocks)	8.5	9.8	-4.0	1.8	5.6	8.4
Exports of goods and services	15.2	20.4	8.4	5.7	-0.8	5.6
Imports of goods and services	12.1	21.3	6.7	3.3	-2.3	4.4
Consumer Price Index (% change)	1.6	5.6	4.9	4.6	3.5	2.2
GDP deflator (% change)	3.8	4.8	5.7	4.5	1.6	2.8
Unemployment (% of labour force)	5.6	4.3	3.9	4.4	4.6	4.5
Employment (% change)	6.2	4.8	3.1	1.8	1.9	2.4
Employment change ('000)	94	78	53	32	34	43
General Gov. Balance (% GDP) *	2.6	4.4	0.9	-0.2	0.1	0.9
General Gov. Debt (% GDP)	48.7	38.3	35.9	32.7	32.1	30.5

* Deficit (-) / Surplus (+).
Source: 1999-2003 CSO, except for public finance figures which are produced by the Department of Finance. 2004 figures are Department of Finance estimates.

2.2 The Economy in 2004

The pace of economic growth accelerated in 2004, partly reflecting a more positive contribution from net exports together with continued strong growth in the residential construction sector. Quarterly national accounts data show that GNP rose by 4.7% year-on-year in the first half of 2004. The corresponding increase in GDP was 5.1%.

[1] The analysis here is based on data available up to end-November 2004, and on the European Commission's assumptions regarding the external environment that are set out in the Annex.

Ireland is one of the most open economies in the world and, as such, our ability to supply goods and services to international markets is essential to our continued economic health. Over the past number of years our competitive position has worsened due to increasing domestic costs and to the appreciation of the euro exchange rate. Regaining competitiveness will remain a key challenge for the Irish economy going forward – particularly in light of the recent enlargement of the European Union and the emergence of other world economies.

External Developments

The global economic expansion is particularly robust in 2004, with all major regions contributing to strong growth. In the US, GDP is projected to expand by an estimated 4.4% (EU Commission figures), partly supported by favourable monetary and fiscal conditions. In the euro area, GDP is forecast to rise by 2.1% this year, compared to 0.6% in 2003. In the UK, which remains a very important trading partner for Ireland, GDP growth is likely to accelerate to 3.3% this year, from 2.2% last year, primarily due to strong domestic demand growth.

Against this favourable international background, exports of goods and services in Ireland rose by 5.7% in the first half of the year. For the year as a whole, total exports are projected to rise by 5.6%.

Domestic Demand

The components of domestic demand have shown a somewhat mixed pattern this year. On the one hand, personal consumption growth has remained relatively modest, rising by 2.4% year-on-year in the first half of 2004. Assuming some improvement over the second half of the year, personal consumption expenditure is estimated to increase by 2.8% in 2004.

On the other hand, investment demand rose strongly in 2004, with gross domestic fixed capital formation rising by 12.3% year-on-year in the first half of 2004. While part of this is due to a recovery in machinery and equipment investment, the increase in residential construction output has also been a contributory factor. Total housing output in 2004 is estimated at around 80,000 units, an increase of 16% on the 2003 outturn. For the year as a whole, investment is estimated to rise by 8.5%.

Final Demand and Imports

Final demand is projected to rise by 5.1% in 2004, compared to growth of 1.1% in 2003. For the year as a whole, imports of goods and services are expected to increase by 4.4%, in contrast to 2003 when imports fell by 2.3%.

The current account of the Balance of Payments for the first half of 2004 recorded a deficit of €795 million, compared to a deficit of €1,247 million in the first half of 2003. The improvement in 2004 to date, relative to the same period in 2003, has been driven primarily by a lower deficit on services trade. For the year as a whole, a current account deficit of the order of 1.5% of GNP is projected, compared to 1.7% last year.

Employment and Earnings Growth

The resilience of the labour market was perhaps the most encouraging aspect of the economic slowdown over the period 2001-2003. This year, the improvement in economic conditions has had a positive impact on the labour market, with employment rising by nearly 48,000 (2.7%) in the first half of the year. At the same time, unemployment has remained low, averaging 4.4% in the first half of the year. Moreover, trends in the Live Register suggest that conditions in the labour market have remained favourable in the second half of the year. In overall terms, therefore, total employment is expected to rise by 43,000 (2.4%) this year. Unemployment is expected to average 4.5%, well below the euro area average.

Available data are consistent with relatively moderate earnings growth this year. Hourly earnings in construction rose by 4.5% year-on-year in the first half of the year, while hourly industrial earnings rose by 4.6% over the same period. In the services sector, rates of increase have been slightly higher.

In the distribution and business services sector, weekly earnings rose by 5.3% year-on-year in the first half of the year, while financial sector earnings were 5.2% higher over the same period. Finally, in the public sector, weekly earnings in the first half of 2004 were 7.8% higher than in the same period of 2003, partly reflecting the implementation of the Benchmarking payments.

Gross Domestic Product and Gross National Product
In overall terms, GDP is projected to rise by 5.3% this year. GNP growth is expected to be 4.9%.

Table 3 – Economic Indicators 2004: Budget Forecast and Estimated Outturn

	2004 Forecast (December 2003)	2004 Estimate (December 2004)
GNP (% volume change)	3.0	4.9
GDP (% volume change)	3.3	5.3
Consumer prices (% change)	2.5	2.2
Unemployment rate (% labour force)	5.0	4.5
Employment growth ('000)	23	43
Employment growth (%)	1.3	2.4

Source: Department of Finance

2.3 Macroeconomic Projections: 2005 - 2007

Over the period 2005-2007, GDP and GNP growth in Ireland are forecast to average 5.3% and 4.8% per annum respectively. These forecasts adopt EU Commission technical assumptions regarding key external variables such as interest rates and exchange rates, as well as assumptions regarding developments in our major trading partners (see Annex).

External Outlook
According to the Autumn EU Commission forecasts, the outlook for the international economy is positive, although the pace of expansion is expected to moderate compared to this year. However, risks to the outlook remain, including uncertainties about oil price developments, the evolution of the US current account deficit, the risk of a sharp appreciation of the euro exchange rate and that growth in our main trading partners might be weaker than currently expected. The Commission's forecasts for GDP growth in key economies are set out in Table 4 below. The Commission projects that demand in Ireland's export markets will grow by 6.7% next year, compared to an estimated 7.8% this year. This growth in export markets should underpin a pick-up in growth in Irish exports in 2005 to around 7.0%.

Table 4 – Real GDP Growth in Ireland's Main Trading Partners

	2004	2005	2006
Germany	1.9	1.5	1.7
France	2.4	2.2	2.2
Italy	1.3	1.8	1.8
Euro area	2.1	2.0	2.2
UK	3.3	2.8	2.8
EU15	2.3	2.2	2.3
EU25	2.5	2.3	2.4
US	4.4	3.0	2.9
Japan	4.2	2.1	2.3

Source: European Commission 2004 Autumn forecasts

Domestic Demand
Personal consumption expenditure is expected to pick up next year, in line with continuing employment and earnings growth. In overall terms, growth of 4.1% is currently projected. In 2006 and 2007, further income growth together with the impact of the release of SSIA funds into the economy should support personal expenditure growth. However, the impact of SSIA funds on expenditure is difficult to predict and so the projections over this period are subject to greater uncertainty than normal.

Investment growth is expected to moderate next year, with overall growth of 2.5% projected. The projected moderation mainly reflects the assumption that output in the residential construction sector will not contribute to growth to the same extent as this year. A gradual easing back of housing output is envisaged over the forecast horizon, although this is expected to be offset by increases in other components of building and construction (assisted by a continuation of a strong public capital programme) as well as a continuation in the recovery in machinery and equipment investment.

We forecast a growth rate in public consumption of 2.9% in 2005 with broadly similar rates of increase in 2006 and 2007.

Final Demand and Imports
Final demand is projected to increase by 5.3% in 2005 with an average increase of 5.6% over the entire forecast period. In line with the above developments, import growth is forecast to be 5.7% in 2005. The current account deficit on the balance of payments is expected to be around 1.1% of GNP next year, stabilising around that level in 2006 and 2007.

Employment and Earnings Growth
In line with the projections for overall demand, the outlook for the labour market remains broadly favourable. Total employment is projected to increase by 35,000 (1.9%) next year, moderating slightly thereafter. Unemployment is assumed to remain relatively low, stabilising at close to its current rate. Average per capita earnings in 2005 are projected to rise at broadly similar rates to those recorded this year.

Gross Domestic Product and Gross National Product
GDP and GNP are projected to grow at 5.1% and 4.7% respectively in 2005, with a modest acceleration in both measures in 2006 and 2007. However, this relatively benign outlook for the Irish economy is subject to a number of downside risks. On the external side, the main risks include the uncertainty for oil prices, the potential for exchange rate fluctuations and the possibility that growth in some of our major trading partners will be lower than currently envisaged. On the domestic front, the main risk to the economy centres around the possibility of a further deterioration in cost competitiveness.

Table 5 – Growth and Associated Factors

	2004	2005	2006	2007
GNP growth at constant market prices	4.9	4.7	4.8	4.9
GNP level at current market prices	121,825	132,025	142,100	152,950
GDP growth at constant market prices	5.3	5.1	5.2	5.4
GDP level at current market prices	146,025	158,400	171,250	185,200
GDP deflator	2.8	3.2	2.7	2.6
HICP change	2.3	2.1	2.0	1.9
CPI change	2.2	2.5	2.4	2.3
Employment growth	2.4	1.9	1.5	1.4
Unemployment rate	4.5	4.4	4.5	4.5
Labour productivity growth	2.2	2.6	3.2	3.4
	% Volume Change			
Private consumption expenditure	2.8	4.1	5.4	6.4
Government consumption expenditure	2.7	2.9	2.9	2.9
Gross fixed capital formation	8.5	2.5	1.6	1.6
Exports of goods and services	5.6	7.0	7.4	6.9
Imports of goods and services	4.4	5.7	6.4	6.2
	Contributions to GDP Growth			
Final domestic demand	3.7	2.9	3.2	3.7
Change in stocks	-0.1	0.2	0.2	0.2
External balance of goods and services	1.8	2.0	1.8	1.6

Source: Department of Finance

2.4 Inflation

Developments in 2004

The moderation in the rate of inflation which began last year continued into 2004, with the CPI expected to average 2.2% for the year as a whole. On the external front, import prices continue to benefit from the lagged effects of the past appreciation of the euro against both sterling and the dollar and this has helped to reduce goods price inflation significantly. This was partly offset by higher oil prices which had an adverse impact on the CPI, particularly in the second half of the year. On the domestic front, service sector inflation continued to moderate, partly reflecting more modest demand growth. Last year's interest rate cuts impacted on the year-on-year rate of CPI inflation in the first half of this year, but their effect has now fallen out of the index. Over the course of 2004, the gap between the Irish harmonised inflation rate and the euro area equivalent narrowed steadily to its lowest level since the beginning of monetary union in 1999. The forecast is for HICP inflation in Ireland to average 2.3% in 2004, compared to a projected (EU Commission) average of 2.1% for the euro area.

Prospects for 2005 and Beyond

In 2005, the rate of inflation is expected to increase marginally to 2.5% in CPI terms, partly reflecting the impact of increases in oil prices. We expect the rate of CPI inflation to remain moderate over the entire forecast period, averaging 2.4% over 2005-2007. We expect the rate of HICP inflation to be slightly lower, averaging 2.1% in 2005 and 2.0% over the entire forecast period

Competitiveness remains a key priority for the Government going forward. The Government is committed to improving competitiveness and to enhancing the conditions for economic growth through further structural reform of product, capital and labour markets, details of which are set out in the 2004 Progress Report on Reforming Product and Capital Markets and the 2004 National Employment Action Plan[2].

[2] Available at http://www.entemp.ie

Range of Forecasts

The following table compares the Department of Finance forecasts with those of other organisations. In some instances the assumptions underpinning the forecasts may be different, and this must be borne in mind when making comparisons.

Table 6 – Comparison of Macroeconomic Forecasts for Ireland in 2005

Annual % change	GDP	GNP	CPI	Employment
Department of Finance (Budget 2005)	5.1	4.7	2.5	1.9
European Commission (Autumn 2004)	4.8	-	2.4*	1.7
OECD (November 2004)	5.5	-	2.8*	1.6
IMF (November 2004)	5.0	5.0	2.1*	1.5
Central Bank of Ireland (Autumn 2004)	5¼	5.0	3.0	2.4
ESRI (October 2004)	5.4	5.0	2.4	1.8

*HICP

Chapter 3 – General Government Balance and Debt

3.1 Summary

The Government's budgetary strategy is based on the objective of continued budgetary sustainability into the medium term. The public finance position is sound.

The debt/GDP ratio is projected to remain around 30% to end-2007, far below the present EU average debt level of around 64% of GDP, and the second lowest in the euro area.

The outlook is for a General Government budget deficit of 0.8% of GDP in 2005 followed by deficits of 0.6% in both 2006 and 2007. These projected balances include the cost of infrastructural investment that is approximately twice the EU average over the period.

The underlying (structural) budget balance respects the terms of the Stability and Growth Pact.

3.2 Policy Strategy

The Government Programme states that the Stability and Growth Pact "provides the overall framework" for budgetary policy.

The key objectives of the Government with regard to budgetary and economic policy are:

- maintaining sustainable public finances while pursuing a budgetary policy which facilitates the recovery of economic competitiveness;
- fostering employment and economic growth;
- enhancing public services and delivering further improvements to those on low incomes;
- continuing to redress the infrastructural deficit to provide the basis for future economic growth.

The formulation of medium term budgetary policy in accordance with the requirements of the Stability and Growth Pact facilitates confidence, investment and growth, and thereby assists the Government objectives for economic development and employment. The Government is determined that Ireland's public finances should be in a good position to address additional budgetary pressures over the longer term, including the public costs of an ageing population.

3.3 Actual Balances and Implications of Forthcoming Budget

A surplus of 0.9% of GDP on the General Government Balance is currently projected in 2004, compared with a surplus of 0.1% in 2003 and a planned deficit of -1.1% for 2004 at the time of last year's Budget. The improved position in 2004 is due mainly to stronger than expected economic and revenue growth and the impact of certain once-off factors

A significant portion of the excess tax receipts received in 2004 is as a result of once-off factors. Special Investigations by the Revenue Commissioners are expected to yield €670 million (0.5% of GDP) this year. With regard to spending, the introduction of the capital envelopes facility in Budget 2004, which allows for a carryover of up to 10% of Departmental capital spending allocations into the following year, resulted in savings of €237 million (0.2% of GDP) in the 2004 General Government Balance. Excluding these, and other minor once-off factors, the underlying budget balance in 2004 is a surplus of the order of 0.1% of GDP.

A General Government deficit of 0.8% of GDP is planned for 2005, followed by deficits of 0.6% in 2006 and 2007. Ireland is expected to continue to have the second lowest debt-to-GDP ratio in the euro area with a ratio of 30.1% in 2005.

Necessary infrastructural investment is having a significant impact on the General Government Balance. In order to address acute infrastructural needs and provide a basis for growth in the medium-term, Ireland's investment in infrastructure is currently running well ahead of the EU average. If public investment in Ireland was at the average of the EU, the General Government Balance position would improve by about 1.5% of GDP.

In response to the infrastructural needs of the economy, public investment including PPP capital funded by annual payments from the Exchequer, will average about 4.7% of GNP over the period 2005-2009. More detailed information in relation to Government expenditure and revenue issues is set out in Chapter 5.

At least 1% of GNP will continue to be set aside annually in the National Pensions Reserve Fund for the pre-funding of part of future pension liabilities, building up assets to help address costs associated with ageing in future decades. This pre-funding does not affect the General Government Balance, but does add to the General Government Debt.

Table 7 – General Government Budgetary Developments in % of GDP

	2003	2004[3]	2005	2006	2007
General government balance	0.1	0.9	-0.8	-0.6	-0.6
Central government	-0.3	0.9	-0.7	-0.8	-0.8
Local government	0.2	-0.2	-0.2	-0.1	-0.1
Social security funds	0.2	0.2	0.2	0.3	0.3
Total receipts	34.4	35.2	34.2	33.8	33.2
Total expenditures	34.3	34.3	35.0	34.5	33.8
Budget balance	0.1	0.9	-0.8	-0.6	-0.6
Net interest payments	0.3	0.2	0.3	0.2	0.3
Primary balance	1.4	2.1	0.6	0.6	0.7
Taxes	24.9	25.7	24.9	24.7	24.4
Social contributions	5.9	6.0	5.9	5.8	5.7
Interest income	1.0	1.0	1.1	1.0	0.9
Other	2.6	2.6	2.4	2.3	2.1
Total receipts	34.4	35.2	34.2	33.8	33.2
Collective consumption	5.6	5.6	5.7	5.6	5.6
Individual consumption	10.3	10.4	10.5	10.4	10.2
Social transfers other than in kind	9.0	9.5	9.4	9.3	9.2
Interest payments	1.3	1.2	1.3	1.2	1.3
Subsidies	0.6	0.6	0.6	0.6	0.6
Gross fixed capital formation	3.9	3.5	3.9	3.9	3.7
Other	3.7	3.6	3.6	3.4	3.2
Total expenditures	34.3	34.3	35.0	34.5	33.8

Source: Department of Finance; preliminary ESA95 basis; rounding may affect totals.

3.4 Structural Balance and Fiscal Stance

Over the course of the business cycle, the economy will typically alternate between periods of above and below-trend growth. The cyclical position of the economy, in turn, will have an impact on the actual budget balance. The Cyclically-Adjusted Budget Balance (CABB) removes the impact of the economic cycle on the budget balance in order to give an insight into the underlying fiscal position. It is calculated by subtracting the cyclically-induced component from the actual budget balance. Changes in the CABB from one year to the next give an indication of discretionary changes in fiscal policy.

[3] The General Government Balance in 2004, adjusted for once-off factors, would be 0.1% of GDP.

The Irish authorities reiterated their reservations, set out in the December 2003 Stability Programme Update, about the precision and relevance of the CABB in estimating the underlying fiscal stance in Ireland. These concerns reflect the 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. The EU Commission has also consistently drawn attention to the uncertainty of these estimates. In addition, there are a wide range of estimates for the sensitivity of the budget balance to changes in GDP growth. In these circumstances, the actual figures for the General Government Balance and the General Government Debt are likely to convey more relevant information and insight into the nature of fiscal policy in Ireland going forward.

Notwithstanding these caveats, estimates of the cyclically-adjusted budget balance are presented in Table 8. The estimates are based on the macro-economic and budgetary forecasts set out elsewhere in this Stability Programme Update. A budget sensitivity factor of 0.42 is used.

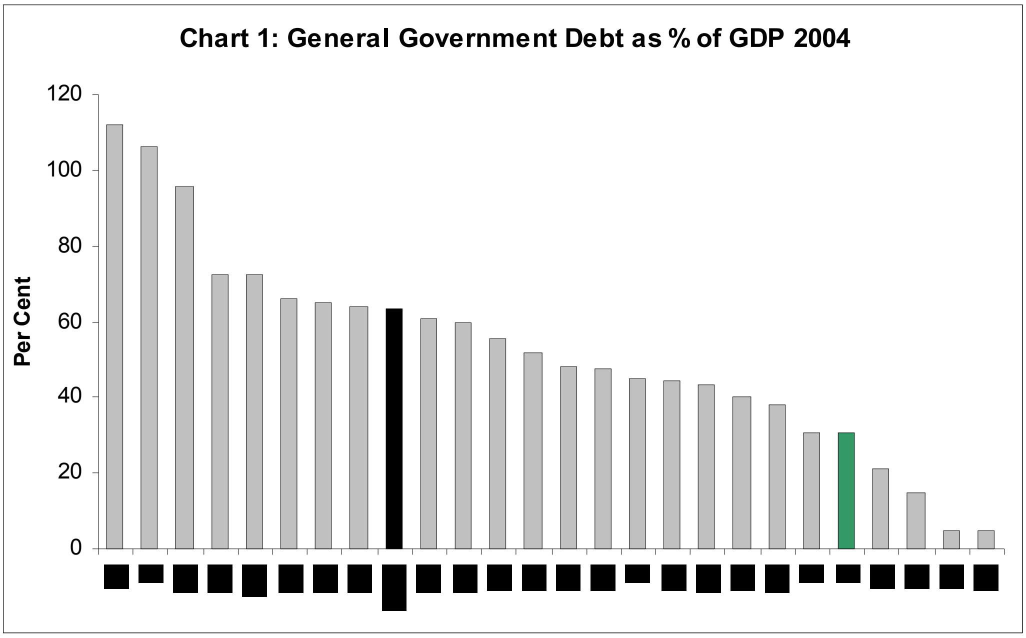
Table 8 – Cyclical Developments

% of GDP	2003	2004*	2005	2006	2007
GDP growth at constant prices	3.7	5.3	5.1	5.2	5.4
Actual balance	0.1	0.9	-0.8	-0.6	-0.6
Potential GDP growth	6.5	6.4	6.0	5.8	5.2
Output gap (% potential output)	-0.1	-1.1	-1.9	-2.4	-2.1
Cyclically adjusted balance[4]	0.1	1.4	0.0	0.4	0.3
Change in cyclically adjusted GGB	1.5	1.2	-1.3	0.3	-0.1

* As indicated at 3.3 (page E.11), the underlying budget balance for 2004, excluding once-off items, is a surplus of 0.1% of GDP. The equivalent cyclically adjusted GGB would be a surplus of 0.5% in 2004.
Source: Department of Finance

3.5 Debt Level and Developments

As indicated by Chart 1 below, Ireland has one of the lowest debt/GDP ratios in the EU25.



Source: EU Commission Autumn Forecasts 2004; Irish data: Department of Finance

[4] If a budget sensitivity of 0.32 was used, the equivalent CABBs over the period 2003-2007 would be: 0.1%, 1.3%, -0.2%, 0.1% and 0.1% respectively.

Over the Programme period as a whole, the gross debt level is expected to remain around 30% of GDP.

When account is taken of the build-up of assets in the National Pensions Reserve Fund (NPRF), the debt to GDP ratio, net of NPRF assets, is projected to be around 23% of GDP at end-2004.

Table 9 - General Government Debt Developments

% of GDP	2003	2004	2005	2006	2007
Gross debt level	32.1	30.5	30.1	30.1	30.0
Change in gross debt level	-0.3	-1.6	-0.3	-0.1	-0.1
Primary balance	-1.4	-2.1	-0.6	-0.6	-0.7
Interest payments	1.3	1.2	1.3	1.2	1.3
Nominal GDP	-1.3	-2.5	-2.4	-2.3	-2.3
Net Receipts of Social Security Funds[5]	1.2	1.2	1.2	1.3	1.4
Other factors influencing the debt ratio	0.0	0.5	0.2	0.3	0.2
Of which: Privatisation receipts	-	-	-	-	-
Increase in local authorities' debt[6]	0.4	0.4	0.4	0.4	0.3
p.m. implicit interest rate on debt	4.1	4.0	4.5	4.3	4.4

Source: Department of Finance

3.6 Balance by Sub-Sectors of Government

The balance by sub sectors of general government is set out in detail in Table 7. In Ireland, Central Government accounts for around 90% of total Government expenditure (including transfers to local government). Ireland does not have a federal or state government system; Local Government, the Social Insurance Fund (SIF) and the National Pensions Reserve Fund (NPRF) (from which no expenditure is scheduled before 2025) account for the balance. It is estimated that the SIF and NPRF had a combined surplus of almost 9% of GDP at end-2003, and this is expected to grow over the Programme period.

[5] Central Government transfers, contributions and investment income
[6] Substantially offset by increased mortgage assets

Chapter 4 – Sensitivity Analysis and Comparison with Previous Updates

4.1 Summary

This Chapter briefly outlines the impact of different economic scenarios on the budgetary balance. It is estimated that a 1% change in the growth rate would change the General Government Balance (GGB) by about ½ % of GDP in year one and by up to 1.2% of GDP in year two. By year three, the impact on the GGB would be around 1% of GDP relative to the baseline scenario. In addition, it is estimated that a 1% change in interest rates could affect economic growth by about ⅓ % by year three, with a similar impact of around ⅓ % on the GGB.

4.2 Alternative Scenarios and Risks

A number of points should be borne in mind when examining the results of the sensitivity analysis set out below. Firstly, the estimates should be seen as indicative and are subject to considerable uncertainty. Secondly, it is assumed that there is no fiscal policy response to the changed budgetary position over the period of the Programme. In reality such a response would occur if desirable in the interests of economic or budgetary sustainability. Finally, it should be noted that the results vary according to the type of economic shock used in the model simulation.

4.3 Sensitivity of Budgetary Projections to Different Scenarios and Assumptions

In line with estimates for previous years, the Economic and Social Research Institute has calculated that a 1% change in the growth rate would change the General Government Balance by about ½ % of GDP in the first year. In the second year, the impact on the GGB could be around 1.2% of GDP (relative to baseline), with the impact on the GGB easing to just below 1% of GDP in the third year. The budgetary impact of a 1% change in the growth rate compared with the central projection is given in Table 10 below.

Table 10 - Impact on the Budget Balance of 1% Change in Rate of Growth

	2005	2006	2007
Baseline GDP Growth (%)	5.1	5.2	5.4
GGB (% GDP) (including contingency)	-0.8	-0.6	-0.6
Cumulative impact of 1% change in growth on GGB (% GDP)	Up to 0.5%	Up to 1.2%	Up to 0.9%
GGB Range (% GDP)	-1.3 to -0.3	-1.8 to +0.6	-1.5 to 0.3

Source: Department of Finance

Interest rate changes impact on the budgetary position in two ways. Firstly, such changes affect debt service costs directly, although as the debt burden declines these effects are declining in importance.

In addition, interest rate changes have an impact on economic activity, with consequences for both Government revenue and expenditure. However, the impact of interest rate changes on economic activity – and hence on the fiscal balance – is uncertain, and will depend on whether the change is perceived as temporary or permanent. Interest rate changes which are seen as temporary in nature will have a smaller impact than changes that are considered to be longer-lasting. In addition, the financial balance sheets of the personal and business sectors are also important determinants of the impact of interest rate changes on economic activity.

Estimates by the Economic and Social Research Institute suggest that a 1% increase in interest rates could reduce growth by as much as ⅓ % after three years. In addition, it is estimated that a 1% change in interest rates could change the GGB by around ⅓ % of GDP relative to baseline after year three.

4.4 Comparison with Previous Update

Table 11 compares this Stability Programme Update with the updated Programme of December 2003. GDP growth in 2004 is now estimated at 5.3%, compared to a forecast of 3.3% in last year's Stability Programme Update. GDP forecasts for 2005 and 2006 have also been revised. GNP growth this year is now estimated to be 4.9%, compared to a forecast of 3.0% in last year's Update.

The General Government Balance in 2004 is now projected at 0.9% of GDP, compared with -1.1% anticipated in the last Update. The forecast outturn for 2004 has been revised primarily because of higher tax revenues due to improved global and domestic economic conditions. The General Government debt ratio, already far below the 'Maastricht' threshold, is set to remain low over the period to 2007.

Table 11 - Divergence from Previous Update

% of GDP	2003	2004	2005	2006	2007
GDP growth					
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					
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	-

Source: Department of Finance

Chapter 5 – Quality of Public Finances

5.1 Summary

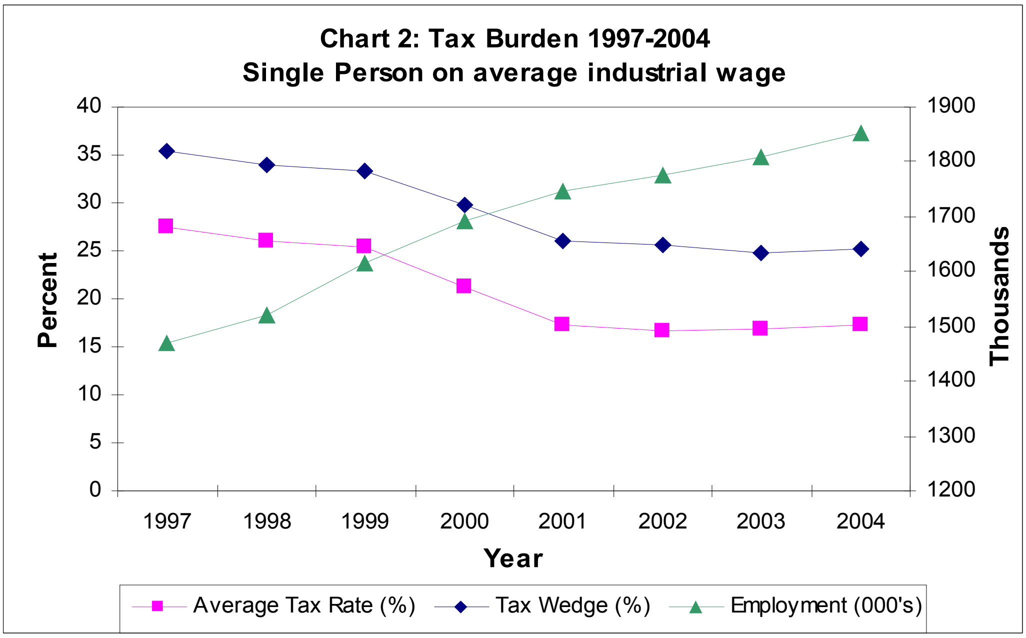
The objectives set out by Government include sustaining a strong economy, promoting competitiveness and building a caring society. In pursuit of these objectives funding has been provided to:

- underpin incentives to reward effort and enterprise, consolidating the progress made in recent years;
- raise the share of national resources devoted to public investment. Exchequer investment in infrastructural development has increased from 3% of GNP in 1997 to an average of 4.9% of GNP for the last four years; and
- improve a broad range of key day-to-day public services – including developments in the health sector, in education and in measures to improve research and development.

5.2 Revenue Strategy

Tax policy is geared to promoting a job-friendly environment to facilitate robust employment growth, the development of a favourable environment for business development, and a better quality of life for citizens. This strategy is in line with the objectives of the Lisbon strategy.

In Budget 2003 and 2004 only limited funds were available for tax reductions. The priority was to consolidate the employment-friendly environment established through the approach taken in previous years. This was done by maintaining the low tax burden on all and focusing the resources available at the lower end of the income scale. This approach is continued in Budget 2005. In 2005 the Government will achieve, ahead of schedule, its target of taking those on the minimum wage out of the income tax net entirely and ensuring that all workers obtain a reduction in real terms in their tax burden.

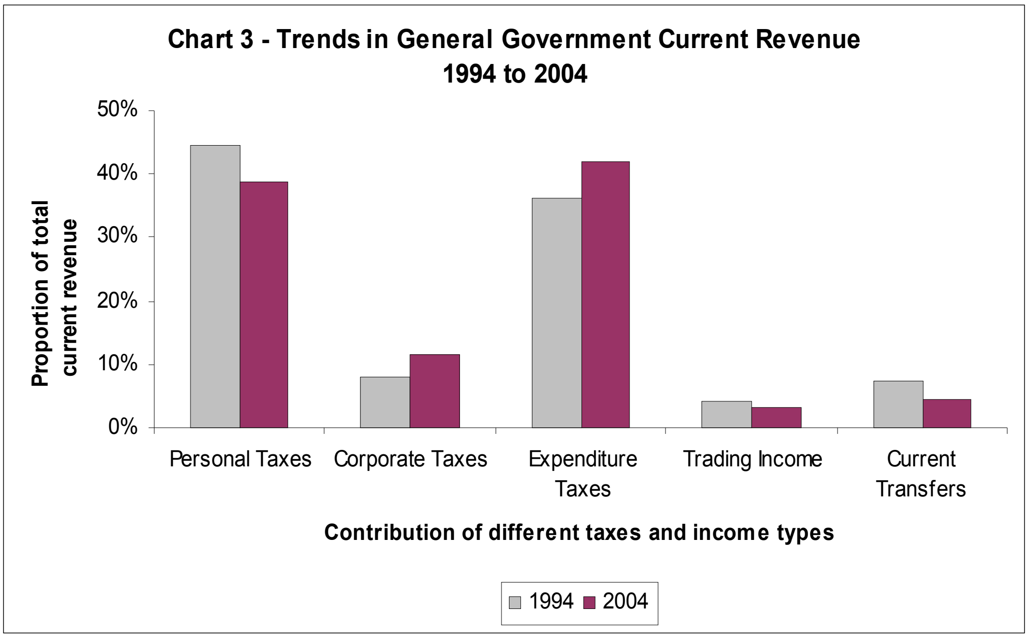


Source: Department of Finance

Growth in the labour force reflects a combination of the underlying growth in the population aged 15 years and over, and increasing female labour force participation, with the latter increasing from below 40% in 1995 to almost 50% in 2003. Proactive labour market tax policies have played an important role in matching this labour force growth with positive employment growth. Employment growth of well over 25% has been achieved between 1997 and mid-2004. Chart 2 shows that the average tax rate at the average industrial wage has fallen quite significantly over this period.

5.3 Changing Sources of Government Revenue

The evolution of the shares of general government current revenues over the last decade is indicated in Chart 3.



Source: Department of Finance

The policy-driven easing of personal taxation, especially for those on lower incomes, led to a decline in its share in total current government revenues over the period. The shares of both indirect and corporate taxes rose in line with the move towards a unified corporate tax rate. Reflecting the continued diminution of net EU transfers to Ireland, government's net current transfer income declined in importance as did the share of net trading income

5.4 Outlook for Expenditure 2005-2007

In 2005, while sustaining strong public investment, resources for day-to-day services will increase by 8.9% on 2004. Within the total provision, key priority areas have been targeted:

- an additional €956 million (10%) in gross current spending for health services;
- an additional €544 million (8.9%) in gross current spending for education and science; and
- an additional €932 million (8.3%) in gross current spending for social welfare.

Total General Government expenditure in 2005 will be 35.0% of GDP and 42.0% of GNP and will average 34.4% of GDP and 41.5% of GNP over the period to 2007. Table 7 shows the development of public expenditure in General Government terms.

5.5 Expenditure Monitoring and Control

The Broad Economic Policy Guidelines 2003-2005 recommended that Ireland "*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*" and "*prioritise the roll-out of the infrastructural elements of the National Development Plan, while preserving budgetary stability*".

Capital expenditure is planned within a 5 year framework following the introduction of rolling 5 year multi-annual capital envelopes in Budget 2004. Spending on day-to-day services is currently planned within an overall 3 year fiscal framework. The Irish Government is committed to an expenditure policy (along with other fiscal policies) that (i) achieves a sustainable match between spending and resources, (ii) meets the circumstances of the Irish economy, and (iii) addresses the key social priorities.

The updated procedures put in place at end-2002 to improve the arrangements for the control and management of public expenditure are continuing to work well. In 2004, the Minister for Finance has reported to Government on a monthly basis on the emerging trends in the public finances. Furthermore, the four Departments with the largest current spending allocations – Education & Science; Health & Children; Justice, Equality & Law Reform and Social & Family Affairs – have reported directly to Government on a bi-monthly basis on the emerging spending trends in their areas.

Table 12 - Measuring Expenditure Management: 1997-2004

Year	Variance: Budget Estimate v. Outturn	Variance as a % of GNP
1997	+1.7%	+0.4%
1998	-0.8%	-0.2%
1999	+1.6%	+0.4%
2000	+1.7%	+0.4%
2001	+1.5%	+0.4%
2002	-0.4%	-0.1%
2003	-0.2%	0.0%

Source: Department of Finance

The above table, and the expected 2004 outturn included in the *Budget 2005 Statistics and Tables,* shows that these arrangements have delivered an improvement in expenditure control. Overall, the expectation for 2004 is that there will be a small saving on day-to-day spending on services.

Chapter 7 includes additional material regarding expenditure management.

5.6 General Government Expenditure on Public Services

Against a background of current economic and revenue growth, Ireland has been able to make considerable progress in addressing the infrastructural deficit, and in improving a broad range of key public services. In relation to the key priority areas of health, education and social welfare, the level of resources invested has been significantly increased, with corresponding improvements in the quality of public services and outcomes. There has also been a significant increase in the level of resources devoted to overseas development aid. Some specific examples include the following:

- Improvements in access to healthcare including a 30% increase since 1997 in the number of patients treated in hospitals as in-patient or day care patients, a reduction in waiting lists, increased funding for services for people with physical and intellectual disabilities resulting in extra residential, respite and day care places, improved services for the elderly and in the areas of childcare and mental health services.

- Improvements in educational achievement. The most recent OECD Programme for International Student Assessment (PISA) finds that Ireland ranks above, or significantly above, the OECD average in reading literacy, mathematical literacy and in scientific literacy among 15 year olds.

- Improvements in access to education for those with special needs, as there are now over 4,000 resource and learning support teachers in the primary system to enable children with special educational needs receive a proper level of educational services. From a base of 400 in 1999, there are also over 5,500 special needs assistants employed in first and second level schools to ensure that children with special educational needs in mainstream classes receive the educational supports necessary.

- Advances made in addressing poverty and improving social welfare rates in real terms. The Economic and Social Research Institute indicates that the proportion of Irish households living in "consistent poverty" fell to 5.2% in 2001, compared with 9.7% in 1997 and 15.1% in 1994. Over the period 1997 to 2005, the old age contributory pension will have increased by over 38% in real terms, and for the lowest social welfare rate the real increase will have been 37%. In addition, child benefit rates have also been increased in very substantial terms.

- EU Member States have committed to collectively increasing their Overseas Development Aid (ODA) to 0.39% of GNP by 2006. Since 1997 Ireland's ODA contributions have increased from 0.31% of GNP to 0.41% of GNP in 2005, compared to the European average contribution of around 0.34%.

The 2005 Estimates provisions for health and education will fund further improvements in services which include the following:

- 230,000 more people will now have access to free GP services, with new medical cards and a new 'doctor visit' medical card. In total, 1.38 million people will now have access to free GP care.

- 10 wide ranging actions to improve Accident and Emergency services, including fully staffed Acute Medical Units in major hospitals.

- New services for people with disabilities delivered by over 1,000 new frontline professionals to begin implementation of the Disability Bill.

- All new units in hospitals will be opened with current funding of €50 million.

- Measures to tackle educational disadvantage at all life stages – from pre-school, through the school system, to access to third level education and participation in adult education and adult literacy initiatives.

- 700 additional teachers and 700 additional Special Needs Assistants that have been assigned to primary and post primary schools.

- The promotion of the knowledge society through significant additional funding for research at third level. In this context the roll-out of broadband ICT facilities in schools is also a key component of the Government's strategy.

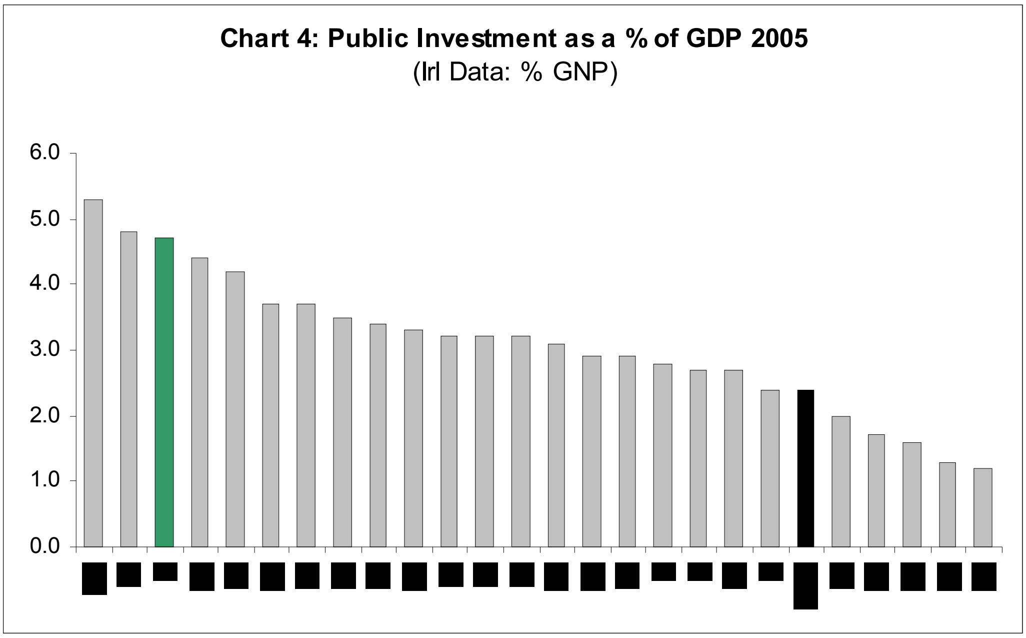
5.7 Infrastructural Investment

The Government has demonstrated its commitment to the provision of key infrastructure through continued investment under the Economic and Social Infrastructure Operational Programme (ESIOP) of the National Development Plan (NDP). Cumulative Exchequer investment under the ESIOP by end 2005 (close to €20 billion) will be well ahead of target. The bulk of this planned investment in roads, public sector transport and water and sewerage services is aimed at addressing existing bottlenecks and supporting further economic growth in the years ahead. In 2005 alone, the Government will invest €3.9 billion under the ESIOP. The programme covers areas such as:

- Roads & Public Transport €1.75 billion
- Housing €1.20 billion
- Water & Sewerage €0.35 billion
- Health €0.59 billion

Given the significant infrastructural deficit in Ireland, we currently spend well in excess of the EU average on investment as illustrated in Chart 4. The 2005 gross Exchequer capital provision is €6.06 billion. This compares with €2 billion in 1997, an increase of 200% over the period. The total capital investment in 2005 under the multi-annual capital envelope will be €6.15 billion or 4.7% of GNP.

The investment measures contained in the Estimates and in Budget 2005 represent a prudent use of available resources to support sustained economic progress into the future. The new approaches to public investment underway, including Public Private Partnerships and the multi-annual 5 year capital investment framework will complement the substantial investment planned in infrastructure.



Source: European Commission Autumn Forecasts 2004; Irish data: Department of Finance (forecasts)

Introduction of Multi-Annual Envelopes

Investment spending is planned on a five year basis under the multi-annual capital investment framework announced in Budget 2004. The multi-annual capital investment framework has allowed Departments to plan and manage their capital programmes more efficiently and effectively. The 2004 Finance Act provided statutory provision for the carryover of capital savings from one year to the next (up to a maximum of 10% of the voted provision). The attached *Budget 2005 Statistics and Tables* (Table 5) includes a figure for capital carryover savings of €237 million (or 4.3% of the 2004 voted capital provision). The definitive amount for capital carryover will be set out in the Appropriation Act, 2004.

The key issue is obtaining better value for money from public investment in infrastructure in the future. Updated Capital Appraisal Guidelines will be published shortly to accompany the envelopes and will apply to all projects funded under them. Other developments such as the establishment of the National Development Finance Agency (NDFA) and the encouragement of PPPs as an alternative means of delivering projects are important in ensuring that capital projects are delivered on time and within budget. The planned introduction of changes in the areas of public sector contracts for construction and construction-related services are important developments in delivering value for money.

More information on these matters and the ongoing development of recent initiatives to improve the evaluation, monitoring and management of expenditure is included in Chapter 7 of this Update

Other Productive Investment

Over recent years, investment in Research & Development, Education, Employment Supports and Training has increased significantly, aimed at improving competitiveness and boosting the supply side of the economy. Productive investment (current and capital) in 2005 in these areas will amount to about €8 billion (6% of GNP) as against €3.6 billion in 1997. The investment can be broken down as follows:

- Education: €6.8 billion
- Research & Development: €451 million
- Employment Supports and Training: €759 million

Investment in Balanced Economic Development

The revised capital envelope for the period 2005-2009 announced in the Budget makes provision for €900 million gross capital expenditure on the programme of decentralisation of Government departments and agencies. This programme will involve the progressive relocation of some 10,000 personnel out of Dublin City to regional centres and is designed to support the objectives of balanced regional development and economic growth contained in the National Spatial Strategy.

Chapter 6 – Sustainability of Public Finances

6.1 Introduction

The sustainability of public finances is defined as the ability to meet projected public expenditures from available public funds, over the long run. Across Europe, the proportion of older people is set to rise significantly over the decades ahead. Population ageing presents budgetary challenges, since a smaller proportion of people in employment must help meet expenditure commitments (principally pensions and health care) associated with a larger proportion of elderly people.

In order to prepare for such budgetary challenges, governments need to take early action. Recognising this reality, Member States across the EU have analysed the extent of the problem and identified the actions that are needed today. European Councils have endorsed a three-pronged strategy for dealing with the economic and budgetary costs of population ageing: stepping up the pace of debt reduction, raising employment rates, especially for women and older workers, and reform of pensions and health care systems.

6.2 Long-Term Budgetary Sustainability – Ireland's Position

Ireland's ageing population will present significant challenges for the public finances over the decades ahead. The latest demographic projections from the Central Statistics Office indicate that the old-age dependency ratio is set to increase from 16.5 in 2005 to 42.2 in 2050 (see Table 13 below). While technical, long-run projections of this nature are subject to large margins of uncertainty, the projections have a value in demonstrating the likely scale of the demographic changes over the longer term.

However, Ireland is positioned better than most in the EU to meet these budgetary challenges. This is borne out by the studies of the EPC[7], and by the analyses of independent observers such as Standard and Poor's[8]. An assessment of the sustainability of Ireland's public finances needs to take account of a number of positive factors, including:

- Ireland's low debt level,
- its low tax ratio,
- the established record of sound budgetary management,
- its relatively high potential growth rate, and
- the impact of early and ongoing policy interventions which are outlined in the next section.

Table 13 - Long-Term Sustainability of Public Finances

	2005	2010	2020	2030	2040	2050
Old Age Dependency Ratio*	16.5	17.4	22.4	27.7	34.2	42.2
Assets of NPRF (% of GDP)+	8.4	11.9	21.3	31.6	45.3	64.1

* Source: Central Statistics Office

+ Gross figure, based on assumption that Fund assets accumulate at the statutory rate of 1% of GNP p.a.; actual net assets from 2025 onwards will depend on the level of draw-downs.

6.3 Policy Responses to Ensure Sustainability of Ireland's Public Finances

Expenditure on old age pensions and on health care – the elements of public expenditure that bear most of the brunt of an ageing population – is on course to rise significantly over the longer-term.

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[7] Economic Policy Committee document - *The impact of ageing on public finances: overview of analysis carried out at EU level and proposals for a future work programme,* October 2003

[8] *The Western World Past Its Prime – Sovereign Rating Perspectives in the Context of Ageing Populations,* March 2004

The importance of long-run budgetary sustainability has become firmly established within Ireland's policy-making processes. Sustainability of public finances is viewed not simply as a matter of budgetary management; priority is also given to the social objective of maintaining older people's living standards into the future. The Government's strategy is to take account in current policies of the pressures arising from long-term expenditure. Some of the principal policy initiatives which will have a positive effect on the sustainability of public finances are as follows.

- <u>The National Pensions Reserve Fund</u>: Established in 1999 in order to help meet the future costs of social welfare and public service pensions. The Government is required by law to contribute 1% of GNP to this fund annually until the year 2055. The Fund's assets can only be drawn down from 2025 onwards, to help smooth the Exchequer burden arising from our additional pension commitments over a very long time. It is estimated that the assets of this fund will stand at €11.1 billion at end-2004, or 7.6% of GDP. Table 13 above includes projections for the build-up of assets, based on certain technical assumptions.

- <u>Public Service Pension Reform:</u> A major reform of public service pensions was announced in last year's Budget – reflecting the recommendations of the Commission on Public Service Pensions – and implementation has proceeded in 2004. The *Public Service Superannuation (Miscellaneous Provisions) Act, 2004* provided, *inter alia,* for raising of the minimum pension age and the removal of a compulsory retirement age for most new public servants. Further reforms were announced in September 2004, including the introduction of cost-neutral early retirement for public servants, with actuarially reduced benefits. Further measures will be brought to Government for decision in due course. The Government's reform programme, when completed, will see the implementation of the vast majority of the Commission's recommendations, thus securing an acceptable retirement income for all public servants on a more sustainable basis.

- <u>Occupational and Supplementary Pensions Sector in Ireland:</u> The Government aims to increase pensions coverage to 70% of the workforce aged over 30. Survey data published by the Central Statistics Office in September 2004 indicates that coverage for the target group is 59% compared to 57% in 2002. To promote the provision of supplementary pensions coverage, the Government has introduced a Personal Retirement Savings Account (PRSA) system, to be offered to consumers by the pensions industry. The Government has indicated that it will monitor the success of this initiative and formally review its progress in 2006.

- <u>Tax Incentives for Private Pensions Provision:</u> A series of significant tax initiatives have been introduced over recent years to promote pension provision for the self-employed, employers in non-pensionable employment and proprietary directors and encouraging people to plan pensions earlier in their working careers.

- <u>Financing Long-Term Care:</u> In mid-2003, the Government published a major study on the future financing of long-term care in Ireland as well as a review of the existing nursing home subvention scheme. Follow-up work in progressing this item has continued during 2004.

6.4 Conclusion

Based on the above considerations, Ireland is in a good position to meet the significant budgetary challenges posed by ageing populations over the decades ahead. The Social Insurance Fund and the National Pensions Reserve Fund are subject to five-yearly actuarial reviews to ensure that their contribution to long-term budgetary policy remains effective. Government strategy is also geared towards improving labour force participation rates (especially among females and older age groups), to maintaining unemployment at its current low level, and to strategic public investment which will support the long-term growth potential of the economy.

Chapter 7 - Horizontal Issues Affecting Public Finances

7.1 Summary

This Chapter sets out a number of continuing reform measures being implemented in relation to the public finances. These include:-

(i) in relation to multi-annual planning:
- embedding of the revisions to the Estimates and Budgetary Process,
- the roll-out of multi-annual financial envelopes for capital investment;

(ii) in relation to structural reform and alternative delivery mechanisms
- the continued development and roll-out of Public Private Partnerships,
- changes in the areas of public sector contracts for construction and construction-related services,
- ongoing reforms in the health services,
- developments in public service pay and the rollout of the modernisation and quality service delivery programme under *Sustaining Progress,*
- implementation of the reduction in public sector numbers;

(iii) in relation to other ongoing developments
- the Expenditure Review Initiative,
- the continued development of a Management Information Framework, and
- a pilot initiative to link resources to outputs and allow for better reporting on achievements.

7.2 Embedding the Revisions to the Estimates and Budgetary Process

In framing Budget 2005, the Minister for Finance has pursued a similar approach to the framing of the Estimates and Budget as in the last 2 years. The important elements of this were the continuation of the Existing Level of Service (ELS) approach, and the setting aside of a Budget Day package – for both current and investment spending.

The ELS approach focuses on the costs of continuing to provide the existing level of service in future years. This methodology has allowed a clearer distinction to be made between technical and policy adjustments, and has provided Government with a clearer basis for selecting priorities in the allocation of net extra resources. The Budget Day spending package focuses on the main economic and social priorities of the Government and normally includes additional social welfare spending and capital investment under the multi-annual capital envelope for the 5 years ahead.

7.3 Roll-Out of Multi-Annual Capital Investment Framework

As mentioned in Chapter 5 above, 2004 was the first year of the multi-annual capital envelopes introduced in last year's Budget. In addition to allowing for infrastructural investment programmes to be planned on a five year basis and thereby providing greater certainty to managers about their funding allocations, the five year investment framework allows for the carryover to the following year of capital savings up to 10% of the voted capital provision. The level of capital savings being carried forward from 2004 into 2005 is 4.3% of the gross voted allocation.

The 2005-2009 multi-annual capital envelopes are set out in the *Annexes to the Summary of the Budget Measures.* The total level of capital investment included in the framework for 2005, including PPPs funded by unitary payments from the Exchequer, is €6.15 billion or about 4.7% of GNP.

7.4 Public Private Partnerships

The Government sees Public Private Partnerships (PPPs) as a means for helping to deliver the conditions needed to sustain output and employment growth in the Irish economy over the medium-term The accelerated delivery of national priority infrastructure projects, together with the attainment of value for money over the full life cycle of the asset are potential key benefits of PPPs.

The new five year capital investment framework for the period 2005-2009 includes a provision of €3.7 billion for PPP/NDFA[9] capital funded by unitary payments from the Exchequer. The target for PPPs funded by user charges, which are additional to the envelope, is €1.2 billion over the same period. The new targets reflect the lead-in time for the development of PPPs and the latest assessment of the take up of PPPs.

There are currently some eighteen major privately-financed projects at various stages of procurement ranging from roads to environmental services, with five projects already operational, including education projects and tolled roads.

7.5 Procurement Management Reform and Planned Changes to Public Sector Contracts

Significant savings and benefits arise from more effective procurement of supplies, services and capital works. The procurement management reform initiative contains a set of actions which seek to improve the way the public sector undertakes procurement with a view to achieving better value for money for the significant spend involved. This initiative is seeking to equip the public sector to better leverage this significant buying power across all markets over the medium to longer term.

To help minimise cost overruns and to facilitate early project delivery, the Government agreed to introduce significant changes involving fixed price lump sum public sector contracts to complement the new rolling multi-annual investment envelopes, which amount to €32.6 billion of Exchequer investment in the period out to 2009, and to provide better value for money for the State. The changes involve the amendment and introduction of new standard forms of construction contracts which will transfer appropriate risks to contractors who are best placed to manage them. The purpose of this initiative is to help reduce the scale and scope of cost overruns on construction projects, to help public sector bodies to control construction projects more effectively and to help facilitate early project delivery.

The new approach will also involve contractors submitting competitive tenders where the price, including a cost for the identified risks they intend to manage and control, is tendered for on a lump sum fixed price basis. Under the new arrangements, the contract price should remain firm and fixed for the duration of the project to the greatest extent possible. In relation to construction related services (e.g. Architects and Engineers), the Government wanted to see a move away from a situation where fees rise as project costs rise and decided to introduce greater competition into the procurement process without compromising on quality.

7.6 Expenditure Management and Reform in the Health Sector

The Government announced, in June 2003, a major programme of reform of the health services to ensure that the quantity and quality of services that people receive match the significant investment in those services. The priorities of reform are improved patient care, better value for taxpayers' money and improved health care. The key features include:

- a major rationalisation of existing health service agencies including the abolition of existing area-based health board structures;
- the establishment of a Health Service Executive to manage the health service as a single national entity;

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[9] The National Development Finance Agency was established in 2002 to provide advice to State authorities to assist them in evaluating financial risks and costs of public investment projects;

- the devolution of responsibility for budgets to the people actually in charge of delivering services; and
- the complete modernisation of supporting processes (service planning, management reporting, etc.) to improve planning and delivery of services, including linking activities with budgets.

This is a large-scale reform programme which includes measures which will impact on every element of the health system. An interim Board of the Health Services Executive (HSE) was put in place late in 2003 and planning for the transition to the new structures is now well advanced. An interim CEO for the new Executive has been appointed and the recruitment of the senior management team is nearing completion. Also, the locations and boundaries for the new administrative offices of the HSE have been announced. The legislation necessary to give full effect to the new structures has been published and the target date for formal establishment of the HSE, at which point it will assume full responsibility for delivery of public health services, remains 1 January 2005. The re-engineering of business and delivery systems within this reformed structure will continue over the coming years.

7.7 Public Service Pay – Modernisation and Service Delivery

On public service pay, the more recent national agreements have restored stability to the public service industrial relations scene and the year-on-year level of increase in the Exchequer paybill is coming down, from 18% in 2001 to 8% in 2005. In 2004 as part of the mid-term review of *Sustaining Progress* a new public service pay agreement was reached. This mirrored the increases agreed for the private sector. The increases agreed were:

- 1.5% from 1 June 2005 (except for those earning up to and including €351 per week where a 2% increase will apply)
- 1.5% from 1 December 2005, and
- 2.5% from 1 June 2006.

In the first phase of the pay agreement under *Sustaining Progress*, the payment of increases was linked to achievement of objectives set out in each sector and included maintenance of industrial peace and co-operation with modernisation initiatives. The achievement of these objectives was monitored by independent Performance Verification Groups. This format will apply equally to the second phase payments.

The parties also agreed that there would be a further public service pay benchmarking exercise that would begin in the second half of 2005 and would report in the second half of 2007. The parties will have discussions in advance of its work on the Body's terms of reference, its membership and will also consider ways in which, having regard to the experience of the last exercise, the process can be improved and streamlined.

The benchmarking process has yielded a number of results. The last exercise moved the system fundamentally away from the rigid system of cross-sectoral relativities where groups in different sectors sought increases based on movement of other grades and instead has moved pay determination to a system that links pay levels in the public service to pay levels for comparable jobs in the private sector.

In addition, in implementing the increases from the last exercise the payments were linked to real and verifiable change and industrial peace (as outlined above). There has been industrial relations stability in the public service since the beginning of the current agreement in 2003 – in contrast to previous years where there was a significant level of disputes e.g. second level teachers, nurses, hospital doctors etc. This has benefited the consumer as services have been uninterrupted. Modernisation changes have been introduced such as standardisation of the school year, more open recruitment to the public service etc.

The intention would be, in the future, to continue to link payments under national agreements to agreed changes in public services and maintenance of industrial peace.

7.8 Implementation of the Reduction in Public Sector Numbers

In Budget 2003, the Minister for Finance announced that public service numbers would be capped and would decrease by 5,000 over a 3 year period. The Government has subsequently agreed the timing and details of the reductions. In agreeing proposals in this area, the Government endeavoured that front-line service delivery staff would not be targeted for reductions.

As part of the Government's commitment to address priority areas of service some adjustments have been agreed to the figures for Health, Education and the Gardaí in respect of frontline staff. Outside of the health and education sectors, the numbers serving in 2004 indicate that the 2004 targets for a reduction in public service number will be met. The Government remains committed to the control of public service numbers, given the size of the public service pay and pensions bill as a component of overall Government expenditure, and is determined that the full effect of the reduction in numbers will materialise in 2005 and 2006.

7.9 Expenditure Review Initiative

The objectives of the Expenditure Review Initiative (ERI) are to analyse in a systematic manner what is being achieved by Exchequer spending and to provide a basis on which more informed decisions can be made on priorities within and between programmes. In addition to the reviews, a substantial amount of evaluation work is also undertaken by Departments and Offices outside of ERI such as under the National Development Plan and sectoral evaluations. The ERI process is overseen by the Expenditure Review Central Steering Committee (ERCSC), chaired by the Secretary General of the Department of Finance and is supported by an Expenditure Reviewers' Network,. A panel of independent Quality Assessors has been established to quality assess reviews carried by Departments.

The ERCSC has recently presented the Minister for Finance with a report reviewing ERI for the period June 2002-June 2004. The broad conclusion of the ERCSC Report is that, while progress has been made by Departments and Offices in undertaking systematic evaluation both within and outside the ERI, and in building an evaluation culture, there is scope for further improvement. The Minister for Finance has accepted the report's conclusions and recommendations and he has written to all Ministers asking them to ensure that their Departments and Offices implement them.

7.10 Management Information Framework

The Management Information Framework (MIF) is an integral part of the Irish Government's public service modernisation programme (the Strategic Management Initiative). It is a framework aimed at providing Government Departments and Offices with modern financial management systems integrated with output measurement to enhance performance and accountability. The MIF will facilitate improved financial and performance reporting and ensure better decision-making about the allocation of resources and better management of resources allocated. It will also facilitate greater transparency in, and accountability for, the use of those resources. MIF financial management systems will have been installed in most Government Departments and Offices by end-2004. Work on the non-financial performance aspects of the MIF is underway across Departments and Offices with a view to completion of the MIF project by its target date of end-2006.

7.11 Pilot Project on Resource Allocation and Business Planning

A pilot project involving the Departments of Agriculture & Food, Social & Family Affairs and Transport is examining ways of improving the links between Departmental strategy statements, business planning and resource allocation in the Estimates to outputs and performance measurement. The Pilot Project is currently in the process of drafting its final report which will be submitted for the consideration of the Minister for Finance.

7.12 Decentralisation

In Budget 2004, the Minister announced a decentralisation programme to facilitate balanced regional development. The programme provides for the voluntary transfer of over 10,000 civil and public servants from Dublin to the provinces. The Minister appointed an Implementation Group to prepare an Implementation Plan and oversee implementation of the programme generally. The past year has seen the completion of, and acceptance by, Government of an overall implementation plan, the provision of a central applications facility for employees who wish to participate in the programme, the preparation of individual implementation plans by each organisation which is due to relocate and the commencement of site acquisition in the regional locations.

The response to the programme has been encouraging. To date, nearly 9,500 applications from staff for decentralisation have been received. Applications will continue to be accepted over the coming years until the programme is complete. The Government recently announced the organisations and locations which will be included in the first phase of moves. It also published the results of a financial assessment of the property-related aspects of the programme.

Annex

Table 14 - Basic Assumptions

	2004	2005	2006	2007
Short-term interest rate (annual average)	2.1	2.6	3.5	3.5
Long-term interest rate (annual average)	4.2	4.6	4.8	4.8
USD/€ exchange rate (annual average)	1.23	1.24	1.24	1.24
World excluding EU, GDP growth	5.7	4.8	4.6	4.6
EU-25 GDP growth	2.5	2.3	2.4	2.4
Growth of relevant foreign markets – export volumes	7.8	6.7	6.5	6.5
World import volumes, excluding EU	11.6	8.8	8.3	8.3
Oil prices, (Brent, US$/barrel)	39.3	45.1	40.1	40.1

Source: European Commission